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

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2019

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM___TO

Commission file number 000-24389

OneSpan Inc.
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**36-4169320**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

121 West Wacker Drive, Suite 2050
Chicago, Illinois 60601
(Address of Principal Executive Offices) (Zip Code)

(312) 766-4001
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	Trading Symbol	Name of each exchange on which registered:
Common Shares	OSPN	NASDAQ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Emerging growth company	☐
		Smaller reporting company	☐

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

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

There were 40,201,365 shares of Common Stock, $.001 par value per share, outstanding at October 28, 2019.

OneSpan Inc.
Form 10-Q
For the Quarter Ended September 30, 2019
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OneSpan Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	September 30, 2019	December 31, 2018
ASSETS		
Current assets		
Cash and equivalents	$ 54,889	$ 76,708
Short term investments	26,442	22,789
Accounts receivable, net of allowances of $1,562 in 2019 and $1,152 in 2018	76,571	59,631
Inventories, net	18,977	14,428
Prepaid expenses	6,645	4,733
Contract assets	6,138	7,962
Other current assets	8,218	5,705
Total current assets	197,880	191,956
Property and equipment:		
Furniture and fixtures	10,726	7,613
Office equipment	11,896	11,059
Total Property and equipment:	22,622	18,672
Accumulated depreciation	(13,826)	(12,422)
Property and equipment, net	8,796	6,250
Operating lease right-of-use assets	10,903	—
Goodwill	91,037	91,841
Intangible assets, net of accumulated amortization	37,752	45,462
Deferred income taxes	5,542	5,601
Contract assets - non-current	5,213	3,316
Other assets	8,154	8,400
Total assets	$ 365,277	$ 352,826
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 13,074	$ 7,202
Deferred revenue	29,456	33,633
Accrued wages and payroll taxes	13,693	13,932
Short-term income taxes payable	4,735	6,905
Other accrued expenses	9,163	9,323
Deferred compensation	1,315	1,362
Total current liabilities	71,436	72,357
Long-term deferred revenue	12,075	10,672
Lease liability long term	11,304	—
Other long-term liabilities	5,518	7,075
Long-term income taxes payable	7,111	7,620
Deferred income taxes	3,758	2,661
Total liabilities	111,202	100,385
Stockholders' equity		
Preferred stock: 500 shares authorized, none issued and outstanding at December 31, 2019 and 2018	—	—
Common stock: $.001 par value per share, 75,000 shares authorized; 40,193 and 40,225 issued and outstanding at September 30, 2019 and December 31, 2018, respectively	40	40
Additional paid-in capital	94,694	93,310
Accumulated income	176,118	172,378
Accumulated other comprehensive loss	(16,777)	(13,287)
Total stockholders' equity	254,075	252,441
Total liabilities and stockholders' equity	$ 365,277	$ 352,826

See accompanying notes to unaudited condensed consolidated financial statements.

OneSpan Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Revenue				
Product and license	$ 61,181	$ 36,882	$ 133,159	$ 105,362
Services and other	18,544	15,613	50,408	42,119
Total revenue	79,725	52,495	183,567	147,481
Cost of goods sold				
Product and license	22,199	14,321	46,966	32,897
Services and other	4,470	3,631	13,622	9,363
Total cost of goods sold	26,669	17,952	60,588	42,260
Gross profit	53,056	34,543	122,979	105,221
Operating costs				
Sales and marketing	14,156	16,039	44,579	46,938
Research and development	9,956	8,992	32,428	22,805
General and administrative	9,490	10,184	29,540	32,168
Amortization / impairment of intangible assets	2,335	2,442	7,051	7,387
Total operating costs	35,937	37,657	113,598	109,298
Operating income (loss)	17,119	(3,114)	9,381	(4,077)
Interest income, net	228	258	432	991
Other income (expense), net	(1,611)	246	(1,711)	2,025
Income (loss) before income taxes	15,736	(2,610)	8,102	(1,061)
Provision for income taxes	3,864	(1,702)	4,363	(943)
Net income (loss)	$ 11,872	$ (908)	$ 3,739	$ (118)
Net income (loss) per share				
Basic	$ 0.30	$ (0.02)	$ 0.09	$ (0.00)
Diluted	$ 0.30	$ (0.02)	$ 0.09	$ (0.00)
Weighted average common shares outstanding				
Basic	40,062	39,922	40,037	39,924
Diluted	40,129	39,922	40,099	39,924

See accompanying notes to unaudited condensed consolidated financial statements.

OneSpan Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Net income (loss)	$ 11,872	$ (908)	$ 3,739	$ (118)
Other comprehensive income (loss)				
Cumulative translation adjustment, net	(3,022)	(1,244)	(3,450)	(3,266)
Pension adjustment, net	(12)	3	(40)	37
Comprehensive income (loss)	$ 8,838	$ (2,149)	$ 249	$ (3,347)

See accompanying notes to unaudited condensed consolidated financial statements.

OneSpan Inc.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)
(unaudited)

For the nine months ended September 30, 2019:

Description	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Income	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at December 31, 2018	40,225	40	93,310	172,378	(13,287)	252,441
Net income (loss)	—	—	—	(5,671)	—	(5,671)
Foreign currency translation adjustment, net of tax	—	—	—	—	870	870
Restricted stock awards	(10)	—	552	—	—	552
Tax payments for stock issuances	—	—	(218)	—	—	(218)
Pension adjustment, net of tax	—	—	—	—	(16)	(16)
Balance at March 31, 2019	40,215	$ 40	$ 93,644	$ 166,707	$ (12,433)	$ 247,958
Net income (loss)	—	—	—	(2,461)	—	(2,461)
Foreign currency translation adjustment, net of tax	—	—	—	—	(1,298)	(1,298)
Restricted stock awards	117	—	677	—	—	677
Tax payments for stock issuances	(4)	—	(49)	—	—	(49)
Pension adjustment, net of tax	—	—	—	—	(12)	(12)
Balance at June 30, 2019	40,328	$ 40	$ 94,272	$ 164,246	$ (13,743)	$ 244,815
Net income (loss)	—	—	—	11,872	—	11,872
Foreign currency translation adjustment, net of tax	—	—	—	—	(3,022)	(3,022)
Restricted stock awards	10	—	549	—	—	549
Tax payments for stock issuances	(145)	—	(127)	—	—	(127)
Pension adjustment, net of tax	—	—	—	—	(12)	(12)
Balance at September 30, 2019	40,193	$ 40	$ 94,694	$ 176,118	$ (16,777)	$ 254,075

See accompanying notes to unaudited condensed consolidated financial statements.

OneSpan Inc.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)
(unaudited)

For the nine months ended September 30, 2018:

Description	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Income	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at December 31, 2017	40,086	40	90,307	156,151	(8,568)	237,930
Cumulative impact of change in accounting principles, net of tax	—	—	—	12,376	—	12,376
Net income (loss)	—	—	—	1,792	—	1,792
Foreign currency translation adjustment, net of tax	—	—	—	—	1,318	1,318
Restricted stock awards	226	—	799	—	—	799
Pension adjustment, net of tax	—	—	—	—	12	12
Balance at March 31, 2018	40,312	$ 40	$ 91,106	$ 170,319	$ (7,239)	$ 254,226
Net income (loss)	—	—	—	(1,002)	—	(1,002)
Foreign currency translation adjustment, net of tax	—	—	—	—	(3,339)	(3,339)
Restricted stock awards	(79)	—	1,009	—	—	1,009
Pension adjustment, net of tax	—	—	—	—	22	22
Balance at June 30, 2018	40,233	$ 40	$ 92,115	$ 169,317	$ (10,556)	$ 250,916
Net income (loss)	—	—	—	(908)	—	(908)
Foreign currency translation adjustment, net of tax	—	—	—	—	(1,244)	(1,244)
Restricted stock awards	(147)	—	1,109	—	—	1,109
Tax payments for stock issuances	—	—	—	—	—	—
Pension adjustment, net of tax	—	—	—	—	3	3
Balance at September 30, 2018	40,086	$ 40	$ 93,224	$ 168,409	$ (11,797)	$ 249,876

See accompanying notes to unaudited condensed consolidated financial statements.

OneSpan Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Cash flows from operating activities:		
Net income (loss)	$ 3,739	$ (118)
Adjustments to reconcile net income (loss) from operations to net cash provided by (used in) operations:		
Depreciation, amortization, and impairment of intangible assets	8,579	9,066
Loss (gain) on disposal of assets	—	(49)
Deferred tax expense (benefit)	(508)	(3,020)
Stock-based compensation	1,778	2,916
Accounts receivable, net	(18,988)	6,183
Inventories, net	(4,549)	(3,267)
Contract assets	(74)	(2,892)
Accounts payable	5,895	(5,258)
Income taxes payable	(2,587)	(8,433)
Accrued expenses	(2,351)	(911)
Deferred compensation	(47)	(541)
Deferred revenue	(2,318)	(405)
Other assets and liabilities	(2,231)	(2,476)
Net cash used in operating activities	(13,662)	(9,205)
Cash flows from investing activities:		
Purchase of short term investments	(24,663)	—
Maturities of short term investments	21,250	80,000
Purchase of Dealflo, net of cash acquired	—	(53,065)
Additions to property and equipment	(4,196)	(3,410)
Net cash provided by (used in) investing activities	(7,609)	23,525
Cash flows from financing activities:		
Tax payments for restricted stock issuances	(394)	(399)
Net cash used in financing activities	(394)	(399)
Effect of exchange rate changes on cash	(154)	(647)
Net increase (decrease) in cash	(21,819)	13,274
Cash, cash equivalents, and restricted cash, beginning of period	77,555	78,661
Cash, cash equivalents, and restricted cash, end of period (1.)	$ 55,736	$ 91,935

(1.) The following table provides a reconciliation of cash, cash equivalents and restricted cash shown above to amounts reported within the unaudited condensed consolidated balance sheet as of September 30, 2019 and December 31, 2018 and amounts previously reported within the unaudited condensed consolidated balance sheet in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018 (in thousands):

	September 30, 2019	September 30, 2018	December 31, 2018
Cash and cash equivalents	$ 54,889	$ 91,935	$ 76,708
Restricted cash included in other non-current assets	847	—	847
Cash, cash equivalents and restricted cash	$ 55,736	$ 91,935	$ 77,555

See accompanying notes to unaudited condensed consolidated financial statements.

OneSpan Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

Unless otherwise noted, references in this Quarterly Report on Form 10-Q to "OneSpan," "Company," "we," "our," and "us," refer to OneSpan Inc. and its subsidiaries.

Note 1 – Description of the Company and Basis of Presentation

Description of the Company

OneSpan Inc. and its wholly owned subsidiaries design, develop and market digital solutions for identity, security, and business productivity that protect and facilitate electronic transactions via mobile and connected devices. OneSpan has operations in Austria, Australia, Belgium, Brazil, Canada, China, France, Japan, The Netherlands, Singapore, Switzerland, the United Arab Emirates, the United Kingdom (U.K.), and the United States (U.S.).

Our operations are reported as a single operating segment.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of OneSpan and its subsidiaries and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles in the United States ("U.S. GAAP") for complete financial statements and should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements, and include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the results of the interim periods presented. All significant intercompany accounts and transactions have been eliminated. The operating results for the interim periods presented are not necessarily indicative of the results expected for a full year.

Principles of Consolidation

The consolidated financial statements include the accounts of OneSpan Inc. and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. 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 financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Foreign Currency Translation and Transactions

The financial position and results of the operations of the majority of the Company's foreign subsidiaries are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. Dollars using current exchange rates as of the balance sheet date. Revenue and expenses are translated at average exchange rates prevailing during the year. Translation adjustments arising from differences in exchange rates are charged or credited to other comprehensive income (loss). Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations in other income (expense), net. Foreign exchange transaction losses aggregated $1.9 million for the three months ended September 30, 2019, compared to net losses aggregated of

$0.1 million for the three months ended September 30, 2018. During the nine months ended September 30, 2019, foreign exchange transaction losses aggregated $2.6 million, compared to net losses aggregated of $0.2 million during the nine months ended September 30, 2018.

The financial position and results of our operations in Singapore, Switzerland, and Canada are measured in U.S. Dollars. For these subsidiaries, gains and losses that result from foreign currency transactions are included in the consolidated statements of operations in other income (expense), net.

Note 2 – Summary of Significant Accounting Policies

Except for the accounting policies related to lease accounting that were updated as a result of the adoption of Accounting Standards Update ("ASU") No. 2016-02, Leases (Accounting Standards Codification ("ASC") Topic 842) issued by the Financial Accounting Standards Board (the "FASB"), there have been no changes to significant accounting policies described in the Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC on March 15, 2019 that have had a material impact on the Company's condensed consolidated financial statements and related notes. See Note 8 - Leases, for updated policies related to lease accounting.

Cash and Cash Equivalents

During the year ended December 31, 2018, we entered into a new lease agreement that required a letter of credit in the amount of $0.8 million to secure the obligation. The restricted cash related to this letter of credit is recorded in other non-current assets on the Condensed Consolidated Balance Sheet at September 30, 2019 and December 31, 2018.

Short Term Investments

Short term investments consist of U.S. treasury bills and notes, U.S. government agency notes, corporate notes, and high quality commercial paper with maturities at acquisition of more than three months and less than twelve months. Fair value is determined using Level 2 inputs as defined by ASC 820, *Fair Value Measurements*.

The hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 – Quoted prices in active markets for identical assets and liabilities.
- Level 2 – Quoted prices in active markets for similar assets and liabilities, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial investment.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

Property and Equipment

Depreciation expense was $0.5 million and $1.5 million for the three and nine months ended September 30, 2019, respectively, compared to $0.6 million and $1.7 million for the three and nine months ended September 30, 2018, respectively.

Leases

The Company adopted ASU 2016-02 as of January 1, 2019, using the modified retrospective approach. Prior period amounts have not been adjusted. In addition, the Company elected the following practical expedients:

- The package of practical expedients permitted under the transition guidance within the new standard. The practical expedient package applies to leases commenced prior to adoption of the new standard and permits companies not to reassess whether existing or expired contracts contain a lease, the lease classification, and any initial direct costs for existing leases.

- The short-term lease practical expedient, which allowed the Company to exclude short-term leases from recognition in the unaudited consolidated balance sheets;
- We have lease agreements that contain lease and non-lease components. For automobile leases, we account for lease and non-lease components together. For office leases, we account for these components separately using a relative standalone selling price basis; and
- We apply the portfolio approach to automobile leases with similar characteristics that commence in the same period.

The adoption of this accounting standard resulted in the recording of Operating lease right-of-use ("ROU") assets and Operating lease liabilities of $9.2 million and $11.0 million, respectively, as of January 1, 2019. The difference between the asset and liability is a result of lease incentives, such as tenant improvement allowances, and deferred rent on the balance sheet at transition. The adoption of ASU 2016-02 had no impact on Retained earnings. See Note 8 - Leases for additional information.

Long Term Investments

Included in Other Assets is a minority equity investment accounted for under the cost-method in a company we believe may be beneficial in executing our strategy. At September 30, 2019 and December 31, 2018, investments were $4.1 million and $4.1 million, respectively.

Fair Value of Financial Instruments

At September 30, 2019 and December 31, 2018, our financial instruments were cash and equivalents, short term investments, accounts receivable, accounts payable and accrued liabilities. The estimated fair value of our financial instruments has been determined by using available market information and appropriate valuation methodologies, as defined in ASC 820, *Fair Value Measurements*. The fair values of the financial instruments were not materially different from their carrying amounts at September 30, 2019 and December 31, 2018.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases.* Since that date, the FASB has issued additional ASU's clarifying certain aspects of ASU 2016-02. The new guidance supersedes the lease guidance under FASB Accounting Standards Codification ("ASC") Topic 840, *Leases*, resulting in the creation of FASB ASC Topic 842, *Leases*. The guidance requires a lessee to recognize on the Balance Sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term for both finance and operating leases. Subsequent guidance issued after February 2016 did not change the core principle of ASU 2016-02. The Company adopted the new guidance effective January 1, 2019, using the modified retrospective method, which did not require the Company to adjust comparative periods. See the *Adoption of ASU 2016-02* section in Note 2 – Summary of Significant Accounting Policies for additional information.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"). The new guidance provides financial statement users with improved information about the expected credit losses on trade receivables and other financial instruments held by a reporting entity at each reporting date. The amendments in this update replace the incurred loss methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to calculate credit loss estimates. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating the impact of adopting ASU 2016-13 on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350) – Simplifying the Test for Goodwill Impairment*. This standard eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge (i.e. Step 2 of the current guidance), instead measuring the impairment charge as the excess of the reporting unit's carrying amount over its fair value (i.e. Step 1 of the current guidance). The guidance is effective for us beginning in the first quarter of 2020, and should be applied prospectively. Early adoption is permitted for impairment testing dates after January 1, 2017. We are currently evaluating the effect, if any, that the ASU will have on our consolidated financial statements and related disclosures.

In June 2018, the FASB issued ASU 2018-07, *Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee share-based payment accounting*, which is intended to reduce the cost and complexity of accounting for, and improve financial reporting for share-based payments to nonemployees for goods and services. The ASU is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018. The guidance should be applied prospectively and early adoption is permitted. We adopted this standard on January 1, 2019 on a prospective basis. The adoption of this standard did not have a material impact on our consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement* ("ASU 2018-13"), which amends ASC 820, *Fair Value Measurement*. ASU 2018-13 modifies the disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. The ASU is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2019, with early adoption permitted for removed or modified disclosures, and delayed adoption of the additional disclosures until their effective date. We are currently evaluating the effect that the ASU will have on our consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Topic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans* (ASU 2018-14), which modifies the disclosure requirements for defined benefit pension plans and other postretirement plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2020, and earlier adoption is permitted. We are currently evaluating the effect that the ASU will have on our consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU 2018-15, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement,* which helps entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (CCA) by providing guidance for determining when an arrangement includes a software license and when an arrangement is solely a hosted CCA service. Under ASU 2018-15, customers will apply the same criteria for capitalizing implementation costs as they would for an arrangement that has a software license. The new guidance also prescribes the balance sheet, income statement, and cash flow classification of the capitalized implementation costs and related amortization expense, and requires additional quantitative and qualitative disclosures. The new standard is effective for us on January 1, 2020. Early adoption is permitted, including adoption in any interim period for which financial statements have not been issued. Entities can choose to adopt the new guidance prospectively to eligible costs incurred on or after the date this guidance is first applied or retrospectively. We are currently evaluating the effect that the ASU will have on our consolidated financial statements and related disclosures.

From time to time, new accounting pronouncements are issued by the FASB or other standard setting bodies that are adopted by us as of the specified effective date. Unless otherwise discussed, our management believes that the issued standards that are not yet effective will not have a material impact on our consolidated financial statements upon adoption.

Note 3 – Business Acquisitions

On May 30, 2018, OneSpan acquired the remaining interest in Dealflo Limited and its subsidiaries ("Dealflo"), increasing our ownership percentage to 100% from 1%. Dealflo, formerly a privately-held company based in the United Kingdom, provides identity verification and end-to-end financial agreement solutions. Upon acquisition, Dealflo became a wholly-owned subsidiary of OneSpan.

Dealflo's total purchase price consideration was $53.9 million, net of $5.7 million of cash acquired. The total purchase price consideration includes $53.1 million of cash paid to acquire the remaining 99% interest in Dealflo, as well as $0.8 million of fair value of our previous 1% ownership interest.

The acquisition is accounted for as a business combination using the acquisition method of accounting, which requires the net assets acquired and liabilities assumed to be recognized at their fair values on the acquisition date. During the nine months ended September 30, 2019, we recorded certain measurement period adjustments to amounts previously reported, comprised primarily of a $1.8 million increase to the deferred tax liability and a $0.6 million increase to other current assets. The effect of the measurement period adjustments recorded before the measurement period ended during the nine months ended September 30, 2019 have been determined as if such adjustments had been accounted for at the acquisition date. The net effect of the measurement period adjustments increased goodwill by $1.1 million. The measurement period adjustments did not result in material income statement effects for the nine months ended September 30, 2019. The measurement period closed on May 30, 2019.

The following table summarizes our final allocation of the purchase price consideration based on the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (net of cash acquired):

		Total (in thousands)
Acquired tangible assets	$	2,700
Acquired identifiable intangible assets		17,900
Liabilities assumed		(6,041)
Goodwill		39,295
Total purchase price consideration	$	53,854

The excess of purchase consideration over net assets assumed was recorded as goodwill, which represents the strategic value assigned to Dealflo, including expected benefits from synergies resulting from the acquisition, as well as the knowledge and experience of the workforce in place. In accordance with applicable accounting standards, goodwill is not amortized and will be tested for impairment at least annually, or more frequently, if certain indicators are present. Goodwill and intangible assets related to this acquisition are not deductible for foreign tax purposes.

Based on the final results of the acquisition valuation, $17.9 million of the purchase price consideration has been allocated to identifiable intangible assets. The following table summarizes the major classes of identifiable intangible assets, as well as the estimated weighted-average amortization periods:

Identifiable Intangible Assets		Estimated Fair Value (in thousands)	Weighted Average Amortization Period (Years)
Customer relationships	$	11,800	7
Technology		5,900	4
Trademarks		200	3
	$	17,900	

The results of operations of Dealflo subsequent to the acquisition date have been included in the consolidated statement of operations for the three and nine months ended September 30, 2019 and September 30, 2018. Revenue generated by Dealflo for the three and nine months ended September 30, 2019 was $1.6 million and $5.6 million, respectively, compared to $1.8 million and $2.3 million generated during the three and nine months ended September 30, 2018, respectively. Dealflo net losses included in the results of operations for the three and nine months ended September 30, 2019 was $1.9 million and $5.3 million, respectively, compared to net losses of $2.1 million and $2.9 million for the three and nine months ended September 30, 2018, respectively.

Unaudited Pro Forma Financial Information

The following presents the unaudited pro forma combined results of operations of the Company with Dealflo for the nine months ended September 30, 2018, assuming Dealflo was acquired at the beginning of 2017, and after giving effect to certain pro forma adjustments. Pro forma adjustments for the nine months ended September 30, 2018 reflect estimated amortization expense for intangible assets purchased of $2.2 million, the elimination of $0.4 million of revenue related to intercompany transactions, and the elimination of $1.1 million of non-recurring acquisition related costs.

These unaudited pro forma results are not necessarily indicative of the actual consolidated results of operations had the acquisition actually occurred on January 1, 2017 or of the future results of operations of the consolidated entities (in thousands except per share data):

	Nine months ended September 30, 2018
Revenue	$ 153,049
Net loss	(7,112)
Basic net loss per share	(0.18)
Diluted net loss per share	(0.18)
Shares used in computing basic and diluted net loss per share	39,924

Note 4 – Revenue

We recognize revenue in accordance with ASC 606 *"Revenue from Contracts with Customers"* ("Topic 606"), as described below.

Disaggregation of Revenues

The following tables present our revenues disaggregated by major products and services, geographical region and timing of revenue recognition.

Revenue by major products (in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Hardware products	$ 42,027	$ 27,056	$ 95,356	$ 69,123
Software licenses	19,154	9,826	37,803	36,239
Subscription	5,547	4,161	16,136	10,949
Professional services	2,338	1,594	3,995	3,715
Maintenance, support and other	10,659	9,858	30,277	27,455
Total Revenue	$ 79,725	$ 52,495	$ 183,567	$ 147,481

Revenue by location of customer for the three months ended September 30, 2019 and 2018 (in thousands)

	EMEA	Americas	APAC	Total
Total Revenue:				
2019	$ 48,728	$ 15,605	$ 15,392	$ 79,725
2018	$ 25,281	$ 11,055	$ 16,159	$ 52,495
Percent of Total:				
2019	61 %	20 %	19 %	100 %
2018	48 %	21 %	31 %	100 %

Revenue by location of customer for the nine months ended September 30, 2019 and 2018 (in thousands)

	EMEA	Americas	APAC	Total
Total Revenue:				
2019	$ 108,168	$ 42,762	$ 32,637	$ 183,567
2018	$ 65,148	$ 40,246	$ 42,087	$ 147,481
Percent of Total:				
2019	59 %	23 %	18 %	100 %
2018	44 %	27 %	29 %	100 %

Timing of revenue recognition (in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Products, Licenses transferred at a point in time	$ 61,181	$ 36,882	$ 133,159	$ 105,362
Services transferred over time	18,544	15,613	50,408	42,119
Total Revenue	$ 79,725	$ 52,495	$ 183,567	$ 147,481

Contract balances

The following table provides information about receivables, contract assets and contract liabilities from contracts with customers.

	September 30, 2019	December 31, 2018
Receivables, inclusive of trade and unbilled	$ 76,571	$ 59,631
Contract Assets (current and non-current)	$ 11,351	$ 11,278
Contract Liabilities (Deferred Revenue current and non-current)	$ 41,531	$ 44,305

Contract assets relate primarily to multi-year term license arrangements and the remaining contractual billings. These contract assets are transferred to receivables when the right to billing occurs, which is normally over 3-5 years. The contract liabilities primarily relate to the advance consideration received from customers for subscription and maintenance services. Revenue is recognized for these services over time.

As a practical expedient, we do not adjust the promised amount of consideration for the effects of a significant financing component when we expect, at contract inception, that the period between our transfer of a promised product or service to a customer and when the customer pays for that product or service will be one year or less. We do not typically include extended payment terms in our contracts with customers.

Revenue recognized during the nine months ended September 30, 2019 included $26.4 million that was included on the December 31, 2018 balance sheet in contract liabilities. Deferred revenue decreased in the same period due to timing of annual renewals.

Transaction price allocated to the remaining performance obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) at the end of the reporting period.

in thousands	2019	2020	2021	Beyond 2021	Total
Future revenue related to current unsatisfied performance obligations	$ 3,401	10,226	$ 6,468	$ 14,507	$ 34,602

The Company applies practical expedients and does not disclose information about remaining performance obligations (a) that have original expected durations of one year or less, or (b) where revenue is recognized as invoiced.

Costs of obtaining a contract

The Company incurs incremental costs related to commissions, which can be directly tied to obtaining a contract. The Company capitalizes commissions associated with certain new contracts and amortizes the costs over a period of benefit based on the transfer of goods or services that we have determined to be up to seven years. The Amortization is reflected in Sales and Marketing in the Statements of Operations. We determined the period of benefit by taking into consideration our customer contracts, our technology and other factors, including customer attrition. Commissions are earned upon invoicing to the customer. For contracts with multiple year payment terms, as the commissions that are payable after year 1 are payable based on continued employment, they are expensed when incurred. Commissions and amortization expense are included in Sales and Marketing expenses on the consolidated statements of operations.

Applying the practical expedient, the Company recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period for the assets that the Company otherwise would have recognized is one year or less. These costs are included in Sales and Marketing expense in the consolidated statements of operations.

The following tables provide information related to the capitalized costs and amortization recognized in the current and prior periods:

in thousands	September 30, 2019	December 31, 2018
Capitalized costs to obtain contracts, current	$ 553	$ 413
Capitalized costs to obtain contracts, non-current	$ 2,648	$ 2,150

	Three months ended September 30,		Nine months ended September 30,	
in thousands	2019	2018	2019	2018
Amortization of capitalized costs to obtain contracts	$ 110	$ 85	$ 329	$ 205
Impairments of capitalized costs to obtain contracts	$ -	$ -	$ -	$ -

Note 5 – Inventories, net

Inventories, net, consisting principally of hardware and component parts, are stated at the lower of cost or net realizable value. Cost is determined using the FIFO method.

Inventories, net are comprised of the following:

	September 30, 2019	December 31, 2018
	(in thousands)	
Component parts	$ 5,841	$ 5,445
Work-in-process and finished goods	13,136	8,983
Total	$ 18,977	$ 14,428

Note 6 – Goodwill

Goodwill activity for the nine months ended September 30, 2019 consisted of the following:

in thousands	
Net balance at December 31, 2018	$ 91,841
Adjustment to provisional estimate of acquisition date fair values	1,128
Net foreign currency translation	(1,932)
Net balance at September 30, 2019	$ 91,037

Prior to the end of the measurement period during the nine months ended September 30, 2019, we recorded $1.1 million of measurement period adjustments related to the Dealflo acquisition. See note 3 – Business Acquisitions for additional detail. No impairment of goodwill was recorded during the nine months ended September 30, 2019 or September 30, 2018.

Note 7 – Intangible Assets

Intangible asset activity for the nine months ended September 30, 2019 is detailed in the following table.

in thousands	Acquired Technology	Customer Relationships	Other	Total Intangible Assets
Net balance at December 31, 2018	$ 8,795	$ 30,408	$ 6,259	$ 45,462
Net foreign currency translation	(132)	(510)	(17)	(659)
Amortization expense	(2,597)	(2,682)	(1,772)	(7,051)
Net balance at September 30, 2019	$ 6,066	$ 27,216	$ 4,470	$ 37,752
September 30, 2019 balance at cost	$ 42,012	$ 38,664	$ 13,688	$ 94,364
Accumulated amortization	(35,946)	(11,448)	(9,218)	(56,612)
Net balance at September 30, 2019	$ 6,066	$ 27,216	$ 4,470	$ 37,752

Certain intangible assets are denominated in local currencies and are subject to currency fluctuations. As a result of the Company rebranding, the value of certain intangible assets was written down, and impairment charges of $0.5 million were recorded during the nine months ended September 30, 2018.

Note 8 – Leases

As mentioned in Note 2 – Summary of Significant Accounting Policies, the Company adopted ASU 2016-02, *Leases* on January 1, 2019, using the modified retrospective approach. The adoption of this accounting standard resulted in the recording of operating lease right-of-use ("ROU") assets of $9.2 million in Operating lease right-of use assets, and operating lease liabilities of $2.5 million and $8.5 million in Other accrued expenses and Long-term lease liabilities, respectively, as of January 1, 2019, to capture the cumulative effect of the standard. The difference between the asset and liability is a result of lease incentives, such as tenant improvement allowances, and deferred rent on the balance sheet at transition.

The Company leases certain real estate and automobiles. Leases with an initial term of 12 months or less ("short-term leases") are not recorded on the unaudited consolidated balance sheet; the Company recognizes lease expense for these leases on a straight-line basis over the lease term. The Company determines if an arrangement is a lease at inception. All of our leases are operating leases.

Operating lease right-of-use ("ROU") assets and operating lease liabilities are recognized based on the present value of lease payments over the lease term at commencement date. Because most of the Company's leases do not provide an implicit rate of return, the Company uses its imputed collateralized rate based on the information available at the commencement date in determining the present value of lease payments. Operating lease ROU assets are comprised of the lease liability plus prepaid rents and are reduced by lease incentives or deferred rents. The Company has lease agreements with non-lease components which are not bifurcated.

Some of our leases include one or more options to renew, with renewal terms that can extend the lease from one to five years. The exercise of a lease renewal option typically occurs at the discretion of both parties. Certain leases also include options to purchase the leased property at fair value. For purposes of calculating operating lease liabilities, lease terms are deemed not to include options to extend the lease termination until it is reasonably certain that the Company will exercise that option. Certain of the Company's lease agreements include payments adjusted periodically for inflation based on the consumer price index. The Company's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Operating lease cost details for the three and nine months ended September 30, 2019 and 2018 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
	(in thousands)		(in thousands)	
Building rent	$ 955	$ 885	$ 2,676	$ 2,846
Automobile rentals	603	297	1,113	958
Total net operating lease costs	$ 1,558	$ 1,182	$ 3,789	$ 3,804

Short term lease costs and variable lease costs recognized during the three and nine months ended September 30, 2019 are immaterial.

Supplemental unaudited consolidated balance sheet information related to leases is as follows:

in thousands	September 30, 2019
Leases	
Assets	10,903
Operating lease assets	$ 10,903
Liabilities	
Current	
Operating lease liabilities	$ 2,924
Noncurrent	
Operating lease liabilities	11,304
Total lease liabilities	$ 14,228

The weighted average remaining lease term for our operating leases is 6.8 years. The weighted-average discount rate for our operating leases is 5.0%.

Supplemental unaudited interim consolidated cash flow information related to leases is as follows:

		Nine months ended September 30, 2019 (in $ thousands)
Supplemental cash flow and other information related to leases was as follows:		
Operating cash payments from operating leases	$	2,736
ROU assets obtained in exchange for new operating lease liabilities	$	4,262

Maturities of our operating leases are as follows:

		As of September 30, 2019 (in $ thousands)
2019 (remaining three months)	$	956
2020		3,176
2021		2,731
2022		2,269
2023		1,851
Later years		6,151
Less imputed interest		(2,906)
Total lease obligations	$	14,228

Disclosures related to periods prior to adoption of ASU 2016-02

Operating lease rent expense was $4.9 million for the year ended December 31, 2018. Future minimum lease payments under non-cancelable rental and lease agreements which had initial or remaining terms in excess of one year are as follows:

		As of December 31, 2018 (in $ thousands)
2019	$	3,817
2020		3,081
2021		2,671
2022		2,244
2023		1,941
Later years		8,870
Minimum lease commitments	$	22,624

During the year ended December 31, 2018, we entered into a new lease agreement of which a portion commenced during the three months ended September 30, 2019, and remainder will commence during the three months ended March 31, 2020. We estimated as of January 1, 2019 and September 30, 2019 that the undiscounted future minimum obligations related to the portion of the lease not yet commenced to be approximately $7.4 million and $2.0 million, respectively. The $7.4 million obligation is disclosed as part of our future minimum lease obligations table above.

Note 9 – Income Taxes

Our estimated annual tax rate for 2019 before discrete items is expected to be approximately 43%. Our global effective tax rate is higher than the U.S. statutory tax rate of 21% primarily due to forecasted losses in jurisdictions for which a valuation allowance will be required. Our ultimate tax expense will depend on the mix of earnings in various jurisdictions. Income taxes paid during the three and nine months ended September 30, 2019 was $0.7 million and $7.5 million, respectively.

At December 31, 2018, we had deferred tax assets of $24.6 million resulting from foreign and state NOL carryforwards of $132.2 million and other foreign deductible carryforwards of $37.0 million. At December 31, 2018, we had a valuation allowance of $15.2 million against deferred tax assets related to certain carryforwards.

Certain of our non-U.S. operations have incurred net operating losses (NOLs), which may become deductible to the extent these operations become profitable. For each of our operations, we evaluate whether it is more likely than not that the tax benefits related to NOLs will be realized. As part of this evaluation, we consider evidence such as tax planning strategies, historical operating results, forecasted taxable income, and recent financial performance. In the year that certain non-U.S. operations record a loss, we do not recognize a corresponding tax benefit, thus increasing our effective tax rate. Upon determining that it is more likely than not that the NOLs will be realized, we reduce the tax valuation allowances related to these NOLs, which results in a reduction to our income tax expense and our effective tax rate in the period.

Note 10 – Long-Term Compensation Plan and Stock Based Compensation (share counts in thousands)

The OneSpan Inc. 2019 Omnibus Incentive Plan ("2019 Plan") was adopted by the Board of Directors on February 1, 2019, and was approved by the stockholders on June 12, 2019. Awards were previously granted under the OneSpan Inc. 2009 Equity Incentive Plan ("2009 Plan"). The 2009 Plan terminated on December 19, 2018, and no additional securities remained for issuance.

Under the 2019 Plan, we awarded 385 shares of restricted stock during the nine months ended September 30, 2019 consisting of 248 unissued shares subject to future performance criteria and 137 issued time-based shares. The market value of the 137 issued restricted shares was $2.0 million at the date of grant, and is being amortized over the vesting period of one to four years. The market value of the 248 unissued shares subject to performance criteria was $3.6 million at the date of grant, and is being amortized over the vesting period of three years.

The following table details long-term compensation plan and stock-based compensation expense for the three and nine months ended September 30, 2019 and 2018:

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
in thousands	(in thousands)		(in thousands)	
Restricted stock	$ 549	$ 1,107	$ 1,778	$ 2,916
Long-term compensation plan	280	526	1,538	1,467
Total compensation	$ 829	$ 1,633	$ 3,316	$ 4,383

Note 11 – Earnings per Share (share counts in thousands)

Basic earnings per share is based on the weighted average number of shares outstanding and excludes the dilutive effect of common stock equivalents. Diluted earnings per share is based on the weighted average number of shares outstanding and includes the dilutive effect of common stock equivalents to the extent they are not anti-dilutive. For the three and nine months ended September 30, 2019, the anti-dilutive effect of our securities is immaterial. Because the Company is in a net loss position for the three and nine months ended September 30, 2018, diluted net loss per share for these periods exclude the effects of common stock equivalents, which are anti-dilutive.

The details of the earnings per share calculations for the three and nine months ended September 30, 2019 and 2018 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
in thousands, except per share data	**2019**	**2018**	**2019**	**2018**
Net income (loss)	$ 11,872	$ (908)	$ 3,739	$ (118)
Weighted average common shares outstanding:				
Basic	40,062	39,922	40,037	39,924
Incremental shares with dilutive effect:				
Restricted stock awards	67	—	62	—
Diluted	40,129	39,922	40,099	39,924
Net income (loss) per share:				
Basic	$ 0.30	$ (0.02)	$ 0.09	$ (0.00)
Diluted	$ 0.30	$ (0.02)	$ 0.09	$ (0.00)

Note 12 – Legal Proceedings and Contingencies

We are a party to or have intellectual property subject to litigation and other proceedings that arise in the ordinary course of our business. These types of matters could result in fines, penalties, compensatory or treble damages or non-monetary sanctions or relief. We believe the probability is remote that the outcome of each of these matters, including the legal proceedings described below, will have a material adverse effect on the corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our financial results in any particular interim reporting period. Among the factors that we consider in this assessment are the nature of existing legal proceedings and claims, the asserted or possible damages or loss contingency (if estimable), the progress of the case, existing law and precedent, the opinions or views of legal counsel and other advisers, our experience in similar cases and the experience of other companies, the facts available to us at the time of assessment and how we intend to respond to the proceeding or claim. Our assessment of these factors may change over time as individual proceedings or claims progress.

Although we cannot predict the outcome of legal or other proceedings with certainty, where there is at least a reasonable possibility that a loss may have been incurred, U.S. GAAP requires us to disclose an estimate of the reasonably possible loss or range of loss or make a statement that such an estimate cannot be made. We follow a process in which we seek to estimate the reasonably possible loss or range of loss, and only if we are unable to make such an estimate do we conclude and disclose that an estimate cannot be made. Accordingly, unless otherwise indicated below in our discussion of legal proceedings, a reasonably possible loss or range of loss associated with any individual legal proceeding cannot be estimated.

We include various types of indemnification clauses in our agreements. These indemnifications may include, but are not limited to, infringement claims related to our intellectual property, direct damages and consequential damages. The type and amount of such indemnifications vary substantially based on our assessment of risk and reward associated with each agreement. We believe the estimated fair value of these indemnification clauses is minimal, and we cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions. We have no liabilities recorded for these clauses as of September 30, 2019.

On March 14, 2017, a complaint was filed in the United States District Court for the District of Massachusetts, captioned StrikeForce Technologies, Inc. v. Vasco Data Security International, Inc., et al., claiming the Company infringed on certain patent rights of the plaintiff. On May 8, 2017, the Company answered the complaint denying the allegations of patent infringement. The parties then engaged in motion practice and discovery in the case. The plaintiff has also brought suit against various other companies in the cybersecurity industry. In one such suit in the federal district court for the Central District of California, on December 1, 2017, the court granted defendant's motion to dismiss, finding that the StrikeForce asserted claims are invalid. StrikeForce appealed such decision. In light of such ruling, on December 20, 2017, the court in the Company's case granted a stay of the proceedings pending the appeal in the related case. On April 16, 2019, the Court dismissed the claims of StrikeForce against us with prejudice. We consider this case to be closed.

From time to time, we have been involved in the litigation incidental to the conduct of our business. Excluding matters disclosed above, we are not a party to any lawsuit or proceeding that, in management's opinion, is likely to have a material adverse effect on its business, financial condition or results of operations.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations (in thousands, except headcount, ratios, time periods and percentages)

Unless otherwise noted, references in this Quarterly Report on Form 10-Q to "OneSpan," "Company," "we," "our," and "us" refer to OneSpan Inc. and its subsidiaries.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, contains forward-looking statements within the meaning of applicable U.S. Securities laws, including statements regarding the potential benefits, performance, and functionality of our products and solutions, including future offerings; our expectations, beliefs, plans, operations and strategies relating to our business and the future of our business; our acquisitions to date and our strategy related to future acquisitions; and our expectations regarding our financial performance in the future. Forward-looking statements may be identified by words such as "seek", "believe", "plan", "estimate", "anticipate", expect", "intend", and statements that an event or result "may", "will", "should", "could", or "might" occur or be achieved and any other similar expressions. These forward-looking statements involve risks and uncertainties, as well as assumptions which, if they do not fully materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Factors that could materially affect our business and financial results include, but are not limited to: market acceptance of our products and solutions and competitors' offerings; the potential effects of technological changes; our ability to effectively identify, purchase and integrate acquisitions; the execution of our transformative strategy on a global scale; the increasing frequency and sophistication of hacking attacks; claims that we have infringed the intellectual property rights of others; changes in customer requirements; price competitive bidding; changing laws, government regulations or policies; pressures on price levels; investments in new products or businesses that may not achieve expected returns; impairment of goodwill or amortizable intangible assets causing a significant charge to earnings; exposure to increased economic and operational uncertainties from operating a global business as well as those factors set forth in our Form 10-K (and other forms) filed with the Securities and Exchange Commission. In particular, we direct you to the risk factors contained under the captions "*Risk Factors*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" in our Form 10-K. In addition, we direct you to our financial statements and the accompanying Notes to Financial Statements contained in this Report. Our SEC filings and other important information can be found on the Investor Relations section of our website at *ir.onespan.com*. We do not have any intent, and disclaim any obligation, to update the forward-looking information to reflect events that occur, circumstances that exist, or changes in our expectations after the date of this Report.

Overview

We design, develop and market digital solutions for identity, security, and business productivity that protect and facilitate electronic transactions via mobile and connected devices. We are a global leader in providing anti-fraud and digital transaction management solutions to financial institutions and other businesses. Our solutions secure access to online accounts, data, assets, and applications for global enterprises; provide tools for application developers to easily integrate security functions into their web-based and mobile applications; and facilitate end-to-end financial agreement automation including digital identity verification, customer due diligence, electronic signature, secure storage and document management. Our core technologies, multi-factor authentication, identity verification and transaction signing, strengthen the process of preventing hacking attacks against online and mobile transactions to allow companies to transact business safely with remote customers.

We offer cloud based and on premises solutions using both open standards and proprietary technologies. Some of our proprietary technologies are patented. Our products and services are used for authentication, fraud mitigation, e-signing transactions and documents, and identity management in Business-to-Business ("B2B"), Business-to-Employee ("B2E") and Business-to-Consumer ("B2C") environments. Our target market is business processes using electronic interface, particularly the Internet, where there is risk of unauthorized access. Our products can increase security associated with accessing business processes, reduce losses from unauthorized access and reduce the cost of the process by automating activities previously performed manually.

Our Business Model

We offer our products through a product sales and licensing model or through our services platform, which includes our cloud-based service offering.

Our solutions are sold worldwide through our direct sales force, as well as through distributors, resellers, systems integrators, and original equipment manufacturers. Our sales force is able to offer customers a choice of an on-site implementation using our traditional on-premises model or a cloud implementation for some solutions using our services platform.

Industry Growth

We believe the markets for authentication, fraud mitigation, agreement automation, and electronic signature solutions will continue to grow driven by new government regulations, growing awareness of the impact of cyber-crime, increasing focus on the digital experience for mobile and online users, and the growth in electronic commerce. The issues driving growth are global; however, the rate of adoption in each country is a function of local culture, competitive position, economic conditions, and the use of technology may vary significantly.

Economic Conditions

Our revenue may vary significantly with changes in the economic conditions in the countries in which we currently sell products. With our current concentration of revenue in Europe and specifically in the banking and finance vertical market, significant changes in the economic outlook for the European banking market may have a significant effect on our revenue.

Cybersecurity Risks

Our use of technology is increasing and is critical in three primary areas of our business:

1. Software and information systems that we use to help us run our business more efficiently and cost effectively;
2. The products we have traditionally sold and continue to sell to our customers for integration into their software applications contain technology that incorporates the use of secret numbers and encryption technology; and
3. New products and services that we introduced to the market are focused on processing information through our servers or in the cloud.

We believe that the risks and consequences of potential incidents in each of the above areas are different.

In the case of the information systems we use to help us run our business, we believe that an incident could disrupt our ability to take orders or deliver product to our customers, but such a delay in these activities would not have a material impact on our overall results. To minimize this risk, we actively use various forms of security and monitor the use of our systems regularly to detect potential incidents as soon as possible.

In the case of products that we have traditionally sold, we believe that the risk of a potential cyber incident is minimal. We offer our customers the ability to either create the secret numbers themselves or have us create the numbers on their behalf. When asked to create the numbers, we do so in a secure environment with limited physical access and store the numbers on a system that is not connected to any other network, including other OneSpan networks, and similarly, is not connected to the Internet.

In the case of our cloud-based solutions, which involve the processing of customer information, we believe a cyber incident could have a material impact on our business. While our revenue from cloud-based solutions comprises a minority of our revenue today, we believe that these solutions will provide substantial future growth. A cyber incident involving these solutions in the future could substantially impair our ability to grow the business and we could suffer significant monetary and other losses and significant reputational harm.

To minimize the risk, we review our product security and procedures on a regular basis. Our reviews include the processes and software code we are currently using as well as the hosting platforms and procedures that we employ. We mitigate the risk of cyber incidents through a series of reviews, tests, tools and training. Certain insurance coverages may apply to certain cyber incidents. Overall, we expect the cost of securing our networks will increase in future periods, whether through increased staff, systems or insurance coverage.

While we did not experience any cyber incidents in the first nine months of 2019 that had a significant impact on our business, it is possible that we could experience an incident in 2019 or future years, which could result in unanticipated costs.

Currency Fluctuation

During the three and nine months ended September 30, 2019, approximately 80% and 77%, respectively, of our revenue was generated outside of the United States. While the majority of our revenues are generated outside of the United States, the majority of our revenue earned during the three months and nine months ended September 30, 2019 was denominated in U.S. Dollars. During the three and nine months ended September 30, 2019, we estimate that approximately 64% and 65%, respectively, of our revenue was denominated in U.S. Dollars.

In addition, during the three and nine months ended September 30, 2019, approximately 72% and 73%, respectively, of our operating expenses were incurred outside of the United States. As a result, changes in currency exchange rates, especially the Euro exchange rate and the Canadian Dollar exchange rate, can have a significant impact on revenue and expenses.

In general, to minimize the net impact of currency fluctuations on operating income, we attempt to denominate an amount of billings in a currency such that it would provide a hedge against the operating expenses incurred in that currency. We expect that changes in currency rates may also impact our future results if we are unable to match amounts of revenue with our operating expenses in the same currency. If the amount of our revenue in Europe denominated in Euros continues as it is now or declines, we may not be able to balance fully the exposures of currency exchange rates on revenue and operating expenses.

The financial position and the results of operations of our foreign subsidiaries, with the exception of our subsidiaries in Switzerland, Singapore and Canada, are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. Dollars using current exchange rates as of the balance sheet date. Revenues and expenses are translated at average exchange rates prevailing during the period. Translation adjustments arising from differences in exchange rates generated other comprehensive loss of $3.0 million and $3.5 million for the three and nine months ended September 30, 2019, respectively, and other comprehensive loss of $1.2 million and $3.3 million for the three and nine months ended September 30, 2018, respectively. These amounts are included as a separate component of stockholders' equity. The functional currency for our subsidiaries in Switzerland, Singapore and Canada is the U.S. Dollar.

Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations in other income (expense), net. Foreign exchange transaction losses aggregated $1.9 million for the three months ended September 30, 2019, compared to losses of $0.1 million for the three months ended September 30, 2018. During the nine months ended September 30, 2019, foreign exchange transaction losses aggregated $2.6 million, compared to losses aggregated of $0.2 million during the nine months ended September 30, 2018.

Components of Operating Results

Revenue

We generate revenue from the sale of our hardware products, software licenses, subscriptions, maintenance and support, and professional services. We believe comparison of revenues between periods is heavily influenced by the timing of orders and shipments reflecting the transactional nature of significant parts of our business.

- *Product* and *license revenue*. Product and license revenue includes hardware products and software licenses.
- *Service and other revenue*. Service and other revenue includes subscription solutions (which is our definition of software-as-a-service solutions), maintenance and support, and professional services.

Cost of Goods Sold

Our total cost of goods sold consists of cost of product and license revenue and cost of service and other revenue. We expect our cost of goods sold to increase in absolute dollars as our business grows, although it may fluctuate as a percentage of total revenue from period to period.

- *Cost of product and license revenue*. Cost of product and license revenue primarily consists of direct product and license costs.
- *Cost of service and other revenue*. Cost of service and other revenue primarily consists of costs related to subscription solutions, including personnel and equipment costs, and personnel costs of employees providing professional services and maintenance and support.

Gross Profit

Gross profit as a percentage of total revenue, or gross margin, has been and will continue to be affected by a variety of factors, including our average selling price, manufacturing costs, the mix of products sold, and the mix of revenue among products, subscriptions and services. We expect our gross margins to fluctuate over time depending on these factors.

Operating Expenses

Our operating expenses are generally based on anticipated revenue levels and fixed over short periods of time. As a result, small variations in revenue may cause significant variations in the period-to-period comparisons of operating income or operating income as a percentage of revenue.

Generally, the most significant factor driving our operating expenses is headcount. Direct compensation and benefit plan expenses generally represent between 60% and 65% of our operating expenses, respectively. In addition, a number of other expense categories are directly related to headcount. We attempt to manage our headcount within the context of the economic environments in which we operate and the investments we believe we need to make for our infrastructure to support future growth and for our products to remain competitive.

Historically, operating expenses have been impacted by changes in foreign exchange rates. We estimate the change in currency rates in the first nine months of 2019 compared to the same period in 2018 resulted in a decrease in operating expenses of approximately $2.8 million.

The comparison of operating expenses can also be impacted significantly by costs related to our stock-based and long-term incentive plans. Operating expenses for the three and nine months ended September 30, 2019 included $0.8 million and $3.3 million, respectively, of expenses related to long-term incentive plan costs compared to $1.6 million and $4.4 million of long-term incentive plan costs for the three and nine months ended September 30, 2018, respectively.

- *Sales and marketing*. Sales and marketing expenses consist primarily of personnel costs, commissions and bonuses, trade shows, marketing programs and other marketing activities, travel, outside consulting costs, and long-term incentive compensation. We expect sales and marketing expenses to increase in absolute dollars as we continue to invest in sales resources in key focus areas, although our sales and marketing expenses may fluctuate as a percentage of total revenue.
- *Research and development*. Research and development expenses consist primarily of personnel costs and long-term incentive compensation. We expect research and development expenses to increase in absolute dollars as we continue to invest in our future solutions, although our research and development expenses may fluctuate as a percentage of total revenue.
- *General and administrative*. General and administrative expenses consist primarily of personnel costs, legal and other professional fees, and long term incentive compensation. We expect general and administrative expenses to increase in absolute dollars although our general and administrative expenses may fluctuate as a percentage of total revenue.
- *Amortization and impairment of intangible assets*. Acquired intangible assets are amortized over their respective amortization periods, and are periodically evaluated for impairment.

Interest Income, Net

Interest income, net consists of income earned on our cash equivalents and short term investments. Our cash equivalents and short term investments are invested in short-term instruments at current market rates.

Other Income (Expense), Net

Other income (expense), net primarily includes exchange gains (losses) on transactions that are denominated in currencies other than our subsidiaries' functional currencies, subsidies received from foreign governments in support of our research and development in those countries and other miscellaneous non-operational expenses.

Income Taxes

Our effective tax rate reflects our global structure related to the ownership of our intellectual property ("IP"). All our IP in our traditional authentication business is owned by two subsidiaries, one in the U.S. and one in Switzerland. These two subsidiaries have entered into agreements with most of the other OneSpan entities under which those other entities provide services to our U.S. and Swiss subsidiaries on either a percentage of revenue or on a cost plus basis or both. Under this structure, the earnings of our service provider subsidiaries are relatively constant. These service provider companies tend to be in jurisdictions with higher effective tax rates. Fluctuations in earnings tend to flow to the U.S. company and Swiss company. In 2019, earnings flowing to the U.S. company are expected to be taxed at a rate of 21% to 25%, while earnings flowing to the Swiss company are expected to be taxed at a rate ranging from 11% to 12%. A Canadian and UK subsidiary currently sell and service global customers directly.

As the majority of our revenues are generated outside of the U.S., our consolidated effective tax rate is strongly influenced by the effective tax rate of our foreign operations. Changes in the effective rate related to foreign operations reflect changes in the geographic mix of earnings and the tax rates in each of the countries in which it is earned. The statutory tax rate for the primary foreign tax jurisdictions ranges from 11% to 35%.

The geographic mix of earnings of our foreign subsidiaries primarily depends on the level of pretax income of our service provider subsidiaries and the benefit realized in Switzerland through the sales of product. The level of pretax income in our service provider subsidiaries is expected to vary based on:

1. the staff, programs and services offered on a yearly basis by the various subsidiaries as determined by management, or

2. the changes in exchange rates related to the currencies in the service provider subsidiaries, or

3. the amount of revenues that the service provider subsidiaries generate.

For items 1 and 2 above, there is a direct impact in the opposite direction on earnings of the U.S. and Swiss entities. Any change from item 3 is generally expected to result in a larger change in income in the U.S. and Swiss entities in the direction of the change (increased revenues expected to result in increased margins/pretax profits and conversely decreased revenues expected to result in decreased margins/pretax profits).

In addition to the provision of services, the intercompany agreements transfer the majority of the business risk to our U.S. and Swiss subsidiaries. As a result, the contracting subsidiaries’ pretax income is reasonably assured while the pretax income of the U.S. and Swiss subsidiaries varies directly with our overall success in the market.

In November 2015, we acquired OneSpan Canada Inc. (formerly eSignLive), a foreign company with substantial IP and net operating losses and other tax carryforwards. The tax benefit of the carryforwards has been fully reserved as realization has not been deemed more likely than not.

In May 2018, we acquired Dealflo Limited (“Dealflo”), a foreign company with substantial IP and net operating losses. The tax benefit of the loss carryforwards will be reserved to the extent they exceed the deferred tax liabilities recognized upon acquisition as realization has not been deemed more likely than not.

Results of Operations

Revenue

Revenue by Product: We generate revenue from the sale of our hardware products, software licenses, subscriptions, professional services, and maintenance and support. Product and license revenue includes hardware products and software licenses. Service and other revenue includes subscription solutions (which is our definition of software-as-a-service solutions), maintenance and support, and professional services.

	Three months ended September 30,			Nine months ended September 30,		
	2019	2018	% Change	2019	2018	% Change
	(in thousands)			(in thousands)		
Revenue						
Product and license	$ 61,181	$ 36,882	66%	$ 133,159	$ 105,362	26%
Services and other	18,544	15,613	19%	50,408	42,119	20%
Total revenue	$ 79,725	$ 52,495	52%	$ 183,567	$ 147,481	24%
% of Total Revenue						
Product and license	77%	70%		73%	71%	
Services and other	23%	30%		27%	29%	

Total revenue increased $27.2 million or 52%, during the three months ended September 30, 2019 compared to the three months ended September 30, 2018. For the nine months ended September 30, 2019, total revenue increased $36.1 million or 24% compared to the nine months ended September 30, 2018.

Product and license revenue increased by $24.3 million or 66% during the three months ended September 30, 2019 compared to the three months ended September 30, 2018, which was driven by higher sales of both hardware products and software licenses. For the nine months ended September 30, 2019, product and license revenue increased $27.8 million or 26% compared to the nine months ended September 30, 2018. The increase in product and license revenue for the nine month period ended September 30, 2019 is driven primarily by an increase in hardware product revenue.

Services and other revenue increased by $2.9 million, or 19% during the three months ended September 30, 2019 compared to the three months ended September 30, 2018. For the nine months ended September 30, 2019, services and other revenue increased $8.3 million or 20% compared to the nine months ended September 30, 2018. The increase for both the three and nine months periods ended September 30, 2019 compared to the same periods in 2018 was due to higher subscription and maintenance revenue.

We believe comparison of revenues between periods is heavily influenced by the timing of orders and shipments reflecting the transactional nature of significant parts of our business. As a result of the volatility in our business, we believe that the overall strength of our business is best evaluated over a longer term where the impact of transactions in any given period is not as significant as in a quarter-over-quarter comparison.

Revenue by Geographic Regions: We classify our sales by customer location in three geographic regions: 1) EMEA, which includes Europe, Middle East and Africa; 2) the Americas, which includes sales in North, Central, and

South America; and 3) Asia Pacific (APAC), which also includes Australia, New Zealand, and India. The breakdown of revenue in each of our major geographic areas was as follows:

	Three months ended September 30,			Nine months ended September 30,		
	2019	2018	% Change	2019	2018	% Change
	(in thousands)			(in thousands)		
Revenue						
EMEA	$ 48,728	$ 25,281	93%	$ 108,168	$ 65,148	66%
Americas	15,605	11,055	41%	42,762	40,246	6%
APAC	15,392	16,159	-5%	32,637	42,087	-22%
Total revenue	$ 79,725	$ 52,495	52%	$ 183,567	$ 147,481	24%
% of Total Revenue						
EMEA	61%	48%		59%	44%	
Americas	20%	21%		23%	27%	
APAC	19%	31%		18%	29%	

Revenue generated in EMEA during the three months ended September 30, 2019 was $23.4 million, or 93% higher than the three months ended September 30, 2018, driven by higher hardware sales, higher software license sales, and maintenance revenue. For the nine months ended September 30, 2019, revenue generated in EMEA was $43.0 million or 66% higher than the same period in 2018. The increase in revenue for both periods is driven by higher hardware and maintenance revenue.

Revenue generated in the Americas during the three months ended September 30, 2019 was $4.6 million, or 41% higher than the three months ended September 30, 2018, driven by an increase in software and maintenance revenue. For the nine months ended September 30, 2019, revenue generated in the Americas was $2.5 million, or 6% higher than the same period in 2018. The increase for the nine months ended September 30, 2019 compared to the same period in 2018 was driven by an increase in software license revenue.

Revenue generated in the Asia Pacific region during the three months ended September 30, 2019 was $0.8 million, or 5% lower than the three months ended September 30, 2018, driven by lower hardware revenue. For the nine months ended September 30, 2019, revenue generated in the Asia Pacific Region was $9.5 million, or 22% lower than the same period in 2018, driven by lower software, maintenance, and hardware revenue.

Cost of Goods Sold and Gross Margin

	Three months ended September 30,			Nine months ended September 30,		
	2019	2018	% Change	2019	2018	% Change
	(in thousands)			(in thousands)		
Cost of goods sold						
Product and license	$ 22,199	$ 14,321	55%	$ 46,966	$ 32,897	43%
Services and other	4,470	3,631	23%	13,622	9,363	45%
Total cost of goods sold	$ 26,669	$ 17,952	49%	$ 60,588	$ 42,260	43%
Gross profit	$ 53,056	$ 34,543	54%	$ 122,979	$ 105,221	17%
Gross margin						
Product and license	64%	61%		65%	69%	
Services and other	76%	77%		73%	78%	
Total gross margin	67%	66%		67%	71%	

The cost of product and license revenue increased $7.9 million, or 55% during the three months ended September 30, 2019 compared to the three months ended September 30, 2018. During the nine months ended September 30, 2019, the cost of product and license revenue increased $14.1 million or 43% compared to the nine months ended September 30, 2018. The increase in cost of product and license during both periods was due to higher token costs, driven by higher hardware sales as a percentage of total revenue.

The cost of services and other revenue increased by $0.8 million, or 23% during the three months ended September 30, 2019 compared to the three months ended September 30, 2018. During the nine months ended September 30, 2019 the cost of services and other revenue increased by $4.3 million or 45% compared to the nine months ended September 30, 2018. The increase in cost of services and other revenue during both periods is reflective of higher subscription revenue, which has increased cloud-based infrastructure costs.

Gross profit increased $18.5 million, or 54% during the three months ended September 30, 2019 compared to the three months ended September 30, 2018. During the nine months ended September 30, 2019 gross profit increased by $17.8 million, or 17% compared to the nine months ended September 30, 2018. Gross profit margin was 67% and 67% for the three and nine months ended September 30, 2019, respectively, compared to 66% and 71% for the three and nine months ended September 30, 2018, respectively. The overall decrease in profit margins for the nine months ended September 30, 2019 was driven by both lower product and license margins, as well as lower services and other margins compared to the comparable periods in the prior year.

The majority of our inventory purchases are denominated in U.S. Dollars. Our sales are denominated in various currencies including the Euro. The impact of changes in currency rates are estimated to have decreased revenue by approximately $2.4 million and $6.4 million for the three and nine months ended September 30, 2019, respectively. Had currency rates in 2019 been equal to rates in 2018, the gross profit margin would have been approximately 3.0 percentage points and 3.5 percentage points higher for the three and nine months ended September 30, 2019, respectively.

Operating Expenses

	Three months ended September 30,			Nine months ended September 30,		
	2019	2018	% Change	2019	2018	% Change
	(in thousands)			(in thousands)		
Operating costs						
Sales and marketing	$ 14,156	$ 16,039	-12%	$ 44,579	$ 46,938	-5%
Research and development	9,956	8,992	11%	32,428	22,805	42%
General and administrative	9,490	10,184	-7%	29,540	32,168	-8%
Amortization / impairment of intangible assets	2,335	2,442	-4%	7,051	7,387	-5%
Total operating costs	$ 35,937	$ 37,657	-5%	$ 113,598	$ 109,298	4%

Sales and Marketing Expenses

Sales and marketing expenses for the three months ended September 30, 2019 were $14.2 million, a decrease of $1.9 million, or 12%, from the three months ended September 30, 2018. Sales and marketing expenses for the nine months ended September 30, 2019, were $44.6 million, a decrease of $2.4 million, or 5%, from the same period of 2018. The decrease in expense for the three and nine months ended September 30, 2019 compared to the same periods in 2018 was primarily attributable to lower headcount and rebranding costs of $0.5 million incurred during the nine months ended September 30, 2018.

Average full-time sales, marketing, support, and operating employee headcount for the three and nine months ended September 30, 2019 was 318 and 319, respectively, compared to 352 and 332 for the three and nine months ended September 30, 2018, respectively. Headcount was 10% and 4% lower for the three and nine months ended September 30, 2019, respectively, compared to the same periods in 2018.

Research and Development Expenses

Research and development expenses for the three months ended September 30, 2019, were $10.0 million, an increase of $1.0 million, or 11%, from the three months ended September 30, 2018. Research and development costs for the nine months ended September 30, 2019 were $32.4 million, an increase of $9.6 million, or 42%, from the same period of 2018. The increases in expense for both the three and nine month periods ended September 30, 2019 were primarily driven by higher employee headcount.

Average full-time research and development employee headcount for the three and nine months ended September 30, 2019 was 304 and 301, respectively, compared to 277 and 236 for the three and nine months ended September 30, 2018, respectively. Average headcount was approximately 10% and 27% higher for the three and nine months ended September 30, 2019, respectively, when compared to the same periods in 2018.

General and Administrative Expenses

General and administrative expenses for the three months ended September 30, 2019, were $9.5 million, a decrease of $0.7 million, or 7%, from the three months ended September 30, 2018. General and administrative expenses for the nine months ended September 30, 2019, were $29.5 million, a decrease of $2.6 million, or 8%, compared to the same period of 2018. The decrease in general and administrative expenses for the three months ended September 30, 2019, compared to the same period in 2018 was primarily driven by lower personnel costs. The decrease in general and administrative expense for the nine months ended September 30, 2019, compared to the same period in 2018 was driven primarily by lower personnel costs, due to turnover of higher paid employees, and by professional costs incurred during 2018 for the acquisition of Dealflo.

Average full-time general and administrative employee headcount for the three and nine months ended September 30, 2019 was 115 and 112, compared to 108 and 103 for the three and nine months ended September 30, 2018, respectively. Average headcount was approximately 6% and 9% higher for the three and nine months ended September 30, 2019, respectively, when compared to the same periods in 2018.

Amortization / impairment of Intangible Assets

Amortization / impairment of intangible assets for the three and nine months ended September 30, 2019 was $2.3 million and $7.1 million, respectively, a decrease of $0.1 million or 4% and $0.3 million or 5% from the comparable periods in 2018. The decrease in amortization / impairment expense for the nine month periods ended September 30, 2019 was driven by expense recognized during the nine months ended September 30, 2018 for assets that were considered impaired as a result of the rebranding.

Interest Income, net

	Three months ended September 30,			Nine months ended September 30,		
	2019	2018	% Change	2019	2018	% Change
	(in thousands)			(in thousands)		
Interest income, net	$ 228	$ 258	-12%	$ 432	$ 991	-56%

Interest income, net was $0.2 million and $0.4 million for the three and nine months ended September 30, 2019, as compared to $0.3 million and $1.0 million for the same periods in 2018. The decrease in interest income, net for both the three and nine months ended September 30, 2019 compared to the same periods in 2018 reflects both a decrease in our short term investment balance and a decrease to the average interest rate earned on our cash equivalents.

Other Income (Expense), net

	Three months ended September 30,		% Change	Nine months ended September 30,		% Change
	2019	2018		2019	2018	
	(in thousands)			(in thousands)		
Other income (expense), net	$ (1,611)	$ 246	-755%	$ (1,711)	$ 2,025	-184%

Other income (expense), net primarily includes subsidies received from foreign governments in support of our research and development in those countries, exchange gains (losses) on transactions that are denominated in currencies other than our subsidiaries' functional currencies, and other miscellaneous non-operational, non-recurring expenses.

Other income (expense), net for the three and nine months ended September 30, 2019 was $(1.6) million and $(1.7) million, respectively, compared to $0.2 million and $2.0 million for the comparable periods of 2018. The expense recognized for the nine months ended September 30, 2019 was attributable to exchange losses. Income recognized during the nine months ended September 30, 2018 was attributable to government subsidies and exchange gains.

Provision (Benefit) for Income Taxes

	Three months ended September 30,		% Change	Nine months ended September 30,		% Change
	2019	2018		2019	2018	
	(in thousands)			(in thousands)		
Provision (benefit) for income taxes	$ 3,864	$ (1,702)	-327%	$ 4,363	$ (943)	-563%

The Company recorded income tax expense for the three months ended September 30, 2019 of $3.9 million, compared to a benefit of $(1.7) million for the three months ended September 30, 2018. The increase was attributable to increased profits in the period excluding losses at entities where we cannot record a tax benefit.

The Company recorded income tax expense for the nine months ended September 30, 2019 of $4.4 million, compared to a benefit of $0.9 million for the nine months ended September 30, 2018. The increase was attributable to increased profits in the period excluding losses at entities where we cannot record a tax benefit (See Note 9 – Income Taxes). Additionally, the nine months ended September 30, 2018 included a $2.5 million favorable tax adjustment related to US tax reform.

Liquidity and Capital Resources

At September 30, 2019, we had net cash balances (total cash and cash equivalents) of $54.9 million and short-term investments of $26.4 million. Short term investments consist of U.S. treasury bills and notes, government agency notes, corporate notes and bonds, and high quality commercial paper with maturities at acquisition of more than three months and less than twelve months.

At December 31, 2018, we had net cash balances of $76.7 million and short-term investments of $22.8 million.

During the year ended December 31, 2018, we entered into a new lease agreement that required a letter of credit in the amount of $0.8 million to secure the obligation. The restricted cash related to this letter of credit is recorded in other non-current assets on the Consolidated Balance Sheet at September 30, 2019 and December 31, 2018.

Our working capital at September 30, 2019 was $126.4 million compared to $119.6 million at December 31, 2018.

As of September 30, 2019, we held $41.1 million of cash and cash equivalents in subsidiaries outside of the United States. Of that amount, $40.8 million is not subject to repatriation restrictions, but may be subject to taxes upon repatriation.

We believe that our financial resources are adequate to meet our operating needs over the next twelve months.

Our cash flows are as follows:

	Nine months ended September 30,	
	2019	2018
	(in thousands)	
Cash provided by (used in):		
Operating activities	$ (13,662)	$ (9,205)
Investing activities	(7,609)	23,525
Financing activities	(394)	(399)
Effect of foreign exchange rate changes on cash and cash equivalents	(154)	(647)

Operating Activities

Cash generated by operating activities is primarily comprised of net income, as adjusted for non-cash items, and changes in operating assets and liabilities. Non-cash adjustments consist primarily of amortization and impairment of intangible assets, depreciation of property and equipment, and stock-based compensation. We expect cash inflows from operating activities to be affected by increases or decreases in sales and timing of collections. Our primary uses of cash from operating activities have been for personnel costs. We expect cash outflows from operating activities to be affected by increases in personnel cost as we grow our business.

For the nine months ended September 30, 2019, net cash used in operating activities was $13.7 million, compared to net cash used in operating activities of $9.2 million during the nine months ended September 30, 2018. The increase is primarily driven by the timing of receivables and higher inventory purchases.

Investing Activities

The changes in cash flows from investing activities primarily relate to timing of purchases, maturities and sales of investments, purchases of property and equipment, and activity in connection with acquisitions. We expect to continue to purchase property and equipment to support the continued growth of our business as well to continue to invest in our infrastructure and activity in connection with acquisitions.

For the nine months ended September 30, 2019, net cash used in investing activities was $7.6 million, compared to net cash provided by investing activities of $23.5 million for the nine months ended September 30, 2018. The decrease is largely attributable to the maturity of $80.0 million of investments during the nine months ended September 30, 2018, offset by the $53.1 million purchase of Dealflo during the same period.

Critical Accounting Policy

Our accounting policies are fully described in Note 1 - Summary of Significant Accounting Policies, to our Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2018 and Note 2 – Summary of Significant Accounting Policies to our Interim Unaudited Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2019. We believe our most critical accounting policies include revenue recognition, purchase accounting and related fair value measurements and accounting for income taxes.

Item 3 - Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in our market risk during the nine months ended September 30, 2019. For additional information, refer to “Item 7A. Quantitative and Qualitative Disclosures about Market Risk”, included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

Item 4 - Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, who, respectively, are our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the “Exchange Act”)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure (i) the information required to be disclosed by us in our reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and (ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that due to the material weakness in our internal control over financial reporting described below and further in our Annual Report on Form 10-K for the year ended December 31, 2018, that our disclosure controls and procedures were not effective as of September 30, 2019.

Changes in Internal Controls

As discussed in Item 9A. of our Annual Report on Form 10-K for the year ended December 31, 2018, Management identified control deficiencies that constituted a material weakness in our internal control over financial reporting as of December 31, 2018.

The Company has implemented additional controls and is in the process of executing a remediation plan. Management expects remediation of the material weakness will be completed in the fiscal year 2019.

Additionally, the Company concluded the implementation of a new global enterprise resource planning (“ERP”) system during the nine months ended September 30, 2019. This ERP system has replaced our existing operating and financial systems and is designed to accurately maintain the Company’s financial records, enhance operational functionality, and provide timely information to the Company’s management team related to the operation of the business.

Subject to the foregoing, there were no changes in our internal control over financial reporting during the three months ended September 30, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on the Effectiveness of Controls

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. However, our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also 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. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

PART II. OTHER INFORMATION

Item 1 - Legal Proceedings

We are a party to or have intellectual property subject to litigation and other proceedings that arise in the ordinary course of our business. These types of matters could result in fines, penalties, compensatory or treble damages or non-monetary sanctions or relief. We believe the probability is remote that the outcome of each of these matters, including the legal proceedings described below, will have a material adverse effect on the corporation as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on our financial results in any particular interim reporting period.

We cannot predict the outcome of legal or other proceedings with certainty, including the legal proceedings which are summarized in "Note 12 – Legal Proceedings and Contingencies" included in our Notes to Condensed Consolidated Financial Statements, incorporated herein by reference, and "Note 12 – Commitments and Contingencies" in our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the U.S. Securities and Exchange Commission. Any reasonably possible loss or range of loss associated with any individual legal proceeding that can be estimated, is provided in Note 12 to Condensed Consolidated Financial Statements contained herein.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about purchases by the Company of its shares of common stock during the third quarter of 2019:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)
July 1, 2019 through July 31, 2019	7,013	$ 13.71	—	—
August 1, 2019 through August 31, 2019	3,899	14.59	—	—
September 1, 2019 through September 30, 2019	974	$ 13.38	—	—

(1.) All transactions represent surrender of vested shares in satisfaction of tax withholdings by grantees under the 2009 Equity Incentive Plan.

(2.) The Company has no publicly announced plans or programs to repurchase its shares.

Item 6 - Exhibits

Exhibit 31.1 - Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated October 29, 2019.

Exhibit 31.2 - Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated October 29, 2019.

Exhibit 32.1 - Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated October 29, 2019.

Exhibit 32.2 - Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated October 29, 2019.

Exhibit 101.INS – XBRL Instance Document

Exhibit 101.SCH – XBRL Taxonomy Extension Schema Document

Exhibit 101.CAL – XBRL Taxonomy Extension Calculation Linkbase Document

Exhibit 101.LAB – XBRL Taxonomy Extension Label Linkbase Document

Exhibit 101.PRE – XBRL Taxonomy Extension Presentation Linkbase Document

Exhibit 101.DEF – XBRL Taxonomy Extension Definition Linkbase Document

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***Certain exhibits, schedules and annexes have been omitted pursuant to Item 601(b)(2) of Regulation S-K. OneSpan undertakes to furnish copies of any such omitted items upon request by the Securities and Exchange Commission.**

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on October 30, 2019.

OneSpan Inc.

/s/ Scott Clements
Scott Clements
Chief Executive Officer
(Principal Executive Officer)

/s/ Mark S. Hoyt
Mark S. Hoyt
Chief Financial Officer
(Principal Financial Officer and Principal
Accounting Officer)

EXHIBIT 31.1

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Scott Clements, certify that:

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

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

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

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

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

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

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

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

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

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

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

Dated: October 30, 2019

/s/ Scott Clements
Scott Clements
Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Mark S. Hoyt, certify that:

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

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

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

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

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

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

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

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

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

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

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

Dated: October 30, 2019

/s/ Mark S. Hoyt
Mark S. Hoyt
Chief Financial Officer
(Principal Financial Officer and Principal
Accounting Officer)

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

I, Scott Clements, certify, based upon a review of the Quarterly Report on Form 10-Q for OneSpan Inc. for the third quarter ended September 30, 2019, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Scott Clements
Scott Clements
Chief Executive Officer

October 30, 2019

EXHIBIT 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

I, Mark S. Hoyt, certify, based upon a review of the Quarterly Report on Form 10-Q for OneSpan Inc. for the third quarter ended on September 30, 2019, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Mark S. Hoyt
Mark S. Hoyt
Chief Financial Officer

October 30, 2019