
Section 1: 10-Q (ZAGG INC FORM 10-Q)

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

FORM 10-Q

(Mark one)

- Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2012, 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. 000-52211

ZAGG INC

(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 [X] 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 Accelerated Filer
- Non-accelerated Filer (do not check if a smaller reporting company) 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: **30,247,533** common shares as of May 7, 2012.

ZAGG INC AND SUBSIDIARIES
FORM 10-Q

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ZAGG INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(Unaudited)

| | <u>March 31,</u> <u>2012</u> | <u>December 31,</u> <u>2011</u> |
|--|---------------------------------|------------------------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 16,856 | \$ 26,433 |
| Accounts receivable, net of allowances of \$2,166 in 2012 and \$2,070 in 2011 | 36,374 | 45,450 |
| Inventories | 25,656 | 29,622 |
| Prepaid expenses and other current assets | 5,387 | 1,593 |
| Deferred income tax assets | 5,063 | 5,132 |
| Total current assets | 89,336 | 108,230 |
| Investment in HzO | 4,416 | 4,879 |
| Property and equipment , net of accumulated depreciation at \$2,101 in 2012 and \$1,857 in 2011 | 4,423 | 4,162 |
| Deferred income tax assets | 82 | 82 |
| Goodwill | 6,925 | 6,925 |
| Intangible assets , net of accumulated amortization at \$6,425 in 2012 and \$3,989 in 2011 | 71,255 | 73,691 |
| Note receivable | 1,099 | 1,349 |
| Other assets | 3,051 | 3,010 |
| Total assets | \$ 180,587 | \$ 202,328 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 16,637 | \$ 16,013 |
| Income taxes payable | 2,223 | 4,294 |
| Accrued liabilities | 2,348 | 3,886 |
| Accrued wages and wage related expenses | 1,420 | 1,468 |
| Deferred revenue | 288 | 320 |
| Current portion of note payable | - | 2,372 |
| Sales returns liability | 5,163 | 5,387 |
| Total current liabilities | 28,079 | 33,740 |
| Revolving line of credit | 1,627 | 23,332 |
| Noncurrent portion of note payable | 41,000 | 42,628 |
| Total liabilities | 70,706 | 99,700 |
| Stockholders' equity | | |
| Common stock, \$0.001 par value; 100,000 shares authorized; 30,236 and 29,782 shares issued and outstanding, respectively | 30 | 30 |
| Additional paid-in capital | 72,409 | 70,248 |
| Accumulated other comprehensive income | (53) | (33) |
| Note receivable collateralized by stock | (566) | (566) |
| Retained earnings | 38,061 | 32,949 |
| Total stockholders' equity | 109,881 | 102,628 |

Total liabilities and stockholders' equity

\$ 180,587

\$ 202,328

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended | |
|---|--------------------|-------------------|
| | March 31, 2012 | March 31, 2011 |
| Net sales | \$ 55,480 | \$ 26,976 |
| Cost of sales | 28,547 | 13,330 |
| Gross profit | 26,933 | 13,646 |
| Operating expenses: | | |
| Advertising and marketing | 2,441 | 2,512 |
| Selling, general and administrative | 11,842 | 6,220 |
| Amortization of definite-lived intangibles | 2,422 | 50 |
| Total operating expenses | 16,705 | 8,782 |
| Income from operations | 10,228 | 4,864 |
| Other income (expense): | | |
| Interest expense | (1,521) | (11) |
| Loss from equity method investment in HzO | (463) | - |
| Other income and (expense) | (147) | - |
| Total other expense | (2,131) | (11) |
| Income before provision for income taxes | 8,097 | 4,853 |
| Income tax provision | (2,985) | (1,595) |
| Net income | 5,112 | 3,258 |
| Net loss attributable to noncontrolling interest | - | 52 |
| Net income attributable to stockholders | \$ 5,112 | \$ 3,310 |
| Earnings per share attributable to stockholders: | | |
| Basic earnings per share | \$ 0.17 | \$ 0.14 |
| Diluted earnings per share | \$ 0.16 | \$ 0.13 |

See accompanying notes to condensed consolidated financial statements.

ZAGG INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(Unaudited)

| | Three Months Ended | |
|---|---------------------------|---------------------------|
| | March 31, 2012 | March 31, 2011 |
| Net income | \$ 5,112 | \$ 3,258 |
| Other comprehensive income (loss), net of tax: | | |
| Foreign currency translation loss | (20) | (25) |
| Total other comprehensive loss | (20) | (25) |
| Comprehensive income | \$ 5,092 | \$ 3,233 |
| Comprehensive loss attributable to noncontrolling interest | - | 52 |
| Comprehensive income attributable to stockholders | \$ 5,092 | \$ 3,285 |

See accompanying notes to condensed consolidated financial statements.

ZAGG INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)
(Unaudited)

| | <u>Common Stock</u> | | <u>Additional Paid-in Capital</u> | <u>Note Receivable Collateralized By Stock</u> | <u>Retained Earnings</u> | <u>Accumulated</u> | <u>Total Stockholders' Equity</u> |
|---|---------------------|---------------|---|--|------------------------------|---|---|
| | <u>Shares</u> | <u>Amount</u> | | | | <u>Other Comprehensive Loss</u> | |
| Balances, December 31, 2011 | 29,782 | \$ 30 | \$ 70,248 | \$ (566) | \$ 32,949 | \$ (33) | \$ 102,628 |
| Comprehensive income: | | | | | | | |
| Net income | - | - | - | - | 5,112 | - | 5,112 |
| Other comprehensive loss | - | - | - | - | - | (20) | (20) |
| Option exercises | 179 | - | 309 | - | - | - | 309 |
| Warrant exercises | 167 | - | 199 | - | - | - | 199 |
| Restricted stock release | 108 | - | - | - | - | - | - |
| Stock-based compensation | - | - | 1,342 | - | - | - | 1,342 |
| Excess tax benefits related to share-based payments | - | - | 311 | - | - | - | 311 |
| Balances, March 31, 2012 | 30,236 | \$ 30 | \$ 72,409 | \$ (566) | \$ 38,061 | \$ (53) | \$ 109,881 |

See accompanying notes to condensed consolidated financial statements.

ZAGG INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

| | Three Months Ended | |
|---|---------------------------|---------------------------|
| | March 31, 2012 | March 31, 2011 |
| Cash flows from operating activities | | |
| Net income | \$ 5,112 | \$ 3,258 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Stock-based compensation | 1,031 | 304 |
| Excess tax benefits related to share-based payments | (311) | (203) |
| Depreciation and amortization | 2,818 | 176 |
| Loss from equity method investment in HzO | 463 | - |
| Loss on disposal of equipment | 220 | - |
| Deferred income taxes | 69 | (320) |
| Amortization of deferred loan costs | 286 | - |
| Expense related to issuance of warrants | 311 | 377 |
| Expense related to issuance of stock for consulting | - | 100 |
| Changes in operating assets and liabilities | | |
| Accounts receivable | 9,142 | 1,466 |
| Inventories | 3,983 | (3,246) |
| Related party other asset | - | - |
| Prepaid expenses and other current assets | (3,438) | 2,119 |
| Other assets | (76) | (4) |
| Accounts payable | 592 | (4,450) |
| Income taxes payable | (1,752) | (5,036) |
| Accrued liabilities | (1,907) | 462 |
| Accrued wages and wage related expenses | (48) | 88 |
| Deferred revenues | (32) | 43 |
| Sales return liability | (225) | (205) |
| Net cash provided by (used in) operating activities | 16,238 | (5,071) |
| Cash flows from investing activities | | |
| Deposits on and purchase of intangible assets | - | (167) |
| Purchase of property and equipment | (855) | (176) |
| Proceeds from disposal of equipment | 2 | - |
| Net cash used in investing activities | (853) | (343) |
| Cash flows from financing activities | | |
| Proceeds from revolving credit facilities | 1,295 | 4,135 |
| Payments on revolving credit facilities | (23,000) | (3) |
| Payments on term loan | (4,000) | - |
| Proceeds from exercise of warrants and options | 508 | 498 |
| Excess tax benefits related to share-based payments | 311 | 203 |
| Net cash provided by (used in) financing activities | (24,886) | 4,833 |
| Effect of foreign currency exchange rates on cash and cash equivalents | (76) | (25) |
| Net decrease in cash and cash equivalents | (9,577) | (606) |
| Cash and cash equivalents at beginning of the period | 26,433 | 2,373 |
| Cash and cash equivalents at end of the period | \$ 16,856 | \$ 1,767 |
| Supplemental disclosure of cash flow information | | |
| Cash paid during the period for interest | 1,262 | \$ 11 |
| Cash paid during the period for taxes | 4,660 | 6,944 |

See accompanying notes to condensed consolidated financial statements.

ZAGG INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Dollars and shares in thousands)
(Unaudited)

Supplemental schedule of noncash investing and financing activities

For the Three Months Ended March 31, 2012:

Foreclosure on real property valued at \$250 that served as collateral to the note receivable (recorded as a component of other noncurrent assets in the condensed consolidated balance sheet).

For the Three Months Ended March 31, 2011:

None

See accompanying notes to condensed consolidated financial statements.

ZAGG INC AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Dollars, units and shares in thousands, except per share data)
(Unaudited)

(1) NATURE OF OPERATIONS AND BASIS OF PRESENTATION

ZAGG Inc and subsidiaries (collectively, the “Company”, or “ZAGG”) provides innovative consumer products like films, skins, keyboards, cases, audio accessories, and power solutions that protect, personalize and enhance the mobile experience. ZAGG's products are distributed worldwide under the following brands: invisibleSHIELD®, ZAGGskins™, ZAGGbuds™, ZAGGsparq™, ZAGGmate™, ZAGGfolio™, ZAGGkeys™, iFrogz™ and Earpollution™.

The accompanying unaudited condensed consolidated financial statements 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. 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, the results of operations and cash flows of the Company for the periods presented. 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 2011 Annual Report on Form 10-K. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the full year.

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of ZAGG Inc and its wholly owned subsidiaries ZAGG Europe Limited, ZAGG International, ZAGG Intellectual Property Holding Co, Inc., ZAGG Retail, Inc., iFrogz, Inc., and iFrogz Europe SAS. All intercompany transactions and balances have been eliminated in consolidation.

(2) ACQUISITION OF IFROGZ

On June 21, 2011, the Company, Reminderband Inc. dba iFrogz (“iFrogz”), and the owners of iFrogz entered into a Stock Purchase Agreement pursuant to which ZAGG acquired 100% of the outstanding shares of iFrogz. The combination of ZAGG and iFrogz represents an opportunity to create a market leader in the mobile device accessories industry by building on complementary brands and increasing overall market share by growing product lines and expanding distribution.

The Company purchased iFrogz for total consideration of \$50,000 in cash and 4,444 shares of ZAGG common stock. The value of the shares of the Company’s common stock used in determining the purchase price was \$12.60 per share, the closing price of the Company’s common stock on June 21, 2011. 2,222 of the shares issued are subject to a 12-month “lock-up” transfer restriction following the date of acquisition and, therefore, the fair value of these shares has been determined considering the restriction resulting in a discount of 20.0% from the closing share price. The other 2,222 shares issued were subject to a 6-month “lock-up” transfer restriction following the date of acquisition in accordance with SEC Rule 144, which expired on December 21, 2011. The fair value of these shares has been determined considering the restriction resulting in a discount of 15.0% from the closing share price. In addition, \$5,000 of the cash consideration paid to the former owners of iFrogz was placed in an escrow account to cover any potential tax, legal, or other contingencies that could potentially arise relating to pre-acquisition events for which ZAGG is indemnified. If charges exceed \$5,000 (not to exceed \$15,000), ZAGG may recover these amounts through cash payments from the former owners of iFrogz or by cancelling an appropriate number of shares subject to the lock-up to cover the charges. Subject to indemnity claims which may be asserted by ZAGG, the cash held in escrow will be released to the former owners of iFrogz 18 months after the acquisition date (December 21, 2012). As of the date of this Report, the Company was not aware of any such contingencies or potential indemnity claims.

ZAGG INC AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Dollars, units and shares in thousands, except per share data)
(Unaudited)

The following summarizes the components of the purchase price:

Value of ZAGG shares issued:

| | |
|--|------------------|
| ZAGG shares issued with 6-month restriction | \$ 23,800 |
| ZAGG shares issued with 12-month restriction | 22,400 |
| | <u>46,200</u> |
| Cash consideration | 50,000 |
| Total | <u>\$ 96,200</u> |

The total purchase price of \$96,200 has been allocated to tangible and intangible assets acquired and liabilities assumed based on their respective fair values. The excess of the purchase price over the fair value of tangible and intangible assets acquired and liabilities assumed was recorded as goodwill. Fair values assigned are based on reasonable methods applicable to the nature of the assets acquired and liabilities assumed. The following table summarizes the allocation of the purchase consideration:

| | |
|---|------------------|
| Cash and cash equivalents | \$ 2,469 |
| Trade receivables (\$5,880 contractual gross receivables) | 5,832 |
| Inventories | 14,962 |
| Prepaid expenses | 579 |
| Property and equipment | 2,078 |
| Deposits | 138 |
| Definite-lived identifiable intangible assets | 49,900 |
| Indefinite-lived identifiable intangible assets | 25,100 |
| Goodwill | 6,925 |
| Current liabilities | (11,783) |
| Total | <u>\$ 96,200</u> |

As part of the acquisition of iFrogz, the Company incurred legal, accounting, and other due diligence fees that were expensed when incurred. Total fees incurred related to the acquisition of iFrogz for the three months ended March 31, 2012 and 2011, were \$0 and \$9, respectively, which is included as a component of selling, general, and administrative expenses in the condensed consolidated statement of operations.

Identifiable Intangible Assets

Classes of acquired intangible assets include customer relationships, trademarks, non-compete agreements, and other intangibles. The fair value of the identifiable intangible assets was determined using various valuation methods, including the income and market approaches. For assets valued under the income approach, the estimate of the present value of expected future cash flows for each identifiable asset was based on discount rates which incorporate a risk premium to take into account the risks inherent in those expected cash flows. The expected cash flows were estimated using available historical data adjusted based on the Company's historical experience and the expectations of market participants. The market approach was utilized to determine appropriate royalty rates applied to the valuation of the trademarks and patents. The amounts assigned to each class of intangible asset and the related weighted average amortization periods are as follows:

| | <u>Intangible asset class</u> | <u>Weighted-average amortization period</u> |
|-------------------------------|-----------------------------------|---|
| Customer relationships | \$ 41,500 | 8.0 years |
| Trademarks (indefinite-lived) | 25,100 | Indefinite |
| Trademarks (definite-lived) | 3,500 | 9.7 years |
| Non-compete agreements | 4,100 | 4.8 years |
| Other | 800 | 3.8 years |
| Total | <u>\$ 75,000</u> | |

ZAGG INC AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Dollars, units and shares in thousands, except per share data)
(Unaudited)

Goodwill

Goodwill represents the excess of the iFrogz purchase price over the fair value of the assets acquired and liabilities assumed.

The Company believes that the acquisition of iFrogz produces the following significant benefits:

- *Create Leading Mobile Device Accessories Company.* The combination of ZAGG and iFrogz has created a leading mobile device accessories company with diverse but complementary product lines, and a combined focus on creating both innovative and functional products in the ever-evolving market of mobile device accessories.
- *Increased Market Presence.* The combination of ZAGG and iFrogz has created an opportunity to capture additional market share domestically and globally from both existing and new customers.

The Company believes that these primary factors support the amount of goodwill recognized as a result of the purchase price paid for iFrogz, in relation to the other acquired tangible and intangible assets.

The goodwill acquired in the acquisition is deductible for income tax purposes and will be amortized over a period of 15 years.

Results of Operations

For the three-months ended March 31, 2012, iFrogz contributed net sales of \$15,643 and net income of \$629 to the condensed consolidated statement of operations. In addition, iFrogz leases office space from its former owners for monthly rent of \$14.

Pro forma Results from Operations

The following table contains unaudited pro-forma results of operations for the three months ended March 31, 2011. The unaudited pro-forma results from operations give effect as if the acquisition had occurred on January 1, 2010, after giving effect to certain adjustments including the amortization of intangible assets, interest expense, tax adjustments, specific transaction related expenses incurred prior to the execution date, and assumes the purchase price was allocated to the assets purchased and liabilities assumed based on their values at the date of purchase.

| | Three Months Ended March 31, 2011 |
|------------|--|
| Net sales | \$ 36,595 |
| Net income | \$ 1,160 |

For the three months ended March 31, 2011, pro forma net income includes projected amortization expense of \$2,276. The unaudited pro forma information is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have occurred had the transaction been consummated for the dates indicated. Furthermore, such unaudited pro forma information is not necessarily indicative of future operating results of the combined companies, due to changes in operating activities following the purchase, and should not be construed as representative of the operating results of the combined companies for any future dates or periods.

ZAGG INC AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Dollars, units and shares in thousands, except per share data)
(Unaudited)

(3) INVENTORIES

At March 31, 2012, and December 31, 2011, inventories consisted of the following:

| | <u>March 31,</u> <u>2012</u> | <u>December 31,</u> <u>2011</u> |
|-----------------|---------------------------------|------------------------------------|
| Finished goods | \$ 18,030 | \$ 19,871 |
| Raw materials | 7,626 | 9,751 |
| Total inventory | <u>\$ 25,656</u> | <u>\$ 29,622</u> |

(4) ASSET PURCHASE CREDITS

The Company entered into a nonmonetary exchange transaction with Argent Trading Inc. (“Argent”) during the second quarter of 2011 whereby the Company transferred inventory with a carrying value of \$986 to Argent in exchange for asset purchase credits with a face value of \$1,350. The credits can be used for the purchase of goods or services from certain vendors until March 1, 2016, when the unused asset purchase credits expire.

The Company accounted for this nonmonetary transaction based on the fair value of the inventory transferred as the inventory’s fair value was more clearly evident than fair value of the asset purchase credits. The Company determined that the inventory had a fair value of \$785 at the date of the transfer and thus recorded an impairment loss on the inventory of \$202, which was recorded as a component of cost of sales in the accompanying condensed consolidated statement of operations. These asset purchase credits of \$785 will be utilized as the asset purchase credits are applied in future periods. The Company evaluates the recoverability of the credits on a quarterly basis and expects to utilize all credits recorded prior to their expiration in March 2016. As of March 31, 2012, \$2 in asset purchase credits had been utilized.

(5) INVESTMENT IN HzO

At December 31, 2010, HzO, Inc. (“HzO”) was consolidated by the Company as a variable interest entity (“VIE”). On August 12, 2011, HzO entered into a Series B Stock Purchase Agreement with third party investors whereby HzO issued 9,869 shares of its newly designated Series B Preferred Stock to new third party investors (collectively, the “HzO Investors”) for net cash of \$2,335. ZAGG considered this a reconsideration event and concluded that HzO remained a VIE and should continue to be consolidated as ZAGG was the primary beneficiary of HzO.

On December 22, 2011, HzO, entered into an Amended Series B Stock Purchase Agreement with another group of third party investors (collectively, the “new HzO investors”) whereby HzO issued 10,768 shares of Series B Preferred Stock for net cash of \$3,000. ZAGG considered this a reconsideration event and concluded that as of December 22, 2011, HzO should no longer be considered a VIE under authoritative accounting literature, but would be considered a voting interest entity. Management concluded that as ZAGG owns 36.8% of HzO following the December 22, 2011 transaction and cannot control HzO through voting interests, seats on the HzO Board of Directors, or through any other contractual agreement or method, HzO should be deconsolidated as of December 22, 2011.

The noncontrolling interest included in the Company’s consolidated financial statements is a result of noncontrolling interest investments in HzO up to the date of deconsolidation of December 22, 2011. Noncontrolling interests are classified in the condensed consolidated statements of operations as part of consolidated net income.

Management applied deconsolidation accounting guidance, which included analyzing ZAGG’s investment in HzO at December 22, 2011 to determine the fair value on the date of deconsolidation and the related gain or loss upon deconsolidation. Management determined that the fair value of ZAGG’s investment in HzO at December 22, 2011 was \$4,879. Appropriate valuation techniques were employed, including the use of the market approach that considered the recent equity transactions between HzO, the HzO investors, and the new HzO investors, and an option pricing model. Ultimately, the fair value of ZAGG’s investment in HzO of \$4,879 was recorded as ZAGG’s equity-method investment in HzO at December 22, 2011. In addition, upon deconsolidation, ZAGG recorded a gain of \$1,906, which is recorded as a component of other income (expense) in the consolidated statement of operations for the year ended December 31, 2011.

ZAGG INC AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Dollars, units and shares in thousands, except per share data)
(Unaudited)

Management accounts for its investment in HzO under the equity method accounting by recognizing ZAGG's share of the earnings or losses of HzO in the periods in which they are reported by HzO in its separate financial statements adjusted for the amortization of the basis difference between the Company's investment in HzO and the Company's underlying share in the net assets of HzO. For the quarter ended March 31, 2012, amortization of \$82 was recorded to reduce the basis difference from \$1,389 at December 31, 2011, to \$1,307 at March 31, 2012. For the quarter ended March 31, 2012, the Company recorded a loss from investment in HzO of \$463 on the condensed consolidated statement of operations. As of March 31, 2012 and December 31, 2011, ZAGG held a 36.8% ownership in the equity interest of HzO, consisting of 18,361 Series A Preferred Shares.

(6) INTANGIBLE ASSETS

Definite-lived Intangibles

Definite-lived intangibles as of March 31, 2012, and December 31, 2011, were as follows:

| | As of March 31, 2012 | | | |
|--------------------------|----------------------------------|-------------------------------------|--------------------------------|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Amortization Period |
| Customer relationships | \$ 41,500 | \$ 4,504 | \$ 36,996 | 8.0 years |
| Non-compete agreements | 4,100 | 708 | 3,392 | 4.8 years |
| Trademarks | 3,500 | 575 | 2,925 | 9.7 years |
| Other | 800 | 331 | 469 | 3.9 years |
| Acquired technology | 564 | 28 | 536 | 7.0 years |
| Internet address | 124 | 44 | 80 | 10.0 years |
| Patents | 1,992 | 235 | 1,757 | 14.0 years |
| Total amortizable assets | <u>\$ 52,580</u> | <u>\$ 6,425</u> | <u>\$ 46,155</u> | 8.0 years |

| | As of December 31, 2011 | | | |
|--------------------------|----------------------------------|-------------------------------------|--------------------------------|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Amortization Period |
| Customer relationships | \$ 41,500 | \$ 2,575 | \$ 38,925 | 8.0 years |
| Non-compete agreements | 4,100 | 479 | 3,621 | 4.8 years |
| Trademarks | 3,500 | 400 | 3,100 | 9.7 years |
| Other | 800 | 293 | 507 | 3.9 years |
| Acquired technology | 564 | 14 | 550 | 7.0 years |
| Internet address | 124 | 40 | 84 | 10.0 years |
| Patents | 1,992 | 188 | 1,804 | 14.0 years |
| Total amortizable assets | <u>\$ 52,580</u> | <u>\$ 3,989</u> | <u>\$ 48,591</u> | 8.0 years |

Customer relationships, trademarks, and other intangibles are amortized on an accelerated basis consistent with their expected future cash flows over their estimated useful life, which results in accelerated amortization. The remaining definite-lived intangible assets are amortized using the straight line method over their estimated useful life. For the three months ended March 31, 2012 and 2011, amortization expense was \$2,422 and \$50, respectively.

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Estimated future amortization expense is as follows:

| | | |
|---------------------|----|---------------|
| Remaining 2012 | \$ | 7,336 |
| 2013 | | 9,077 |
| 2014 | | 7,989 |
| 2015 | | 6,869 |
| 2016 and thereafter | | 14,884 |
| Total | \$ | <u>46,155</u> |

Indefinite-lived Intangibles

The gross carrying amount of indefinite-lived intangibles as of March 31, 2012 and December 31, 2011 were as follows:

| | <u>March 31,</u> <u>2012</u> | <u>December 31,</u> <u>2011</u> |
|------------------------------|---------------------------------|------------------------------------|
| Trademarks | \$ 25,100 | \$ 25,100 |
| Total non-amortizable assets | <u>\$ 25,100</u> | <u>\$ 25,100</u> |

(7) DEBT AND LETTERS OF CREDIT

Term Loan and Revolving Credit Facility

On June 21, 2011, and in conjunction with the acquisition of iFrogz, the Company entered into a financing agreement (the "Financing Agreement") led by Cerberus Business Finance, LLC ("Cerberus") and PNC Bank National Association ("PNC"), which is acting as the administrative bank. The Financing Agreement consists of a \$45,000 term loan ("Term Loan"), a \$45,000 revolving credit facility ("Revolving Credit Facility"), and a \$5,000 letters of credit facility, which is a subset of the \$45,000 Revolving Credit Facility. The Company's obligations under the Financing Agreement were secured by all or substantially all of the Company's assets. The Term Loan matures on July 20, 2016, and the Revolving Credit Facility and letters of credit mature on July 20, 2014.

As of March 31, 2012, \$41,000 of the Term Loan was outstanding after a payment of \$4,000 was made in March 2012, \$1,627 of the Revolving Credit Facility was outstanding after payments totaling \$23,000 were made in March 2012, and no letters of credit were outstanding.

At the election of the Company, borrowings under the Financing Agreement bear interest at either the Reference Rate plus an applicable margin or the Eurodollar Rate plus an applicable margin, both as defined in the Financing Agreement. All current borrowings were made under the Reference Rate, which is calculated as the greater of (1) 2.75%, (2) the Federal Funds Effective Rate plus 0.50%, (3) the Eurodollar Rate plus 1.00%, or (4) the rate of interest publicly announced by PNC Financial Service Group, Inc. as its reference rate, base rate, or prime rate. The applicable margin for the Reference Rate is 4.00%. At March 31, 2012, the weighted average interest rate on all outstanding borrowings was 7.25%. At March 31, 2012, the effective interest rate was 8.17%.

There are no scheduled payments on either the Term Loan or Revolving Credit Facility prior to maturity. However, the Financing Agreement calls for mandatory prepayment of the Term Loan if certain conditions are met. The prepayment requirement is calculated for the fiscal year ended December 31, 2012, and the calculation is based on a percentage of "excess cash flow" as defined in the Financing Agreement. Payment is required to be made within ten days of issuing the year-end consolidated financial statements. Based on current projections, the Company estimates that no prepayment will be required to be made during March 2013. The entire Term Loan and Revolving Credit Facility balances are classified as noncurrent.

Starting July 1, 2011, the Company began paying a commitment fee of 0.375% of the unused portion of the borrowing capacity under the Revolving Credit Facility based on the average principal amount outstanding for the month compared to \$45,000. For the three ended March 31, 2012, the Company incurred \$21 in commitment fees, which is included as a component of interest expense in the condensed consolidated statement of operations.

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The Company incurred and capitalized \$2,538 of direct costs related to the issuance of the Term Loan and Revolving Credit Facility. Of the total amount incurred, \$1,699 was directly related to the Term Loan and \$839 was directly related to the Revolving Credit Facility. As neither debt instrument has a mandatory payment schedule and the entire balance of each is due at maturity, the Company amortizes these deferred loan costs on a straight-line basis over the respective terms of the loan: the Term Loan is being amortized through June 20, 2016, and the Revolving Credit Facility through June 20, 2014. For the three months ended March 31, 2012, the Company amortized \$154 of these loan costs, which is included as a component of interest expense in the condensed consolidated statement of operations. In addition, the Company recorded additional amortization of \$132 through interest expense due to the \$4.0 million payment on the Term Loan prior to maturity. The carrying value of deferred loan costs at March 31, 2012, was \$1,923 and is included as a component of noncurrent other assets in the condensed consolidated balance sheet.

Attached to the Term Loan and Revolving Credit Facility are a number of financial and non-financial covenants. At March 31, 2012, the Company was in compliance with covenants associated with the Term Loan and Revolving Credit Facility.

US Bank Line of Credit

Effective May 13, 2010, the Company entered into a Loan Agreement (the “Loan Agreement”) with U.S. Bank National Association (“US Bank”). The Loan Agreement provided for revolving loans and other financial accommodations to or for the benefit of the Company of up to \$5,000, to be used for working capital and other corporate purposes. The Company’s obligations under the Loan Agreement and all related agreements were secured by all or substantially all of the Company’s assets. The obligation of U.S. Bank to make advances under the Loan Agreement was subject to the conditions set forth in the Loan Agreement. The Loan Agreement and the credit facility were to mature on May 13, 2011.

On March 8, 2011, the Company entered into an Amended and Restated Loan Agreement (the “Amended and Restated Loan Agreement”) with U.S. Bank which provided for revolving loans and other financial accommodations to or for the benefit of the Company of a principal amount not to exceed \$20,000. Advances under the Amended and Restated Loan Agreement bear interest at LIBOR plus 1.75%. The Amended and Restated Loan Agreement required the Company to maintain a fixed charge coverage ratio of no less than 1.25 to 1.00 measured quarterly on a trailing twelve month basis and a leverage ratio of no greater than 2.5 to 1.0 measured quarterly on a trailing twelve month basis. The Amended and Restated Loan Agreement and the credit facility were to mature on March 15, 2012.

On June 21, 2011 the Company paid off the entire outstanding balance on the line of credit, and the Loan Agreement with U.S. Bank was terminated.

(8) STOCK-BASED COMPENSATION

Common Stock Options – For the three months ended March 31, 2012 and 2011, the Company granted zero and 93 stock option awards, respectively. For awards granted during the three months ended March 31, 2011, the weighted-average fair value per stock option was \$4.98. The fair value for stock options granted is calculated using the Black-Scholes option-pricing model on the date of grant. For the three months ended March 31, 2011, the following assumptions were used in determining the fair value:

| | Three Months Ended March 31, 2011 |
|-------------------------|--|
| Expected dividend yield | 0.0% |
| Risk-free interest rate | 1.21% |
| Expected term (years) | 3.5 years |
| Expected volatility | 90.59% |

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The Company recorded share-based compensation expense only for those options that are expected to vest. The estimated fair value of the stock options is recognized on a straight-line basis over the requisite service period of the award, which is generally the vesting term of the award. During the three months ended March 31, 2012 and 2011, the Company recorded equity-based compensation expense related to stock options of \$270 and \$263, respectively.

Warrants – During the three months ended March 31, 2012 and 2011, the Company issued warrants for investor relations consulting services for 50 and 50 common shares, respectively, exercisable at \$9.02 and \$9.05 per share, respectively, expiring in 5 years and which vested upon issuance. The warrant grants were valued using the Black-Scholes option pricing model based on the fair value of the Company’s common stock on the date of grant, expected term equal to the contractual term, expected volatility weighted between the Company’s historical volatility and the average historical volatility of similar entities with publicly traded shares over the expected term, and risk-free rate for the expected term based on the U.S. Treasury yield curve on the grant date. For the three months ended March 31, 2012 and 2011, the Company recorded expense of \$311 and \$318, respectively, for these warrants.

The Company also issued warrants for investor relations consulting services during the three months ended March 31, 2010, for 100 common shares exercisable at \$2.58 per share expiring in 5 years and vesting equally over the 12 month period from the grant date (the last tranche of shares vested in the first quarter of 2011). Each vesting tranche of the warrants was independently valued using the Black-Scholes option pricing model with separate assumptions for each tranche based on the fair value of the Company’s common stock on each vesting date, expected term equal to the remaining contractual term on each vesting date, expected volatility weighted between the Company’s historical volatility and the average historical volatility of similar entities with publicly traded shares over the expected term for each vesting date, and risk-free rate for the expected term based on the U.S. Treasury yield curve in effect with a period that approximates the remaining contractual term for each vesting date.

For the three months ended March 31, 2012 and 2011, the following assumptions were used in determining the fair value of warrants granted:

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|-------------------------|--|--|
| Expected dividend yield | 0.0% | 0.0% |
| Risk-free interest rate | 0.81% | 2.02% |
| Expected term (years) | 5.0 years | 4.9 years |
| Expected volatility | 89.50% | 90.71% |

Restricted Stock - The Company granted 293 and 238 shares of restricted stock during the three months ended March 31, 2012 and 2011, respectively. The shares of restricted stock granted during the three months ended March 31, 2012 and 2011, were estimated to have a weighted-average fair value per share of \$9.37 and \$7.11, respectively. The fair value of the restricted stock granted is based on the closing share price of the Company’s common stock on the date of grant. The shares of restricted stock vest annually on a straight-line basis over a 10-month to three-year vesting term, depending on the terms of the individual grant.

The Company recorded share-based compensation expense only for those shares of restricted stock that are expected to vest. The estimated fair value of the restricted stock is recognized on a straight-line basis over the requisite service period of the award, which is generally the vesting term of the award. During the three months ended March 31, 2012 and 2011, the Company recorded equity-based compensation expense related to restricted stock of \$761 and \$40, respectively, which is included as a component of selling, general and administrative expense.

On March 30, 2012, the Company implemented a new incentive program for non-executive employees that provides for the issuance of a fixed amount of restricted stock to eligible employees if certain annual financial targets are reached. If the targets are reached for the 2012 fiscal year, these restricted shares will be transferred to employees during March 2013. The Company considers it probable that the financial targets will be reached and thus began recognizing stock compensation expense on the grant date ratably over the service period of the award.

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(9) INCOME TAXES

The Company's effective tax rate was 36.9% and 32.9% for the three months ended March 31, 2012 and 2011, respectively. The Company's effective tax rate will generally differ from the U.S. Federal Statutory rate of 35%, due to state taxes, permanent items and favorable tax rates associated with certain earnings from the Company's operations in Ireland. All earnings at foreign locations are considered to be permanently re-invested for tax purposes.

(10) EARNINGS PER SHARE

Basic earnings per common share excludes dilution and is computed by dividing net income attributable to stockholders by weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share reflect the potential dilution that could occur if stock options or other common stock equivalents were exercised or converted into common stock. The dilutive effect of stock options or other common stock equivalents is calculated using the treasury stock method.

The following is a reconciliation of the numerator and denominator used to calculate basic earnings per share and diluted earnings per share for the three months ended March 31, 2012 and 2011:

| | March 31, 2012 | March 31, 2011 |
|--|---------------------------|---------------------------|
| Net income attributable to stockholders | \$ 5,112 | \$ 3,310 |
| Weighted average shares outstanding | 29,924 | 24,096 |
| Dilutive effect of warrants, restricted stock and stock options | 1,493 | 2,120 |
| Diluted shares | 31,417 | 26,216 |
| Earnings per share attributable to stockholders: | | |
| Basic | \$ 0.17 | \$ 0.14 |
| Dilutive | \$ 0.16 | \$ 0.13 |

For the three months ended March 31, 2012 and 2011, warrants, restricted stock, and stock options to purchase 111, and 156, respectively, were not considered in calculating diluted earnings per share because the warrant or stock option exercise prices or the total expected proceeds under the treasury stock method for the warrants, restricted stock, or stock options was greater than the average market price of common shares during the period and, therefore, the effect would be anti-dilutive.

(11) NOTE RECEIVABLE

In June 2008, Lorence Harmer became a member of the board of directors and in December 2009, was appointed as the chairman of the Audit Committee. Mr. Harmer introduced the Company to a consumer electronics product, which became known as the ZAGGbox. The ZAGGbox was intended to aggregate digital content such as music, pictures, videos and movies into a single location so that users could share the content with most other networked media players, including mobile devices. After investigating the market opportunity for the ZAGGbox, the Company determined in June 2009 that it wished to obtain certain rights for the development and sale of the ZAGGbox in North America. The Company entered into negotiations with Teleportall, LLC ("Teleportall"), the owner of the technology used in the ZAGGbox, regarding production and distribution of the ZAGGbox. On June 17, 2009, the Company issued its initial purchase order for ZAGGbox units in the amount of \$3,500 and advanced to Teleportall a total of \$1,153 representing a \$200 non-recurring engineering (NRE) fee and \$953 in payment of 30% of the total purchase price for the units ordered by the Company. Mr. Harmer participated in the negotiations between the Company and Teleportall, and continued to represent the Company throughout 2009 and 2010 concerning the ZAGGbox. In May 2010, the Company entered into a Distribution and License Agreement with Teleportall, which memorialized Teleportall's agreement to manufacture and deliver ZAGGboxes to the Company and appointed the Company as the exclusive distributor for the ZAGGbox in North American. Additionally, in May 2010 the Company entered into an agreement with Harmer Holdings, LLC, an affiliate of Mr. Harmer, under which Harmer Holdings, LLC agreed to repurchase unsold ZAGGboxes under certain circumstances.

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Teleportall proceeded to develop the ZAGGbox and provided periodic progress reports to the Company. However, Teleportall did not deliver the product in time for the 2009 Christmas selling season. Subsequently, during the December 1, 2009 meeting of the Board of Directors of the Company, Mr. Harmer disclosed to the other members of the Board that he owned an interest in Teleportall. After a discussion about his financial interest in Teleportall during that meeting, Mr. Harmer stated he was willing to divest himself of any ownership in Teleportall and the Board of Directors voted unanimously to accept Mr. Harmer's proposal that he would do so, and assumed thereafter that Mr. Harmer had completed his divestiture.

The development of the product continued in 2010 with the expectation that the product would be delivered in time for the 2010 Christmas selling season. The Company made additional payments for long lead-time parts to Teleportall in the aggregate amount of \$2,747. When it became obvious to the Company that the product would not be ready to market and sell during the 2010 Christmas season, the Company commenced discussions to restructure the Distribution and License Agreement with Teleportall. During the course of those discussions, the Company learned in January 2011 that Mr. Harmer did not divest himself of any interest in Teleportall following the December 2009 meeting of the Board of Directors of the Company where he agreed to do so, but retained an indirect ownership interest of 25% in Teleportall as well as other entities potentially affiliated with the ZAGGbox. As a result of the foregoing, the Company entered into an agreement with Teleportall, Mr. Harmer and several entities owned or controlled by Mr. Harmer (the "Harmer Agreement"), dated March 23, 2011, but subject to further negotiations and ratification through April 5, 2011. Pursuant to the Harmer Agreement, the parties agreed to terminate the Distribution and License Agreement on the following terms:

- Mr. Harmer, Teleportall, and certain of their affiliates delivered a promissory note (the "Note") dated March 23, 2011 to the Company in the original principal amount of \$4,126 which accrues interest at the rate of LIBOR plus 4% per annum (adjusted quarterly) payable as follows: (i) interest only payments (a) on September 23, 2011, and (b) thereafter on or before the last day of each calendar quarter, (ii) 50% of the net profits of each ZAGGbox sale by Teleportall and its affiliates to be applied, first, to accrued interest and, second, to the principal balance of the Note, and (iii) the unpaid balance of principal and interest due in full on March 23, 2013. The principal amount of the Note is the aggregate amount of the payments made by the Company to Teleportall plus the internal cost of the ZAGGbox project incurred by the Company. The Note is secured by certain real property, interests in entities that own real property and restricted and free-trading securities.
- Teleportall and the Company entered into a License Agreement on March 23, 2011 under which the Company licensed to Teleportall the use of certain ZAGG names and trademarks to sell and distribute the ZAGGbox product. Teleportall will pay ZAGG a 10% royalty on net sales of ZAGGboxes per calendar quarter as a license fee.
- Teleportall and ZAGG entered into a non-exclusive, two year Commission Agreement on March 23, 2011, under which Teleportall could make introductions of many ZAGG products in all countries where ZAGG does not currently have exclusive dealing agreements in respect of the marketing, distribution or sale of its products. The Commission Agreement provided that (a) it would automatically terminate concurrent with any uncured default under the Note, and (b) the term could be extended for an additional time period on reasonable terms if Teleportall's introductions during the initial two year term result in the purchase of no less than \$25,000 of ZAGG products during the initial term. Payment terms of the Commission Agreement are as follows:
 - 10.0% commission payments on orders received by the Company from retailers and distributors first introduced to the Company by Teleportall during the first 60 days after the introduction is made (the "Load-in Period") to be split 50/50 between cash to Teleportall and principal payments on the Note. However, all commission payments will be paid to ZAGG if Teleportall is in breach of the terms of the Note or any other agreements between the parties;

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- 3.0% commission on all orders within the first 24 months after the Load-in Period, and 2.0% thereafter, from retailers and distributors first introduced to the Company as described under the terms set forth in the preceding bullet point. The 3.0% and 2.0% commissions will be split 50/50 between cash to Teleportall and principal payments on the Note; and
- 3.0% commission on all orders generated in countries where Teleportall is paid commission under the terms of the preceding two bullet points (excluding the United States), regardless of Teleportall's involvement in ZAGG's receipt of the order until the first to occur of (i) payment in full of the Note, (ii) termination of the Commission Agreement or (iii) 24 months after the applicable Load-in Period.

No revenue has been recognized from Teleportall.

As part of the Harmer Agreement, the Company modified a previously granted stock option award to Mr. Harmer, which resulted in a charge of \$1,560 that was recorded in the second quarter of 2011. The charge was recorded in the second quarter of 2011 due to further negotiations and ratification on April 5, 2011. The further negotiations concerned the restricted legend placed on 80 shares of stock subject to repayment of the Note.

The Note was originally accounted for under the cost recovery method and was originally included in the consolidated balance sheet at \$3,900 which was the value of the ZAGGbox inventory advances. The original face value of the Note of \$4,126 was for reimbursement of the inventory advances and other costs associated with the ZAGGbox and approximated fair value at March 23, 2011 as the variable interest rate on the Note approximated market rates.

On September 20, 2011, and prior to the due date of the first interest-only payment due on the Note, Mr. Harmer and two of his affiliates, Harmer Holdings, LLC, ("Holdings") and Teleportall, filed a lawsuit in Utah state court against the Company, Robert G. Pedersen, II (ZAGG's CEO), Brandon T. O'Brien (ZAGG's CFO) and KPMG LLP (ZAGG's independent registered public accounting firm). KPMG has subsequently been dismissed from the lawsuit. In their lawsuit, the plaintiffs allege that the defendants defamed Mr. Harmer, breached the Harmer Agreement and interfered with other rights of the plaintiffs. The Company has responded to the plaintiffs' claims, denying all of the material allegations made by the plaintiffs. The Company believes the plaintiff's claims to be without merit and intends to vigorously defend against them.

Subsequently, Mr. Harmer failed to make the required interest-only payment to the Company due on September 23, 2011, and had until October 23, 2011 to cure the default. Mr. Harmer failed to cure the default by October 23, 2011, and on that date, management directed ZAGG legal counsel to commence foreclosure on the collateral securing the loan, which consists of real property, interests in entities that own real property, and restricted and free-trading securities, which included 45 shares of ZAGG common stock. In addition to the collateral, Mr. Harmer had also agreed that he would not sell 80 shares of ZAGG common stock until two months after the Note was paid in full. Given the Note is full recourse, and the shares have a restrictive legend associated with repayment of the Note, the Company believes they can recover the 80 shares.

Given Mr. Harmer's default on the loan on September 23, 2011, and failure to cure the default on October 23, 2011, management determined that it was probable that the Company would be unable to collect all amounts due from Mr. Harmer according to the terms of the Note. As the Note became collateral-dependent upon Mr. Harmer's default, management engaged various third-party certified appraisers valuation specialists to assist management in its determination of the fair value of the collateral and whether it is sufficient to recover the Note balance. As of March 31, 2012, management noted that the estimated fair value of the underlying collateral was between \$2,145 and \$2,588. As management has not been able to ascertain whether Mr. Harmer owns 50% or 100% of Holdings, management used the low end of the above range (\$2,145) and compared it to the carrying amount of the note of \$1,665. The remaining note balance of \$1,665 appears to be collectable given management's best estimate of the cash recovery on the collateral securing the Note (fair value, less cost to sell) of \$2,145. Additionally, the Company has reclassified \$566 of the Note as an offset to equity, representing the collateral secured by ZAGG, which management intends to recover to repay the Note. Ultimately, any recovery in excess of the carrying value of the Note will be recognized when realized.

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We determined the fair values of the collateral of the note receivable, which required significant estimates and assumptions. Management determined the value of the 80 shares of ZAGG common stock held by Mr. Harmer based on quoted market prices. The real estate holdings were valued primarily based on the sales comparison approach as sales of comparable properties were utilized. The investments in real estate companies, and private company stock and warrants were valued utilizing comparable market sales, a discounted cash flow analysis, and other appropriate valuation methodologies including the use of the Black-Scholes option pricing model for the private company warrants.

Since the Note became collateral dependent in October 2011, management has (1) foreclosed and sold 45 shares of ZAGG common stock for \$496 (December 2011) and (2) foreclosed on real property valued at \$250 (January 2012). These foreclosures were recorded as a reduction to the note receivable in the period in which the foreclosure occurred. Management is currently engaged in the foreclosure of the other property that collateralizes the note receivable.

At March 31, 2012, the total unpaid principle balance, including accrued interest, late fees and costs incurred on collection, totaled \$3,715.

(12) FAIR VALUE MEASURES

Fair Value of Financial Instruments

At March 31, 2012, and December 31, 2011, the Company's financial instruments included cash and cash equivalents, accounts receivable, accounts payable, a note receivable, a Revolving Credit Facility, and a Term Loan. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturities of these financial instruments. The carrying value of the debt balances approximate fair value because the variable interest rates approximate current market rates.

In addition, as discussed in Note 11, management engaged third party appraisal and valuation specialists to assist them in determining the fair value of assets that collateralize the note receivable. The collateral includes private company stock and warrants, real property, and interests in entities that own real property.

Fair Value Measurements

The Company measures at fair value certain financial and non-financial assets by using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, essentially an exit price, based on the highest and best use of the asset or liability. The levels of the fair value hierarchy are:

Level 1 — Quoted market prices in active markets for identical assets or liabilities;

Level 2 — Significant other observable inputs (e.g., quoted prices for similar items in active markets, quoted prices for identical or similar items in markets that are not active, inputs other than quoted prices that are observable such as interest rate and yield curves, and market-corroborated inputs); and

Level 3 — Unobservable inputs in which there is little or no market data, which require the reporting unit to develop its own assumptions.

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At March 31, 2012, and December 31, 2011, the following assets and liabilities were measured at fair value on a recurring basis using the level of inputs shown:

| | March 31, 2012 | Fair Value Measurements Using: | | |
|------------------|---------------------------|---------------------------------------|-----------------------|-----------------------|
| | | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs |
| Cash equivalents | \$ 20 | \$ 20 | — | — |

| | December 31, 2011 | Fair Value Measurements Using: | | |
|------------------|------------------------------|---------------------------------------|-----------------------|-----------------------|
| | | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs |
| Cash equivalents | \$ 1,452 | \$ 1,452 | — | — |

Non-Recurring Fair Value Measurements

The Company also measures the fair value of certain assets on a non-recurring basis, generally quarterly, annually or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. These assets include intangible assets, goodwill, property and equipment, asset purchase credits, and collateral securing the note receivable.

There were no assets held at March 31, 2012, measured at fair value on a non-recurring basis and no impairments were recorded during the period.

The following table presents assets held as of December 31, 2011, measured at fair value on a non-recurring basis using the level of inputs shown at the time of impairment:

| | December 31, 2011 | Fair Value Measurements Using: | | |
|-----------------|------------------------------|---------------------------------------|-----------------------|-----------------------|
| | | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs |
| Note receivable | \$ 1,915 | \$ 566 | \$ 1,089 | \$ 260 |

At December 31, 2011, the note receivable was recorded at the fair value of the underlying collateral. Management considered the 80 shares of ZAGG common stock to be a Level 1 asset as quoted market prices exist. The real estate holdings were considered Level 2 assets as significant observable inputs exist for similar items in active markets. The investments in real estate companies, and private company preferred stock and warrants were considered Level 3 assets as the value was determined based on unobservable inputs.

(13) CONCENTRATIONS

Concentration of credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and accounts receivable. The Company places its cash with high-credit-quality financial institutions. The Company maintains its cash in bank deposit accounts, which, at times, exceed federally insured limits. The Company has not experienced any losses in such accounts through March 31, 2012.

At March 31, 2012, and December 31, 2011, approximately 58% and 62%, respectively, of the balance of accounts receivable was due from two customers. No other customer account balances were more than 10% of accounts receivable. If one or more of the Company's significant customers were to become insolvent or were otherwise unable to pay for the products provided, it would have a material adverse effect on the Company's financial condition and results of operations.

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Concentration of supplier

The Company purchases its raw materials related to the invisibleSHIELD product line primarily from one source. Management is aware of similar raw materials that would be available from other sources if required and has current plans to immediately engage such resources if necessary. A change in supplier, however, could cause a delay in manufacturing and a possible loss of sales, which could adversely affect operating results.

In addition, iFrogz purchases all inventory through one third party sourcing Company. Management is aware of other manufacturing sources that it could utilize if there was a disruption in the operations of the third party sourcing Company. A change in the sourcing Company, however, could cause a delay in manufacturing and a possible loss of sales, which could adversely affect operating results.

Concentration of sales

For the three months ended March 31, 2012, three customers individually accounted for over 10% of the quarterly revenues at 28%, 12%, and 10%. No other customer account balances were more than 10% of sales. For the three months ended March 31, 2011, two customers individually accounted for 10% of the quarterly revenues at 27% and 11%. No other customer account balances were more than 10% of sales. If the Company loses one or more of the Company's significant customers, it would have a material adverse effect on the Company's financial condition and results of operations.

The percentage of sales by geographic region for the three months ended March 31, 2012 and 2011, was approximately:

| | Three months ended March 31, 2012 | Three months ended March 31, 2011 |
|---------------|--|--|
| United States | 89% | 95% |
| Europe | 6% | 4% |
| Other | 5% | 1% |

(14) COMMITMENTS AND CONTINGENCIES

Operating leases

The Company leases office and warehouse space, office equipment, and mall cart locations under operating leases that expire through 2017. Future minimum rental payments required under the operating leases at March 31, 2012 are as follows:

| | | |
|---------------------|----|-----------------|
| Remaining 2012 | \$ | 704 |
| 2013 | | 651 |
| 2014 | | 558 |
| 2015 | | 331 |
| 2016 and thereafter | | 135 |
| Total | | <u>\$ 2,379</u> |

For the three months ended March 31, 2012 and 2011, rent expense was \$357 and \$140, respectively. Rent expense is recognized on a basis which approximates straight line over the lease term.

Commercial Litigation

Wrapsol, LLC, v. ZAGG Inc, U.S. District Court, District of Massachusetts, 1:11-cv-11006-RGS. The Company was engaged as the defendant in civil litigation in Massachusetts in which Wrapsol, LLC ("Wrapsol") has alleged unfair competition and tortious interference with business relations claiming that the Company's sales representatives attempted to harm Wrapsol by making false allegations. The Company denied these allegations. The parties conducted extensive written discovery, and engaged in settlement negotiations. On March 2, 2012, Wrapsol dismissed the case with prejudice without payment of any consideration by the Company to Wrapsol.

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(Dollars, units and shares in thousands, except per share data)
(Unaudited)

Lorence A. Harmer, et al v ZAGG Inc et al, Third Judicial District Court, Salt Lake County, State of Utah, Civil No. 110917687. On September 20, 2011, Lorence A. Harmer, a former director of ZAGG Inc and two of his affiliates, Harmer Holdings, LLC, and Teleportal, LLC, filed a lawsuit in Utah state court against the Company, Robert G. Pedersen, II, Brandon T. O'Brien and KPMG LLP. KPMG has subsequently been dismissed from the lawsuit. This case is discussed in greater detail in Note 11, Note Receivable. Plaintiffs allege that the defendants defamed Mr. Harmer, breached a settlement agreement and other agreements between the plaintiffs and ZAGG, and interfered with other rights of the plaintiffs. ZAGG has responded to the plaintiffs' claims, denying all of the material allegations made by the plaintiffs, and has asserted affirmative defenses. Fact discovery has commenced. The Company believes the Plaintiffs' claims to be without merit and intends to vigorously defend against them.

Patent Litigation

ZAGG Intellectual Property Holding Co. Inc. v. NLU Products, LLC, Wrapsol, LLC, U.S. District Court, Central District of California, 2:10-cv-06511; ZAGG Intellectual Property Holding Co. Inc. v. Ghost Armor, Griffin Technology, Russell B. Taylor, United SGP, XO Skins, U.S. District Court, District of Utah, 2:10-cv-01257. The Company's wholly owned subsidiary, ZAGG Intellectual Property Holding Company, Inc. ("ZAGG IP"), is engaged as the plaintiff in patent infringement litigation pending in California and in Utah that seeks to enforce rights under United States Patent No. 7,784,610 (one of the patents acquired from Andrew Mason, see below). The defendants in these cases have raised defenses and, in some cases, asserted counterclaims against ZAGG IP that seek declarations of unenforceability or non-infringement of the patent. These counterclaims do not assert any claims for affirmative relief against ZAGG IP or the Company, apart from a request for an award against ZAGG IP of costs and attorney's fees. Most of the defendants have settled with ZAGG IP and the remaining parties are engaged in discovery. One of the defendants filed a motion for summary judgment in respect of all of the claims of ZAGG IP, but that motion was denied by the court. The parties have recently filed briefs relating to claims construction. In the opinion of management, the ultimate disposition of these patent infringement claims, including disposition of the counterclaims, will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity. Management believes the likelihood of an unfavorable outcome in this case is remote and that any potential loss contingency is not estimable at this time.

ZAGG Intellectual Property Holding Co. Inc. v. NLU Products et al, U.S. District Court, District of Utah, 2:11-cv-00517. ZAGG IP is also engaged as the plaintiff in patent infringement litigation pending in Utah that seeks to enforce rights under United States Patent No. 7,957,524. The defendants in this case have raised defenses and, in some cases, asserted counterclaims against ZAGG IP, that seek declarations of unenforceability or non-infringement of the patent. These counterclaims do not assert any claims for affirmative relief, including claims for damages, against ZAGG IP or the Company, apart from a request for an award of costs and attorney's fees to the prevailing party. Discovery has not yet commenced in this case, however, several of the defendants have settled with ZAGG IP. A petition to reexamine U.S. Patent No. 7,957,524 filed by Wrapsol, one of the defendants, was recently granted. Accordingly, this patent is currently being reexamined by the United States Patent and Trademark Office. There are no claims asserted in these actions against the Company. In the opinion of management, the ultimate disposition of these patent infringement claims, including disposition of the counterclaims, will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

ZAGG v. Trekstor, Regional Court, Dusseldorf, Germany. The Company brought suit in Dusseldorf, Germany against Trekstor for infringement of ZAGG design registrations for ZAGGmate and the Logitech Keyboard Case by ZAGG. The Company also brought claims for unfair competition. As of the date of this Report, all briefing had been completed and a hearing was held. The Court has not yet ruled on these claims. TrekStor has also filed an application for a declaration of invalidity of the Company's design registrations. The Company believes this allegation of invalidity to be without merit and intends to vigorously defend against it.

The Company is not a party to any other litigation or other claims at this time. While the Company currently believes that the amount of any ultimate potential loss for known matters would not be material to the Company's financial condition, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial condition or results of operations in a particular period.

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Patent Acquisition

On August 31, 2010, Andrew Mason (“Mason”) filed a complaint against the Company claiming infringement of United States Patent Nos. 7,389,869 and 7,784,610 as a result of the Company’s invisibleSHIELD installation kits. On September 4, 2010, the Company filed a counter complaint against Mason and his company, eShields LLC (“eShields”). On November 9, 2010, before either party had responded on the merits to the claims asserted, the Company, Mason and eShields entered into an Asset Purchase Agreement (“Purchase Agreement”) under which a wholly owned subsidiary of the Company, ZAGG Intellectual Property Holding Company, Inc. (“ZAGG IP”), acquired all of the rights of Mason in (i) the patents (United States Patent Nos. 7,389,869 and 7,784,610) which were the subject of the litigation, (ii) the patent application filed on August 13, 2010 (the “CIP Application”) and (iii) rights to sue for infringement of the patents.

In consideration for the conveyance of Mason’s assets described above, the Company agreed to pay or convey to Mason the following:

- (a) a first payment of \$200 by November 11, 2010, and a second payment of \$150 after December 31, 2010;
- (b) issue to Mason five-year warrants (the “Warrant”) to purchase 750 shares of the Company’s restricted Common Stock at an exercise price equal to the closing bid price on November 9, 2010 (\$8.53); provided that 500 of the 750 warrant shares are exercisable only upon the issuance of a patent from the CIP Application with at least one claim that satisfies the Claim Conditions (as defined below);
- (c) issue to Mason 70 shares of the Company’s restricted Common Stock; and
- (d) grant eShields a fully paid-up, perpetual, non-exclusive license, with limited rights to transfer or sublicense, for the patents and CIP Applications.

The Company also agreed to dismiss the claims asserted against Mason and eShields, and to make additional payments to Mason if the US Patent and Trademark Office (“USPTO”) issues a U.S. patent on the CIP Application that includes at least one claim that broadly encompasses any protective kit that includes a package, as well as a squeegee and an adhesive-coated protective film for a consumer electronic device with a peel-away backing within the package (collectively, the “Claim Conditions”). If the Claim Conditions are met, the Company will:

- (a) pay Mason the sum of \$500; and
- (b) issue to Mason 430 shares of the Company’s restricted Common Stock.

If the Claim Conditions are not met, the Company has no obligation to make the payment or issue the shares described in the preceding paragraph and Mason will not be able to exercise 500 of the Warrants. There can be no assurance that the USPTO will issue a patent on the CIP Application that meets the requirements of the Claim Conditions. As of March 31, 2012, no applicable patent had been issued by the USPTO.

We establish liabilities when a particular contingency is probable and estimable. We have not accrued for any loss at March 31, 2012 in our condensed consolidated financial statements in light of the probability and ability to estimate any potential liability. It is reasonably possible that the potential losses may exceed our accrued liabilities for contingencies; however, the amount cannot be currently estimated.

(15) SEGMENT REPORTING

The operating segments reported below are the Company’s segments for which separate financial information is available and upon which operating results are evaluated by the chief operating decision maker on a timely basis to assess performance and to allocate resources.

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Prior to the Company's acquisition of iFrogz, the Company was a single reporting segment consistent with the nature of its operations. Due to the acquisition, the Company has reassessed its reporting segments and concluded that it will analyze its worldwide operations based on the following three reportable segments:

- ZAGG segment – This segment designs, manufactures and distributes protective coverings, audio accessories and power solutions for consumer electronic and hand-held devices under the brand names invisibleSHIELD®, ZAGGskins™, ZAGGbuds™, ZAGGsparq™, ZAGGfolio™, ZAGGmate™, and ZAGGkeys™.
- iFrogz segment – This segment designs, manufactures and distributes protective coverings and digital audio accessories for consumer electronic and hand-held devices under the brand names iFrogz™ and Earpollution™.
- HzO segment – This segment is engaged in the development of water blocking coating technologies for consumer and industrial applications. As discussed in Note 5, HzO was deconsolidated as of December 22, 2011; however, management will continue to report HzO's operations within the segment reporting below.

The Company evaluates segment performance based on the segment's income from operations. Other income (expense), which includes interest expense, is not presented by segment since it is not included in the measure of segment profitability reviewed by the chief operating decision maker. All inter-segment transactions have been eliminated. Information concerning our operations by reportable segment is as follows:

| | Three Months Ended | |
|----------------|---------------------------|---------------------------|
| | March 31, 2012 | March 31, 2011 |
| Revenue | | |
| ZAGG segment | \$ 39,837 | \$ 26,976 |
| iFrogz segment | 15,643 | — |
| HzO segment | — | — |
| Total | <u>\$ 55,480</u> | <u>\$ 26,976</u> |

| | Three Months Ended | |
|--|---------------------------|---------------------------|
| | March 31, 2012 | March 31, 2011 |
| Income from Operations | | |
| ZAGG segment | \$ 9,474 | \$ 5,042 |
| iFrogz segment | 754 | — |
| HzO segment | — | \$ (178) |
| Total income from operations | \$ 10,228 | \$ 4,864 |
| Loss from investment in HzO | (463) | — |
| Other income (expense) | (1,668) | (11) |
| Income before provision for income taxes | <u>\$ 8,097</u> | <u>\$ 4,853</u> |

| | As of | |
|----------------------------|---------------------------|------------------------------|
| | March 31, 2012 | December 31, 2011 |
| Identifiable Assets | | |
| ZAGG segment | \$ 69,784 | \$ 88,671 |
| iFrogz segment | 106,387 | 108,778 |
| HzO segment | 4,416 | 4,879 |
| Total | <u>\$ 180,587</u> | <u>\$ 202,328</u> |

(16) SUBSEQUENT EVENTS

There were no subsequent events identified that would require disclosure or adjustment to the condensed consolidated financial statements.

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

Certain statements, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words "believes," "project," "expects," "anticipates," "estimates," "forecasts," "intends," "strategy," "plan," "may," "will," "would," "will be," "will continue," "will likely result," and similar expressions. We intend such forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and are including this statement for purposes of complying with those safe-harbor provisions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on our operations and future prospects include, but are not limited to: changes in economic conditions, legislative/regulatory changes, availability of capital, interest rates, competition, and generally accepted accounting principles. These risks and uncertainties should also be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Further information concerning our business, including additional factors that could materially affect our financial results, is included herein and in our other filings with the SEC.

Our Business (dollars in thousands)

ZAGG Inc, headquartered in Salt Lake City, Utah, designs, manufactures and distributes protective coverings, audio accessories and power solutions for consumer electronic and hand-held devices under the brand names invisibleSHIELD®, ZAGGskins™, ZAGGbuds™, ZAGGsparq™, ZAGGfolio™, ZAGGmate™, ZAGGkeys™, iFrozg™ and Earpollution™.

Our flagship product, the invisibleSHIELD, is made from a protective film covering that was developed originally to protect the leading edges of rotary blades of military helicopters. We determined that this same film product could be configured to fit onto the surface of electronic devices and marketed to consumers for use in protecting such devices from every day wear and tear, including scratches, scrapes, debris and other surface blemishes. The film also permits touch sensitivity, meaning it can be used on devices that have a touch-screen interface. The invisibleSHIELD film material is highly reliable and durable because it was originally developed for use in a high friction, high velocity context within the aerospace industry. The film provides long lasting protection for the surface of electronic devices subject to normal wear and tear. The film is a form of polyurethane substance, akin to a very thin, pliable, flexible and durable clear plastic that adheres to the surface and shape of the object it is applied to.

The invisibleSHIELD is designed specifically for iPods®, iPads®, laptops, cell phones, digital cameras, watch faces, GPS systems, gaming devices, and other mobile devices. The product is "cut" to fit specific devices and packaged together with a moisture activating solution which makes the invisibleSHIELD adhere to the surface of the device, literally "like a second skin," and virtually invisible to the eye. The patent-pending invisibleSHIELD is the first scratch protection solution of its kind on the market. The invisibleSHIELD is not ornamental, but rather provides a long lasting barrier to preserve the brand new look of the surface of an electronic device. In early 2010, we introduced the invisibleSHIELD DRY through retail partners, which is a protective film made from the same material as the original invisibleSHIELD, and engineered to be clearer, smoother to the touch, and apply without the need for fluid. In the beginning of 2011, we added the invisibleSHIELD Smudge-Proof to our line, which also incorporates the invisibleSHIELD film with added features that eliminate smudges, fingerprints, and glare from the device display. In January 2012, we introduced the invisibleSHIELD HD, a new premium version of the invisibleSHIELD that offers industry-leading clarity and finish, online at www.ZAGG.com and at select retail partners.

Currently, ZAGG offers over 5,900 precision, pre-cut invisibleSHIELD designs with a lifetime replacement warranty through online channels, big-box retailers, electronics specialty stores, resellers, college bookstores, Mac stores, and mall kiosks. We plan to increase our product lines to offer new electronic accessories to our tech-savvy customer base, as well as an expanded array of invisibleSHIELD products for other industries. Given the success of the invisibleSHIELD (evidenced by an increase in sales, comparing the three months ended March 31, 2012 to 2011, of 28%, from \$20,772 to \$26,602), ZAGG has the unique opportunity to offer additional accessories from a trusted source to gadget enthusiasts worldwide.

The ZAGGaudio brand of electronics accessories and products were first released in late 2008, and continue to focus on innovation and superior value. The flagship product within ZAGGaudio is the award winning ZAGGsmartbuds™ line, which includes ZAGGaquabuds, a water-resistant earbud introduced in late 2010. A previous winner of the coveted CES Design and Innovation award, the ZAGGsmartbuds line has been well received by professional reviewers, experts and the consumer base. On January 12, 2010, we were awarded patent number US D 607,875 by the U.S. Patent and Trademark Office, covering design elements of ZAGGsmartbuds in-ear headphones.

ZAGGskins were introduced in November 2009, and combine customizable, high-resolution images with the scratch protection of ZAGG's invisibleSHIELD. To create a ZAGGskin, consumers select from a library of professional designs or upload their own high-resolution personal photos or images. The printed image, custom designed for their device, is then merged with the exclusive, ultra-tough, patented invisibleSHIELD film, which allows customers to both protect and individualize their gadgets with a single product.

In early 2009, we introduced the ZAGGsparq, a small, powerful, portable battery that can recharge a power-hungry "smartphone" up to four times before the ZAGGsparq itself needs to be recharged. Featuring a 6000ma lithium polymer cell, the ZAGGsparq plugs into a wall outlet and provides two USB ports for charging mobile devices. An adapter is also included that fits many international standards. The ZAGGsparq is compatible with any USB-charged device, including Apple iPads, iPods, and iPhones, as well as cell phones, handheld gaming systems, and digital cameras.

We also introduced ZAGG LEATHERskins in early 2010. ZAGG LEATHERskins are thin, pliable cases that apply directly to personal electronics like a film, and are created from genuine leather. Available in typical leather shades and premium animal patterns, ZAGG LEATHERskins use an adhesive that holds the skin firmly in place on the device, but can be removed if necessary. Later in 2010, we broadened the line to include ZAGG sportLEATHER, which are also created from genuine leather and feature authentic recreations of baseball, football and basketball textures. ZAGG LEATHERskins and sportLEATHERS are available for the most popular personal electronics.

We introduced the ZAGGmate in November 2010. The ZAGGmate is a protective and functional companion to the Apple iPad and iPad 2, as well as the new iPad, that accentuates both the appearance and utility of Apple's innovative device. Made from aircraft-grade aluminum with a high quality finish, the patent-pending ZAGGmate matches the design, look and feel of the iPad and iPad 2. The ZAGGmate line features two models, one with a simple, innovative stand and built-in wireless Bluetooth® keyboard that allows for fast, responsive typing, and interaction with the iPad's features. The second model replaces the keyboard with a more versatile stand that provides multiple angles for use. The ZAGGmate was the recipient of several prestigious industry awards, including the Macworld Expo 2011 Best of Show and recognition as a CES Innovations Design and Engineering Honoree. On April 7, 2011, we partnered with Logitech on the ZAGGmate product and renamed it the Logitech Keyboard Case by ZAGG. Under the partnership with Logitech, we receive royalty payments for all units sold by Logitech.

As a follow up to our very successful ZAGGmate, we launched the ZAGGfolio in July 2011. The ZAGGfolio is a stylish and functional case for the iPad 2, the new iPad, and Samsung Galaxy tablet that not only offers full protection, but increases productivity through a removable, Bluetooth keyboard. Operating with Bluetooth 3.0, the integrated battery will last for months between charges. A true 3-in-1 solution with a keyboard, stand and full protective cover, the patent pending ZAGGfolio is the winner of multiple awards including the 2012 CES Innovations Design and Engineering Showcase Honors. In fall of 2011, we expanded the ZAGGfolio family to include 11 different colors, textures and patterns, including genuine leather.

In November 2011, ZAGG launched the ZAGGkeys FLEX, a portable Bluetooth keyboard and stand. As implied by its name, the FLEX offers flexible function for the two most popular tablet and smartphone operating systems; a switch on the keyboard toggles between the Apple iOS and Android®. The ZAGGkeys FLEX utilizes same keyboard layout as our award-winning Logitech Keyboard Case and ZAGGfolio, ensuring a true typing experience. The ZAGGkeys FLEX includes a unique keyboard cover that easily converts into a stable stand compatible with nearly any tablet or smartphone. The ZAGGkeys FLEX was named an honoree at the 2012 CES Innovations Design and Engineering Showcase.

We maintain our corporate offices and operational facility at 3855 South 500 West, Suites B, C, D, I, J, K, L, M, N, O and S, Salt Lake City, Utah, 84115. The telephone number of the Company is 801-263-0699. Our website addresses are www.ZAGG.com and www.iFrogz.com. Information contained on, or accessible through, our website is not a part of, and is not incorporated by reference into, this report.

Acquisition of iFrogz

On June 21, 2011, the Company, ReminderBand, Inc., dba iFrogz (“iFrogz”), and the owners of iFrogz entered into a Stock Purchase Agreement pursuant to which ZAGG acquired 100% of the outstanding shares of iFrogz. The combination of ZAGG and iFrogz represents an opportunity to create a market leader in the mobile device accessories industry by building on complementary brands and increasing overall market share by growing product lines and expanding distribution.

iFrogz is headquartered in Logan, Utah, and designs, manufactures and distributes protective coverings and digital audio accessories for consumer electronic and hand-held devices under the brand names iFrogz™ and Earpollution™.

iFrogz began in 2006 by creating protective covers for iPods with a unique combination of fashion and quality that was received well by the marketplace through online sales only. In early 2007, iFrogz began distributing through large retailers. Subsequently, the iFrogz product offering has expanded into cell phones, other music devices, and a wider variety of fashion assortments for mobile devices, while continuing to expand its retail customer base.

In the summer of 2007, iFrogz released its first line of audio products under the Earpollution brand. The eclectic selection of Earpollution™ earbuds and headphones targets a younger demographic, yet still appeals to a wide demographic of consumers.

iFrogz continues to innovate its product lines allowing it to remain ahead of the curve in the electronic device accessory fashion market.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based on our 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 us 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, we evaluate our 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, the useful life of property and equipment, stock-based compensation expense and income taxes.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably may have been used, or if changes in the estimate that are reasonably likely to occur may materially impact the financial statements. Management believes the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition

We record revenue when persuasive evidence of an arrangement exists, product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. Our revenue is derived from sales of our products through our indirect channel, including retailers and distributors; through our direct channel including www.ZAGG.com, www.iFrogz.com, and our corporate-owned and third-party-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, our standard shipping terms are FOB shipping point, and we record 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, we record revenue when the product is delivered, net of estimated returns and discounts. For license fees, we recognize revenue on a straight-line basis over the life of the license term. We record revenue from royalty agreements in the period in which the royalty is earned.

Promotional products given to customers or potential customers are recognized as a cost of sales. Cash incentives provided to our 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

For product sales, the Company records revenue, net of estimated returns and discounts, when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. Our 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. In addition, the Company generally provides the ultimate consumer a warranty with each product. Due to the nature of the invisibleSHIELD product line, returns for the invisibleSHIELD are generally not salvageable and are not included in inventory. We estimate a reserve for sales returns and warranty and record the estimated reserve amount as a reduction of sales and as a sales return reserve liability. The estimate for sales returns and warranty requires management to make significant estimates regarding return rates for sales and warranty returns. Historical experience, actual claims, and customer return rights are the key factors used in determining the estimated sales return and warranty reserve.

Allowance for Doubtful Accounts

We provide customary credit terms to our customers. We perform ongoing credit evaluations of the financial condition of our customers and maintain an allowance for doubtful accounts based upon historical collections experience and judgments as to expected collectability of accounts. Our actual bad debts may differ from our estimates.

Valuation of Note Receivable

We engaged independent third-party appraisal firms to assist us in determining the fair values of collateral of the note receivable. Such valuations require significant estimates and assumptions. Management determined the value of the 80 shares of ZAGG common stock held by Mr. Harmer based on quoted market prices. The real estate holdings securing the note receivable were valued primarily based on the sales comparison approach as sales of comparable properties were utilized. The investments in real estate companies, and private company stock and warrants securing the note receivable were valued utilizing comparable market sales, a discounted cash flow analysis, and other appropriate valuation methodologies including the use of the Black-Scholes option pricing model for the private company warrants.

Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates.

Inventories

In assessing the realization of inventories, we are required to make judgments as to future demand requirements and to compare these with current inventory levels. When the market value of inventory is less than the carrying value, the inventory cost is written down to the estimated net realizable value thereby establishing a new cost basis. Our inventory requirements may change based on our projected customer demand, market conditions, technological and product life cycle changes, longer or shorter than expected usage periods, and other factors that could affect the valuation of our inventories.

Income taxes

Deferred income tax assets are reviewed for recoverability, and valuation allowances are provided, when necessary, to reduce deferred income tax assets to the amounts that are more likely than not to be realized based on our estimate of future taxable income. Should our expectations of taxable income change in future periods, it may be necessary to establish a valuation allowance, which could affect our results of operations in the period such a determination is made. We record income tax provision or benefit during interim periods at a rate that is based on expected results for the full year. If future changes in market conditions cause actual results for the year to be more or less favorable than those expected, adjustments to the effective income tax rate could be required.

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. The determination of the realization of certain income tax positions is subject to significant estimates based upon the facts and circumstances of each position.

Long-lived Assets

We have significant long-lived tangible and intangible assets consisting of property, plant and equipment, definite-lived intangibles, indefinite-lived intangibles, an investment in HzO and goodwill. We review these assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. In addition, we perform an impairment test related to indefinite-lived intangibles and goodwill at least annually. Our goodwill and intangibles are largely attributable to our acquisition of iFrogz.

At least annually and when events and circumstances warrant an evaluation, we perform our impairment assessment of goodwill, which requires the use of a fair-value based analysis. We determine the fair value of our reporting unit based on discounted cash flows and market approach analyses as considered necessary, and consider factors such as a weakened economy, reduced expectations for future cash flows coupled with a decline in the market price of our stock and market capitalization for a sustained period as indicators for potential goodwill impairment. If the reporting unit's carrying amount exceeds its estimated fair value, a second step must be performed to measure the amount of the goodwill impairment loss, if any. The second step compares the implied fair value of the reporting unit's goodwill, determined in the same manner as the amount of goodwill recognized in a business combination, with the carrying amount of such goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

Indefinite lived intangible assets are tested for impairment annually, or, more frequently upon the occurrence of a triggering event. The Company evaluates the recoverability of indefinite lived intangible assets by comparing the indefinite lived intangible assets book value to its estimated fair value. The fair value for indefinite lived intangible assets is determined by performing cash flow analysis and other market evaluations. If the fair value of the indefinite lived intangible assets is less than book value, the difference is recognized as an impairment loss.

We test our investment in HzO each reporting period to determine whether HzO's operations or other factors indicate that the investment in HzO is not recoverable. When indicators of impairment exist, we measure the fair value of our investments in HzO and compare the fair value to the carrying value. The determination of the amount of impairment, if any, is based upon the difference between the asset's carrying value and estimated fair value. Fair value is determined through various valuation techniques, including market and income approaches as considered necessary.

We assess other long-lived assets, specifically definite-lived intangibles and property, plant and equipment, for potential impairment given similar impairment indicators. When indicators of impairment exist related to our long-lived tangible assets and definite-lived intangible assets, we use an estimate of the undiscounted net cash flows in measuring whether the carrying amount of the assets is recoverable. Measurement of the amount of impairment, if any, is based upon the difference between the asset's carrying value and estimated fair value. Fair value is determined through various valuation techniques, including market and income approaches as considered necessary.

If forecasts and assumptions used to support the realizability of our goodwill and other long-lived assets change in the future, significant impairment charges could result that would adversely affect our results of operations and financial condition.

Stock-based compensation

The Company recognizes stock-based compensation expense in its consolidated financial statements for awards granted to employees and non-employees under its stock incentive plan, which include restricted stock and stock options. Equity-classified awards are measured at the grant date fair value of the award. The fair value of stock options is measured on the grant date using the Black-Scholes option pricing model (BSM), which involves the use of assumptions such as expected volatility, expected term, dividend rate, and risk-free rate. Volatility is a key factor used to determine the fair value of stock options in the BSM. The Company does not have sufficient historical data or implied volatility information to determine volatility based upon its own information. Therefore the Company uses significant judgment to identify a peer group and determine the appropriate weighting in order to estimate a volatility rate for use in the BSM.

On March 30, 2012, the Company implemented a new incentive program for non-executive employees that provides for the issuance of a fixed amount of restricted stock to eligible employees if certain annual financial targets are reached. If the targets are reached for the 2012 fiscal year, these restricted shares will be transferred to employees during March 2013. The Company considers it probable that the financial targets will be reached and thus began recognizing stock compensation expense on the grant date ratably over the service period of the award.

Business Combinations

We allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the purchase price over these fair values is recorded as goodwill. We engaged independent third-party appraisal firms to assist us in determining the fair values of assets acquired and liabilities assumed. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets. The significant purchased classes of intangible assets recorded by us include customer relationships, trademarks, non-compete agreements, developed technology, patents, and backlog. The fair values assigned to the identified intangible assets are discussed in Note 2 to the condensed consolidated financial statements.

Critical estimates in valuing certain intangible assets include but are not limited to: future expected cash flows related to each individual asset, market position of the trademarks, as well as assumptions about cash flow savings from the trademarks, and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates.

Results of Operations

THREE MONTHS ENDED MARCH 31, 2012 AND 2011 (amounts in thousands, except per share data)

Net sales

Net sales for the quarter ended March 31, 2012, were \$55,480 as compared to net sales of \$26,976 for the quarter ended March 31, 2011, an increase of \$28,504 or 106%.

For the quarter ended March 31, 2012, sales of our invisibleSHIELD product line accounted for approximately 48% of our revenues. We have experienced significant growth in our indirect channel to big-box retailers such as Best Buy, Walmart, Target and Radio Shack, wireless carriers such as AT&T, Verizon, The Carphone Warehouse and Cricket, and both domestic and foreign electronics accessory distributors. We are still focused on distribution through our mall kiosk program and through our websites (www.ZAGG.com, and www.iFrogz.com), but the significant growth for the first quarter of 2012 was through our continued expansion within our indirect channel as we began selling through additional customers and expanded our SKU count in our current customers. For the quarter ended March 31, 2012, approximately 82% of our overall net sales were through our indirect channel, 12% was through our website, 5% was through our mall cart and kiosk programs and 1% was from shipping and handling charges.

Cost of sales

Cost of sales includes raw materials, packing materials and shipping and fulfillment costs. For the quarter ended March 31, 2012, cost of sales amounted to \$28,547 or approximately 51% of net sales compared to cost of sales of \$13,330 or 49% of net sales for the quarter ended March 31, 2011. The increase in cost of sales as a percentage of net revenues for the quarter ended March 31, 2012, as compared to the quarter ended March 31, 2011, is attributable to the continued shift towards our indirect channel partners where sales are at lower margins than from web sales.

Gross profit

Gross profit for the quarter ended March 31, 2012, was \$26,933 or approximately 49% of net sales, as compared to \$13,646 or approximately 51% of net sales for the quarter ended March 31, 2011. The decrease in gross profit percentage is due to the continued shift towards our indirect channel partners where sales are at lower margins than from web sales. As we continue to grow our business, we anticipate that we will have increased sales to our indirect customers which will continue to put pressure on our gross profit margins as sales through indirect channel partners occur at lower profit margins. There are no assurances that we will continue to recognize similar gross profit margins in the future.

Operating expenses

Total operating expenses for the quarter ended March 31, 2012, were \$16,705, an increase of \$7,923 from total operating expenses for the quarter ended March 31, 2011, of \$8,782. The increases are primarily attributable to the following:

- For the quarter ended March 31, 2012, marketing, advertising and promotion expenses were \$2,441, a decrease of \$71 as compared to \$2,512 for the quarter ended March 31, 2011. We invested heavily in advertising for the ZAGGmate product line during the quarter ended March 31, 2011 and did not have a similar significant marketing campaign for the quarter ended March 31, 2012. We expect our marketing and advertising expenses to continue to be a significant expenditure as our revenues increase and expect to spend increased funds on advertising and promotion of our products as well as sales training.
- For the quarter ended March 31, 2012, amortization expense was \$2,422, an increase of \$2,372 as compared to \$50 for the quarter ended March 31, 2011. The increase is directly attributable to amortization expense on intangibles acquired as part of the acquisition of iFrogz in the second quarter of 2011.
- For the quarter ended March 31, 2012, salaries and related taxes increased by \$3,959 to \$6,111 from \$2,152 for the quarter ended March 31, 2011. The increase is due to (1) the increase in our staff as we continue to build the personnel infrastructure necessary to meet the demand for our product and continue to develop new products and offerings and (2) the remaining compensation expense related to our stock based compensation plan of \$1,342, an increase of \$1,038 over the three months ended March 31, 2011 balance of \$304.
- For the quarter ended March 31, 2012, other selling, general and administrative expenses, net of salaries and related taxes described above, were \$5,730 as compared to \$4,068 for the quarter ended March 31, 2011. The changes by category are summarized in the table below:

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---------------------------|--|--|
| Professional fees | \$ 1,202 | \$ 835 |
| Rent | 357 | 140 |
| Credit card and bank fees | 430 | 356 |
| Commissions | 1,374 | 750 |
| Depreciation | 382 | 120 |
| Other | 1,986 | 1,867 |
| Total | \$ 5,731 | \$ 4,068 |

The increase in professional fees is due to legal expenses incurred related to the defense of our patents and audit fees incurred. Rent increased due to the expansion into additional office space at the ZAGG corporate offices and rent at the iFrogz corporate offices. Commissions were also up on a comparison basis due to the strong sales in 2012 compared to 2011, continued growth through indirect accounts for which we utilize a third-party sales company, and commissions incurred related to sales at the iFrogz segment.

Income from operations

We reported income from operations of \$10,228 for the quarter ended March 31, 2012 as compared to income from operations of \$4,864 for the quarter ended March 31, 2011, an increase of \$5,364. The increase in income from operations for the quarter ended March 31, 2012 as compared to the quarter ended March 31, 2011 is primarily attributable to continued strong sales of our invisibleSHIELD, keyboard, and audio product lines. In addition, the iFrogz segment contributed to the overall increase in income from operations.

Other expense

For the quarter ended March 31, 2012, total other expense was \$2,131 as compared to other expense of \$11 for the quarter ended March 31, 2011. The increase is primarily attributable to (1) interest expense on the Revolving Credit Facility and Term Loan and (2) the loss from investment in HzO.

Income taxes

We recognized an income tax expense of \$2,985 for the quarter ended March 31, 2012, compared to income tax expense of \$1,595 for the quarter ended March 31, 2011.

Our effective tax rate was 36.9% and 32.9% for the three months ended March 31, 2012 and 2011, respectively. Our effective tax rate will generally differ from the U.S. Federal Statutory rate of 35%, due to state taxes, permanent items and favorable tax rates associated with certain earnings from our operations in Ireland.

Net income attributable to stockholders

As a result of these factors, we reported net income attributable to stockholders of \$5,112 or \$0.16 per share on a fully diluted basis for the quarter ended March 31, 2012 as compared to net income attributable to stockholders of \$3,310 or \$0.13 per share on a fully diluted basis for the quarter ended March 31, 2011.

Liquidity and Capital Resources (amounts in thousands)

At March 31, 2012, our principle sources of liquidity were cash generated by operations, cash on-hand, and the issuance of a term loan and revolving credit facility. Our principle uses of cash have been to fund working capital requirements and the continued growth of the business, and the payment of debt.

Cash on-hand decreased to \$16,856 on March 31, 2012 from \$26,433 on December 31, 2011, a decrease of \$9,577. Earnings from foreign operations are considered permanently re-invested and of the \$16,856 cash balance on March 31, 2012, cash from foreign entities totaled \$3,280, which constitutes 19.5% of the total cash balance. If the Company were to repatriate this cash, it would be subject to applicable taxes under tax law in the United States. However, management has no intention of repatriating this cash.

At March 31, 2012, we had working capital of \$61,257 compared to \$74,490 as of December 31, 2011. The decrease is primarily attributable to \$27,000 in debt payments made during March 2012.

Based on our current level of operations, we believe that cash generated from operations, cash on hand, and available borrowings under our existing credit arrangements will be adequate to meet our currently expected capital expenditures and working capital needs for the next 12 months and beyond.

Debt and Letters of Credit

On June 21, 2011, and in conjunction with the acquisition of iFrogz, the Company entered into a financing agreement (the "Financing Agreement") led by Cerberus Business Finance, LLC ("Cerberus") and PNC Bank National Association ("PNC"), which is acting as the administrative bank. The Financing Agreement consists of a \$45,000 term loan ("Term Loan"), a \$45,000 revolving credit facility ("Revolving Credit Facility"), and a \$5,000 letters of credit facility, which is a subset of the \$45,000 Revolving Credit Facility. The Company's obligations under the Financing Agreement were secured by all or substantially all of the Company's assets. The Term Loan matures on July 20, 2016, and the Revolving Credit Facility and letters of credit mature on July 20, 2014.

As of March 31, 2012, \$41,000 of the Term Loan was outstanding after a payment of \$4,000 was made in March 2012, \$1,627 of the Revolving Credit Facility was outstanding after payments totaling \$23,000 were made in March 2012, and no letters of credit were outstanding.

At the election of the Company, borrowings under the Financing Agreement bear interest at either the Reference Rate plus an applicable margin or the Eurodollar Rate plus an applicable margin, both as defined in the Financing Agreement. All current borrowings were made under the Reference Rate, which is calculated as the greater of (1) 2.75%, (2) the Federal Funds Effective Rate plus 0.50%, (3) the Eurodollar Rate plus 1.00%, or (4) the rate of interest publicly announced by PNC Financial Service Group, Inc. as its reference rate, base rate, or prime rate. The applicable margin for the Reference Rate is 4.00%. At March 31, 2012, the weighted average interest rate on all outstanding borrowings was 7.25%. At March 31, 2012, the effective interest rate was 8.17%.

There are no scheduled payments on either the Term Loan or Revolving Credit Facility prior to maturity. However, the Financing Agreement calls for prepayment of the Term Loan if certain conditions are met. The prepayment requirement is calculated for the fiscal year ended December 31, 2012, and the calculation is based on a percentage of "excess cash flow" as defined in the Financing Agreement. Payment is required to be made within ten days of issuing the year-end consolidated financial statements. Based on current projections, the Company estimates that no prepayment will be required to be made during March 2013. The entire Term Loan and Revolving Credit Facility balances are classified as noncurrent.

Starting July 1, 2011, the Company began paying a commitment fee of 0.375% of the unused portion of the borrowing capacity under the Revolving Credit Facility based on the average principal amount outstanding for the month compared to \$45,000. For the three ended March 31, 2012, the Company incurred \$21 in commitment fees, which is included as a component of interest expense in the condensed consolidated statement of operations.

The Company incurred and capitalized \$2,538 of direct costs related to the issuance of the Term Loan and Revolving Credit Facility. Of the total amount incurred, \$1,699 was directly related to the Term Loan and \$839 was directly related to the Revolving Credit Facility. As neither debt instrument has a mandatory payment schedule and the entire balance of each is due at maturity, the Company amortizes these deferred loan costs on a straight-line basis over the respective terms of the loan: the Term Loan is being amortized through June 20, 2016, and the Revolving Credit Facility through June 20, 2014. For the three months ended March 31, 2012, the Company amortized \$154 of these loan costs, which is included as a component of interest expense in the condensed consolidated statement of operations. In addition, the Company recorded additional amortization of \$132 through interest expense due to the \$4.0 million payment on the Term Loan prior to maturity. The carrying value of deferred loan costs at March 31, 2012, was \$1,923 and is included as a component of noncurrent other assets in the condensed consolidated balance sheet.

Attached to the Term Loan and Revolving Credit Facility are a number of financial and non-financial covenants. At March 31, 2012, the Company was in compliance with covenants associated with the Term Loan and Revolving Credit Facility.

Contractual Obligations and Commitments

The following table provides information on our contractual obligations as of March 31, 2012:

| | Payments on Debt | Interest on Debt | Operating Leases | Total contractual obligations |
|---------------------|-----------------------------|-----------------------------|-----------------------------|--|
| Remaining 2012 | \$ - | \$ 2,386 | \$ 704 | \$ 3,090 |
| 2013 | - | 3,374 | 651 | 4,025 |
| 2014 | - | 3,274 | 558 | 3,832 |
| 2015 | 1,627 | 3,193 | 331 | 5,151 |
| 2016 and thereafter | 41,000 | 1,596 | 135 | 42,731 |
| Total | <u>\$ 42,627</u> | <u>\$ 13,823</u> | <u>\$ 2,379</u> | <u>\$ 58,829</u> |

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks in the ordinary course of our business. These risks result primarily from changes in foreign currency exchange rates and interest rates. In addition, our international operations are subject to risks related to differing economic conditions, changes in political climate, differing tax structures and other regulations and restrictions.

To date, we have not utilized derivative financial instruments or derivative commodity instruments. We do not expect to employ these or other strategies to hedge market risk in the foreseeable future. We invest our cash in money market funds, which we believe are subject to minimal credit and market risk. We believe that the market risks associated with these financial instruments are immaterial.

Item 4. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15b under the Securities Exchange Act of 1934 as of the end of the period covered by this Report. Based on their review of our disclosure controls and procedures, they have concluded that our disclosure controls and procedures were not effective as of the period covered by this Quarterly Report on Form 10-Q due to a material weakness identified during 2011 related to a lack of a sufficient number of accounting and IT professionals with the necessary experience and training. During the first quarter of 2012, management commenced the remediation process by hiring additional accounting support staff with the necessary experience and training.

Changes in Internal Controls over Financial Reporting

As a result of rapid growth, the Company has experienced a lack of a sufficient number of accounting and IT professionals with the necessary experience and training. However as noted above, during the quarter ended March 31, 2012, we implemented the following changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting:

- We have hired additional accounting and IT professionals with the necessary experience and training.
- We have commenced the process of reviewing key accounting, IT, and operational processes to ensure that controls within the processes are designed and implemented. We will begin internal tests of operating effectiveness during subsequent periods as part of management's 2012 assessment of internal controls over financial reporting.
- We are in the process of reviewing our information systems and related controls to provide assurance that they effectively and efficiently capture and process data.

Although management believes our internal control over financial reporting has been, or is reasonably likely to be, materially and positively affected by the changes described above, a material weakness in our internal control over financial reporting continues to exist as March 31, 2012. We are still in the process of enacting changes to remediate the material weakness.

Limitations on the Effectiveness of Internal Controls

An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the internal control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings (*dollars and shares in thousands*)

Commercial Litigation

Wrapsol, LLC, v. ZAGG Inc, U.S. District Court, District of Massachusetts, 1:11-cv-11006-RGS. The Company was engaged as the defendant in civil litigation in Massachusetts in which Wrapsol, LLC (“Wrapsol”) has alleged unfair competition and tortious interference with business relations claiming that the Company’s sales representatives attempted to harm Wrapsol by making false allegations. The Company denied these allegations. The parties conducted extensive written discovery, and engaged in settlement negotiations. On March 2, 2012, Wrapsol dismissed the case with prejudice without payment of any consideration by the Company to Wrapsol.

Lorence A. Harmer, et al v ZAGG Inc et al, Third Judicial District Court, Salt Lake County, State of Utah, Civil No. 110917687. On September 20, 2011, Lorence A. Harmer, a former director of ZAGG Inc and two of his affiliates, Harmer Holdings, LLC, and Teleportal, LLC, filed a lawsuit in Utah state court against the Company, Robert G. Pedersen, II, Brandon T. O’Brien and KPMG LLP. KPMG has subsequently been dismissed from the lawsuit. This case is discussed in greater detail in Note 11, Note Receivable. Plaintiffs allege that the defendants defamed Mr. Harmer, breached a settlement agreement and other agreements between the plaintiffs and ZAGG, and interfered with other rights of the plaintiffs. ZAGG has responded to the plaintiffs’ claims, denying all of the material allegations made by the plaintiffs, and has asserted affirmative defenses. Fact discovery has commenced. The Company believes the Plaintiffs’ claims to be without merit and intends to vigorously defend against them.

Patent Litigation

ZAGG Intellectual Property Holding Co. Inc. v. NLU Products, LLC, Wrapsol, LLC, U.S. District Court, Central District of California, 2:10-cv-06511; ZAGG Intellectual Property Holding Co. Inc. v. Ghost Armor, Griffin Technology, Russell B. Taylor, United SGP, XO Skins, U.S. District Court, District of Utah, 2:10-cv-01257. The Company’s wholly owned subsidiary, ZAGG Intellectual Property Holding Company, Inc. (“ZAGG IP”), is engaged as the plaintiff in patent infringement litigation pending in California and in Utah that seeks to enforce rights under United States Patent No. 7,784,610 (one of the patents acquired from Andrew Mason, see below). The defendants in these cases have raised defenses and, in some cases, asserted counterclaims against ZAGG IP that seek declarations of unenforceability or non-infringement of the patent. These counterclaims do not assert any claims for affirmative relief against ZAGG IP or the Company, apart from a request for an award against ZAGG IP of costs and attorney’s fees. Most of the defendants have settled with ZAGG IP and the remaining parties are engaged in discovery. One of the defendants filed a motion for summary judgment in respect of all of the claims of ZAGG IP, but that motion was denied by the court. The parties have recently filed briefs relating to claims construction. In the opinion of management, the ultimate disposition of these patent infringement claims, including disposition of the counterclaims, will not have a material adverse effect on the Company’s consolidated financial position, results of operations, or liquidity. Management believes the likelihood of an unfavorable outcome in this case is remote and that any potential loss contingency is not estimable at this time.

ZAGG Intellectual Property Holding Co. Inc. v. NLU Products et al, U.S. District Court, District of Utah, 2:11-cv-00517. ZAGG IP is also engaged as the plaintiff in patent infringement litigation pending in Utah that seeks to enforce rights under United States Patent No. 7,957,524. The defendants in this case have raised defenses and, in some cases, asserted counterclaims against ZAGG IP, that seek declarations of unenforceability or non-infringement of the patent. These counterclaims do not assert any claims for affirmative relief, including claims for damages, against ZAGG IP or the Company, apart from a request for an award of costs and attorney's fees to the prevailing party. Discovery has not yet commenced in this case, however, several of the defendants have settled with ZAGG IP. A petition to reexamine U.S. Patent No. 7,957,524 filed by Wrapsol, one of the defendants, was recently granted. Accordingly, this patent is currently being reexamined by the United States Patent and Trademark Office. There are no claims asserted in these actions against the Company. In the opinion of management, the ultimate disposition of these patent infringement claims, including disposition of the counterclaims, will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

ZAGG v. Trekstor, Regional Court, Dusseldorf, Germany. The Company brought suit in Dusseldorf, Germany against Trekstor for infringement of ZAGG design registrations for ZAGGmate and the Logitech Keyboard Case by ZAGG. The Company also brought claims for unfair competition. As of the date of this Report, all briefing had been completed and a hearing was held. The Court has not yet ruled on these claims. TrekStor has also filed an application for a declaration of invalidity of the Company's design registrations. The Company believes this allegation of invalidity to be without merit and intends to vigorously defend against it.

The Company is not a party to any other litigation or other claims at this time. While the Company currently believes that the amount of any ultimate potential loss for known matters would not be material to the Company's financial condition, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial condition or results of operations in a particular period.

Patent Acquisition

On August 31, 2010, Andrew Mason ("Mason") filed a complaint against the Company claiming infringement of United States Patent Nos. 7,389,869 and 7,784,610 as a result of the Company's invisibleSHIELD installation kits. On September 4, 2010, the Company filed a counter complaint against Mason and his company, eShields LLC ("eShields"). On November 9, 2010, before either party had responded on the merits to the claims asserted, the Company, Mason and eShields entered into an Asset Purchase Agreement ("Purchase Agreement") under which a wholly owned subsidiary of the Company, ZAGG Intellectual Property Holding Company, Inc. ("ZAGG IP"), acquired all of the rights of Mason in (i) the patents (United States Patent Nos. 7,389,869 and 7,784,610) which were the subject of the litigation, (ii) the patent application filed on August 13, 2010 (the "CIP Application") and (iii) rights to sue for infringement of the patents.

In consideration for the conveyance of Mason's assets described above, the Company agreed to pay or convey to Mason the following:

- (a) a first payment of \$200 by November 11, 2010, and a second payment of \$150 after December 31, 2010;
- (b) issue to Mason five-year warrants (the "Warrant") to purchase 750 shares of the Company's restricted Common Stock at an exercise price equal to the closing bid price on November 9, 2010 (\$8.53); provided that 500 of the 750 warrant shares are exercisable only upon the issuance of a patent from the CIP Application with at least one claim that satisfies the Claim Conditions (as defined below);
- (c) issue to Mason 70 shares of the Company's restricted Common Stock; and
- (d) grant eShields a fully paid-up, perpetual, non-exclusive license, with limited rights to transfer or sublicense, for the patents and CIP Applications.

The Company also agreed to dismiss the claims asserted against Mason and eShields, and to make additional payments to Mason if the US Patent and Trademark Office ("USPTO") issues a U.S. patent on the CIP Application that includes at least one claim that broadly encompasses any protective kit that includes a package, as well as a squeegee and an adhesive-coated protective film for a consumer electronic device with a peel-away backing within the package (collectively, the "Claim Conditions"). If the Claim Conditions are met, the Company will:

- (a) pay Mason the sum of \$500; and
- (b) issue to Mason 430 shares of the Company's restricted Common Stock.

If the Claim Conditions are not met, the Company has no obligation to make the payment or issue the shares described in the preceding paragraph and Mason will not be able to exercise 500 of the Warrants. There can be no assurance that the USPTO will issue a patent on the CIP Application that meets the requirements of the Claim Conditions. As of March 31, 2012, no applicable patent had been issued by the USPTO.

We establish liabilities when a particular contingency is probable and estimable. We have not accrued for any loss at March 31, 2012 in our condensed consolidated financial statements in light of the probability and ability to estimate any potential liability. It is reasonably possible that the potential losses may exceed our accrued liabilities for contingencies; however, the amount cannot be currently estimated.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2011 (the “2011 Form 10-K”), which could materially affect our business, financial condition or future results. These risk factors should be read carefully in connection with evaluating our business and in connection with the forward-looking statements contained in this Quarterly Report on Form 10-Q. Any of the risks described in the 2011 Form 10-K could materially adversely affect our business, financial condition or future results and the actual outcome of matters as to which forward-looking statements are made. These are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds(dollars and shares in thousands)

During the three months ended March 31, 2012, we issued the following securities:

We issued 167 shares of common stock upon the exercise of warrants to purchase 171 shares. We received proceeds of \$199 related to the exercise of the warrants.

During the three months ended March 31, 2011, we issued the following securities:

We issued 10 shares of common stock valued at \$100, to a consultant in exchange for consulting services provided. The terms of the transaction were privately negotiated, and did not involve any public offering.

We issued 152 shares of common stock in exercise of warrants to purchase 152 shares. We received proceeds of \$198 related to the exercise of the warrants.

In each of the transactions listed above, the securities were issued pursuant to Section 4(2) of the Securities Act of 1933, as amended, and rules and regulations promulgated thereunder. None of the transactions involved a public offering.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

a. Exhibits: The following Exhibits are filed with this Form 10-Q pursuant to Item 601(a) of Regulation S-K:

| Exhibit No. | Description of Exhibit |
|-------------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Rules 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as Amended. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rules 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as Amended. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| EX-101.INS | XBRL Instance Document |
| EX-101.SCH | XBRL Taxonomy Extension Schema Document |
| EX-101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| EX-101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| EX-101.LAB | XBRL Taxonomy Extension Labels Linkbase |
| EX-101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

SIGNATURES

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

ZAGG INC

Date: May 10, 2012

By: /s/ **ROBERT G. PEDERSEN II**

Robert G. Pedersen II,
Chairman and Chief Executive Officer
(Principal executive officer)

Date: May 10, 2012

/s/ **BRANDON T. O'BRIEN**

Brandon T. O'Brien,
Chief Financial Officer
(Principal financial officer)

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Section 2: EX-31.1 (EXHIBIT 31.1)

EXHIBIT 31.1

CERTIFICATIONS

I, Robert G. Pedersen II, certify that:

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

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2012

/s/ ROBERT G PEDERSEN II

Robert G. Pedersen II
Chairman of the Board and Chief Executive Officer

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Section 3: EX-31.2 (EXHIBIT 31.2)

EXHIBIT 31.2

CERTIFICATIONS

I, Brandon T. O'Brien, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of ZAGG Inc;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for the periods presented in this report.

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the

Date: May 10, 2012

/s/ BRANDON T O'BRIEN

Brandon T O'Brien
Chief Financial Officer

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Section 4: EX-32.1 (EXHIBIT 32.1)

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of ZAGG Inc (the "Company") for the quarter ended March 31, 2012 as filed with the Securities and Exchange Commission (the "Report"), I, Robert G. Pedersen II, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ROBERT G. PEDERSEN II

Robert G. Pedersen II
Chairman of the Board and Chief Executive Officer
May 10, 2012

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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Section 5: EX-32.2 (EXHIBIT 32.2)

Exhibit 32.2

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of ZAGG Inc (the "Company") for the quarter ended March 31, 2012 as filed with the Securities and Exchange Commission (the "Report"), I, Brandon T. O'Brien, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ BRANDON T. O'BRIEN

Brandon T. O'Brien
Chief Financial Officer
May 10, 2012

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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