

AWARE INC /MA/

FORM 10-Q (Quarterly Report)

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

**Quarterly Report Pursuant To Section 13 Or 15(d) Of The
Securities Exchange Act of 1934**

For the quarter ended June 30, 2017

Commission file number 000-21129

AWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Massachusetts

(State or Other Jurisdiction of
Incorporation or Organization)

04-2911026

(I.R.S. Employer Identification No.)

40 Middlesex Turnpike, Bedford, Massachusetts, 01730

(Address of Principal Executive Offices)
(Zip Code)

(781) 276-4000

(Registrant's Telephone Number, Including Area Code)

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

Large Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company)

Emerging Growth Company

Accelerated Filer

Smaller Reporting Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

Indicate the number of shares outstanding of the issuer's common stock as of July 24, 2017:

Class
Common Stock, par value \$0.01 per share

Number of Shares Outstanding
21,729,163 shares

AWARE, INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2017

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PART 1. FINANCIAL INFORMATION
ITEM 1: CONSOLIDATED FINANCIAL STATEMENTS
AWARE, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	<u>June 30,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 49,425	\$ 51,913
Accounts receivable, net	3,321	3,016
Prepaid expenses and other current assets	272	268
Total current assets	<u>53,018</u>	<u>55,197</u>
Property and equipment, net	4,479	4,634
Investments	-	951
Deferred tax assets	5,843	1,078
Other assets	71	124
Total assets	<u>\$ 63,411</u>	<u>\$ 61,984</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 200	\$ 135
Accrued expenses	1,124	1,075
Deferred revenue	2,136	2,722
Total current liabilities	<u>3,460</u>	<u>3,932</u>
Long-term deferred revenue	<u>155</u>	<u>211</u>
Commitments and contingent liabilities		
Stockholders' equity:		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized, none outstanding	-	-
Common stock, \$.01 par value; 70,000,000 shares authorized; issued and outstanding 21,675,149 as of June 30, 2017 and 22,370,713 as of December 31, 2016	217	224
Additional paid-in capital	97,037	100,485
Accumulated other comprehensive loss	-	(19)
Accumulated deficit	<u>(37,458)</u>	<u>(42,849)</u>
Total stockholders' equity	<u>59,796</u>	<u>57,841</u>
Total liabilities and stockholders' equity	<u>\$ 63,411</u>	<u>\$ 61,984</u>

The accompanying notes are an integral part of the consolidated financial statements.

AWARE, INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Revenue:				
Software licenses	\$ 1,214	\$ 5,347	\$ 3,900	\$ 8,121
Software maintenance	1,282	1,181	2,534	2,462
Services	206	216	580	635
Hardware	-	31	-	317
Royalties	43	129	78	203
Total revenue	<u>2,745</u>	<u>6,904</u>	<u>7,092</u>	<u>11,738</u>
Costs and expenses:				
Cost of software licenses	-	858	247	1,101
Cost of services	104	158	320	372
Cost of hardware	-	29	-	234
Research and development	1,876	1,802	3,733	3,451
Selling and marketing	1,024	1,111	1,966	2,031
General and administrative	816	872	1,605	1,595
Total costs and expenses	<u>3,820</u>	<u>4,830</u>	<u>7,871</u>	<u>8,784</u>
Patent related income	<u>1,313</u>	<u>-</u>	<u>1,403</u>	<u>-</u>
Operating income	238	2,074	624	2,954
Other income	36	-	36	-
Interest income	88	72	172	138
Income before provision for income taxes	<u>362</u>	<u>2,146</u>	<u>832</u>	<u>3,092</u>
Provision for income taxes	134	710	198	1,022
Net income	<u>\$ 228</u>	<u>\$ 1,436</u>	<u>\$ 634</u>	<u>\$ 2,070</u>
Net income per share – basic	\$ 0.01	\$ 0.06	\$ 0.03	\$ 0.09
Net income per share – diluted	\$ 0.01	\$ 0.06	\$ 0.03	\$ 0.09
Weighted-average shares – basic	21,774	22,964	22,013	22,978
Weighted-average shares - diluted	21,919	23,124	22,119	23,064
Comprehensive income:				
Net income	\$ 228	\$ 1,436	\$ 634	\$ 2,070
Other comprehensive income (net of tax):				
Unrealized gains (losses) on available for sale securities	(9)	(9)	19	(12)
Comprehensive income	<u>\$ 219</u>	<u>\$ 1,427</u>	<u>\$ 653</u>	<u>\$ 2,058</u>

The accompanying notes are an integral part of the consolidated financial statements.

AWARE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 634	\$ 2,070
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	260	324
Stock-based compensation	267	190
Deferred tax provision (benefit) on other comprehensive income	(9)	6
Amortization of discount on investments	(4)	(6)
Gain on sale of investments	(36)	-
Changes in assets and liabilities:		
Accounts receivable	(305)	(815)
Prepaid expenses and other current assets	(4)	14
Deferred tax assets	(7)	1
Accounts payable	65	821
Accrued expenses	49	39
Accrued income taxes	-	(236)
Deferred revenue	(642)	(1,398)
Net cash provided by operating activities	<u>268</u>	<u>1,010</u>
Cash flows from investing activities:		
Purchases of property and equipment	(53)	(54)
Sales of investments	1,019	-
Net cash provided from (used) in investing activities	<u>966</u>	<u>(54)</u>
Cash flows from financing activities:		
Proceeds from issuance of common stock	43	21
Excess tax benefits from stock-based compensation	-	457
Payments made for taxes of employees who surrendered shares related to unrestricted stock	(119)	(61)
Repurchase of common stock	(3,646)	(349)
Net cash provided by (used in) financing activities	<u>(3,722)</u>	<u>68</u>
Increase (decrease) in cash and cash equivalents	(2,488)	1,024
Cash and cash equivalents, beginning of period	<u>51,913</u>	<u>51,232</u>
Cash and cash equivalents, end of period	<u>\$ 49,425</u>	<u>\$ 52,256</u>
Supplemental disclosure:		
Cash paid for income taxes	<u>\$ 275</u>	<u>\$ 833</u>

The accompanying notes are an integral part of the consolidated financial statements.

AWARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

- A) **Nature of Business.** We are a leading provider of software and services to the biometrics industry. Our software products are used in government and commercial biometrics systems, which are capable of determining or verifying an individual's identity. We also offer engineering services related to software customization, integration, and installation, as well as complete systems development. We sell our biometrics software products and services globally through systems integrators, OEMs, and directly to end user customers. We also derive a portion of our revenue from the sale of imaging software.
- B) **Basis of Presentation.** The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and notes necessary for a complete presentation of our financial position, results of operations and cash flows, in conformity with generally accepted accounting principles. We filed audited financial statements which included all information and notes necessary for such presentation for the three years ended December 31, 2016 in conjunction with our 2016 Annual Report on Form 10-K. This Form 10-Q should be read in conjunction with that Form 10-K.

The accompanying unaudited consolidated balance sheets, statements of income and comprehensive income, and statements of cash flows reflect all adjustments (consisting only of normal recurring items) which are, in the opinion of management, necessary for a fair presentation of financial position at June 30, 2017, and of operations and cash flows for the interim periods ended June 30, 2017 and 2016.

The results of operations for the interim period ended June 30, 2017 are not necessarily indicative of the results to be expected for the year.

- C) **Fair Value Measurements.** The Financial Accounting Standards Board ("FASB") Codification defines fair value, and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to the unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under the FASB Codification are: i) Level 1 – valuations that are based on quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date; ii) Level 2 – valuations that are based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly; and iii) Level 3 – valuations that require inputs that are both significant to the fair value measurement and unobservable.

Cash and cash equivalents, which primarily include money market mutual funds, were \$49.4 million and \$51.9 million as of June 30, 2017 and December 31, 2016, respectively. We classified our cash equivalents of \$47.4 million and \$49.8 million as of June 30, 2017 and December 31, 2016 within Level 1 of the fair value hierarchy because they are valued using quoted market prices.

Our investments, which consist of high yield corporate debt securities, are also classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. We categorize our investments as available-for-sale securities, and carry them at fair value in our financial statements. We had \$1.0 million of available-for-sale investments as of December 31, 2016.

As of June 30, 2017, our assets that are measured at fair value on a recurring basis and whose carrying values approximate their respective fair values include the following (in thousands):

	Fair Value Measurement at June 30, 2017 Using:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate debt securities	\$ -	\$ -	\$ -
Money market funds (included in cash and cash equivalents)	47,411		
Total	\$ 47,411	\$ -	\$ -

As of December 31, 2016, our assets that are measured at fair value on a recurring basis and whose carrying values approximate their respective fair values include the following (in thousands):

	Fair Value Measurement at December 31, 2016 Using:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate debt securities	\$ 951	\$ -	\$ -
Money market funds (included in cash and cash equivalents)	49,839		
Total	\$ 50,790	\$ -	\$ -

- D) **Computation of Earnings per Share.** Basic earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding plus additional common shares that would have been outstanding if dilutive potential common shares had been issued. For the purposes of this calculation, stock options are considered common stock equivalents in periods in which they have a dilutive effect. Stock options that are anti-dilutive are excluded from the calculation.

Net income per share is calculated as follows (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net income	\$ 228	\$ 1,436	\$ 634	\$ 2,070
Shares outstanding:				
Weighted-average common shares outstanding	21,774	22,964	22,013	22,978
Additional dilutive common stock equivalents	145	160	106	86
Diluted shares outstanding	<u>21,919</u>	<u>23,124</u>	<u>22,119</u>	<u>23,064</u>
Net income per share – basic	\$ 0.01	\$ 0.06	\$ 0.03	\$ 0.09
Net income per share - diluted	\$ 0.01	\$ 0.06	\$ 0.03	\$ 0.09

For the three and six month periods ended June 30, 2016, options to purchase 54,034 shares of common stock were outstanding, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common stock and thus would be anti-dilutive.

E) **Stock-Based Compensation.** The following table presents stock-based employee compensation expenses included in our unaudited consolidated statements of comprehensive income (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Cost of services	\$ 2	\$ 3	\$ 4	\$ 3
Research and development	36	28	48	30
Selling and marketing	4	4	6	4
General and administrative	154	147	209	153
Stock-based compensation expense	<u>\$ 196</u>	<u>\$ 182</u>	<u>\$ 267</u>	<u>\$ 190</u>

Stock Option Grants . We may grant stock options under our 2001 Nonqualified Stock Plan although we have not granted any stock options since the first quarter of 2012. When we grant stock options, we estimate their fair value using the Black-Scholes valuation model. This valuation model takes into account the exercise price of the award, as well as a variety of significant assumptions. The assumptions used to estimate the fair value of stock options include the expected term, the expected volatility of our stock over the expected term, the risk-free interest rate over the expected term, and our expected annual dividend yield. We believe that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of our stock options. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

Unrestricted Stock Grants . We also grant unrestricted shares of stock under our 2001 Nonqualified Stock Plan. Stock-based compensation expense for stock grants is determined based on the fair market value of our stock on the date of grant, provided the number of shares in the grant is fixed on the grant date.

We granted shares of unrestricted stock in 2017 and 2016 that affected financial results for the three and six month periods ended June 30, 2017 and 2016. These grants are described below.

2017 Grant. On February 27, 2017, we granted 134,000 shares of unrestricted stock to directors, officers and employees. The shares will be issued in two equal installments shortly after June 30, 2017 and December 31, 2017, provided each grantee is serving as a director, officer or employee on those dates. The total stock-based compensation expense related to this grant is \$663,000, of which \$196,000 and \$267,000 was charged to expense in the three and six months ended June 30, 2017 and we anticipate the remaining \$396,000 will be charged to expense ratably over the remaining two quarters of 2017.

2016 Grant . In March 2016, we granted 152,000 shares of unrestricted stock to directors, officers and employees. The shares were issued in two equal installments shortly after June 30, 2016 and December 31, 2016. We expensed the entire \$558,000 stock-based compensation expense related to this grant in 2016. We issued shares of common stock related to this grant as follows: i) 58,902 net shares of common stock were issued in early July 2016 after employees surrendered 17,098 shares for which we paid \$74,000 of withholding taxes on their behalf; and ii) 56,443 net shares of common stock were issued in early January 2017 after employees surrendered 19,557 shares for which we paid \$119,000 of withholding taxes on their behalf.

F) **Business Segments** . We organize ourselves into a single segment that reports to the chief operating decision maker.

We conduct our operations in the United States and sell our products and services to domestic and international customers. Revenues were generated from the following geographic regions for the three and six months ended June 30, 2017 and 2016 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
United States	\$ 1,870	\$ 6,180	\$ 5,113	\$ 9,920
Rest of World	875	724	1,979	1,818
	<u>\$ 2,745</u>	<u>\$ 6,904</u>	<u>\$ 7,092</u>	<u>\$ 11,738</u>

Revenue by product group for the three months ended June 30, 2017 and 2016 was (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Biometrics	\$ 2,488	\$ 5,443	\$ 6,491	\$ 8,727
Imaging	214	1,332	524	2,808
DSL royalties	43	129	77	203
	<u>\$ 2,745</u>	<u>\$ 6,904</u>	<u>\$ 7,092</u>	<u>\$ 11,738</u>

G) **Recent Accounting Pronouncements.**

FASB ASU No. 2014-09. In May 2014, the FASB issued Accounting Standard Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU is the result of a joint project by the FASB and the International Accounting Standards Board ("IASB") to clarify the principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards ("IFRS") that would: remove inconsistencies and weaknesses, provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices across entities, jurisdictions, industries, and capital markets, improve disclosure requirements and resulting financial statements, and simplify the presentation of financial statements. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. On July 9, 2015, the FASB voted to delay the effective date of the new revenue standard by one year, but to permit entities to choose to adopt the standard as of the original effective date.

We have begun to evaluate the effect the new revenue standard will have on our consolidated financial statements and related disclosures, but have not completed our evaluation and implementation process. We intend to complete that process during 2017 and adopt the new standard on January 1, 2018 using the full retrospective adoption transition method. Based on our preliminary evaluations to date, we believe that revenue recognized under the new standard will generally approximate revenue recognized under current GAAP with the exception of the following expected significant differences:

- i) 2015 imaging software license contract. We consummated a \$4.625 million license contract in October 2015 that included a \$4.5 million license fee plus a \$125,000 software maintenance fee. We delivered the licensed software and the customer paid us in the fourth quarter of 2015. Under current GAAP, we were unable to establish vendor specific objective evidence ("VSOE") for the maintenance element and, as a result we recognized the total fee ratably over the twelve-month period that ran from October 2015 to October 2016. Under the new standard, license revenue from that contract will be recognized in 2015 when control over the software was transferred to the customer. That change will have a material impact on our 2015 and 2016 financial statements.

- ii) DSL royalty contracts. Under our current revenue recognition policy, we recognize DSL royalty revenue in the period in which we receive royalty reports, which is typically in the quarter immediately following the quarter in which sales of royalty-bearing products occurred. Under the new standard, we will be required to make estimates of royalties earned in the current period and record royalty revenue based on those estimates.
- iii) Minimum license/royalty payment contracts. Some of our revenue contracts require customers to make minimum license/royalty payments. Under current GAAP, we recognize that revenue when those minimum payments become due. Under the new standard, we may have to recognize the expected minimum payments in the period in which such contracts are signed.
- iv) Sales commissions and other third party acquisition costs. Under current GAAP, sales commissions and other third party acquisition costs resulting directly from securing contracts with customers are currently expensed as incurred. ASC 606 will require these costs to be recognized as an asset when incurred and expensed over an amortization period. As a practical expedient, if the term of the contract is one year or less, the Company will expense the costs as incurred. The Company is currently assessing the impact of the cost guidance.

The foregoing observations are subject to change as we complete our implementation process.

FASB ASU No. 2016-09. In March 2016, the FASB issued Accounting Standard Update No. 2016-09, "Improvements to Employee Share-Based Payment Accounting," which is intended to simplify various aspects of how share-based payments are accounted for and presented in financial statements. The standard is effective prospectively for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted.

The new standard contains several amendments that will simplify the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The changes in the new standard eliminate the accounting for excess tax benefits to be recognized in additional paid-in capital and tax deficiencies recognized either in the income tax provision or in additional paid-in capital. In addition, the new standard eliminates the limitation on recognition of excess stock compensation benefits until such benefits are actually realized, and instead applies the general recognition standard to these deferred tax assets. We adopted ASU 2016-09 in the first quarter of 2017 which will be applied using a modified retrospective approach. Upon adoption, we recorded a deferred tax asset of \$4.8 million with an offsetting adjustment to retained earnings related to excess stock compensation deductions that were not previously recorded as tax assets. For the six month period ended June 30, 2017, we recognized all excess tax benefits and tax deficiencies as income tax expense or benefit as a discrete event. We have elected to present the cash flow statement on a prospective transition method and no prior periods have been adjusted.

FASB ASU No. 2016-13. In June 2016, the FASB issued Accounting Standard Update No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This new standard replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, entities will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. This standard is effective for fiscal years beginning after December 15, 2019 with early adoption permitted in fiscal years beginning after December 15, 2018. We are currently evaluating the effect this standard will have on our consolidated financial statements and related disclosures.

With the exception of the standards discussed above, there have been no other recently issued accounting pronouncements that are of significance or potential significance to us that we have not adopted as of June 30, 2017.

- H) **Income Taxes** . Income tax expense was \$0.1 million and \$0.7 million for the three months ended June 30, 2017 and 2016, respectively. Income tax expense was \$0.2 and \$1.0 million for the six months ended June 30, 2017 and 2016, respectively. Income tax expense in the three and six month periods of 2017 and 2016 was based on the U.S. statutory rate of 34%, increased by state income taxes, and reduced by permanent adjustments and research tax credits.

In the six month period ended June 30, 2016, we utilized deferred tax assets to reduce our tax liability payable to the government. A portion of the deferred tax assets we used comprised cumulative deductions for stock options in excess of book expense. Under income tax accounting rules at that time, that portion of tax benefits attributable to such deductions must be recorded as an adjustment to equity versus a reduction of income tax expense. The tax benefits from such stock-based awards were \$0.5 million in the six month period ended June 30, 2016. These tax benefits were recorded as an equity adjustment to additional paid-in capital.

For the six month period ended June 30, 2017, we recognized all excess tax benefits and tax deficiencies as income tax expense or benefit as a discrete event.

As of June 30, 2017, we had a total of \$5.8 million of deferred tax assets for which we had recorded no valuation allowance. We have assessed the need for a valuation allowance on our deferred tax assets. Based on our assessment of future sources of income, including reversing deferred tax liabilities, and future earnings, we have determined that it is more likely than not that the deferred tax assets will be realized, and therefore there is no valuation allowance required for the deferred tax assets. We will continue to assess the level of valuation allowance in future periods. Should evidence regarding the realizability of tax assets change at a future point in time, the valuation allowance will be adjusted accordingly.

In the second quarter of 2017, the Internal Revenue Service commenced an examination of our tax return for the year ended December 31, 2015.

- I) **Accumulated Other Comprehensive Loss**. The components of accumulated other comprehensive loss and activity were as follows (in thousands):

	December 31, 2016	Increase/ Decrease	Reclassification Adjustments	June 30, 2017
Unrealized losses on available for sale securities	\$ (45)	\$ 21	\$ 24	\$ -
Unrealized gains on available for sale securities	17	21	(38)	-
Net unrealized gains (losses) on available for sale securities	(28)	42	(14)	-
Income tax benefit (expense) on other comprehensive loss	9	(14)	5	-
Total accumulated other comprehensive income (loss), net of taxes	<u>\$ (19)</u>	<u>\$ 28</u>	<u>\$ (9)</u>	<u>-</u>

All amounts reclassified from accumulated other comprehensive income were related to realized gains on available-for-sale securities. These reclassifications impacted "other income" on the Consolidated Statements of Income and Other Comprehensive Income.

- J) **Share Repurchase Program**. On April 26, 2016, we announced that our Board of Directors had approved a program authorizing the Company to purchase up to \$10 million of our common stock. The shares may be purchased from time to time in the open market or through privately negotiated transactions at management's discretion, depending upon market conditions and other factors. The authorization to repurchase our stock expires on December 31, 2017.

We repurchased 168,925 shares of common stock under this program for a total cost of \$0.8 million during the three months ended June 30, 2017. We repurchased 762,644 shares of common stock under this program for a total cost of \$3.6 million during the six months ended June 30, 2017. Included in the shares repurchased during the first six months of 2017 were 210,000 shares repurchased through a privately negotiated transaction. On March 9, 2017, after approval by the Company's Audit Committee and Board of Directors, the Company repurchased 210,000 shares from Richard P. Moberg, the Company's former co-Chief Executive Officer, co-President and Chief Financial Officer and current member of the Board of Directors at a 10% discount off of the market closing price of the Company's stock on March 8, 2017. The closing price of our common stock on March 8, 2017 was \$4.85. The resulting sale price, after calculating the ten percent (10%) discount was \$4.36 and the total transaction cost was \$915,600.

Since the program commenced in April 2016, we have repurchased 1,453,445 shares for a total cost of \$7.3 million.

K) ***Income from patent arrangement.*** We entered into an arrangement with an unaffiliated third party in 2010 under which we assigned certain patents in return for royalties on proceeds from patent monetization efforts by the third party. The third party has engaged in various patent monetization activities, including enforcement, litigation and licensing. In the three and six months ended June 30, 2017, the third party reported and we recorded \$1.3 million and \$1.4 million, respectively, of income from this arrangement.

ITEM 2:
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Cautionary Statement for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995

Some of the information in this Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "estimate," "continue" and similar words. You should read statements that contain these words carefully because they: (1) discuss our future expectations; (2) contain projections of our future operating results or financial condition; or (3) state other "forward-looking" information. However, we may not be able to predict future events accurately. The risk factors listed in our Annual Report on Form 10-K for the year ended December 31, 2016, as well as any cautionary language in this Form 10-Q, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should be aware that the occurrence of any of the events described in these risk factors and elsewhere in this Form 10-Q could materially and adversely affect our business.

Summary of Operations

We are primarily engaged in the development and sale of biometrics products and services. Our software products are used in government and commercial biometrics systems to identify or authenticate people. Principal government applications of biometrics systems include border control, visitor screening, law enforcement, national defense, intelligence, secure credentialing, access control, and background checks. Principal commercial applications include: i) user authentication for login and access to mobile devices, computers, networks, and software programs; ii) user authentication for financial transactions and purchases (online and in-person); iii) physical access control to buildings, and iv) screening and background checks of prospective employees and customers. We sell our software and services globally through systems integrators and OEMs, and directly to end user customers. We also derive a portion of our revenue from the sale of imaging software licenses to OEMs and systems integrators that incorporate our software into medical imaging products and medical systems.

Summary of Financial Results

We use revenue and operating income to summarize financial results as we believe these measurements are the most meaningful way to understand our operating performance.

Revenue and operating income for the three months ended June 30, 2017 were \$2.7 million and \$0.2 million, respectively. These results compared to revenue of \$6.9 million and operating income of \$2.1 million in the three months ended June 30, 2016. Lower revenue and operating income in the current quarter versus the year ago quarter were primarily due to lower imaging and biometrics software license sales. This was partially offset by: i) income from a patent arrangement, ii) lower cost of software licenses; and iii) lower operating expenses.

Revenue and operating income for the six months ended June 30, 2017 were \$7.1 million and \$0.6 million, respectively. These results compared to revenue of \$11.7 million and operating income of \$3.0 million in the three months ended June 30, 2016. Lower revenue and operating income in the current six month period were primarily due to: i) lower imaging and biometrics software license sales, ii) no hardware sales; and iii) lower DSL royalties. This was partially offset by: i) income from a patent arrangement, ii) lower cost of software licenses; and iii) lower cost of hardware.

These and all other financial results are discussed in more detail in the results of operations section that follows.

Results of Operations

Software licenses. Software licenses consist of revenue from the sale of biometrics and imaging software products. Sales of software products depend on our ability to win proposals to supply software for biometrics systems projects either directly to end user customers or indirectly through channel partners.

Software license revenue decreased 77% from \$5.3 million in the three months ended June 30, 2016 to \$1.2 million in the same three month period in 2017. As a percentage of total revenue, software license revenue decreased from 77% in the second quarter of 2016 to 44% in the current year quarter. The \$4.1 million decrease in software license revenue was primarily due to: i) a \$3.0 million decrease in biometrics software license sales, and ii) a \$1.1 million decrease in imaging software license sales. The reasons for the changes in biometrics and imaging software licenses were:

- i) Biometrics software licenses – Biometrics software license sales were \$1.0 million in the second quarter of 2017 versus \$4.1 million in the same quarter last year. The dollar decrease was primarily due to a software license sale to the U.S. Marine Corps ("USMC") in the second quarter of 2016 whereas we had no such sale in the second quarter of 2017. This was slightly offset by higher license sales to our channel partners that serve government customers.
- ii) Imaging software licenses – Imaging software license sales were \$0.2 million in the second quarter of 2017 versus \$1.3 million in the same quarter last year. The decrease was primarily due to a software license agreement we entered into in October 2015 with a systems integrator. The \$4.5 million license fee from that arrangement was recognized over a twelve-month period that ran from October 2015 to October 2016. We recognized \$1.1 million from that sale in the second quarter of 2016. There is no remaining license revenue to be recognized from this agreement in 2017.

Software license revenue decreased 52% from \$8.1 million in the six months ended June 30, 2016 to \$3.9 million in the same six month period in 2017. As a percentage of total revenue, software license revenue decreased from 69% in the first six months of 2016 to 55% in the current year quarter. The \$4.2 million decrease in software license revenue was primarily due to: i) a \$1.9 million decrease in biometrics software license sales, and ii) a \$2.3 million decrease in imaging software license sales. The reasons for the changes in imaging and biometrics software licenses were:

- i) Biometrics software licenses – Biometrics software license sales were \$3.5 million in the six months ended June 30, 2017 versus \$5.4 million in the same quarter last year. The decrease was primarily due to: i) a \$0.6 million software sales to the U.S. Navy (the "Navy") in the first six months of 2016 whereas there was no such sale in the corresponding period of 2017; and ii) software sales of \$3.2 million to the USMC in the second quarter of 2016 versus \$0.9 million in the corresponding period of 2017. This was partially offset by higher license revenue from our other biometrics customers. We are unable to predict whether the USMC or the Navy will purchase this software again in the future.
- ii) Imaging software licenses – Imaging software license sales were \$0.5 million in the six months ended June 30, 2017 versus \$2.7 million in the corresponding period a year ago. The decrease was primarily due to a software license agreement we entered into in October 2015 with a systems integrator. The \$4.5 million license fee from that arrangement was recognized over a twelve-month period that ran from October 2015 to October 2016. We recognized \$2.2 million from that sale in the first six months of 2016. There is no remaining license revenue to be recognized from this agreement in 2017.

As described in the strategy section of our Form 10-K for the year ended December 31, 2016, our market strategy is to continue to focus on our legacy government biometrics markets and expand into new commercial biometrics markets. We are unable to predict future revenue from commercial markets as these are emerging markets.

Software maintenance . Software maintenance consists of revenue from the sale of software maintenance contracts. Software maintenance contracts entitle customers to receive software support and software updates, if and when they become available, during the term of the contract.

Software maintenance revenue increased 9% from \$1.2 million in the three months ended June 30, 2016 to \$1.3 million in the same three month period in 2017. As a percentage of total revenue, software maintenance revenue increased from 17% in the second quarter of 2016 to 47% in the current year quarter.

Software maintenance revenue increased 3% from \$2.46 million in the six months ended June 30, 2016 to \$2.53 million in the same six month period in 2017. As a percentage of total revenue, software maintenance revenue increased from 21% in the first six months of 2016 to 36% in the corresponding period of 2017.

For the three and six month periods ended June 30, 2017, the dollar increase in software maintenance revenue was primarily due to a base of maintenance revenue from prior periods that grows as we sell maintenance contracts with new licenses in current periods.

Services . Services consist of fees we charge to perform software development, integration, installation, and customization services. Similar to software license revenue, services revenue depends on our ability to win biometrics systems projects either directly with end user customers or in conjunction with channel partners. Services revenue will fluctuate when we commence new projects and/or when we complete projects that were started in previous periods.

Services decreased 5% from \$216,000 in the three months ended June 30, 2016 to \$206,000 in the same three month period in 2017. As a percentage of total revenue, services increased from 3% in the second quarter of 2016 to 8% in the current year quarter.

Services decreased 9% from \$635,000 in the six months ended June 30, 2016 to \$580,000 in the same six month period in 2017. As a percentage of total revenue, services increased from 5% in the first six months of 2016 to 8% in the corresponding period of 2017.

For the three and six month periods ended June 30, 2017, the dollar decrease in services revenue was primarily due to lower revenue from our non-U.S. government customers and the Navy that was partially offset by higher revenue from the USMC.

Services backlog of \$0.2 million was minimal as of June 30, 2017, which means that services revenue in 2017 is unlikely to return to the levels we achieved in 2014 and 2015 unless we are able to obtain new service projects.

Hardware. Hardware revenue consists of sales of biometrics equipment to the Navy for whom we developed biometrics software. Hardware products sold to this customer integrate hardware purchased from third parties with software from other third parties as well as software from Aware. We evaluated the classification of gross versus net revenue recognition and determined gross recognition was appropriate.

Hardware revenue decreased 100% from \$31,000 in the three months ended June 30, 2016 to zero in the same three month period in 2017. The dollar decrease in hardware revenue was due to the delivery of an order in the second quarter of 2016 whereas we had no such order in the current year quarter.

Hardware revenue decreased 100% from \$317,000 in the six months ended June 30, 2016 to zero in the same six month period in 2017. As a percentage of total revenue, hardware revenue decreased from 3% in the first six months of 2016 to 0% in the corresponding period of 2017. The dollar decrease in hardware revenue was due to the delivery of orders in the first six months of 2016 whereas we had no such orders in the corresponding period of 2017.

We believe that future hardware orders from the Navy may be minimal as we believe it has completed the bulk of its purchasing. We had no hardware orders in backlog as of June 30, 2017. It is worth noting that our strategy does not include maintaining or growing biometrics hardware revenue. We agreed to provide hardware products as an accommodation to this important customer.

Royalties. Royalties consist primarily of royalty payments we receive under DSL silicon contracts with two customers that incorporate our silicon intellectual property (“IP”) in their DSL chipsets. We sold our DSL IP business in 2009, but we continue to receive royalty payments from these customers. Royalties are reported in continuing operations in accordance with ASC 205-20, Reporting Discontinued Operations, because we have continuing ongoing cash flows from this business.

Royalties decreased 66% from \$129,000 in the three months ended June 30, 2016 to \$43,000 in the same three month period in 2017. As a percentage of total revenue, royalties were 2% for both periods.

Royalties decreased 62% from \$203,000 in the six months ended June 30, 2016 to \$77,000 in the same six month period in 2017. As a percentage of total revenue, royalties decreased from 2% in the first six months of 2016 to 1% in the corresponding period of 2017.

We do not consider DSL royalties to be a key element of our strategy and we expect that this revenue will continue to decline in future periods.

Cost of software licenses. Cost of software licenses consists primarily of the cost of third party software included in certain software products delivered to the Navy and USMC.

Cost of software licenses decreased 100% from \$0.9 million in the three months ended June 30, 2016 to zero in the same three month period in 2017. The dollar decrease in cost of software licenses was primarily due to the delivery of software to the USMC that included third party software in the second quarter of 2016 whereas we had no such order in the second quarter of 2017.

Cost of software licenses decreased 78% from \$1.1 million in the six months ended June 30, 2016 to \$0.2 million in the same six month period in 2017. Cost of software licenses as a percentage of software license sales decreased from 14% in the first six months of 2016 to 6% in the corresponding of 2017, which means that gross margins increased from 86% to 94%. The dollar decrease in cost of software licenses was primarily due to lower sales of software to the Navy and USMC that included third party software.

Cost of Services. Cost of services consists of engineering costs to perform customer services projects. Such costs primarily include: i) engineering salaries, stock-based compensation, fringe benefits, and facilities; and ii) engineering consultants and contractors.

Cost of services decreased 34% from \$158,000 in the three months ended June 30, 2016 to \$104,000 in the same three month period in 2017. Cost of services as a percentage of services decreased from 73% in the second quarter of 2016 to 51% in the current year quarter, which means that gross margins increased from 27% to 49%.

Cost of services decreased 14% from \$372,000 in the six months ended June 30, 2016 to \$320,000 in the same six month period in 2017. Cost of services as a percentage of services decreased from 58% in the first six months of 2016 to 55% in the corresponding period of 2017, which means that gross margins increased from 42% to 45%.

For the three and six month periods ended June 30, 2017, the dollar decrease in cost of services was due to: the profitably profile of the projects comprising services revenue; and ii) a decrease in services revenue.

Cost of hardware. Cost of hardware consists primarily of the cost of third party equipment and software included in hardware shipments.

Cost of hardware sales decreased 100% from \$29,000 in the three months ended June 30, 2016 to zero in the same three month period in 2017. Cost of hardware sales decreased 100% from \$234,000 in the six months ended June 30, 2016 to zero in the same six month period in 2017.

For the three and six month periods ended June 30, 2017, the dollar decrease in cost of hardware was due to the delivery of replacement parts to the Navy in 2016, whereas we had no hardware shipments in the corresponding periods of 2017.

Research and development expense. Research and development expense consists of costs for: i) engineering personnel, including salaries, stock-based compensation, fringe benefits, and facilities; ii) engineering consultants and contractors, and iii) other engineering expenses such as supplies, equipment depreciation, dues and memberships and travel. Engineering costs incurred to develop our technology and products are classified as research and development expense. As described in the cost of services section, engineering costs incurred to provide engineering services for customer projects are classified as cost of services, and are not included in research and development expense.

The classification of total engineering costs to research and development expense and cost of services was (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Research and development expense	\$ 1,876	\$ 1,802	\$ 3,733	\$ 3,451
Cost of services	104	158	320	372
Total engineering costs	\$ 1,980	\$ 1,960	\$ 4,053	\$ 3,823

Research and development expense increased 4% from \$1.8 million in the three months ended June 30, 2016 to \$1.9 million in the same three month period in 2017. As a percentage of total revenue, research and development expense increased from 26% in the second quarter of 2016 to 68% in the corresponding period of 2017.

Research and development expense increased 8% from \$3.5 million in the six months ended June 30, 2016 to \$3.7 million in the same six month period in 2017. As a percentage of total revenue, research and development expense increased from 29% in the first six months of 2016 to 53% in the corresponding period of 2017.

For the three and six month periods ended June 30, 2017, the increase in research and development expense was primarily due to the engagement of a third party software development company to assist us in the development of an important new product. Work with the development company commenced in the fourth quarter of 2016 and we expect that research and development expenses in the remainder of 2017 may include an additional \$450,000 in fees to the development company depending on the achievement of contract milestones. This expense was partially offset by lower employee costs due to lower headcount.

We anticipate that we will continue to focus our future research and development activities on enhancing our existing products and developing new products.

Selling and marketing expense. Selling and marketing expense primarily consists of costs for: i) sales and marketing personnel, including salaries, sales commissions, stock-based compensation, fringe benefits, travel, and facilities; and ii) advertising and promotion expenses.

Sales and marketing expense decreased 8% from \$1.1 million in the three months ended June 30, 2016 to \$1.0 million in the same three month period of 2017. As a percentage of total revenue, sales and marketing expense increased from 16% in the second quarter of 2016 to 37% in the corresponding period of 2017. The dollar decrease in sales and marketing expense was primarily due to lower sales commissions, which was partially offset by higher advertising and tradeshow expenses.

Sales and marketing expense decreased 3% from \$2.03 million in the six months ended June 30, 2016 to \$1.97 million in the same six month period of 2017. As a percentage of total revenue, sales and marketing expense increased from 17% in the first six months of 2016 to 28% in the corresponding period of 2017. The dollar decrease in sales and marketing expense was primarily due to lower sales commission, which was partially offset by higher spending on sales agents and higher advertising and tradeshow expenses.

General and administrative expense. General and administrative expense consists primarily of costs for: i) officers, directors and administrative personnel, including salaries, bonuses, director compensation, stock-based compensation, fringe benefits, and facilities; ii) professional fees, including legal and audit fees; iii) public company expenses; and iv) other administrative expenses, such as insurance costs and bad debt provisions.

General and administrative expense decreased 6% from \$0.9 million in the three months ended June 30, 2016 to \$0.8 million in the same three month period in 2017. As a percentage of total revenue, general and administrative expense increased from 13% in the second quarter of 2016 to 30% in the corresponding period in 2017. The decrease in general and administrative expense was primarily due to lower employee costs.

General and administrative expense was essentially unchanged at \$1.6 million in the six months ended June 30, 2017 and 2016. As a percentage of total revenue, general and administrative expense increased from 14% in the first six months of 2016 to 23% in the corresponding period in 2017. Unchanged general and administrative expense in the first six months of 2017 was primarily due to lower employee costs that were offset by higher stock-based compensation and higher legal fees related to corporate matters and patents.

Patent related income. We entered into an arrangement with an unaffiliated third party in 2010 under which we assigned certain patents in return for royalties on proceeds from patent monetization efforts by the third party. The third party has engaged in various patent monetization activities, including enforcement, litigation and licensing. In the three and six months ended June 30, 2017, the third party reported and we recorded \$1.3 million and \$1.4 million, respectively, of income from this arrangement. There was no such income in the three and six month periods ended June 30, 2016. We continue to have a contractual relationship with this third party. However, we are unable to predict how much more income we might receive from this arrangement, if any, because we do not know whether any patent monetization efforts by the third party will be successful.

Other income. We recorded \$36,000 of other income in the three and six months ended June 30, 2017. This amount represented a \$37,000 realized gain offset by a \$1,000 realized loss on the sale of two high yield bonds.

Interest income. Interest income increased 23% from \$72,000 in the three months ended June 30, 2016 to \$89,000 in the same three month period in 2017. Interest income increased 25% from \$138,000 in the six months ended June 30, 2016 to \$172,000 in the same six month period in 2017. For the three and six month periods, the dollar increase in interest income was primarily due to higher interest rates.

Income taxes. Income tax expense was \$0.1 million and \$0.7 million for the three months ended June 30, 2017 and 2016, respectively. Income tax expense was \$0.2 and \$1.0 million for the six months ended June 30, 2017 and 2016, respectively. Income tax expense in the three and six month periods of 2017 and 2016 was based on the U.S. statutory rate of 34%, increased by state income taxes, and reduced by permanent adjustments and research tax credits.

In the six month period ended June 30, 2016, we utilized deferred tax assets to reduce our tax liability payable to the government. A portion of the deferred tax assets we used comprised cumulative deductions for stock options in excess of book expense. Under income tax accounting rules at that time, that portion of tax benefits attributable to such deductions must be recorded as an adjustment to equity versus a reduction of income tax expense. The tax benefits from such stock-based awards were \$0.5 million in the six month period ended June 30, 2016. These tax benefits were recorded as an equity adjustment to additional paid-in capital.

For the six month period ended June 30, 2017, we recognized all excess tax benefits and tax deficiencies as income tax expense or benefit as a discrete event.

As of June 30, 2017, we had a total of \$5.8 million of deferred tax assets for which we had recorded no valuation allowance. We have assessed the need for a valuation allowance on our deferred tax assets. Based on our assessment of future sources of income, including reversing deferred tax liabilities, and future earnings, we have determined that it is more likely than not that the deferred tax assets will be realized, and therefore there is no valuation allowance required for the deferred tax assets. We will continue to assess the level of valuation allowance in future periods. Should evidence regarding the realizability of tax assets change at a future point in time, the valuation allowance will be adjusted accordingly.

In the second quarter of 2017, the Internal Revenue Service commenced an examination of our tax return for the year ended December 31, 2015.

Liquidity and Capital Resources

At June 30, 2017, we had cash and cash equivalents of \$49.4 million, which represented a decrease of \$2.5 million from December 31, 2016. The decrease in cash and cash equivalents was primarily due to the following factors:

Cash provided by operations was \$0.3 million in the first six months of 2017. Cash provided from operations was primarily the result of \$0.6 million of net income and the add back of \$0.5 million of non-cash items primarily for depreciation, amortization, and stock-based compensation. Cash from these sources was partially offset by \$0.8 million of changes in assets and liabilities.

Cash provided by investing activities was \$966,000 in the first six months of 2017. Cash provided from investing activities consisted of \$1,019,000 from sales of investments less \$53,000 of purchases of property and equipment.

Cash used in financing activities was \$3.7 million in the first six months of 2017. Financing activity cash usage was primarily the result of \$3.6 million used to buy back stock under our stock repurchase program and \$119,000 used to pay income taxes for employees who surrendered shares in connection with stock grants. Cash used for these purposes was partially offset by \$43,000 of proceeds from our employee stock purchase plan and stock option exercises.

While we cannot assure you that we will not require additional financing, or that such financing will be available to us, we believe that our cash and cash equivalents will be sufficient to fund our operations for at least the next twelve months.

Recent Accounting Pronouncements

See Note G to our Consolidated Financial Statements in Item 1.

ITEM 3:
Quantitative and Qualitative Disclosures about Market Risk

Our exposure to market risk relates primarily to our investment portfolio, and the effect that changes in interest rates would have on that portfolio. Our investment portfolio at June 30, 2017 consisted of one element:

Cash and cash equivalents . As of June 30, 2017, our cash and cash equivalents of \$49.4 million were primarily invested in money market funds. The money market funds were invested in high quality, short term financial instruments. Due to the nature, short duration, and professional management of these funds, we do not expect that a general increase in interest rates would result in any material loss.

We do not use derivative financial instruments for speculative or trading purposes.

ITEM 4:
Controls and Procedures

Our management, including our chief executive officer and chief financial officer, has evaluated our disclosure controls and procedures as of the end of the quarterly period covered by this Form 10-Q and has concluded that our disclosure controls and procedures are effective. They also concluded that there were no changes in our internal control over financial reporting that occurred during the quarterly period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1: Legal Proceedings

From time to time we are involved in litigation incidental to the conduct of our business. We are not party to any lawsuit or proceeding that, in our opinion, is likely to seriously harm our business.

ITEM 1A: Risk Factors

The risks described in Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2016, could materially and adversely affect our business, financial condition and results of operations. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations. No material change in the risk factors discussed in that Form 10-K has occurred.

ITEM 2: Unregistered Sales of Equity Securities and Use of Proceeds Issuer Purchases of Equity Securities

<u>Period</u>	<u>(a) Total Number of Shares Purchased</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)</u>	<u>(d) Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs</u>
April 2017	-	-	-	-
May 2017	106,254	\$ 4.80	106,254	-
June 2017	62,671	\$ 4.92	62,671	\$ 2,699,144

(1) On April 26, 2016, we issued a press release announcing that our board of directors had approved the repurchase of up to \$10,000,000 of our common stock from time to time through December 31, 2017. During the three months ended June 30, 2017, we purchased 168,925 shares under this plan at an aggregate purchase price of \$818,079.

ITEM 4: Mine Safety Disclosures

Not applicable.

**ITEM 6:
Exhibits**

(a) Exhibits

- Exhibit 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 101* The following financial statements from Aware, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in XBRL (eXtensible Business Reporting Language), as follows: (i) Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016, (ii) Consolidated Statements of Income and Comprehensive Income for the Three and six Months Ended June 30, 2017 and June 30, 2016, (iii) Consolidated Statements of Cash Flows for the six Months Ended June 30, 2017 and June 30, 2016, and (iv) Notes to Consolidated Financial Statements.

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto shall not be deemed filed for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

SIGNATURES

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

AWARE, INC.

Date: July 28, 2017

By: /s/ Kevin T. Russell
Kevin T. Russell
Chief Executive Officer & President
General Counsel

Date: July 28, 2017

By: /s/ David J. Martin
David J. Martin
Chief Financial Officer (Principal Financial and Accounting Officer)

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Kevin T. Russell, Chief Executive Officer of Aware, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Aware, Inc.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;
4. The registrant's other certifying officer 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 15d-15(f)) for the registrant and we 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 quarterly 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 quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - d) disclosed in this quarterly 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 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 registrant's board of directors (or persons performing the equivalent function):
 - 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: July 28, 2017

/s/ Kevin T. Russell

Kevin T. Russell

Chief Executive Officer & President

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, David J. Martin, Chief Financial Officer of Aware, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Aware, Inc.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;
4. The registrant's other certifying officer 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 15d-15(f)) for the registrant and we 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 quarterly 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 quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - d) disclosed in this quarterly 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 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 registrant's board of directors (or persons performing the equivalent function):
 - 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: July 28, 2017

/s/ David J. Martin

David J. Martin

Chief Financial Officer

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report on Form 10-Q of Aware, Inc. (the "Company") for the quarter ended June 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned Chief Executive Officer and Chief Financial Officer of the Company, certifies, to the best knowledge and belief of the signatory, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (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/ Kevin T. Russell

Chief Executive Officer & President

/s/ David J. Martin

Chief Financial Officer

Date: July 28, 2017

Date: July 28, 2017

The certification set forth above is being furnished as an exhibit solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the Form 10-Q or as a separate disclosure document of the Company or the certifying officers.
