ZAGG Inc
Form 10-K/A
January 27, 2012
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K/A
Amendment No. 1

(Mark One)

x ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 001-34528

ZAGG INC

NEVADA (State or other jurisdiction of incorporation or organization)	20-2559624 (I.R.S. Employer Identification No.)
3855 S 500 W, Suite J, Salt Lake City, UT (Address of principal executive offices)	84115 (Zip Code)

Issuer’s telephone number: (801) 263-0699

Securities registered under 12(b) of the Exchange Act: None

Securities registered under 12 (g) of the Exchange Act:

Common Stock, par value $0.001

(Title of Class)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 2 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No þ

Indicated by check mark whether the registrant:(1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 þ No o

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company þ

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2010, was $47,475,026. For purposes of the foregoing calculation only, directors and executive officers and holders of 10% or more of the issuer's common capital stock have been deemed affiliates.

The number of shares of the Registrant's common stock outstanding as of March 17, 2011, was 24,128,874.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A ("Amendment No. 1") amends the Annual Report on Form 10-K of ZAGG Inc (the "Company") for the fiscal year ended December 31, 2010, as originally filed with the Securities and Exchange Commission (the "SEC") on March 25, 2011 (the "Original Filing"). This Form 10-K/A amends the Original Filing to reflect a restatement in management's assessment of the disclosure controls and procedures as of December 31, 2010, and to restate Management's Report on Internal Control Over Financial Reporting to include a material weaknesses resulting from the lack of a sufficient number of accounting professionals with the necessary experience and training as of December 31, 2010. In addition, this Amendment No. 1 includes a restated Report of Independent Registered Public Accounting Firm regarding Internal Control Over Financial Reporting, and a restated Report of Independent Registered Public Accounting Firm as part of Item 8, Financial Statements and Supplementary Data. Amendment No. 1 does not include any changes to the Company's Consolidated Financial Statements included in the Original Filing. The following sections of the Original Filing are revised in this Amendment No. 1:

Part II

- Item 8 – Financial Statements and Supplementary Data

- Report of Independent Registered Public Accounting Firm

- Item 9A – Controls and Procedures

- Item 9A.1 Disclosure Controls and Procedures
- Item 9A.2 Changes in Internal Control Over Financial Reporting
- Item 9A.3 Management's Report on Internal Control over Financial Reporting
- Item 9A.5 Report of Independent Registered Public Accounting Firm

In addition, the Company's principal executive officer and principal financial officer have provided new certifications in connection with this Amendment No. 1 (Exhibits 31.1, 31.2, 32.1, and 32.2).

Except as described above, no other amendments have been made to the Original Filing. This Amendment continues to speak as of the date of the Original Filing, and the Company has not updated the disclosure contained herein to reflect events that have occurred since the date of the Original Filing. Accordingly, this Amendment No. 1 should be read in conjunction with the Original Filing (except as amended hereby), as well as the Company's other filings made with the SEC subsequent to the filing of the Original Filing, including any amendments to those filings.

PART II

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
ZAGG Incorporated:

We have audited the accompanying consolidated balance sheet of ZAGG Incorporated and subsidiaries as of December 31, 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ZAGG Incorporated and subsidiaries as of December 31, 2010, and the results of their operations and their cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), ZAGG Incorporated's internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 24, 2011, except for the restatement of the effectiveness of internal control over financial reporting for the material weakness related to the lack of a sufficient number of accounting professionals with the necessary experience and training, which is as of January 27, 2012, expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

(signed) KPMG LLP

Salt Lake City, Utah
March 24, 2011, except for the restatement of the effectiveness of internal control over financial reporting, which is as of January 27, 2012.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
ZAGG Incorporated

We have audited the accompanying consolidated balance sheet of ZAGG Incorporated and subsidiary (the "Company") as of December 31, 2009, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the two years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ZAGG Incorporated and subsidiary as of December 31, 2009, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

HANSEN, BARNETT & MAXWELL, P.C.

Salt Lake City, Utah
March 12, 2010

ZAGG INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2010	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,373,293	$ 4,970,756
Accounts receivable, net	17,668,612	5,450,722
Inventories	17,946,948	3,695,840
Prepaid expenses and other current assets	2,620,308	758,835
Related party other asset	3,899,910	1,152,500
Deposit on intangible asset	-	1,151,000
Deferred income tax assets	2,195,687	255,653
Total current assets	46,704,758	17,435,306
Property and equipment, net	1,496,532	887,705
Deferred income tax assets	-	446,154
Other assets	63,310	9,688
Intangible assets, net	9,167,466	119,627
Total assets	$ 57,432,066	$ 18,898,480
LIABILITIES AND EQUITY		
Current liabilities		
Notes payable	$ 30,923	$ -
Accounts payable	12,122,011	2,781,425
Income taxes payable	8,030,719	1,228,899
Accrued liabilities	240,454	23,562
Accrued wages and wage related expenses	302,965	164,495
Deferred revenue	294,931	262,937
Sales returns liability	2,067,671	550,201
Total current liabilities	23,089,674	5,011,519
Deferred income tax liability	1,561,465	-
Total liabilities	24,651,139	5,011,519
Equity		

Stockholders' equity		
Common stock, $0.001 par value; 50,000,000 shares authorized;		
23,925,763 and 21,711,862 shares issued and outstanding, respectively	23,926	21,712
Additional paid-in capital	15,494,836	9,239,285
Cumulative translation adjustment	(59,802)	(112,039)
Retained earnings	14,701,074	4,738,003
Total stockholders' equity	30,160,034	13,886,961
Noncontrolling interest	2,620,893	-
Total equity	32,780,927	13,886,961
Total liabilities and equity	$ 57,432,066	$ 18,898,480

See accompanying notes to consolidated financial statements.

ZAGG INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2010	2009	2008
Net sales	$ 76,135,025	$ 38,361,747	$ 19,791,603
Cost of sales	38,738,077	16,308,501	6,593,718
Gross profit	37,396,948	22,053,246	13,197,885
Operating expenses:			
Advertising and marketing	5,067,377	5,845,801	3,976,015
Selling, general and administrative	15,516,149	10,497,394	6,842,921
Total operating expenses	20,583,526	16,343,195	10,818,936
Income from operations	16,813,422	5,710,051	2,378,949
Other (expense) income:			
Interest expense	(242,617)	(231,445)	(6,022)
Interest and other income	6,593	34,833	227,223
Total other (expense) income	(236,024)	(196,612)	221,201
Income before provision for income taxes	16,577,398	5,513,439	2,600,150
Income tax provision	(6,649,740)	(2,132,010)	(501,188)
Net income	9,927,658	3,381,429	2,098,962
Net loss attributable to noncontrolling interest	35,414	-	-
Net income attributable to stockholders	$ 9,963,072	$ 3,381,429	$ 2,098,962
Earnings per share attributable to stockholders:			
Basic earnings per share	$ 0.44	$ 0.16	$ 0.11
Diluted earnings per share	$ 0.41	$ 0.15	$ 0.11

See accompanying notes to consolidated financial statements.

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ZAGG INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE INCOME

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings (Deficit)	Cumulative Translation Adjustment	Total Stockholders' Equity	Noncontrolling Interest	Total Equity
Balances, December 31, 2007	18,853,995	$ 18,855	$ 4,091,864	$ (742,388)	$ (3,866)	$ 3,364,465	$ -	$ 3,364,465
Comprehensive income:								
Net income	-	-	-	2,098,962	-	2,098,962	-	2,098,962
Foreign currency translation loss	-	-	-	-	(102,764)	(102,764)	-	(102,764)
Comprehensive income						1,996,198	-	1,996,198
Issuance of common stock to employees and consultants	210,000	210	178,229	-	-	178,439	-	178,439
Issuance of common stock for exercise of warrants	100,000	100	38,762	-	-	38,862	-	38,862
Option expense	-	-	238,763	-	-	238,763	-	238,763
Balances, December 31, 2008	19,163,995	19,165	4,547,618	1,356,574	(106,630)	5,816,727	-	5,816,727
Comprehensive income:								
Net income	-	-	-	3,381,428	-	3,381,428	-	3,381,428
Foreign currency translation loss	-	-	-	-	(5,409)	(5,409)	-	(5,409)

Comprehensive income						3,376,019	-	3,376,019
Issuance of common stock to employees	80,000	80	282,720	-	-	282,800	-	282,800
Option exercises	634,299	633	467,881	-	-	468,514	-	468,514
Warrant exercises	1,833,568	1,834	2,275,071	-	-	2,276,905	-	2,276,905
Warrant grant	-	-	221,917	-	-	221,917	-	221,917
Option expense	-	-	381,992	-	-	381,992	-	381,992
Excess tax benefits related to share-based payments	-	-	1,062,086	-	-	1,062,086	-	1,062,086
Balances, December 31, 2009	21,711,862	21,712	9,239,285	4,738,002	(112,039)	13,886,960	-	13,886,960
Purchase of HzO technology and equipment	-	-	-	-	-	-	2,656,307	2,656,307
Comprehensive income:								
Net income (loss)	-	-	-	9,963,072	-	9,963,072	(35,414)	9,927,658
Foreign currency translation gain	-	-	-	-	52,237	52,237	-	52,237
Comprehensive income						10,015,309	(35,414)	9,979,895
Issuance of common stock to employees	20,000	20	42,180	-	-	42,200	-	42,200
Option exercises	524,301	524	709,753	-	-	710,277	-	710,277

Warrant exercises	1,599,600	1,600	2,077,879	-	-	2,079,479	-	2,079,479
Warrant grant	-	-	292,992	-	-	292,992	-	292,992
Patent acquisition	70,000	70	1,604,965	-	-	1,605,035	-	1,605,035
Option expense	-	-	951,276	-	-	951,276	-	951,276
Excess tax benefits related to share-based payments	-	-	576,506	-	-	576,506	-	576,506
Balances, December 31, 2010	23,925,763	$ 23,926	$ 15,494,836	$ 14,701,074	$ (59,802)	$ 30,160,034	$ 2,620,893	$ 32,780,927

See accompanying notes to consolidated financial statements.

ZAGG INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2010	2009	2008
Cash flows from operating activities			
Net income	$ 9,927,658	$ 3,381,429	$ 2,098,962
Adjustments to reconcile net income to net cash			
provided by (used in) operating activities:			
Stock-based compensation	993,475	664,792	406,064
Excess tax benefits related to share-based payments	(619,534)	(1,062,086)	-
Depreciation and amortization	348,177	243,119	160,269
Deferred income taxes	(1,481,785)	507,943	370,347
Expense related to issuance of warrants	292,993	-	-
Impairment expense for short term note	-	438,000	-
Gain on asset disposals	-	-	(12,215)
Changes in operating assets and liabilities			
Accounts receivable	(12,217,890)	(1,856,835)	(3,191,441)
Inventories	(14,251,108)	(1,782,543)	(1,466,253)
Related party other asset	(2,747,410)	(1,152,500)	-
Prepaid expenses and other current assets	(1,861,473)	(7,758)	(315,920)
Other assets	(53,622)	-	-
Accounts payable	9,340,585	1,155,035	1,120,815
Income taxes payable	6,801,820	-	-
Accrued liabilities	686,338	978,643	176,940
Accrued wages and wage related expenses	138,470	43,383	25,575
Deferred revenues	31,994	(103,653)	265,679
Sales return liability	1,517,470	259,082	267,258
Net cash (used in) provided by operating activities	(3,153,842)	1,706,051	(93,920)
Cash flows from investing activities			
Deposits on and purchase of intangible assets	(2,116,540)	(1,230,264)	(4,904)
Short-term loans	-	-	(513,000)
Proceeds from disposal of equipment	-	-	2,994
Purchase of property and equipment	(819,531)	(574,473)	(380,102)
Net cash used in investing activities	(2,936,071)	(1,804,737)	(895,012)
Cash flows from financing activities			
Payments on debt	-	(20,223)	(21,867)
Proceeds from notes payable	30,923	-	-
Proceeds from exercise of warrants and options	2,789,756	2,967,336	-
Excess tax benefits related to share-based payments	619,534	1,062,086	-
Proceeds from issuance of common stock and warrants	-	-	50,000
Net cash provided by financing activities	3,440,213	4,009,199	28,133

Effect of foreign current exchange rates on cash and cash equivalents	52,237	(5,409)	(102,764)
Net (decrease) increase in cash and cash equivalents	(2,597,463)	3,905,104	(1,063,563)
Cash and cash equivalents at beginning of the period	4,970,756	1,065,652	2,129,215
Cash and cash equivalents at end of the period	$ 2,373,293	$ 4,970,756	$ 1,065,652
Supplemental disclosure of cash flow information			
Cash paid during the period for interest	$ 242,617	$ 231,445	$ 6,022
Cash paid during the period for taxes	710,171	551,683	-

See accompanying notes to consolidated financial statements.

ZAGG INCORPORATED AND SUBSIDIARIES
STATEMENTS OF CASH FLOWS (Continued)

Supplemental schedule of noncash investing and financing activities

For the Year Ended December 31, 2010:

Issued 100,000 warrants to consultants.

Issued 70,000 shares of common stock and 250,000 warrants in connection with the acquisition of patents. See Note 5.

Issued 8,417,506 shares of HzO Series A Preferred Stock in connection with the acquisition of the HzO technology. See Note 5.

Issued 500,000 shares of HzO Series A Preferred Stock for the purchase of equipment.

Issued 20,000 shares of common stock to employees.

For the Year Ended December 31, 2009:

Issued 370,000 warrants to consultants.

Issued 80,000 shares of common stock to employees.

For the Year Ended December 31, 2008:

Issued 210,000 shares of common stock to employees and consultants.

See accompanying notes to consolidated financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

ZAGG Incorporated (the "Company") was incorporated in the State of Utah on March 25, 2005, as Protective Solutions, Inc. On January 30, 2006, the Company amended its articles of incorporation and changed its name to ShieldZone Corporation. On February 8, 2007 the Company was acquired by an inactive publicly held company, Amerasia Khan Enterprises Ltd. in a transaction accounted for as a recapitalization of the Company. On March 1, 2007, the Company redomesticated its operating subsidiary by reincorporating it in the State of Nevada and on that same date the Company merged that subsidiary into Amerasia Khan Enterprises Ltd, the parent, who was the surviving entity. In connection with the merger, the Company changed the name of Amerasia Khan Enterprises Ltd. to ZAGG Incorporated.

The Company provides innovative consumer products like films, skins, audio and power solutions that protect, personalize, and enhance the mobile experience. ZAGG's products are distributed worldwide under the following brands, invisibleSHIELD®, ZAGGskins™, ZAGGsparq™, ZAGGbuds™, ZAGG LEATHERskins™, and ZAGGmate™.

Certain reclassifications of prior year amounts have been made to conform to the current year presentation.

Use of estimates

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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates include the allowance for doubtful accounts, inventories, sales returns and warranty liability, the useful life of property and equipment and intangible assets, stock-based compensation, deferred tax assets, and income tax uncertainties and other contingencies. These estimates and assumptions are based on management's best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the economic environment, which management believes to be reasonable under the circumstances. Management adjusts such estimates and assumptions when facts and circumstances dictate.

Principles of consolidation

The consolidated financial statements include the accounts of ZAGG Incorporated and its wholly owned subsidiaries ZAGG Europe Limited, ZAGG International and ZAGG Intellectual Property Holding Co, Inc., and HzO, Inc. which is a variable interest entity. All intercompany transactions and balances have been eliminated in consolidation.

Cash equivalents

The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. Amounts receivable from credit card processors are also considered cash equivalents because they are both short-term and highly liquid in nature and are typically converted to cash within three days of the sales transaction. Cash equivalents as of December 31, 2010 and 2009, consisted primarily of money market fund investments and amounts receivable from credit card processors.

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.

Accounts receivable

The Company sells its products to end users through indirect distribution channels and other resellers who are extended credit terms after an analysis of their financial condition and credit worthiness. Credit terms to distributors and resellers, when extended, are based on evaluation of the customers' financial condition. Accounts receivable are recorded at invoiced amounts and do not bear interest.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. Management regularly evaluates the allowance for doubtful accounts considering historical losses adjusted to take into account current market conditions, customers' financial condition, receivables in dispute, receivables aging and current payment patterns. Account balances are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Payments subsequently received on written off receivables are credited to the bad debt expense in the period of recovery.

The following summarizes the activity in the Company's allowance for doubtful accounts for the years ended December 31, 2010, 2009 and 2008:

	For the Year Ended December 31,		
	2010	2009	2008
Balance at beginning of year	$ 685,155	$ 218,936	$ 63,241
Additions charged to expense	219,141	466,219	155,695
Write-downs charged against the allowance	—	—	—
Recoveries of amounts previously charged off	—	—	—
Balance at end of year	$ 904,296	$ 685,155	$ 218,936

On May 13, 2009, the Company entered into an accounts receivable financing agreement with Faunus Group International, Inc. ("FGI"). Under the agreement, the Company could offer to sell its accounts receivable to FGI each month during the term of the Agreement, up to a maximum amount outstanding at any time of $4,000,000. The Company could sell accounts receivable to FGI on either a credit approved or full recourse basis. Credit approved invoices were sold to FGI with no recourse, FGI accepted all credit default risk on invoices sold under the credit approved terms. The Company accounted for the sale of the credit approved invoices as a reduction to accounts receivable. Amounts sold under the financing agreement for 2010, 2009, and 2008 were $5,988,875, $6,614,532, and $0, respectively. Under the terms of the agreement, the Company was charged a monthly collateral management fee of 0.87% of the average monthly outstanding balance and interest at 7% per annum. The term of the agreement was for a period of four years. However, effective May 12, 2010, the Company terminated the receivable financing agreement with FGI. As a result of the early termination of the agreement, the Company paid a termination fee of $75,000 to FGI that was recorded as interest expense in the accompanying consolidated financial statements in full satisfaction of the Company's obligations under the agreement.

Inventories

Inventories, consisting primarily of finished goods and raw materials, are valued at the lower of cost, determined on a first-in, first-out basis, or market. Management performs periodic assessments to determine the existence of obsolete, slow moving and non-saleable inventories, and records necessary write downs in cost to reduce such inventories to net realizable value.

Property and equipment

Property and equipment are recorded at cost. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the useful life of the asset or the term of the lease.

Major additions and improvements are capitalized, while costs for minor replacements, maintenance and repairs that do not increase the useful life of an asset are expensed as incurred. Upon retirement or other disposition of property and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. The

resulting gain or loss is reflected in selling, general and administrative expense.

Intangibles assets

Intangible assets include internet addresses, patent applications, and purchased patents and intellectual property and are amortized over their estimated economic lives, using a straight-line or accelerated method. Amortization expense related to certain acquired patents and intellectual property is classified as a component of cost of goods sold.

Impairment of long-lived assets

Long-lived assets, such as property and equipment, and purchased intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, recoverability of long-lived assets is measured by comparison of its carrying amount to the undiscounted cash flows that the asset or asset group is expected to generate over the remaining life in measuring whether the assets are recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

Revenue recognition

The Company's revenue is derived from sales of its products through its indirect channel including retailers and distributors and through its direct channel including www.ZAGG.com and its corporate owned and third-party-owned mall kiosks, and from the license fees for the sale of exclusive independent distributor licenses related to the kiosk program. 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. Shipping and other transportation costs charged to buyers are recorded in both sales and cost of sales. Sales taxes collected from customers and remitted to governmental authorities are accounted for on a net basis and therefore are excluded from revenues. For kiosk license fees, the Company recognizes revenue on a straight-line basis over the term of the license which is generally three years.

Promotional products given to customers or potential customers are recognized as a component of selling, general and administrative expenses. Sales incentives provided to customers are recognized as a reduction of the related sale price at the time of sale, and, therefore, are a reduction in revenues.

Reserve for sales returns and warranty liability

The Company's return policy generally allows its end users and retailers to return purchased products for refund or in exchange for new products within 45 days of end user purchase. In addition, the Company generally provides the ultimate consumer a warranty with each product. The Company estimates a reserve for sales returns and warranty liability and records that reserve amount as a reduction of revenues and as a sales return reserve liability.

The following summarizes the activity in the Company's sales return and warranty liability for the years ended December 31, 2010, 2009 and 2008:

	For the Year Ended December 31,		
	2010	2009	2008
Balance at beginning of year	$ 550,201	$ 291,119	$ 23,861
Additions charged to expense	7,047,467	2,845,956	1,053,587
Sales returns and warranty claims charged against the reserve	(5,529,997)	(2,586,874)	(786,329)
Balance at end of year	$ 2,067,671	$ 550,201	$ 291,119

Income taxes

The Company recognizes deferred income tax assets or liabilities for expected future tax consequences of events that have been recognized in the financial statements or tax returns. Under this method, deferred income tax assets or liabilities are determined based upon the difference between the financial statement and income tax bases of assets and liabilities using enacted tax rates expected to apply when differences are expected to be settled or realized. Deferred income tax assets are reviewed for recoverability and valuation allowances are provided when it is more likely than not that a deferred tax asset will not be realizable in the future. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records estimated interest and penalties related to unrecognized tax benefits as a component of income tax provision.

The Company has foreign subsidiaries formed or acquired to conduct or support its business outside the United States. The Company does not provide for U.S. income taxes on undistributed earnings for its foreign subsidiaries as the foreign earnings will be permanently reinvested in such foreign jurisdictions.

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 restricted stock is measured on the grant date based on the quoted closing market price of the Company's common stock. The fair value of the stock options is measured on the grant date using the Black-Scholes option pricing model based on the underlying common stock closing price as of the date of grant, the expected term, stock price volatility, and risk-free interest rates. The Company recognizes compensation expense net of estimated forfeitures on a straight-line basis over the requisite service period of the award, which is generally the vesting term of the award. No compensation cost is ultimately recognized for awards for which employees do not render the requisite service and are forfeited. Excess tax benefits of awards that are recognized in equity related to stock option exercises are reflected as financing cash inflows.

Advertising and marketing

General advertising is expensed as incurred. Advertising allowances provided to retailers are recorded as an expense when incurred as the Company receives an identifiable benefit in return for the allowance. Advertising expenses for the years ended December 31, 2010, 2009 and 2008 were $5,067,377, $5,845,801 and $3,976,015, respectively. Included in the December 31, 2008, expense was $190,787 related to an infomercial that the company had produced, but subsequently abandoned.

Foreign currency translation and transactions

The Company's primary operations are at the parent level which uses the U.S. dollar (USD) as its functional currency. The British Pound is the functional currency of the Company's ZAGG Europe Limited subsidiary and the Euro is the functional currency of the Company's ZAGG International subsidiary. Accordingly, assets and liabilities for these subsidiaries are translated into USD using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are recorded as a component of accumulated other comprehensive income in stockholders' equity. Gains and losses resulting from foreign currency transactions are included in income as a component of other, net in the consolidated statements of operations and totaled $(15,916), $(98,612) and $181,195 for the years ended December 31, 2010, 2009 and 2008, respectively.

Segment Reporting

The accounting guidance requires disclosures related to components of a company for which separate financial information is available that is evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance. Management believes that the Company has only one operating segment in accordance with accounting guidance because the Company's business consists of sales of consumer electronics accessories, primarily related to the invisibleSHIELD product line.

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 reflects 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 years ended December 31, 2010, 2009 and 2008:

	2010	2009	2008
Net income attributable to stockholders	$ 9,963,072	$ 3,381,429	$ 2,098,962
Weighted average shares outstanding	22,518,441	20,633,812	18,971,399
Dilutive effect of stock options and warrants	1,744,052	2,355,227	293,830
Diluted shares	24,262,493	22,989,039	19,265,229
Earnings per share attributable to stockholders:			
Basic	$ 0.44	$ 0.16	$ 0.11
Dilutive	$ 0.41	$ 0.15	$ 0.11

For the years ended December 31, 2010, 2009, and 2008, warrants and stock options to purchase 1,156,608, 422,500, and 4,146,953, 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 or stock options was greater than the average market price of common shares during the period and, therefore, the effect would be anti-dilutive.

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Comprehensive Income

Comprehensive income includes changes to equity accounts that were not the result of transactions with stockholders. Comprehensive income is comprised of net income and changes in the cumulative foreign currency translation adjustments.

Recent accounting pronouncements

In January 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2010-06, Improving Disclosures About Fair Value Measurements, which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. ASU 2010-06 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. We do not expect the remaining adoption of ASU 2010-06 related to the reconciliation of Level 3 fair value measurements to have a material impact on our consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13, which amends ASC Topic 605, Revenue Recognition, to require companies to allocate revenue in multiple-element arrangements based on an element's estimated selling price if vendor-specific or other third-party evidence of value is not available. ASU 2009-13 is effective for annual reporting periods beginning after December 15, 2010. We do not expect the adoption of ASU 2009-13 to have a material impact on our consolidated financial statements.

NOTE 2 – PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets are summarized in the table below:

	December 31,	
	2010	2009
Interest and other receivables	$ 97,719	$ 69,459
Inventory deposits	2,277,615	360,635
Other	244,974	328,741
Total prepaid expenses and other current assets	$ 2,620,308	$ 758,835

NOTE 3 – INVENTORIES

Inventory consisted of the following components:

	December 31,	
	2010	2009
Finished goods	$ 7,925,387	$ 778,871
Raw materials	10,021,561	2,916,969
Total inventory	$ 17,946,948	$ 3,695,840

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

		December 31,	
		2010	2009
	Useful Lives		
Computer equipment and software	3 to 5 years	$ 587,127	$ 431,923
Equipment	3 to10 years	936,638	452,473
Furniture and fixtures	7 years	98,407	109,392
Automobiles	5 years	176,476	93,002
Leasehold improvements	1 to 4.75 years	549,902	318,180
		2,348,550	1,404,970
Less accumulated depreciation		(852,018)	(517,265)
Net property and equipment		$ 1,496,532	$ 887,705

NOTE 5 – INTANGIBLE ASSETS

The Company's intangible assets are summarized in the table below:

	December 31, 2010			
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
Intangibles subject to amortization:				
Internet addresses	10 yrs	$ 124,234	(28,069)	96,165
Patents	14 yrs	1,835,575	—	1,835,575
Intangibles not subject to amortization:				
Patent application costs	N/A	47,039	—	47,039
HzO technology	N/A	7,188,687	—	7,188,687
Total		$ 9,195,535	(28,069)	9,167,466

	December 31, 2009			
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
Intangibles subject to amortization:				
Internet addresses	10 yrs	$ 124,234	(15,646)	108,588
Intangibles not subject to amortization:				
Patent application costs	N/A	11,039	—	11,039
Total		$ 135,273	(15,646)	119,627

For the years ended December 31, 2010, 2009 and 2008, amortization expense was $12,423, $6,981 and $4,454, respectively. Estimated aggregate amortization for definite-lived intangible assets for the next five years is as follows:

2011	$ 200,424
2012	217,525
2013	219,532
2014	222,598
2015	226,616
	$ 1,086,695

Internet addresses

Internet addresses consists of amounts paid to secure the Company's Internet addresses. The Company has contractual rights customary in the industry to use its Internet addresses. However, the Company does not have and cannot acquire any property rights to the internet addresses. The Company does not expect to lose its rights to use the Internet addresses; however, there can be no assurance in this regard and such loss could have a material adverse effect on the Company's financial position and results of operations. Amortization is being recorded straight line and is included in selling, general and administrative expenses.

Patent application costs

Patent application costs for the years ended December 31, 2010 and 2009 include legal fees paid in connection with the Company's patent applications of $47,039 and $11,039, respectively. As of December 31, 2010, the patents had not been granted. Accordingly, the Company has not begun to amortize the patent application costs and will begin amortizing the patents over the economic life of the patents, when the patent is granted.

Patents

On August 31, 2010, Andrew Mason ("Mason") filed a complaint against the Company claiming patent infringement on 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 Co., Inc., a Nevada corporation, acquired all of the rights of Mason in the (i) patents which are the subject of the litigation, (ii) 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 $200,000 by November 11, 2010, and a second payment of $150,000 after December 31, 2010;
(b) issue to Mason five-year warrants (the "Warrant") to purchase 750,000 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 500,000 of the 750,000 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 70,000 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 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 $500,000; and
(b) issue to Mason 430,000 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 500,000 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.

The Company determined the fair value of the consideration paid, excluding the consideration contingent upon issuance of a patent on the CIP Application, was $1,955,035 which includes $350,000 of cash consideration, $1,605,035 of fair value for the 250,000 warrants. The fair value of the 250,000 warrants that are not contingent on the CIP application was determined using the Black-Scholes option pricing model. The fair value of the 70,000 shares of common stock was determined considering the restrictions, resulting in a discount of 15% from the closing share price on the date of the settlement. The Company then determined the fair value of the patents acquired and the litigation settlement using a relief from royalty method, which is an income approach, to determine the present value of expected future cash flows and cash flows during the period of claimed patent infringement. The fair values of the elements of the arrangement were in excess of the fair value of the consideration paid, as such, the Company allocated the consideration to the components based on relative fair value, resulting in $1,835,575 allocated to the patents acquired and $119,460 allocated to the litigation settlement, which was recorded as a component of selling, general and administrative expense. The life of the patents was determined based upon the period of time over which the Company expects to benefit from the patents and is amortized using an accelerated method of amortization based on estimated cash flows and is recognized as a component of cost of goods sold. No amortization expense was recognized in 2010 as the assets were acquired near the end of the year.

HzO Technology

On September 28, 2009, the Company entered into a bridge loan agreement with HzO, Inc., a Delaware corporation ("HzO"), whereunder the Company loaned to HzO $1,151,000 and received a secured convertible promissory note (the "Note"). In connection with the funding of the bridge loan, HzO entered into a Technology Contribution Agreement to acquire certain rights to the Golden Shellback technology (the "HzO technology") developed by Northeast Maritime Institute, Inc. ("NMI") for $3,150,000 of cash consideration and 10,521,882 shares of HzO Series A Preferred

Stock. The technology is a molecular, vacuum deposited coating that is nonflammable, has low toxicity and has the ability to weatherproof electronic devices and other surfaces. Pursuant to a separate agreement with HzO, the Company was granted the exclusive worldwide marketing rights for the HzO technology due to its efforts in assisting HzO in securing the HzO technology and funding the bridge loan.

On August 11, 2010, the Company made an additional advance of $220,000 on the same terms as those of the bridge loan to HzO. HzO used this advance to make a partial payment to NMI and defer the Closing under the Technology Contribution Agreement until November 4, 2010. The Company received a warrant for 126,262 shares of HzO Series A Preferred Stock as additional consideration for making the loan.

On November 5, 2010, the Company determined to pay the balance of $1,800,000 due to NMI under the Technology Contribution Agreement. The Company made an additional advance of $1,800,000 under the bridge loan to HzO. The Company received an additional warrant for 1,136,363 shares of HzO Series A Preferred Stock as additional consideration for making the loan, for an aggregate of 1,988,635 warrants. Immediately following the funding of the additional advance of $1,800,000 under the bridge loan, the Company converted the outstanding principal balance of the bridge loan of $3,151,000 to 6,628,787 shares of HzO Series A Preferred Stock.

As consideration to NMI for the purchase of the HzO technology, NMI received in aggregate $3,150,000 in cash and 10,521,882 in HzO Series A Preferred Stock. Of the HzO Series A Preferred Stock received by NMI, 2,104,376 shares are held in escrow until a patent meeting certain conditions is obtained on the HzO technology. If a patent meeting the required conditions is not obtained within four years, the escrowed shares will be forfeited.

As a result of the transaction, HzO has acquired the HzO technology and recorded the value at $7,188,687, which includes $3,150,000 of cash consideration, $2,532,257 of fair value for the Series A Preferred Stock in HzO, and $1,506,430 due to the tax consequence of an asset acquisition that is not a business combination. The fair value of the Series A Preferred Stock in HzO was determined based upon using a market approach which considered the portion of the Series A Preferred Stock in HzO issued to NMI which are held in escrow and ZAGG has a call option to acquire NMI’s interests in HzO for $3,000,000. The $1,506,430 due to the tax consequence is a result of the book basis exceeding the tax basis in the asset, thus resulting in the recognition of a deferred tax liability and an increase to the asset. As the HzO technology was acquired near year end, the Company has not begun utilizing it to generate cash flows from sales or licensing arrangements. Therefore, upon the Company finalizing how the HzO technology will be utilized, a useful life will then be determined based upon the forecasted cash flows. The Company anticipates having sales associated with the HzO technology beginning in 2011. The HzO technology will be amortized using an accelerated method of amortization based on estimated cash flows and will be recognized as a component of cost of goods sold. The HzO Series A Preferred Stock issued to NMI is reflected in the consolidated balance sheets as a noncontrolling interest and is further discussed in Note 7. The Company also issued 500,000 shares of Series A Preferred Stock in HzO for the purchase of equipment from NMI in 2010.

In the prior period the Company accounted for the transactions with HzO as an unconsolidated entity. Upon further review of the relationship between the Company and HzO, it was determined that HzO was a Variable Interest Entity (VIE) as of its inception in February 2009 and that the Company is the primary beneficiary. Therefore the Company should have consolidated HzO in its 2009 consolidated financial statements. As HzO had no operations during 2009, the impact of consolidating HzO resulted in a reclassification only from convertible bridge loan to deposit on intangible assets as of December 31, 2009. Accordingly, the Company's investment in HzO reflected as a bridge loan in the prior year has been reclassed to a deposit on intangible assets in the current year presentation. At the time of the purchase of the HzO technology, the Company assessed its interest in HzO and has determined that the entity continues to be a VIE for which the Company is the primary beneficiary and has consolidated the operations of HzO in the accompanying consolidated financial statements. The consolidated assets of the VIE consist primarily of the acquired HzO technology, which is included in intangible assets in the accompanying consolidated balance sheets. The equity interests of HzO not owned by the Company are reported as a noncontrolling interest in the accompanying consolidated financial statements. The creditors of HzO do not have recourse to other assets of the Company.

NOTE 6 – INCOME TAXES

The components of income tax (provision) benefit for the years ended December 31, 2010, 2009 and 2008 are:

	2010	2009	2008
Current provision:			
Federal	$ (7,057,934)	$ (1,079,701)	$ —
State	(1,073,591)	(155,456)	—
Total current	(8,131,525)	(1,235,157)	—
Deferred (provision) benefit:			
Federal	1,283,142	(776,631)	(476,129)
State	198,643	(120,222)	(25,059)

Total deferred	1,481,785	(896,853)	(501,188)
Total (provision) benefit	$ (6,649,740)	$ (2,132,010)	$ (501,188)

The following is a reconciliation of the income taxes computed using the federal statutory rate to the provision for income taxes for the years ended December 31, 2010, 2009 and 2008:

	2010	2009	2008
Tax at statutory rate (34%)	$ (5,636,316)	$ (1,838,699)	$ (884,051)
State tax, net of federal tax benefit	(555,941)	(178,462)	(85,805)
Non-deductible expense and other	(198,451)	(114,849)	(6,582)
Domestic production activities deduction	587,230	—	—
Return to provision adjustment	(436,335)	—	—
Interest and penalties	(201,148)	—	—
Federal 38% rate bracket surcharge	(208,779)	—	—
Utilization of NOL carryforward	—	—	475,250
	$ (6,649,740)	$ (2,132,010)	$ (501,188)

The tax effects of temporary differences that gave rise to significant portions of deferred tax assets and liabilities at December 31, 2010 and 2009, are as follows:

	2010	2009
Deferred tax assets:		
Allowance for doubtful accounts	$ 337,302	$ 255,563
Deferred revenue	48,338	—
Net operating loss carryforward	45,307	3,151
Loss from foreign subsidiary	—	80,254
Inventories	1,044,573	27,761
Stock-based compensation	234,420	191,659
Sales returns accrual	765,474	205,225
Total deferred tax assets	2,475,414	763,613
Deferred tax liabilities:		
Property and equipment	313,605	61,896
Intangible assets	1,527,587	—
Total gross deferred tax liabilities	1,841,192	61,896
Net deferred tax assets	$ 634,222	$ 701,717
Deferred tax assets, net – current	$ 2,195,687	$ 255,563
Deferred tax (liabilities) assets, net – non-current	(1,561,465)	446,154
Net deferred tax assets	$ 634,222	$ 701,717

At December 31, 2010, the Company has net operating loss carryforwards for federal and state income tax purposes of $121,467, resulting from taxable losses of HzO, which are available to offset future federal and state taxable income of HzO, if any, through 2030.

There was no valuation allowance at December 31, 2010, as management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize its deferred tax assets.

The Company has not recognized a deferred tax liability for the undistributed earnings of its foreign operations that arose in 2010 and prior years as the Company considers these earnings to be indefinitely reinvested. In addition, the tax implications of the Company's foreign subsidiaries is not considered to be material based on the amounts of the historical losses incurred and the fact that any net operating loss carryforward would not be more likely than not of being realized.

The Company recognizes the impact of a tax position in the financial statements if that position is more likely than not of being sustained on audit, based on the technical merits of the position. As of December 31, 2010 and 2009, the Company had no unrecognized tax benefits. For the year ended December 31, 2010, the Company recorded $201,148 in interest and penalties, which are included as a component of income tax provision.

The Company is currently not under examination by any federal or state tax authority, but remains subject to income tax examinations for each of its open tax years, which extend back to 2007 for federal income tax purposes and 2006 for state income tax purposes.

During the fourth quarter ended December 31, 2010, the Company recorded a $436,335 increase to income tax provision due to a return to provision adjustment.

NOTE 7 – COMMON STOCK AND NONCONTROLLING INTEREST

Common stock

During 2008, the Company issued 310,000 shares of its common stock. Of such shares, 210,000 were issued to employees and consultants, and 100,000 were issued in connection with the exercise of a warrant to purchase 100,000 shares of the Company's common stock. The Company received proceeds of $50,000 in connection with the exercise of the warrant.

During 2009, the Company issued 2,547,867 shares of its common stock. Of such shares, 80,000 were issued to employees, 634,299 were issued in connection with the exercise of stock options and 1,833,568 were issued in connection with the exercise of warrants. The Company recognized compensation expense in the amount of $282,800 related to the issuance of 80,000 shares to employees and received proceeds of $468,514 related to the option exercises and $2,276,905 related to the exercise of the warrants.

During 2010, the Company issued 2,213,901 shares of its common stock. Of such shares, 20,000 were issued to employees as compensation, 524,301 were issued in connection with the exercise of stock options, 1,599,600 were issued in connection with the exercise of warrants and 70,000 were issued in connection with the acquisition of patents. The Company recognized compensation expense of $42,200 related to the issuance of 20,000 shares to employees and received proceeds of $710,277 related to the option exercises and $2,079,479 related to the exercise of the warrants.

Noncontrolling interest

Noncontrolling interests are classified in the consolidated statements of operations as part of net income attributable to stockholders and the accumulated amount of noncontrolling interests is included in the consolidated balance sheets as part of equity. If a change in ownership of a consolidated subsidiary results in loss of control and deconsolidation, any retained ownership interests are remeasured with the gain or loss reported in net earnings.

The value of the noncontrolling interest in the consolidated financial statements primarily represents the Series A Preferred Stock in HzO issued to NMI as part of the HzO technology purchase. The Series A Preferred Stock in HzO has the same voting rights as HzO Common Stock and has one vote for each share of Series A Preferred Stock. The Series A Preferred Stock is convertible into Common Stock, at the option of the holder, at a fixed conversion ratio of 1 share of Series A Preferred Stock to 1 share of Common Stock. All outstanding Series A Preferred Stock shares are redeemable at any time after 8/21/2014 at the election of at least 2/3rds of the Series A Preferred Stock holders. As the Company has at least 1/3rd of the HzO Series A Preferred Stock, it can control the redemption of the HzO Series A Preferred Stock and therefore the associated noncontrolling interest is recorded within permanent equity. The Series A Preferred Stock is redeemable at the fixed price of $0.4752 per share. As of December 31, 2010, the Company and NMI hold 6.6 million and 11.1 million shares of HzO Series A Preferred Stock, respectively. However, 2.1 million shares of the 11.1 million shares of HzO Series A Preferred Stock issued to NMI are held in escrow pending a future event (see Note 5). HzO Series A Preferred Stock holders are entitled to receive dividends annually at a stated dividend rate of $0.038 per share when, as, and if declared by the Board of Directors of HzO. No dividends had been declared as of December 31, 2010. The Company holds a call option to acquire all of NMI's equity interests and rights in HzO for $3,000,000 which is exercisable any time through October 1, 2013. The Company also has the right of first refusal if NMI has an offer to purchase its interests in HzO. The call option does not meet the definition of a derivative, and therefore it is not marked to fair value at each period end.

Noncontrolling interest consists of a 47% equity interest in the HzO, Inc. subsidiary held by third parties, excluding shares of HzO Series A Preferred Stock held in escrow.

NOTE 8 – STOCK OPTIONS AND WARRANTS

Common Stock Options - In 2007, the Company's board of directors adopted and in 2008 the Company's shareholders approved the ZAGG Incorporated 2007 Stock Incentive Plan which provides for the issuance of up to 2,000,000 shares of common stock to the company's directors, employees, consultants and advisors (the "2007 Incentive Plan"). On July 16, 2009, the Company's shareholders approved an amendment to the 2007 Incentive Plan to increase the number of shares issuable under the 2007 Incentive Plan to 5,000,000. As of December 31, 2010, there were 1,492,793 shares available for grant under the 2007 Incentive Plan.

The 2007 Incentive Plan provides for awards in the form of options to acquire shares of common stock and restricted stock grants. The 2007 Incentive Plan is administered by the Compensation Committee of the Company's Board of Directors. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant; those option awards generally vest based on 3 years of continuous service and have 5-year contractual terms.

The fair value of stock options has been estimated as of the grant date using the Black-Scholes option pricing model. For the years ended December 31, 2010, 2009 and 2008 the following assumptions were used in determining the fair value:

	2010	2009	2008
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	1.20%	1.31%	2.05%
Expected term (years)	3.5 years	3.5 years	3.7 years
Expected volatility	95.83%	90.52%	73.95%

The Company determines the expected term of its stock option awards by using the simplified method, which assumes each vesting tranche of the award has a term equal to the midpoint between when the award vests and when the award expires. Expected volatility is calculated by weighting the Company's historical stock price to calculate expected volatility over the expected term of each grant. As the Company's historical stock price history does not cover the entire expected term, expected volatility is also weighted based on the average historical volatility of similar entities with publicly traded shares over the expected term of each grant, The risk-free interest rate for the expected term of each option granted is based on the U.S. Treasury yield curve in effect at the time of grant with a period that approximates the expected term of the option.

The following table summarizes the stock option activity for the Company's stock incentive plan for the year ended December 31, 2010:

	Options (In thousands)	Weighted-Average Exercise Price (Per share)	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2009	2,113	$ 1.39	3.8	
Granted	892	2.86		
Exercised	(524)	1.34		
Forfeited/expired	(127)	1.69		
Outstanding at December 31, 2010	2,354	$ 1.94	3.3	$ 13,358
Vested and expected to vest at December 31, 2010	2,206	$ 1.92	3.3	$ 12,581
Exercisable at December 31, 2010	381	$ 1.00	2.7	$ 2,523

The weighted-average grant-date fair value of options granted during the years ended December 31, 2010, 2009 and 2008 was $1.82, $1.29, and $0.35, respectively. The total intrinsic value of options exercised during the years ended December 31, 2010, 2009 and 2008, was $2,016,209, $2,355,966, and $0, respectively.

As of December 31, 2010, there was $1,744,557 of total unrecognized compensation cost related to nonvested stock options granted under the stock incentive plan. That cost is expected to be recognized over a weighted-average period of 1.5 years. The total fair value of shares vested during the years ended December 31, 2010, 2009 and 2008, was $614,719, $230,090, and $180,000, respectively.

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 years ended December 31, 2010, 2009 and 2008, the Company recorded equity-based compensation expense of $951,276, $664,792 and $406,064, respectively, which is included as a component of selling, general and administrative expense. The net tax benefit recognized on equity-based compensation expense for the year ended December 31, 2010, 2009 and 2008 was $36,256, $(6,059), and $64,226, respectively. The tax benefit realized from stock options exercised for the year ended December 31, 2010, 2009 and 2008 was $707,814, $1,237,574, and $0, respectively.

Warrants - During the year ended December 31, 2010, the Company issued warrants for investor relations consulting services for 100,000 common shares exercisable at $2.58 per share expiring in 5 years and vesting equally over the twelve month period from the grant date. 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 year ended December 31, 2010, the Company recorded expense of $292,992 for these warrants. The Company also issued warrants for 250,000 common shares exercisable at $8.53 per share expiring in 5 years and vesting immediately to Andrew Mason as part of the asset purchase agreement discussed in Note 5. The determination of the fair value of the warrants is further discussed in Note 5.

During the year ended December 31, 2009, the Company issued warrants for consulting services for 20,000 common shares exercisable at $2.05 per share expiring in 1 year and vesting immediately, warrants for sales commissions to an independent third party for 175,000 common shares exercisable at $6.40 per share expiring in 1 year and vesting immediately, and additional warrants for sales commissions to an independent third party for 175,000 common shares exercisable at $4.00 per share expiring in 2.5 years and vesting immediately. Each warrant grant was independently valued using the Black-Scholes option pricing model. For the year ended December 31, 2009, the Company recorded expense of $221,917. No warrants were issued during 2008. The warrants are accounted for as equity instruments.

The fair value of warrants have been estimated as of the vesting date using the Black-Scholes option pricing model. For the years ended December 31, 2010 and 2009 the following assumptions were used in determining the fair value:

	2010	2009
Expected dividend yield	0.0%	0.0%
Risk-free interest rate	1.91%	0.17%
Expected term (years)	4.46 years	0.2 years
Expected volatility	88.88%	66.65%

The following table summarizes the warrant activity for the year ended December 31, 2010:

	Warrants	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
	(In thousands)	(Per share)	(In years)	(In thousands)
Outstanding at December 31, 2009	2,736	$ 1.80	2.7	
Granted	350	6.83		
Exercised	(1,600)	1.30		
Forfeited/expired	(175)	6.40		
Outstanding at December 31, 2010	1,311	$ 3.14	2.5	$ 5,879
Vested and expected to vest at December 31, 2010	1,311	$ 3.14	2.5	$ 5,879
Exercisable at December 31, 2010	1,303	$ 3.14	2.5	$ 5,837

The weighted-average and grant-date or vest-date fair value of warrants granted during the years ended December 31, 2010 and 2009, was $3.47 and $0.62. No warrants were granted during 2008. The total intrinsic value of warrants exercised during the years ended December 31, 2010, 2009 and 2008, was $5,080,278, $6,158,609, and $62,000, respectively.

As of December 31, 2010, there was $51,928 of total unrecognized estimated compensation cost related to nonvested warrants granted. That cost is expected to be recognized over a weighted-average period of 0.1 years. The total fair value of warrants vested during the years ended December 31, 2010, 2009, and 2008 was $1,390,493, $220,359, and $0, respectively.

For warrants that are compensatory, the Company records share-based compensation expense related to warrants only for warrants that have vested. The amount of the expense recognized is based on the estimated fair value of the warrants on the vesting date. During the years ended December 31, 2010, 2009 and 2008, the Company recorded equity-based compensation expense related to warrants of $292,993, $199,041, and $0, respectively, which is included as a component of selling, general and administrative expense. The net tax benefit recognized on equity-based compensation expense related to warrants for the year ended December 31, 2010, 2009 and 2008 was $67,347, $74,640, and $0, respectively. No tax benefits were realized from warrants exercised for the year ended December 31, 2010, 2009 and 2008, respectively.

NOTE 9 – FAIR VALUE MEASUREMENTS

At December 31, 2010 and 2009, the Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and notes receivable. 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 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.

At December 31, 2010 and 2009, the following financial asset was measured at fair value on a recurring basis using the type of inputs shown:

		Fair Value Measurements Using:		
	December 31, 2010	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Cash equivalents	$ 416,312	$ 416,312	—	—

		Fair Value Measurements Using:		
	December 31, 2009	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Cash equivalents	$ 4,085,193	$ 4,085,193	—	—

The majority of the Company's non-financial instruments, which include intangible assets, inventories, and property and equipment, are not required to be carried at fair value on a recurring basis. However, if certain triggering events occur such that a non-financial instrument is required to be evaluated for impairment, based upon a comparison of the non-financial instrument's fair value to its carrying value, an impairment is recorded to reduce the carrying value to the fair value, if the carrying value exceeds the fair value.

For the years ended December 31, 2010 and 2009, there were no non-financial instruments measured at fair value on a nonrecurring basis.

NOTE 10 – NOTES RECEIVABLE

On March 11, 2008, the Company entered into an agreement to fund a bridge loan (the "Bridge Loan") of up to $500,000 to Brighton Partners, LLC. The purpose of the secured loan is to fund the development of a superhero series created by Stan Lee and POW! Entertainment, Inc., in partnership with Brighton Partners, LLC, with the hope that ZAGG would benefit from the marketing exposure and any intellectual property created using ZAGG's trademarks.

In consideration of the bridge loan, Brighton Partners, LLC executed a secured promissory note with a 3% origination fee and bearing 10% interest for the 90 day term of the note. As of December 31, 2009, the Company determined that the note had become impaired and reserved against the full balance of the note and accrued interest. The Company recorded a charge of $438,000 for the note receivable and $274,000 for the related accrued interest in the accompanying consolidated financial statements. The Company will continue to assert its legal rights with relation to the note receivable.

NOTE 11 – 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 million, 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. At December 31, 2010, there was $2 million outstanding in letters of credit for purchases related to the ZAGGbox. The letter of credit subsequently expired on February 28, 2011, and was not drawn down against the line of credit.

Advances under the Loan Agreement bore interest at LIBOR plus 2%. The default rate of interest was 3% per annum over the otherwise applicable interest rate. In addition to the accrual of interest at the default rate, in the event a payment was more than fifteen days past due, the Company was to pay a late fee equal to five percent of the missed payment. The Loan Agreement also called for an unused commitment fee equal to 0.2% per annum for the difference between the commitment amount of $5 million and the amount utilized on the line. For the year ended December 31, 2010, the Company paid $7,400 in unused commitment fees related to the line of credit.

At maturity, the entire outstanding principal balance, all remaining accrued and unpaid interest and all other amounts outstanding were due and payable in full to U.S. Bank.

The Loan Agreement contained customary representations and warranties, certain affirmative and negative covenants as well as events that constitute events of default. The occurrence of an event of default could result in the acceleration of the obligations under the Loan Agreement. The 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 2.0 to 1.0 measured quarterly on a trailing twelve month basis. The Loan Agreement's affirmative covenants required the Company to, among other things, deliver its financial statements, comply with applicable laws, and maintain its taxes and insurance. The Loan Agreement's negative covenants limited or restricted the Company's ability to, among other things, refund indebtedness or fund a distribution to equity holders, grant liens, or consummate mergers or the sale of assets. As of December 31, 2010, the Company was in compliance with all covenants under the Loan Agreement and no funds had been drawn against the credit facility.

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 provides for revolving loans and other financial accommodations to or for the benefit of the Company of a principal amount not to exceed $20 million. Advances under the Amended and Restated Loan Agreement bear interest at LIBOR plus 1.75%. The Amended and Restated Loan Agreement requires 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.

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Operating leases

The Company leases office and warehouse space, office equipment and mall cart locations under operating leases that expire through July 2015. Future minimum rental payments required under the operating leases at December 31, 2010 are as follows:

2011	$ 431,709
2012	298,178
2013	315,537
2014	326,037
2015	190,667
Total	$ 1,562,129

For the years ended December 31, 2010, 2009 and 2008, rent expense was $911,300, $534,435 and $427,288, respectively. Rent expense is recognized on a basis which approximates straight line over the term.

Legal matters

The Company's wholly owned subsidiary, ZAGG Intellectual Property Holding Company, Inc., 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. The defendants in these cases have raised defenses and, in some cases, asserted counterclaims against ZAGG Intellectual Property Holding Company, Inc., that seek declarations of unenforceability or non-infringement of the patent. These counterclaims do not assert any claims for affirmative relief apart from a request for an award of costs and attorney's fees to the prevailing party. 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.

The Company is not a party to any litigation or other claims at this time. However, from time to time the Company may become subject to lawsuits and other claims in the ordinary course of business. Such matters are subject to many uncertainties, and most outcomes are not predictable with assurance.

NOTE 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 December 31, 2010.

At December 31, 2010, approximately 64% and 17% of the balance of accounts receivable was due from two customers. At December 31, 2009, approximately 67%, of the balance of accounts receivable was due from one customer. No other customer account balances were more that 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.

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.

Concentration of sales

For the years ended December 31, 2010, 2009, and 2008, one customer accounted for 41%, 35%, and 12% of the Company's sales. No other customer account balances were more that 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 years ended December 31, 2010, 2009 and 2008 was approximately:

	2010		2009		2008	
United States	83	%	85	%	83	%
Europe	12	%	8	%	10	%
Other	5	%	7	%	7	%

There are no material assets located in foreign jurisdictions.

NOTE 14 – QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly financial information is presented in the following summary:

	Year ended December 31, 2010				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Net sales	$ 8,775,559	$ 15,058,783	$ 23,055,763	$ 29,244,920	$ 76,135,025
Operating income	1,331,792	3,224,278	6,153,296	6,104,056	16,813,422
Net income attributable to stockholders	791,076	1,911,040	3,859,092	3,401,864	9,963,072
Earnings per share attributable to stockholders: (1)					
Basic	$ 0.04	$ 0.09	$ 0.17	$ 0.14	$ 0.44
Diluted	0.03	0.08	0.16	0.13	0.41
Weighted average common shares:					
Basic	21,719,274	22,061,570	22,565,300	23,702,509	22,518,441
Diluted	23,370,610	23,536,603	24,029,177	25,446,561	24,262,493

	Year ended December 31, 2009				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Net sales	$ 8,090,951	$ 9,214,971	$ 9,728,528	$ 11,327,297	$ 38,361,747
Operating income	1,603,892	1,863,110	1,471,288	771,791	5,710,051
Net income attributable to stockholders	1,028,240	1,194,264	908,081	250,844	3,381,429
Earnings per share attributable to stockholders: (1)					
Basic	$ 0.05	$ 0.06	$ 0.04	$ 0.01	$ 0.16
Diluted	0.05	0.05	0.04	0.01	0.15
Weighted average common shares:					
Basic	19,185,642	20,062,839	21,540,033	21,701,829	20,633,812
Diluted	19,869,440	22,614,394	24,252,718	23,852,584	22,989,039

(1) The earnings per share calculations for each of the quarters were based upon the weighted average number of shares outstanding during each period, and the sum of the quarters may not be equal to the full year earnings per common share amounts.

NOTE 15 – SUBSEQUENT EVENTS

In June 2008, a former member of our board of directors, Lorance Harmer, introduced the Company to a potential consumer electronics product, which became known as the ZAGGbox. The ZAGGbox aggregates digital content such as music, pictures, videos and movies in a single location and allows the user to 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 to license certain rights for the development and sale of the ZAGGbox in North America. Thereafter, the Company entered into a Distribution and License Agreement with Teleportall, LLC, the owner of the technology used in the ZAGGbox, under which Teleportall agreed to manufacture and deliver ZAGGboxes to the Company and the Company was appointed the exclusive distributor for the ZAGGbox in North American. On June 17, 2009, the Company issued its initial purchase order for 15,000 ZAGGbox units and advanced to Teleportall a total of $1,152,500 representing a $200,000 NRE fee and $952,500 in payment of 30% of the total purchase price for the 15,000 units ordered by the Company.

Teleportall proceeded to develop and test prototypes of the ZAGGbox and provided periodic progress reports to the Company. The Company continued to conduct market analysis for the product and requested several changes to the functions and features of the ZAGGbox. Teleportall did not deliver the product in time for the 2009 Christmas selling season.

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 $2,747,410. 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 had an indirect interest of 25% in Teleportall. As a result, on March 23, 2011, the Company entered into a settlement agreement with Mr. Harmer and several entities owned or controlled by Mr. Harmer, pursuant to which 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 $4,125,902 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 thereafter (b) 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 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 and 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 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 marks to sell and distribute the ZAGGbox product. Teleportall shall pay ZAGG a 10% royalty on net sales of ZAGGboxes per calendar quarter.

- Teleportall and ZAGG entered into a non-exclusive Commission Agreement on March 23, 2011, under which Teleportall may 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 is for a term of two (2) years; provided that (a) the Commission Agreement shall automatically terminate concurrent with any uncured default under the Note, and (b) the term may be extended for an additional term on reasonable terms if Teleportall's introductions during the initial term result in the purchase of no less than $25,000,000 of ZAGG products during the initial term. Payment terms of the Commission Agreement are as follows:

o 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; and

o 3.0% commission on all orders within the first 24 months after the Load-in Period, and 2.0% thereafter, from any orders generated in the countries where Teleportall is paid a commission under the terms set forth in the preceding bullet point (excluding the United States) regardless of Teleportall's involvement in ZAGG's receipt of the order for 5 years. The 3.0% and 2.0% commissions will be split 50/50 between cash to Teleportall and principal payments on the Note.

ITEM 9A. CONTROLS AND PROCEDURES

1. Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of December 31, 2010. Based on that evaluation in the Original Filing, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective. Subsequently, we determined that we had a material weakness in internal control over financial reporting resulting from the lack of a sufficient number of accounting professionals with the necessary experience and training as of December 31, 2010. As a result of the material weakness that has been determined to exist as described in Management’s Report on Internal Control Over Financial Reporting, our principal executive officer and principal financial officer have now concluded that our disclosure control and procedures were not effective as of December 31, 2010.

2. Changes in Internal Control Over Financial Reporting

Other than the material weakness noted below, there have been no significant changes in our internal control over financial reporting during the quarter ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

3. Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed 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. Internal control over financial reporting includes those written policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles;
- provide reasonable assurance that our receipts and expenditures are being made only in accordance with authorization of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on our consolidated financial statements.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management had concluded in the Original Filing that as of December 31, 2010, we maintained effective internal control over financial reporting. Subsequently, we identified a material weakness in internal control over financial reporting specifically, we lack a sufficient number of accounting professionals with the necessary experience and training as of December 31, 2010.

As a result of the material weakness described above, management has now concluded that our internal control over financial reporting was not effective as of December 31, 2010.

Our independent registered public accounting firm, KPMG LLP, has issued an attestation report on the effectiveness of our internal control over financial reporting, which is included at 9A.5 below.

4. Inherent Limitations on Effectiveness of Controls

Management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. 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. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or 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. Controls also can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls.

The design of any system of controls is based in part on 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. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

5. Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of ZAGG Incorporated

We have audited ZAGG Incorporated's internal control over financial reporting as of December 31, 2010 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). ZAGG Incorporated's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting (Item 9A.3). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. A material weakness related to a lack of a sufficient number of accounting professionals with the necessary experience and training has been identified and included in management's assessment. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of ZAGG Incorporated and subsidiaries as of

December 31, 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for the year then ended. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements for the year ended December 31, 2010, and this report does not affect our report on the consolidated financial statements dated March 24, 2011, which expressed an unqualified opinion on those consolidated financial statements.

The assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting has been restated by ZAGG Incorporated management to disclose the aforementioned material weakness and the resultant ineffectiveness of its internal control over financial reporting.

In our opinion, because of the effect of the aforementioned material weakness on the achievement of the objectives of the control criteria, ZAGG Incorporated has not maintained effective internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control—Integrated Framework issued by COSO.

/s/ KPMG LLP

Salt Lake City, Utah
March 24, 2011, except as to the restatement of the effectiveness of internal control over financial reporting for the material weakness related to a lack of a sufficient number of accounting professionals with the necessary experience and training, which is as of January 27, 2012

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SIGNATURES

Pursuant to the requirements of section 13 or 15 (d) 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.

ZAGG INC

Dated:	January 27, 2012	By: /s/ ROBERT G. PEDERSEN II Robert G. Pedersen II CEO and Chairman (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Dated:	January 27, 2012	By: /s/ ROBERT G. PEDERSEN II Robert G. Pedersen II CEO and Chairman (Principal Executive Officer)
Dated:	January 27, 2012	By: /s/ BRANDON T. O’BRIEN Brandon T. O’Brien Chief Financial Officer (Principal Accounting and Financial Officer)
Dated:	January 27, 2012	By: /s/ ED EKSTROM Ed Ekstrom Director
Dated:	January 27, 2012	By: /s/ SHU UEYAMA Shu Ueyama Director
Dated:	January 27, 2012	By: /s/ RANDY HALES Randy Hales President, Chief Operating Officer & Director
Dated:	January 27, 2012	By: /s/ CHERYL LARABEE Cheryl Larabee Director