FORM S-1 · REGISTRATION STATEMENT

Digimarc Corp

IPO priced 1999-12-02 · $20.00 a share · DMRC



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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON SEPTEMBER 21, 1999 REGISTRATION NO. 333- SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 FORM S-1 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 DIGIMARC CORPORATION (EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Oregon	7370	93-1170830
(State or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

ONE CENTERPOINTE DRIVE, SUITE 500 LAKE OSWEGO, OREGON 97035-8615 (503) 968-2908 (ADDRESS AND TELEPHONE NUMBER OF PRINCIPAL EXECUTIVE OFFICES AND PRINCIPAL PLACE OF BUSINESS) BRUCE DAVIS PRESIDENT AND CHIEF EXECUTIVE OFFICER DIGIMARC CORPORATION ONE CENTERPOINTE DRIVE, SUITE 500 LAKE OSWEGO, OREGON 97035-8615 (503) 968-2908 (NAME, ADDRESS, AND TELEPHONE NUMBER OF AGENT FOR SERVICE) COPIES TO:

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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC: AS SOON AS PRACTICABLE AFTER THIS REGISTRATION STATEMENT BECOMES EFFECTIVE.

IF ANY OF THE SECURITIES BEING REGISTERED ON THIS FORM ARE TO BE OFFERED ON A DELAYED OR CONTINUOUS BASIS PURSUANT TO RULE 415 UNDER THE SECURITIES ACT OF 1933 CHECK THE FOLLOWING BOX. [_] IF THIS FORM IS FILED TO REGISTER ADDITIONAL SECURITIES FOR AN OFFERING PURSUANT TO RULE 462(B) UNDER THE SECURITIES ACT, PLEASE CHECK THE FOLLOWING BOX AND LIST THE SECURITIES ACT REGISTRATION STATEMENT NUMBER OF THE EARLIER EFFECTIVE REGISTRATION STATEMENT FOR THE SAME OFFERING. [_] IF THIS FORM IS A POST-EFFECTIVE AMENDMENT FILED PURSUANT TO RULE 462(C) UNDER THE SECURITIES ACT, CHECK THE FOLLOWING BOX AND LIST THE SECURITIES ACT REGISTRATION STATEMENT NUMBER OF THE EARLIER EFFECTIVE REGISTRATION STATEMENT FOR THE SAME OFFERING. [_] IF THIS FORM IS A POST-EFFECTIVE AMENDMENT FILED PURSUANT TO RULE 462(D) UNDER THE SECURITIES ACT, CHECK THE FOLLOWING BOX AND LIST THE SECURITIES ACT REGISTRATION NUMBER OF THE EARLIER EFFECTIVE REGISTRATION STATEMENT FOR THE SAME OFFERING. [_] IF DELIVERY OF THE PROSPECTUS IS EXPECTED TO BE MADE PURSUANT TO RULE 434, PLEASE CHECK THE FOLLOWING BOX. [_]

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price(1)(2)	Amount of Registration Fee
COMMON STOCK, $0.001 PAR VALUE PER SHARE	$35,000,000	$9,730

(1) INCLUDES SHARES OF COMMON STOCK WHICH MAY BE PURCHASED BY THE UNDERWRITERS TO COVER OVER-ALLOTMENTS, IF ANY. (2) ESTIMATED SOLELY FOR THE PURPOSE OF DETERMINING THE REGISTRATION FEE IN ACCORDANCE WITH RULE 457(O) UNDER THE SECURITIES ACT OF 1933. THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT THAT SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

++ +THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY + +NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE + +SECURITIES AND

EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN + +OFFER TO SELL THESE SECURITIES, AND WE ARE NOT SOLICITING OFFERS TO BUY THESE + +SECURITIES, IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED. +

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SUBJECT TO COMPLETION, DATED SEPTEMBER 21, 1999 DIGIMARC CORPORATION [LOGO] SHARES COMMON STOCK

Digimarc Corporation is offering shares of its common stock. This is Digimarc's initial public offering and no public market currently exists for its shares. We have applied to list our common stock on the Nasdaq National Market under the symbol "DMRC." We anticipate that the initial public offering price will be between $ and $ per share.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS. SEE "RISK FACTORS" BEGINNING ON PAGE 4.

	PER SHARE	TOTAL
Public Offering Price	$	$
Underwriting Discounts and Commissions	$	$
Proceeds to Digimarc	$	$

THE SECURITIES AND EXCHANGE COMMISSION AND STATE SECURITIES REGULATORS HAVE NOT APPROVED OR DISAPPROVED THESE SECURITIES, OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

DIGIMARC HAS GRANTED THE UNDERWRITERS A 30-DAY OPTION TO PURCHASE UP TO AN ADDITIONAL SHARES OF COMMON STOCK TO COVER ANY OVER-ALLOTMENTS.

BANCBOSTON ROBERTSON STEPHENS HAMBRECHT & QUIST U.S. BANCORP PIPER JAFFRAY THE DATE OF THIS PROSPECTUS IS , 1999.

[THE DIGIMARC CORPORATION LOGO WITH THE TEXT "DIGITAL WATERMARKING."]

[OUR B'DOOP TRADEMARK WITH A PHOTOGRAPH OF AN INDIVIDUAL USING OUR B'DOOP APPLICATION THAT INCLUDES THE FOLLOWING TEXT: "BRIDGING TRADITIONAL AND ONLINE MARKETING," "PUBLISHED MATERIALS BECOME PORTALS TO THE INTERNET."]

YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED IN THIS PROSPECTUS. WE HAVE NOT AUTHORIZED ANYONE TO PROVIDE YOU WITH INFORMATION DIFFERENT FROM THAT CONTAINED IN THIS PROSPECTUS. WE ARE OFFERING TO SELL, AND SEEKING OFFERS TO BUY, SHARES OF COMMON STOCK ONLY IN JURISDICTIONS WHERE OFFERS AND SALES ARE PERMITTED. THE INFORMATION CONTAINED IN THIS PROSPECTUS IS ACCURATE ONLY AS OF THE DATE OF THIS PROSPECTUS, REGARDLESS OF THE TIME OF DELIVERY OF THIS PROSPECTUS OR OF ANY SALE OF OUR COMMON STOCK. IN THIS PROSPECTUS, REFERENCES TO "DIGIMARC," "WE," "OUR" AND "US" REFER TO DIGIMARC CORPORATION.

UNTIL , 1999, ALL DEALERS THAT BUY, SELL OR TRADE OUR COMMON STOCK, WHETHER OR NOT PARTICIPATING IN THIS OFFERING, MAY BE REQUIRED TO DELIVER A PROSPECTUS. THIS REQUIREMENT IS IN ADDITION TO THE DEALERS' OBLIGATION TO DELIVER A PROSPECTUS WHEN ACTING AS UNDERWRITERS AND WITH RESPECT TO THEIR UNSOLD ALLOTMENTS OR SUBSCRIPTIONS.

Table of Contents

Page

Summary..... 1 Risk Factors..... 4 You Should Not Rely on Forward-Looking Statements Because They Are Inherently Uncertain..... 14 Use of Proceeds..... 15 Dividend Policy..... 15 Dilution..... 16 Capitalization..... 17 Selected Financial Data.....

18 Management's Discussion and Analysis of Financial Condition and Results of Operations..... 19 Business..... 31 Management..... 46 Related Party Transactions..... 56 Principal Stockholders..... 58 Description of Capital Stock..... 60 Shares Eligible for Future Sale..... 64 Underwriting..... 66 Legal Matters..... 68 Experts..... 68 Where You Can Find Additional Information..... 69 Index to Financial Statements..... F-1 "Digimarc" and "MarcSpider" are registered trademarks, and "Paper-as-Portal," "MarcCentre" and "b'doop" are trademarks, of Digimarc Corporation. This prospectus also contains other product names, trade names and trademarks of Digimarc Corporation and of other organizations.

Summary

You should read the following summary together with the more detailed information in this prospectus, including risk factors, regarding our company and the common stock being sold in this offering.

Digimarc Corporation

Digimarc is a leading provider of patented digital watermarking technologies that allow imperceptible digital code to be embedded in traditional and digital content, including movies, photographic or artistic images and valuable documents such as financial instruments, passports and event tickets. Our technologies enable new communications capabilities related to protecting copyrights, deterring counterfeiting or piracy and, for the first time, directly linking physical content with the Internet.

Digimarc has been awarded a multi-year contract by a consortium of leading central banks to develop a system to deter the use of personal computers in the counterfeiting of currency. We are also using our technologies to develop products we call Paper-as-Portal applications, the first of which, named b'doop, is planned for release in the second half of 2000. This application is intended to enable imperceptible digital code to be embedded within print media, such as magazine advertisements or articles, direct mail coupons or catalogs and bank cards or business cards. When recognized by PC cameras enabled by our patented reader technology, the code will automatically launch the user to the specific Internet destination chosen by the producer of the printed content. In this way, we believe that b'doop will deliver more efficient Internet navigation and access to consumers and more effective means for print advertisers to link readers directly to a targeted e-commerce point- of-sale.

Recent advances in multimedia, digital imaging and printing technologies have given computer users at every level of sophistication access to highly advanced image manipulation and reproduction capabilities. This access has led to new challenges in the areas of document security and counterfeiting and piracy deterrence by allowing virtually any user to create expert-quality copies of traditional and digital content. At the same time, advances in technology have introduced millions of people to the

Internet. The growth of the Internet has allowed the Web to become a global distribution channel for unauthorized reproductions of proprietary content. At the same time, the increasing volume of Internet content and number of Web destinations has made navigation and information retrieval more challenging. Despite the availability of numerous search methods, research indicates that users often experience difficulty when retrieving information on desired products or services, causing a loss of potential e-commerce revenue.

Applications of Digimarc's technologies will address both the security and the access problems that are increasingly arising as the world grows more dependent on multimedia computing and the Internet. Our core goals are to establish our technologies as basic components of industry standards for controlling the use or consumption of visual content and to establish our Paper-as-Portal applications as a leading means of Internet access and navigation. We intend to achieve this objective by driving proliferation of our reader technology as a resident application on personal computers and related devices, and to this end we have executed letters of intent with leading PC camera vendors such as 3Com and Logitech. We are simultaneously developing other new applications for our digital watermarking technologies. We will focus on expansion of our reader technology installed base as a means of driving demand for our applications and, in a complementary fashion, will continue developing compelling applications in order to push proliferation of our reader technology. We intend to maintain our intellectual property leadership in digital watermarking technologies through continued innovation and rigorous intellectual property development and protection. By broadly licensing our technologies for deterring copyright infringement, counterfeiting and piracy, and for linking digital content with the physical world, we intend to build long-term demand for our technologies and promote public awareness of our brand.

We believe that our applications offer strong advantages over other image commerce and secure documents approaches because our digital watermarks are imperceptible, persistent and format-independent, allowing them to operate in both analog and digital environments. Our applications are compatible with a wide variety of Internet, computing and communications solutions because virtually any visual content can contain our imperceptible digital watermarking codes.

We were incorporated in Oregon on January 3, 1995, and we intend to reincorporate in Delaware prior to the closing of this offering. Our principal executive offices are located at One Centerpointe Drive, Suite 500, Lake Oswego, Oregon 97035-8615, and our telephone number is (503) 968-2908. Our Web site is located at www.digimarc.com. Information contained on our Web site does not constitute part of this prospectus.

Unless otherwise indicated, the information in this prospectus assumes the automatic conversion of all outstanding shares of preferred stock into 11,169,573 shares of common stock effective automatically upon the closing of this offering and no exercise by the underwriters of their option to purchase additional shares of common stock.

The Offering

Common stock offered..... shares Common stock to be outstanding after this offering..... shares Use of proceeds..... For repayment of indebtedness and for general corporate purposes, including working capital, expansion of our sales and marketing efforts, product development, expansion of our customer support organization and capital expenditures. See "Use of Proceeds." Proposed Nasdaq National Market Symbol..... DMRC The number of shares of common stock to be outstanding after this offering is based on the number of shares outstanding as of June 30, 1999 and excludes:

. 320,000 shares of common stock issuable upon conversion of our Series D-X preferred stock;

. 21,565 shares of common stock issued subsequent to June 30, 1999 upon exercise of options;

. 4,431,923 shares of common stock issuable upon exercise of options outstanding as of September 20, 1999 at a weighted average exercise price of $0.58 per share; and . 4,624,213 shares of common stock reserved for future issuance under our 1995 stock incentive plan, our 1999 stock incentive plan and our 1999 employee stock purchase plan.

Summary Financial Data (in thousands, except share and per share data) The pro forma basic and diluted net loss per share data in the statement of operations data below and the pro forma data in the balance sheet data below reflect the automatic conversion of all outstanding preferred stock into common stock effective upon the closing of this offering. The pro forma as adjusted data reflects adjustments to the pro forma data to show our receipt of the estimated net proceeds of $ from the sale of shares of our common stock in this offering at an assumed initial public offering price of $ per share, after deducting estimated underwriting discounts and commissions and estimated offering expenses.

					Six Months Ended June 30, (unaudited)	
	Period from January 3, 1995 (inception) to December 31, 1995	Year Ended December 31, 1996	1997	1998	1998	1999
Statement of Operations Data: Total revenue.....	$--	$ 236	$ 186	$ 984	$ 407	$2,055 Gross margin..... -- 229 60 (596) (122) 1,120 Total operating expenses..... 840 1,900 3,999 2,890 1,519 1,669 Operating loss..... (840) (1,671) (3,939) (3,486) (1,641) (549) Net loss..... $ (874)	$(1,578)	$(3,979)	$(3,442)	$(1,609)	$ (577) Basic and diluted net loss per share..... $(0.50)	$ (0.35)	$ (0.94)	$ (0.75)	$ (0.35)	$ (0.12) Weighted average shares used in basic and diluted net loss per share..... 1,738,956 4,453,038 4,240,955 4,576,884 4,564,061 4,657,874 Pro forma basic and diluted net loss per share..... $ (0.27) $ (0.04) Weighted average shares used in pro forma basic and diluted net loss per share..... 12,894,457 13,003,580 June 30, 1999 (unaudited) Pro Forma Actual Pro Forma As Adjusted				

Balance Sheet Data:			
Cash and cash equivalents.....	$ 6,169	$6,169	$
Working capital.....	6,607	6,607	
Total assets.....	8,623	8,623	
Redeemable convertible preferred stock.....	16,476	--	
Total stockholders' equity (deficit).....	(9,634)	6,842	

Risk Factors

An investment in our shares involves risks and uncertainties. You should carefully consider the factors described below before making an investment in our securities. In addition, you should keep in mind that the risks described below are not the only risks that we face. The risks described below are the risks that we currently believe are material risks of our business, the industry in which we compete and this offering. However, risks not presently known to us, or risks that we currently believe are immaterial, may also harm our business.

Our business, operating results and financial condition could be adversely affected by any of the following risks. If we are adversely affected by these risks, then the trading price of our common stock could decline and you could lose all or part of your investment.

Risks Related to Our Business We have a limited operating history and are subject to the risks encountered by early-stage companies We incorporated in January 1995. Accordingly, we have a limited operating history, and our business and prospects must be considered in light of the risks and uncertainties to which early-stage companies in new and rapidly evolving markets, such as digital watermarking, are exposed. These risks include the following:

. our developing revenue models and anticipated products and services may fail to attract or retain customers;

. the intense competition and rapid technological change in our industry could adversely affect the market's acceptance of our products and services;

. we may be unable to build and maintain our brand;

. we may be unable to develop and maintain the strategic relationships upon which we currently rely for our revenue; and . our quarterly operating results may fluctuate significantly.

We cannot assure you that our business strategy will be successful or that we will successfully address these risks and the risks described below.

We have a history of losses, expect future losses and cannot assure you that we will achieve profitability We have incurred significant net losses since inception. We incurred net losses of $874,000 in 1995, $1.6 million in 1996, $4.0 million in 1997, $3.4 million in 1998 and $577,000 in the six months ended June 30, 1999. We have not been profitable and cannot assure you that we will realize sufficient revenue to achieve profitability. Our accumulated deficit as of June 30, 1999 was approximately $10.6 million. We anticipate that we will increase our research and development, sales and marketing, product development and general and administrative expenses in 1999 and for the foreseeable future. In order to achieve profitability, we will need to generate significantly higher revenue than we have in prior years. Even if we ultimately do achieve profitability, we may not be able to sustain or increase our profitability. If our revenue grows more slowly than we anticipate, or if our operating expenses exceed our expectations, our operating results will be harmed.

Most of our significant revenue models are under development, and the corresponding anticipated products and services may fail to attract or retain customers Our business involves embedding digital watermarks in traditional and digital media, including secure documents, images on the Internet and video merchandise. Our current applications include image commerce and counterfeiting and piracy deterrence. To date, our revenue stream has been based primarily on a combination of development, consulting, subscription and license fees from copyright communication, and in recent periods, from secure document applications. In the future, we anticipate that an increasing share of our revenue will be from sales of our Paper-as-Portal applications, such as b'doop, and sales of other applications of our digital watermarking technologies. We have not fully developed a revenue model for our Paper-as-Portal products, including b'doop, or for our other future applications, including the proliferation of our reader technology. We must complete the development of b'doop and obtain revenue from its commercial launch in order to meet our revenue objectives. If we do not successfully develop, market and support b'doop, it is likely that our future revenue would fall below our targeted objectives. Any shortfall in revenue from b'doop or our other future applications could reduce the trading price of our common stock. We believe that it is too early to determine certain aspects of the revenue models that would apply to these initiatives, and the revenue models that we develop may be unsuccessful and require changes after adoption. We cannot assure you that our anticipated products and services will be able to compete effectively against other alternative technologies in our target markets or that we will be able to compete effectively against current or future digital watermark companies in terms of price, performance, applications or other features of their technologies. In addition, as we develop revenue models, they may not be sustainable over time, and as a result, our operating results and financial condition may be harmed.

Because we currently receive 91% of our revenue from a single customer, the loss of this customer would seriously harm our business, operating results and financial condition We have derived a substantial portion of our revenue from a consortium of leading central banks with whom we have a development and license agreement related to banknote counterfeit deterrence. Revenue from products and services provided to this significant customer accounted for 51% of our total revenue in 1998 and 91% of our total revenue for the first half of 1999. We anticipate that this relationship will account for most of our revenue until we are able to generate revenue from the introduction of other new products and services that we are developing, including b'doop.

Under the terms of our agreement with this customer, we are obliged to keep the identity of the participating banks, design of the system and timetable for deployment confidential. Any change in our relationship with this customer, including any actual or alleged breach of the contract by either party or the termination of, or any other material change in, the agreement would seriously harm our business, operating results and financial condition.

Our future growth will depend on the successful implementation of our solutions by third-party providers We are currently developing b'doop and our other Paper-as-Portal technologies and applications. These technologies and other applications and services which we plan on providing in the future will rely on the successful implementation of our product solutions, including our reader technology, by third party software developers and original equipment manufacturers. We anticipate

maintaining and entering into new agreements with major third-party vendors to create and promote products that incorporate, embed, integrate or bundle our technologies. If we fail to obtain partners that will incorporate, embed, integrate or bundle our technologies or such partners are unsuccessful in these efforts, our business, operating results and financial condition could be seriously harmed. In addition, if our technologies do not perform according to market expectations, our business will be seriously harmed.

Our future quarterly operating results may not meet analysts' expectations and may fluctuate significantly in the future, which could adversely affect our stock price We expect that our quarterly operating results will fluctuate significantly in the future. Accordingly, you should not rely on quarter-to-quarter comparisons of our historical results as an indication of future performance. If our quarterly operating results do not meet the expectations of analysts or investors, the market price of our common stock will likely decline.

Our quarterly results may fluctuate in the future as a result of many factors, some of which are outside our control, including:

. the timing, introduction and successful commercialization of our new products and services, including b'doop;

. the timing and success of our brand-building and marketing campaigns;

. the loss of or reduction in revenue from the customer that currently accounts for 91% of our total revenue or any other significant customer;

. the market's acceptance of our products and services, including b'doop;

. our ability to establish and maintain strategic relationships;

. the potential costs of litigation and intellectual property protection;

. the operating costs and capital expenditures related to the expansion of our business operations and infrastructure, domestically and internationally, including the hiring of key personnel and new employees;

. the introduction of similar or substitute technologies by our competitors;

. the timing of future licensing revenue; and . the marketing arrangements that we enter into during early market development.

In addition, since the markets for our products and services are new and rapidly evolving, it is difficult for us to predict our future financial results. Our research and development, sales and marketing efforts and business expenditures are based in part on predictions regarding certain developments in counterfeiting and piracy, and the use of digital watermarking as a solution to those problems. To the extent that these predictions prove inaccurate, our revenue and operating results will fluctuate from our anticipated results.

The markets for digital watermark applications are new and developing Digital watermarking is a new and developing technology. Our success depends on the acceptance of this technology and the adoption of applications in areas such as digital image commerce, counterfeiting and piracy deterrence and self- authentication of documents. The markets for products and services using digital watermarks are rapidly evolving and are characterized by an increasing number of market entrants who have introduced or developed products and services using digital watermarking or alternative technologies. As is typical in a new and rapidly evolving industry, demand and market acceptance of recently introduced products and services are subject to a high level of uncertainty. Our products and services are currently used by only a limited number of customers. It is difficult to predict the future growth rate, if any, and ultimate size of these markets or our anticipated future markets. We cannot assure you that markets for our products and services will develop.

We may not be able to adequately protect our intellectual property, and we may be subject to infringement claims Our success depends on our proprietary technologies. We rely on a combination of patent, copyright, trademark and trade secret rights, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights. As a result, we face risks associated with our patent position, including the potential need to engage in significant legal proceedings to enforce our patents, the possibility that the validity or enforceability of our patents may be denied, the possibility that third parties will be able to compete against us without infringing our patents and the possibility that our products may infringe patent rights of third parties. If we fail to protect our intellectual property rights and proprietary technologies adequately, if there are changes in applicable laws which are adverse to our interests, or if we become involved in litigation relating to our intellectual property rights and proprietary technologies or relating to the intellectual property rights of others, our business could be harmed.

As part of our confidentiality procedures, we generally enter into non- disclosure agreements with our employees, consultants and corporate partners and attempt to control access to and distribution of our technologies, documentation and other proprietary information. Despite these procedures, third parties could copy or otherwise obtain and make unauthorized use of our technologies or independently develop similar technologies. The steps we have taken may not prevent misappropriation of our solutions or technologies, particularly in foreign countries where laws or law enforcement practices may not protect our proprietary rights as fully as in the United States.

Effective protection of intellectual property rights may be unavailable or limited, both in the United States and in foreign countries. Patent protection throughout the world is generally established on a country-by-country basis. We have applied for patent protection both inside the United States and in various countries outside the United States. However, we cannot assure you that pending patents will issue or that issued patents will be valid or enforceable. We cannot assure you that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technologies, duplicate our services or design around any patents or other intellectual property rights we hold.

We license some rights management technology from a third party, and may need the assistance of this third party to enforce our rights to this technology. Although we do not currently rely on this technology for our core products, we may in the future. The cooperation of any third party in enforcement of patent rights we may license cannot be assured.

We have registered "Digimarc" as a trademark in the United States and other countries, and are pursuing registration in additional countries. However, our tradename or trademark may be registered by third parties in other countries, impairing our ability to enter and compete in such markets. In the United States, the trademark "Digimark" and the domain name "Digimark.com" have been registered by an unrelated company. While we have successfully co-existed for several years with this other company, we cannot assure you that this state of affairs will continue. If we were forced to change our name, we would lose a significant amount of our brand equity.

As more companies enter the digital watermark marketplace and develop intellectual property rights, it is increasingly likely that claims may arise which assert that some of our products or services infringe upon other parties' intellectual property rights. These claims could subject us to costly litigation, divert management resources and result in the invalidation of our intellectual property rights. These claims may require us to pay significant damages, cease production of infringing products, terminate our use of infringing technologies or develop non-infringing technologies. In these circumstances, continued use of our technologies may require that we acquire licenses to the intellectual property that is the subject of the alleged infringement, and we might not be able to obtain such licenses on commercially reasonable terms or at all. Our use of protected technologies may result in liability that threatens our continuing operation.

The security systems that we use in our proprietary technologies may be circumvented by third parties Our products and services involve the embedding of imperceptible digital data in visual content that is imperceptible in normal use but that can be read by digitally-enabled devices. The success of our products and services depends on the security of our image commerce, anti-counterfeiting and piracy systems and self-authentication solutions. Security breaches of these systems and solutions could damage our reputation and expose us to a risk of loss or litigation and possible liability. The security measures that we use in our products and services may not prevent security breaches, and failure to prevent these security breaches may disrupt our business. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions or otherwise damage our products and services and the properties of our customers. If unintended parties obtain sensitive data and information, or create bugs or viruses in an attempt to sabotage the functionality of our products and services, we may receive negative publicity, incur liability to our customers or lose the confidence of our customers, any of which may cause the termination or modification of our contracts.

We may be required to expend significant capital and other resources to protect ourselves against the threat of security breaches or to alleviate problems caused by these breaches. However, protection may not be available at a reasonable price or at all.

Our products could have unknown defects Products as complex as those we offer or develop frequently contain undetected defects or errors. Despite testing, defects or errors may occur in existing or new products, which could result in loss of revenue or market share, failure to achieve market acceptance, diversion of development resources, injury to our reputation, increased insurance costs and increased service and warranty costs, any of which could materially harm our business. Furthermore, we often provide implementation, customization, consulting and other technical services in connection with the implementation and ongoing maintenance of our products. The performance of these products typically involves working with sophisticated software, computing and communications systems. Our failure to meet customer expectations or project milestones in a timely manner could also result in a loss of, or delay in, revenue, loss of market share, failure to achieve market acceptance, injury to our reputation and increased costs.

Because customers rely on our products for critical security applications, defects or errors in our products might discourage customers from purchasing our products. These defects or errors could also result in product liability or warranty claims. Although we attempt to reduce the risk of losses resulting from such claims through warranty disclaimers and liability limitation clauses in our sales agreements, these contractual provisions may not be enforceable in every instance. Furthermore, although we maintain errors and omissions insurance, this insurance coverage may not adequately cover these claims. If a court refused to enforce the liability-limiting provisions of our contracts for any reason, or if liabilities arose that were not contractually limited or adequately covered by insurance, our business could be materially harmed.

We may encounter difficulties managing our growth and expansion that may harm our business We expect to experience rapid growth. To manage the future growth we may experience, our management must continue to improve our operational and financial systems and expand, train, retain and manage our employee base. Any additional growth will place a significant strain on our managerial and financial resources. If we cannot manage our growth effectively, we may not be able to coordinate the activities of our technical, accounting and marketing staffs, and our business could be harmed.

We depend on our key employees for our future success Our success depends to a significant extent on the performance and continued service of our senior management. None of our senior management has an employment agreement. Although our employees have executed agreements containing non-competition clauses, there is no assurance that a court would enforce all of the terms of these clauses or the clauses generally. If these clauses were not fully enforced, our employees would be freely able to join our competitors. In addition, we currently have key person life insurance only on Bruce Davis, our president and chief executive officer, and Geoffrey Rhoads, our chief technology officer and secretary. The loss of the services of any of our senior management or any of our other key employees could harm our business.

If we are not able to hire, integrate or retain qualified personnel, our business may be harmed The recent growth in our business has resulted in an increase in the responsibilities for both existing and new management personnel. Many of our personnel are presently serving in more than one capacity. In addition, we expect that we will need to hire additional personnel in all areas in the rest of 1999 and

in 2000, including general managers for new operations in key market segments. Competition for experienced personnel in our market segments is intense. We may not be able to retain our current key employees or attract, integrate or retain other qualified personnel in the future. If we do not succeed in attracting new personnel or in integrating, retaining and motivating our current personnel, our business could be harmed. In addition, new employees generally require substantial training. This training will require substantial resources and management attention.

Our promotion of the Digimarc brand must be successful in order for us to attract users as well as advertisers and other strategic partners We believe that establishing and maintaining our brand is critical to our success and that the importance of brand recognition will increase due to the growing number of technologies that compete with our watermarking technologies and the increasing number of competitors offering technologies similar to ours. We intend to increase our marketing and branding expenditures in our effort to increase awareness of our brand. If our brand- building strategy is unsuccessful, these expenses may never be recovered, we may be unable to increase our future revenue, and our business could be materially harmed.

We may need to raise additional funds, which may not be available We believe that our current cash resources, combined with the net proceeds from this offering, will be sufficient to meet our presently anticipated working capital and capital expenditure requirements for at least the next 12 months following the date of this prospectus. We may need to raise additional funds, however, to do the following:

. research and develop new applications for digital watermarking, and new products and services;

. respond to competitive pressures; and . acquire complementary businesses or technologies.

Our future liquidity and capital requirements will depend on numerous factors, including the success of our existing and future products and services and potentially competing technological and market developments. We may be required to raise additional funds through public or private financing, strategic relationships or other arrangements. Raising additional equity capital would have a dilutive effect on existing stockholders. We cannot assure you that such additional funding, if needed, will be available on terms acceptable to us or at all. If adequate funds are not available on acceptable terms, our ability to develop or enhance our products and services, take advantage of future opportunities or respond to competitive pressures would be significantly limited. Any of these limitations could harm our business, operating results and financial condition.

Risks Related to Our Industry If we are unable to respond to regulatory or industry standards effectively, our operating results could be harmed Our future success will depend in part on our ability to enhance and improve the responsiveness, functionality and features of our products and services in accordance with newly-imposed regulatory or industry standards. Our ability to remain competitive will depend in part on our ability to influence and respond to emerging industry standards, including any standards which may be adopted for the protection of digital photography or video on DVD, in a timely and cost-effective manner. For instance, our video copy prevention solution is competing with another solution to become the industry standard for DVD copy protection. If we are unable to influence or respond to these standards effectively, our operating results could be harmed.

If we are unable to integrate new technologies effectively, our business could be harmed Our target markets are characterized by new and evolving technologies. The success of our business will depend on our ability to address the increasingly sophisticated technological needs of our customers in a timely and cost- effective manner. Our ability to remain competitive will depend, in part, on our ability to:

. enhance and improve the responsiveness, functionality and other features of the products and services we offer or plan to offer;

. continue to develop our technical expertise; and . develop and introduce new services, applications and technologies to meet changing customer needs and preferences and to integrate new technologies.

We cannot assure you that we will be successful in responding to the foregoing technological and industry challenges in a timely and cost-effective manner. If we are unable to integrate new technologies effectively or respond to these changing needs, our business could be harmed.

Our markets are highly competitive The markets for digital watermarking applications are new, intensely competitive and rapidly evolving. We expect competition to continue to increase from both existing competitors and new market entrants. We face competition from other companies using digital watermarking technologies and from alternative technologies. As we expand the applications for our digital watermarking technologies, we will experience more competition from products and services that are substitutes for our digital watermarking products. Because our business model is new and emerging, we may face competition from unexpected sources. Alternative technologies that may directly or indirectly compete with certain applications of our watermarking technologies include:

. encryption--securing data during distribution using a secret code so it cannot be accessed except by authorized users;

. containers--inserting a media object in a "wrapper," which prevents the media object from being duplicated;

. dataglyphs--a visible modification of the characteristics of an image that is machine-readable;

. scrambled indicia--optical refraction-based data-hiding technique that is inserted into an image and can be read with a glass;

. traditional anti-counterfeiting technologies--a number of solutions used currently by many governments that compete for budgetary outlays designed to deter counterfeiting, including optically sensitive ink, magnetic "threads" and other materials used in the printing of currencies;

. radio frequency tags--embedding a chip that emits a signal when in close proximity with a receiver, which is being used in photo identification, labels and tags;

. Internet technologies--numerous existing and potential Internet access and search methods will be potentially competitive with b'doop and other Paper-as-Portal applications; and . bar codes--visible data-carrying code.

In addition, as we apply our technologies to the Internet through the anticipated introduction of b'doop and other Paper-as-Portal applications, we may begin to compete with a wide range of other companies. Many of the companies that currently compete with us, as well as other companies with whom we may compete in the future, are national or international in scope and may have greater resources than we do. These resources could enable these companies to initiate severe price cuts or take other measures in an effort to gain market share in our target markets. We cannot assure you that digital watermarking technologies, and our products and services using these technologies, will gain widespread market acceptance.

We cannot assure you that we will be able to compete successfully against current or future participants in our markets or against alternative technologies, nor can we assure you that the competitive pressures we face will not harm our business, operating results and financial condition.

Our business may be negatively affected by Year 2000 issues Many currently installed computer systems and software products are coded to accept only two-digit entries in the date code field. These date code fields will need to accept four-digit entries to distinguish 21st century dates from 20th century dates. As a result, many companies' software and computer systems may need to be upgraded or replaced in order to comply with Year 2000 requirements. We utilize third-party equipment and software that may not be Year 2000 compliant. Failure of this third-party equipment or software to be Year 2000 compliant could require us to incur unanticipated expenses to remedy any problems, which could harm our business, operating results and financial condition. Furthermore, the purchasing patterns of customers or potential customers may be affected by Year 2000 issues as companies expend significant resources to correct their current systems for Year 2000 compliance. These expenditures may result in reduced funds being available to purchase products and services we offer, which could harm our business, operating results and financial condition.

Risks Related to This Offering There has been no public market for our common stock prior to this offering Although we have applied to list our common stock on the Nasdaq National Market, a trading market for our common stock may not develop or, if a market does develop, our common stock may still be difficult to trade. The initial public offering price of our common stock will be determined through negotiations between us and the representatives of the underwriters, based on factors that may bear no relation to the price at which our common stock will trade in the public market. We cannot assure you that you will be able to resell your shares easily or that you will be able to resell your shares at or above the initial public offering price.

Our stock price may be volatile The market price of our common stock is likely to be highly volatile and fluctuate significantly in response to a number of factors, most of which are beyond our control, including:

. fluctuations in quarterly operating results;

. announcements of significant contracts, acquisitions or capital commitments;

. changes in financial estimates by securities analysts;

. failure to obtain patents or defend them successfully;

. failure to complete significant license transactions;

. additions or departures of key personnel; and . stock market price and volume fluctuations, which are particularly common among highly volatile securities of high-technology and software companies.

In the past, securities class action litigation has often been instituted against a company following periods of volatility in the company's stock price. This type of litigation could result in substantial costs and could divert our management's attention and resources.

Additional shares held by existing stockholders may be sold into the public market in the future, which may cause our stock price to decline.

Sales of a substantial number of shares of common stock after this offering could adversely affect the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities. After the closing of this offering, we will have outstanding shares of common stock, assuming no exercise of outstanding options or warrants after June 30, 1999 and no exercise of the underwriters' over-allotment option. The shares of common stock sold in this offering, which would be shares if the underwriters' over-allotment option to purchase additional shares is exercised in full, will be freely tradeable without restriction or further registration under the federal securities laws unless purchased by persons who are considered affiliates under the federal securities laws. The remaining shares of common stock outstanding upon the closing of this offering will be considered restricted securities under the federal securities laws.

Many of our stockholders, option holders and warrant holders are subject to agreements that limit their ability to sell their shares of common stock. Subject to certain limited exceptions, these securityholders cannot sell or otherwise dispose of any shares of common stock for a period of at least 180 days after the date of this prospectus without the prior written approval of BancBoston Robertson Stephens. When these agreements expire, these shares and the shares underlying the options will become eligible for sale, in some cases only pursuant to the volume, manner of sale and notice requirements of the federal securities laws. See "Shares Eligible for Future Sale" and "Underwriting."

Our management will retain broad discretion in the use of proceeds from this offering and may use the proceeds in ways with which you do not agree We intend to use the net proceeds from this offering for the repayment of indebtedness, working capital and general corporate purposes, including market expansion, acquisitions and product and technology development. Accordingly, our management will have significant flexibility in applying the net proceeds from this offering and may use the net proceeds in ways with which you do not agree. Until the net proceeds are needed, we plan to invest them in investment- grade, interest-bearing securities. We cannot assure you that investment of the net proceeds will yield a favorable or any return. The failure of our management to apply these funds effectively could harm our business.

Anti-takeover provisions in our charter documents could negatively impact our stockholders The anti-takeover provisions of Delaware law and our certificate of incorporation and bylaws may make a change of control of us more difficult, even if a change of control would be beneficial to our

stockholders. These provisions may allow our board of directors to prevent changes in management and control of us. Under Delaware law, our board may adopt additional anti- takeover measures in the future.

We have adopted the following anti-takeover provisions, each to take effect upon the closing of this offering:

. our board of directors will be divided into three classes of directors, with a separate class of directors being elected at each successive annual meeting for a term of three years;

. special meetings of the stockholders may be called only by our president, our secretary or at the discretion of our board of directors;

. vacancies on our board of directors may be filled by a majority of directors in office, and not by the stockholders; and . our board of directors may issue preferred stock and determine the price, rights, preferences and privileges of those shares without any vote or further action by the stockholders.

These provisions could have the effect of discouraging a third party from making a tender offer or otherwise attempting to gain control of us. In addition, these provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

You Should Not Rely on Forward-looking Statements Because They Are Inherently Uncertain

This prospectus contains forward-looking statements that involve risks and uncertainties. We use words such as "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate" and similar expressions to identify forward- looking statements. This prospectus also contains forward-looking statements attributed to third parties relating to their estimates regarding the prevalence and growth of the number of incidences of copyright infringement, counterfeiting and piracy. Readers are cautioned not to place undue reliance on any of these forward-looking statements, which reflect our management's views as of the date of this prospectus. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us and described in "Risk Factors" and elsewhere in this prospectus.

Use of Proceeds

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  We estimate that we will receive net proceeds of $    from the sale of the
     shares of common stock in this offering, assuming an initial public
offering price of $    per share and after deducting the estimated underwriting
discounts and commissions, and estimated offering expenses. If the
underwriters' over-allotment option is exercised in full, our net proceeds will
be approximately $   .
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We intend to use a portion of the net proceeds to repay in full principal of and interest on unsecured notes payable to common stockholders, totaling $305,000 at June 30, 1999, which is due upon the closing of this offering. We expect to use the remainder of the net proceeds from this offering primarily

for working capital and general corporate purposes, including product development, sales and marketing and capital expenditures made in the ordinary course of business. Pending these uses, the net proceeds from this offering will be invested in short-term, interest-bearing, investment grade, instruments.

The principal purposes of this offering are:

. to obtain additional working capital;

. to create a public market for our common stock; and . to facilitate future access by Digimarc to public equity markets.

The amounts we actually spend for these purposes may vary significantly and will depend on a number of factors, including our future revenue and cash generated by operations and the other factors described under "Risk Factors." Therefore, we will have broad discretion in the way we use the net proceeds.

Dividend Policy

We have never declared or paid any cash dividends on shares of our common stock. We currently intend to retain future earnings, if any, to support the development of our business and do not anticipate paying any cash dividends in the foreseeable future. Our board of directors will have discretion as to whether future dividends will be paid, after taking into account factors such as our financial condition, operating results and current and anticipated cash needs.

Dilution

As of June 30, 1999, our pro forma net tangible book value was approximately $6.8 million or $0.44 per share of common stock. Pro forma net tangible book value per share represents the amount of our total tangible assets less total liabilities, divided by the pro forma number of shares of common stock outstanding. After giving effect to the sale of the shares of common stock we are offering at an assumed initial public offering price of $, our pro forma net tangible book value as of June 30, 1999 would have been $ million or $ per share of common stock. This represents an immediate increase in net tangible book value of $ per share to existing stockholders and an immediate dilution of $ per share to new investors. The following table illustrates this per share dilution:

Assumed initial public offering price per share	$
Pro forma net tangible book value per share as of June 30, 1999	$0.44
Increase per share attributable to new investors	
Pro forma net tangible book value per share after this offering	
Dilution per share to new investors	$

The following table summarizes, on a pro forma basis as of June 30, 1999, the number of shares of common stock purchased, the total consideration paid and the average price per share paid by the existing stockholders and the new investors purchasing shares of common stock in this offering. The

information presented is based upon an assumed initial public offering price of $ per share, before deducting estimated underwriting discounts and commissions, and estimated offering expenses of this offering:

Shares Purchased Total Consideration ---------- ---------- Average Price Number Percent Amount Percent Per Share

Existing stockholders.....	15,624,947	%	$17,563,000	%	$1.12
New investors.....					
Total.....		100.0%		100.0%	

The information presented with respect to existing stockholders includes 8,720,573 shares of preferred stock, which will be automatically converted into 10,849,573 shares of common stock upon the closing of this offering. This information is as of June 30, 1999 and excludes:

. 320,000 shares of common stock issuable upon conversion of our Series D-X preferred stock;

. 21,565 shares of common stock issued subsequent to June 30, 1999 upon exercise of options;

. 4,431,923 shares of common stock issuable upon exercise of options outstanding as of September 20, 1999 at a weighted average exercise price of $0.58 per share; and . 4,624,213 shares of common stock reserved for future issuance under our 1995 stock incentive plan, our 1999 stock incentive plan and our 1999 employee stock purchase plan.

Capitalization

The following table sets forth our capitalization as of June 30, 1999 on an actual basis, on a pro forma basis to give effect to the conversion of all outstanding shares of preferred stock into common stock and on a pro forma as adjusted basis to give effect to the conversion of all outstanding shares of our preferred stock into common stock and the receipt of the estimated net proceeds from the sale of shares of common stock offered in this offering at an assumed initial public offering price of $ per share and after deducting estimated underwriting discounts and commissions, and estimated offering expenses.

The actual, pro forma and pro forma as adjusted information below is unaudited and should be read in conjunction with our financial statements and the notes to those financial statements appearing at the end of this prospectus.

June 30, 1999 (unaudited) Pro Forma Actual Pro Forma As Adjusted (dollars in thousands) Mandatorily redeemable preferred stock, $0.001 par value, 21,748,000 shares authorized, 8,395,573 shares issued and outstanding, actual; no shares authorized, issued or outstanding, pro forma and pro forma as adjusted..... $ 16,476 $ -- $ -- Stockholders' equity (deficit): Convertible preferred stock, $0.001 par value; 650,000 shares authorized, 325,000 shares issued and outstanding, actual; no shares issued and outstanding, pro forma and pro forma as adjusted..... -- -- -- Common stock, $0.001 par value; 25,000,000 shares authorized; 4,775,374 shares issued and outstanding, actual; 15,624,947 shares issued and outstanding, pro forma; and shares issued and outstanding, pro forma as

adjusted..... 2 13 Additional paid in capital..... 1,118 17,583 Deferred compensation..... (202) (202) (202) Accumulated deficit..... (10,552) (10,552) (10,552) Total stockholders' equity (deficit)..... (9,634) 6,842 Total capitalization..... $ 6,842 $ 6,842 $ The number of shares of common stock to be outstanding after this offering is based on the number of shares outstanding as of June 30, 1999 and excludes:

. 320,000 shares of common stock issuable upon conversion of our Series D-X preferred stock;

. 21,565 shares of common stock issued subsequent to June 30, 1999 upon exercise of options;

. 4,431,923 shares of common stock issuable upon exercise of options outstanding as of September 20, 1999 at a weighted average exercise price of $0.58 per share; and . 4,624,213 shares of common stock reserved for future issuance under our 1995 stock incentive plan, our 1999 stock incentive plan and our 1999 employee stock purchase plan.

Selected Financial Data

The following selected financial data should be read in conjunction with our financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this prospectus. The statement of operations data for the years ended December 31, 1996, 1997 and 1998, and the balance sheet data at December 31, 1997 and 1998, are derived from our financial statements that KPMG LLP, independent certified public accountants, have audited and are included in this prospectus. The statement of operations data for the period from January 3, 1995 (inception) through December 31, 1995 and the balance sheet data at December 31, 1995 and 1996 are derived from our audited financial statements not included in this prospectus. The statement of operations data for the six-month periods ended June 30, 1998 and 1999, and the balance sheet data at June 30, 1999, are derived from unaudited interim financial statements included in this prospectus. The unaudited financial statements have been prepared on substantially the same basis as the audited financial statements and, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of operations for such periods. Historical results are not necessarily indicative of the results to be expected in the future, and results of interim periods are not necessarily indicative of results for the entire year.

	Period from January 3, 1995 (inception) through December 31,	Year Ended December 31,			Six Months Ended June 30, (unaudited)	
	1995	1996	1997	1998	1998	1999
	(in thousands, except share and per share data)					
Statement of Operations Data:						
Revenue:						
License and subscription.....	$ --	$ 236	$ 161	$ 484	$ 282	$ 116
Service.....	--	--	25	500	125	1,939
Total revenue.....	--	236	186	984	407	2,055
Cost of revenue:						

License and subscription	--	7	126	114	62	57
Service	--	--	--	1,466	467	878
Total cost of revenue	--	7	126	1,580	529	935
Gross margin	--	229	60	(596)	(122)	1,120
Operating expenses:						
Sales and marketing	36	376	1,330	825	498	394
Research and development	327	690	1,387	658	415	247
General and administrative	477	834	1,282	1,407	606	1,028
Total operating expenses	840	1,900	3,999	2,890	1,519	1,669
Operating loss	(840)	(1,671)	(3,939)	(3,486)	(1,641)	(549)
Other income (expense)	(34)	93	(40)	44	32	(28)
Loss before income taxes	(874)	(1,578)	(3,979)	(3,442)	(1,609)	(577)
Provision for income taxes	--	--	--	--	--	--
Net loss	$ (874)	$ (1,578)	$ (3,979)	$ (3,442)	$ (1,609)	$ (577)
Basic and diluted net loss per share	$ (0.50)	$ (0.35)	$ (0.94)	$ (0.75)	$ (0.35)	$ (0.12)
Weighted average shares outstanding used in basic and diluted net loss per share calculation	1,738,956	4,453,038	4,240,955	4,576,884	4,564,061	4,657,874

		December 31,			June 30, (unaudited)
	1995	1996	1997	1998	1999
	(in thousands)				
Balance Sheet Data:					
Cash and cash equivalents	$ 46	$ 3,113	$ 5,638	$ 2,137	$ 6,169
Working capital	(244)	2,782	4,631	1,196	6,607
Total assets	63	3,376	6,168	2,978	8,623
Long-term debt, net of current portion	438	271	284	298	--
Redeemable convertible preferred stock	--	4,441	10,185	10,185	16,476
Total stockholders' deficit	(690)	(1,885)	(5,680)	(9,095)	(9,634)

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the financial statements and related notes included in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of factors described within this prospectus. We refer you also to the section "You Should Not Rely on Forward-Looking Statements Because They Are Inherently Uncertain."

Overview

Digimarc is a leading provider of patented digital watermarking technologies that allow an imperceptible digital code to be embedded in traditional and digital content, including movies, magazines, photographic or artistic images and valuable documents such as financial instruments, passports and event tickets. Our technologies enable new communications capabilities for visual content relating to copyright protection, counterfeiting and piracy deterrence and, for the first time, the direct linking of physical content with the Internet.

From our inception in January 1995 through late 1996, we devoted substantially all of our efforts to product development, raising capital and recruiting personnel. We first generated licensing revenue in the third quarter of 1996 through the licensing of our software plug-ins to Adobe Systems. In the fourth quarter of 1996, we introduced a subscription-based service for communicating copyrights of digital images across the Internet. This product offering was followed by the introduction in mid-1997 of MarcSpider, our service that searches the Internet for images containing Digimarc watermarks and produces reports on the locations of these images. In late 1997, we began expanding the use of our digital watermarking technologies to counterfeiting and piracy deterrence.

In 1998, we began working with a consortium of leading central banks to develop a system to deter the use of personal computer systems in the counterfeiting of currency. Providing services relating to the development of this anti-counterfeiting system accounted for 51% of our total revenue in 1998 and 91% of our total revenue for the first six months of 1999. This increase in the share of total revenue resulted from our securing a contractual relationship with the consortium. We anticipate that this development project will account for most of our revenue until we are able to generate substantial revenue from the introduction of new products that we are developing relating to document security and our Paper-as-Portal applications.

In early 1999, we began to place increasing emphasis on developing b'doop, the first of our Paper-as-Portal applications. Our efforts to develop and introduce b'doop and related Paper-as-Portal applications will require significant continuing investment. To date, we have not derived any revenue from b'doop or any other Paper-as-Portal application. We expect to begin marketing b'doop in the second half of 2000. Successful introduction and marketing of b'doop and other Paper-as-Portal applications, if achieved, is expected to expand the sources, change the mix and reduce the concentration of our revenue.

To date, we have derived our revenue from licensing software products, delivering subscription-based services and providing development and consulting services to the consortium of central banks. We license our software products to owners of digital images. Revenue is recognized on delivery of software, assuming no significant obligations or customer acceptance rights exist. We provide subscription services to users for tracking of their watermarked images across the Internet.

Subscriptions are paid in advance, and revenue is recognized ratably over the term of the subscription. We also provide development and consulting services related to the customization, integration and installation of our technologies. This revenue is recognized as services are performed, unless

completion is subject to customer acceptance. Revenue from our international sales has primarily been denominated in U.S. dollars. Therefore, fluctuations in foreign currency exchange rates have not had a material effect on our business.

We intend to increase our revenue through the marketing of new digital watermarking applications and the licensing of b'doop and other Paper-as-Portal applications. We expect to target, among other sources of revenue, publishers, advertisers and other producers of printed materials. Our aim is to license our technologies to those content producers so that they may embed our digital watermarks in their print media, such as magazine ads or articles, direct mail coupons or catalogs and credit or business cards. Our current and anticipated products are intended to enable them to control reproduction and alteration of their content, as well as to enable their print materials to provide a link to relevant Web destinations. Revenue from our new applications may include one- time licenses, time-based or usage-based fees, royalties and revenue-sharing. We anticipate that the calculation of fees and royalties will be based at least in part on the size of the installed base of PCs, cameras, scanners, digital image capture and output devices, and software carrying our patented reader technology as well as the nature of the use, and the nature and amount of licensed content carrying our b'doop digital watermarks.

We believe that development of our business will require increasing levels of expenditures in future periods, including a significant increase in our sales and marketing efforts for the launch of new products, including b'doop and other applications of our Paper-as-Portal technology. Accordingly, we anticipate that we will continue to invest significantly in sales and marketing for the foreseeable future and that the dollar amount of sales and marketing expenses is likely to increase in the future. We believe that a significant increase in our research and development investment will be necessary for the development of additional applications of our technologies. We anticipate that we will continue to invest significantly in product research and development for the foreseeable future and that research and development expenses are likely to increase in the future. Due to the short development period between achievement of technological feasibility and the general availability of our software to customers, software development costs qualifying for capitalization have been insignificant, and as a result, are expensed as they are incurred. We also believe that our general and administrative expenses will continue to increase as a result of the continued expansion of our administrative staff and the expenses associated with becoming a public company, including annual and other public-reporting costs, directors' and officers' liability insurance, investor-relations programs and professional-service fees.

Since inception, we have invested in attracting top senior management, in developing products and in building our sales and marketing organizations. We have a limited operating history upon which investors may evaluate our business and prospects. We have incurred significant losses to date, and as of June 30, 1999, we had an accumulated deficit of approximately $10.6 million. We intend to continue to expend significant financial and management resources on developing additional products and services, increasing sales and marketing activities, improving our technologies and expanding our operations. As a result, we expect to continue to incur additional losses and negative cash flow through 2001 and possibly beyond. Our revenue may not increase or even continue at its current levels and we

may not achieve or maintain profitability or generate cash from operations in future periods. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies deploying new technologies and applications, such as our efforts to develop our Paper-as-Portal technology as a new means of using the Internet.

Results of Operations The following table presents our statement of operations data for the periods indicated as a percentage of total revenue.

	Year Ended December 31,			Six Months Ended June 30, (unaudited)	
	1996	1997	1998	1998	1999
Revenue:					
License and subscription..	100%	87%	49%	69%	6%
Service.....	--	13	51	31	94
Total revenue.....	100	100	100	100	100
Cost of revenue:					
License and subscription..	3	68	12	15	3
Service.....	--	--	149	115	43
Total cost of revenue...	3	68	161	130	46
Gross margin.....	97	32	(61)	(30)	54
Operating expenses:					
Sales and marketing.....	159	715	84	122	19
Research and development..	292	746	67	102	12
General and administrative.....	353	689	143	149	50
Total operating expenses.....	804	2150	294	373	81
Operating loss.....	(707)	(2118)	(355)	(403)	(27)
Other Income (Expense)....	39	(21)	5	8	(1)
Loss before income taxes..	(668)	(2,139)	(350)	(395)	(28)
Provision for income taxes.....	--	--	--	--	--
Net loss.....	(668)%	(2,139)%	(350)%	(395)%	(28)%

Six Months Ended June 30, 1998 and 1999 Revenue Total revenue was $407,000 and $2.1 million for the six months ended June 30, 1998 and 1999, respectively, representing an increase of $1.6 million. This increase was primarily the result of increased service revenue which we earned through securing a relationship with a consortium of leading central banks. We had one customer that accounted for approximately 31% of our total revenue for the six months ended June 30, 1998, and another customer that accounted for approximately 91% of our total revenue for the six months ended June 30, 1999. Successful introduction and implementation of new products and services, including self-authenticating documents, b'doop and other Paper-as-Portal applications, if achieved, is expected to significantly change the mix and concentration of our future revenue.

License and subscription. License and subscription revenue was $282,000 and $116,000 for the six months ended June 30, 1998 and 1999, respectively, representing a decrease of $166,000. This decrease was the result of an increased use of our sales, marketing and research and development personnel to provide education, outreach and product definition services to our anti-counterfeiting system customer.

Service. Service revenue was $125,000 and $1.9 million for the six months ended June 30, 1998 and 1999, respectively, representing an increase of $1.8 million. This increase was the direct result of our securing a relationship with a consortium of leading central banks under which we are developing a system to deter the use of personal computer systems in the counterfeiting of currency.

Cost of Revenue

License and subscription. Cost of license and subscription revenue includes compensation for operations personnel, cost of outsourced customer support, Internet service provider connectivity charges and image search data fees to support our services. Cost of license and subscription revenue was $62,000 and $57,000 for the six months ended June 30, 1998 and 1999, respectively.

Service. Cost of service revenue primarily includes compensation for software developers, quality assurance personnel, product managers and business development personnel, outside contractors and travel costs directly attributable to certain service and development contracts. Cost of service revenue was $467,000 and $878,000 for the six months ended June 30, 1998 and 1999, respectively, representing an increase of $411,000. This increase was the result of an increased use of our sales and marketing personnel to provide education, outreach and product definition services to our anti-counterfeiting system customer. Cost of service revenue as a percentage of service revenue decreased from 374% in the six months ended June 30, 1998 to 45% in the six months ended June 30, 1999. This decrease resulted from our securing a development contract with a consortium of leading central banks in 1999, where in 1998 we performed a feasibility study for this customer which included substantial research and development accounted for as cost of service.

Operating Expenses

Sales and marketing. Sales and marketing expenses consist primarily of compensation, benefits and related costs of sales and marketing personnel, product managers and sales engineers, as well as recruiting, travel, market research and costs associated with marketing programs, such as trade shows, public relations and new product launches. Sales and marketing expenses were $498,000 and $394,000 for the six months ended June 30, 1998 and 1999, respectively, representing a decrease of $104,000. This decrease resulted primarily from an increase in the number of sales and marketing personnel who provide education, outreach and product definition services to our anti- counterfeiting system customer, resulting in these expenses being allocated to cost of service revenue. Sales and marketing employees totaled six and eleven as of June 30, 1998 and 1999, respectively. We believe that a significant increase in our sales and marketing effort is essential for the introduction of new products, including additional secure document applications, and b'doop and other Paper-as-Portal applications. Accordingly, we anticipate that we will continue to invest significantly in sales and marketing for the foreseeable future, and that sales and marketing expenses are likely to increase in the future.

Research and development. Research and development expenses consist primarily of compensation, benefits and related costs of software developers and quality assurance personnel and payments to outside contractors. Research and development expenses were $415,000 and $247,000 for the six months ended June 30, 1998 and 1999, respectively, representing a decrease of $168,000. This decrease resulted primarily from an increased use of research and development personnel to provide

services to our anti-counterfeiting system customer, resulting in these expenses being allocated to cost of service revenue. Research and development personnel totaled 12 and 15 as of June 30, 1998 and 1999, respectively. We believe that a significant increase in our research and development investment is essential for us to maintain our market position, to continue to expand our product lines and to enhance our technologies and intellectual property rights. Accordingly, we anticipate that we will continue to invest significantly in product research and development for the foreseeable future, and that research and development expenses are likely to increase in the future.

General and administrative. General and administrative expenses consist primarily of compensation, benefits and related costs of executive, finance and administrative personnel, facilities costs, legal and other professional fees and depreciation expense. General and administrative expenses were $606,000 and $1.0 million for the six months ended June 30, 1998 and 1999, respectively, representing an increase of $422,000. This increase was primarily the result of increased executive compensation and travel expenses, as well as executive recruiting fees and professional fees related to our recent growth. General and administrative employees totaled four and five as of June 30, 1998 and 1999, respectively. We believe that our general and administrative expenses will continue to increase as a result of the continued expansion of our administrative staff and expenses associated with being a public company, including annual and other public-reporting costs, directors' and officers' liability insurance, investor-relations programs and professional-services fees.

Compensation expense includes costs relating to stock-based employee compensation arrangements. Stock compensation expense is based on the difference between the fair market value of our common stock and the exercise price of options to purchase that stock on the date of the grant, and is being recognized over the vesting periods of the related options, usually four years. The total unearned compensation recorded by us from inception to June 30, 1999 was $202,000. The fair value per share used to determine unearned compensation was derived by reference to the preferred stock values reduced by a discount factor. We expect to record an additional $2.3 million of total unearned compensation for the third quarter ended September 30, 1999 related to stock grants.

Years Ended December 31, 1996, 1997 and 1998 Revenue Total revenue was $236,000, $186,000 and $984,000 in 1996, 1997 and 1998, respectively, representing a decrease of $50,000 from 1996 to 1997 and an increase of $798,000 from 1997 to 1998. The decrease in revenue was caused by higher licensing fees in 1996, and the increase in revenue was caused by increased service revenue in 1998. We had two customers that each accounted for more than 10% of our revenue, representing in aggregate approximately 78% of our total revenue, for the year ended December 31, 1996; two customers that accounted for more than 10%, representing in aggregate approximately 30% of our total revenue for the year ended December 31, 1997; and one customer that accounted for more than 10%, representing approximately 51% of our total revenue for the year ended December 31, 1998.

License and subscription. License and subscription revenue was $236,000, $161,000 and $484,000 in 1996, 1997 and 1998, respectively, representing a decrease of $75,000 from 1996 to 1997 and an increase of $323,000 from 1997 to 1998. The decrease from 1996 to 1997 was primarily the result of one-time licensing fees received from Adobe Systems and Corel Corporation in 1996. The increase

from 1997 to 1998 was primarily the result of our introduction and the market's acceptance of our subscription-based services designed to address the needs of corporations that want to distribute and promote their image collections on the Internet.

Service. Service revenue was $25,000 and $500,000 in 1997 and 1998, respectively, representing an increase of $475,000. This increase was a result of our completion of an anti-counterfeiting feasibility study in 1998. This has since led to the award of a contract to develop a system to deter the use of personal computers in the counterfeiting of currency.

Cost of Revenue

License and subscription. Cost of license and subscription revenue was $7,000, $126,000 and $114,000 in 1996, 1997 and 1998, respectively. The cost of license and subscription revenue increased $119,000 from 1996 to 1997, and decreased $12,000 from 1997 to 1998. The increase in cost of license and subscription revenue from 1996 to 1997 was primarily caused by the growth of our service department and related costs to support our software product and service introductions made in the fourth quarter of 1996. The decrease from 1997 to 1998 was primarily the result of cost savings associated with providing customer technical support in-house, which had previously been provided by a third party, and a reduction in database development costs.

Service. We recorded cost of service revenue of $1.5 million in 1998 as a result of the use of our product managers, sales, marketing and research and development personnel in our performance of a feasibility study for a consortium of leading central banks which led to a contract to develop a system to deter the use of personal computer systems in the counterfeiting of currency. Cost of service revenue was 293% of service revenue for the year ended 1998.

Operating Expenses

Sales and marketing. Sales and marketing expenses were $376,000, $1.3 million and $825,000 in 1996, 1997 and 1998, respectively. This represents an increase of $954,000 from 1996 to 1997, and a decrease of $505,000 from 1997 to 1998. The increase from 1996 to 1997 resulted primarily from the hiring of sales management and sales and marketing personnel, increased travel and enhanced promotional programs. The decrease from 1997 to 1998 was the result of devoting an increasing amount of sales and marketing personnel to provide education, outreach and product definition services to our anti-counterfeiting system customer. Sales and marketing employees totaled five, ten and eight at December 31, 1996, 1997 and 1998, respectively. We believe that a significant increase in our sales and marketing efforts is essential for the introduction of new products, including self-authenticating documents, b'doop and other Paper-as- Portal applications.

Research and development. Research and development expenses were $690,000, $1.4 million and $658,000 in 1996, 1997 and 1998, respectively. Research and development expenses increased $697,000 from 1996 to 1997 and decreased $729,000 from 1997 to 1998. The increase from 1996 to 1997 was primarily due to increased hiring of software development and quality-assurance personnel and the write-down of purchased technology, as those costs were determined to be unrecoverable. The decrease from 1997 to 1998 resulted primarily from an increased use of our research and development

personnel to provide services to our anti-counterfeiting system customer, resulting in these expenses being allocated to cost of service revenue and the write-down of purchased technology occurring in 1997. Research and development personnel totaled eight, ten and fourteen for 1996, 1997 and 1998, respectively. We believe that a significant increase in our research and development investment is essential for us to maintain our market position, to continue to expand our product line and to enhance our technologies and associated intellectual property. Accordingly, we anticipate that we will continue to invest significantly in product research and development for the foreseeable future, and research and development expenses are likely to increase in the future. In the development of our new products such as self-authenticating documents, b'doop and other Paper-as-Portal applications and enhancements of existing products, the technological feasibility of the software is not established until substantially all product development is complete.

General and administrative. General and administrative expenses were $834,000, $1.3 million and $1.4 million in 1996, 1997 and 1998, respectively, representing increases of $448,000 from 1996 to 1997 and $125,000 from 1997 to 1998. The increase in general and administrative expenses from 1996 to 1997 was primarily the result of increased salary expense and related payroll taxes and benefits from hiring new personnel. Increases in general and administrative expenses from 1997 to 1998 were primarily the result of the implementation of an incentive compensation program. General and administrative employees totaled four, three and four at December 31, 1996, 1997 and 1998, respectively.

Provision for Income Taxes We have recognized operating losses since inception and as such have not incurred income tax expense. As of December 31, 1998, we had operating loss carryovers for federal and state income tax reporting purposes of approximately $8.6 million and research and development tax credit carryforwards of $113,000, the last of which will expire through 2018 if not utilized. Under the Tax Reform Act of 1986, the amounts of and benefits from net operating loss carryforwards may be impaired or limited in certain circumstances, including a change of more than 50% in ownership. Such a change in ownership occurred with the sale of preferred stock in June 1996 and again in July 1996. Accordingly, we estimate that the approximately $915,000 of net operating loss carryforwards generated from inception through July of 1996 will be limited.

Quarterly Results of Operations The following table presents certain unaudited statement of operations data for the six quarters ended June 30, 1999 in dollars. In our management's opinion, this unaudited information has been prepared on the same basis as the audited annual financial statements and includes all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of the unaudited information for the quarters presented. You should read this information in conjunction with the financial statements and the related notes, included elsewhere in this prospectus. The results of operations for any quarter are not necessarily indicative of results that we might achieve for any subsequent periods.

Quarter Ended (unaudited) Dec. Mar. 31, June 30, Sept. 30, 31, Mar. 31, June 30, 1998 1998 1998 1998 1999 1999 (in thousands)

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Statement of Operations
Revenue:
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License and subscription.....	$ 161	$ 121	$ 97	$ 105	$ 74	$ 42
Service.....	--	125	187	188	985	954
Total revenue.....	161	246	284	293	1,059	996
Cost of revenue:						
License and subscription.....	31	31	31	21	21	36
Service.....	128	339	308	691	459	419
Total cost of revenue.....	159	370	339	712	480	455
Gross margin.....	2	(124)	(55)	(419)	579	541
Operating expenses:						
Sales and marketing...	294	204	244	83	131	263
Research and development.....	236	179	131	112	107	140
General and administrative.....	275	331	307	494	459	569
Total operating expense.....	805	714	682	689	697	972
Operating loss.....	(803)	(838)	(737)	(1,108)	(118)	(431)
Other income (expense)..	16	16	25	(13)	(11)	(17)
Loss before provision for income taxes.....	(787)	(822)	(712)	(1,121)	(129)	(448)
Provision for income taxes.....	--	--	--	--	--	--
Net loss.....	$(787)	$(822)	$(712)	$(1,121)	$(129)	$(448)

We expect operating results to fluctuate significantly in the future as a result of a variety of factors, many of which are outside of our control. See "Risk Factors--Our future quarterly operating results may not meet analysts' expectations and may fluctuate significantly in the future, which could adversely affect our stock price" for more information on quarterly fluctuations and how they affect our business.

We believe that comparisons of our historical quarterly operating results will not necessarily be meaningful, and you should not rely on them as an indication of future performance. It is possible that in some future periods our operating results may fail to meet the expectations of analysts and investors. In such event, the trading price of our common stock may decline.

Liquidity and Capital Resources Since inception, we have financed our operations primarily through the private placement of our preferred stock, equipment financings, lines of credit and long-term loans from shareholders. As of June 30, 1999, we had raised approximately $17.0 million through the sale of our preferred stock. In August 1999, we raised an additional $800,000 through the sale of preferred stock.

As of June 30, 1999, we had cash and cash equivalents of $6.2 million, representing an increase of $4.1 million from $2.1 million at December 31, 1998. Our working capital at June 30, 1999 was $6.6 million, compared to working capital of $1.2 million at December 31, 1998. This increase in working capital is attributable primarily to a $6.3 million sale of our preferred stock in June 1999 and an increase in our trade accounts receivable due to increased revenue from a single customer.

Our operating activities resulted in net cash outflows of $1.3 million and $1.9 million for the six months ended June 30, 1998 and 1999, respectively. This $619,000 increase in operating cash outflows from the six months ended June 30, 1998 to the six months ended June 30, 1999 was due primarily to an increase in accounts receivable and a reduction in deferred revenue, offset by improved

operating results in the six months ended June 30, 1999. Operating activities resulted in net cash outflows of $1.5 million in 1996, $3.1 million in 1997, and $3.2 million in 1998. The $1.6 million increase in operating cash outflows from 1996 to 1997 was attributable primarily to an increase in operating losses, offset by an increase in deferred revenue. The $68,000 increase in operating cash outflows from 1997 to 1998 resulted from further growth of deferred revenue and accrued payroll and related costs, offset by lower operating losses.

Investing activities used cash of $49,000 and $72,000 for the six months ended June 30, 1998 and 1999, respectively. In addition, investing activities used cash of $165,000 in 1996, $440,000 in 1997 and $58,000 in 1998. Net cash used in investing activities in 1996 was related primarily to the acquisition of property and equipment. Net cash used in investing activities in 1997 was related primarily to the acquisition of selected assets of a business. Net cash used in investing activities in 1998 was related primarily to the purchase of patents. We anticipate that we will experience an increase in our capital expenditures consistent with our anticipated growth in operations, infrastructure and personnel.

Financing activities used net cash of $38,000 and provided cash of $6.0 million for the six months ended June 30, 1998 and 1999, respectively. Financing activities provided cash of $4.8 million in 1996 and $6.1 million in 1997 and used cash of $233,000 in 1998. Net cash provided by, or used in, financing activities in each of these periods was related primarily to the sales of shares of our preferred stock in 1996, 1997 and the first half of 1999 and proceeds from borrowing in 1997, offset by principal payments on our bank line of credit and equipment lease obligations in 1998 and the first half of 1999.

We have a $400,000 bank revolving line of credit that matures on November 20, 1999. This facility requires that we maintain certain financial covenants. As of June 30, 1999, we had no outstanding borrowings under the revolving line of credit. Any advances would bear interest at the bank's prime interest rate plus 1% and would be secured by substantially all of our assets, excluding intellectual property. We have computers and office equipment financed under long-term capital leases that expire over the next 40 months. As of June 30, 1999, we had an outstanding balance of $341,000 of capital lease obligations. We had unsecured notes payable to common stockholders totaling $305,000 at June 30, 1999 which bear interest at 7% per annum. The payments under these notes will be accelerated by this offering, and we intend to repay in full the outstanding amounts from the net proceeds of this offering. Other significant commitments consist of obligations under non-cancelable operating leases, which totaled $2.0 million as of June 30, 1999, and are payable in monthly installments through 2004.

We currently anticipate that we will continue to experience significant growth in our operating expenses for the foreseeable future as we:

. enter new markets for our products and services;

. increase research and development spending;

. increase sales and marketing activities;

. develop new distribution channels;

. improve our operational and financial systems; and . broaden our professional service capabilities.

These operating expenses will consume a material amount of our cash resources, including a portion of the net proceeds from this offering. We believe that the net proceeds from this offering, together with our existing cash and cash equivalents and available bank borrowings, will be sufficient to meet our anticipated cash needs for at least the next 12 months, although we may seek to raise additional capital during that period. If additional funds are raised through the issuance of equity securities, stockholders may experience additional dilution, and such equity securities may have rights, preferences or privileges senior to those of the holders of our common stock. There can be no assurance that additional financing will be available on acceptable terms or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, which could harm our business, operating results and financial condition.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to the increase or decrease in the amount of interest income we can earn on our investment portfolio and on the increase or decrease in the amount of any interest expense we must pay with respect to outstanding debt instruments. The risk associated with fluctuating interest expense is limited, however, to the exposure related to those debt instruments and credit facilities which are tied to market rates. We do not plan to use derivative financial instruments in our investment portfolio. We plan to ensure the safety and preservation of its invested principal funds by limiting default risks, market risk and investment risk. We plan to mitigate default risk by investing in low-risk securities. At December 31, 1998, we had an investment portfolio of money market funds, commercial securities and U.S. Government securities, including those classified as short-term investments, of $2.1 million. We had loans outstanding of $548,000 at December 31, 1998. If market interest rates were to increase immediately and uniformly by 10% from levels as of December 31, 1998, the decline of the fair market value of the fixed income portfolio and loans outstanding would not be material.

New Accounting Pronouncements In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities."

SFAS No. 133 establishes methods for derivative financial instruments and hedging activities related to those instruments, as well as other hedging activities. Because we do not currently hold any derivative instruments and do not currently engage in hedging activities, we expect that the adoption of SFAS No. 133 will not have a material impact on our financial position or results of operations. In June 1999, the FASB issued Statement No. 137, "Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133, an Amendment of FASB Statement No. 133." Statement No. 137 defers the effective date of Statement No. 133 for one year. Statement No. 133, as amended, is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000.

In December 1998, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 98-9, "Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions." SOP 98-9 amends SOP 97-2 and SOP 98-4, extending the deferral of the application of certain provisions of SOP 97-2 amended by SOP 98-4 through fiscal years beginning on or before March 15, 1999. All other provisions of SOP 98-9 are effective for transactions entered into in fiscal years beginning after March 15, 1999. Before 1998, we recognized software license revenue in accordance with the AICPA SOP 91-1, "Software Revenue Recognition." Beginning in 1998, we have recognized software license revenue in accordance with AICPA SOP 97-2, "Software Revenue Recognition," and related amendments and interpretations contained in the AICPA's SOP 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2." Although these pronouncements apply to our subscription and license revenue and service revenue, we do not expect the adoption of SOP 98-9 to have a material effect on our results of operations or financial condition or to materially impact our revenue recognition practices.

Year 2000 Readiness

Many currently installed computer systems and software products worldwide are coded to accept only two-digit entries to identify a year in the date code field. Consequently, on January 1, 2000, these systems could fail or malfunction because they are not able to distinguish between the year 1900 and the year 2000. Accordingly, many companies, including ourselves and our customers, potential customers, vendors and strategic partners, may need to upgrade their systems to comply with applicable Year 2000 requirements.

Risks of Year 2000 Issues Because we and our customers depend to a very substantial degree upon proper functioning of computer systems, a failure of these systems to correctly recognize dates beyond January 1, 2000 could disrupt operations. Any disruptions could harm our business. Additionally, our failure to provide Year 2000 compliant solutions to our customers could result in financial loss, harm of reputation and legal liability to us. We believe that our products and services are Year 2000 compliant; however, our products and services are often integrated with other systems that may not be compliant.

Our State of Readiness We have reviewed our internal management information and other critical business systems to identify any Year 2000 problems. Our review consisted of:

. quality assurance testing of our applications;

. assessing repair or replacement requirements;

. implementing repair or replacement as necessary; and . creating contingency plans in the event of Year 2000 failures.

We have tested our software products and have determined that the currently shipping versions of all of our software products are Year 2000 compliant. We have also investigated the Year 2000 readiness of external vendors that supply us with material software and information. In the course of these investigations, we have not encountered any material Year 2000 problems with these third-party products. We continue to monitor these third parties for updates to their products as part of our ongoing Year 2000 effort. We have not made a full assessment of the extent to which our customers

might be vulnerable to Year 2000 issues. Likewise, we have not made a full assessment of the extent to which other third parties with which we transact business have determined their vulnerability to Year 2000 issues.

We believe that the Year 2000 risk will not present significant operational problems for us. However, there can be no assurance that our Year 2000 program will prevent any harm to our business.

Contingency Plan

Although we have regular data back-up procedures that would assist us in the recovery of lost business information, we have not yet developed a contingency plan for handling Year 2000 problems that are not detected and corrected prior to their occurrence. Any failure to address any unforeseen Year 2000 issue could harm our business.

Costs to Address Year 2000 Issues We expect that costs directly related to Year 2000 issues will not exceed approximately $50,000 for both costs incurred to date and future costs, including cases where non-compliant third-party products have been or need to be replaced. We would have incurred the replacement cost of non-compliant third-party products regardless of the Year 2000 issue due to technology obsolescence and/or our growth. We have expensed and continue to expense all costs arising from Year 2000 issues as incurred, funding them from working capital.

If our Year 2000 program is inadequate and our business operations are materially impacted, we could incur additional costs to recover any lost information and replace affected systems. We believe that these systems could be replaced without significant difficulties, as replacement systems are generally available on commercially reasonable terms.

Business

Overview

Digimarc is a leading provider of patented digital watermarking technologies that allow imperceptible digital code to be embedded in traditional and digital content, including movies, photographic or artistic images, and valuable documents such as financial instruments, passports and event tickets. Our technologies enable new communications capabilities related to protecting copyrights, deterring counterfeiting or piracy and, for the first time, directly linking physical content with the Internet.

Since the introduction of our first product in 1996, we have built a broad technology platform that we believe has a range of applications. Our initial products allowed copyright owners to deter the use of advanced digital imaging tools in producing unauthorized high-quality copies of their images. We later developed image commerce applications that allowed customers to persistently identify their protected properties or locate these properties across the Internet, and thereby discourage their unauthorized distribution or use.

Today, our business focuses on providing image commerce solutions, including copyright protection, and counterfeiting and piracy deterrence. We are currently developing additional applications to address other forms of visual media such as DVD and video, and other distribution channels such as the Internet. We are also using our technologies to develop products we call Paper- as-Portal applications, the first of which, named b'doop, is planned for release in the second half of 2000. This application is intended to enable imperceptible digital code to be embedded within print media, such as magazine advertisements or articles, direct mail coupons or catalogs and bank cards or business cards. When recognized by PC cameras enabled by our patented reader technology, that code will automatically launch the user directly to the specific Internet destination chosen by the producer of the print media. In this way, we believe that b'doop will deliver more efficient Internet navigation and access to consumers and more effective means for print advertisers to link readers directly to targeted e-commerce points-of-sale.

Industry Background

The Proliferation of Advanced Computing and the Internet Computing systems widely available today are more powerful than ever before, incorporating high-resolution scanning, streaming media and data compression as well as significant increases in processing power, bandwidth and memory. Advances in multimedia, digital imaging and printing technologies have given users of every level of sophistication access to highly advanced image manipulation and printing capabilities. Higher scanner and printer resolution, now typically at 600 dots per inch or higher, have enabled users to digitally capture and subsequently print images more quickly and precisely. Very high- resolution digital camera technology, with over one million pixels per image, has become standard in consumer digital camera products, giving users the ability to capture images that approach photo quality. International Data Corporation, or IDC, estimates that worldwide scanner shipments will increase at 23.3% per year to 39.5 million units by 2003 and worldwide PC camera shipments will grow from approximately 600,000 in 1997 to more than 9.2 million units by 2002.

These advances in computing performance, coupled with computer system price decreases, are also enabling millions of people to participate in the growth of activity on the Internet. IDC estimates that the number of Internet users worldwide will grow from 104 million in 1998 to 320 million by . The Internet represents a fundamental change in the way people conduct business and access or distribute information and contributes to an acceleration of content digitization. NEC estimates that the number of Web pages will increase from 320 million in 1997 to 9.1 billion in 2002 and IDC estimates that the number of users who will make purchases on the Web will increase from 18 million in 1997 to over 128 million in 2002. The rapid growth in the Internet, Internet-based business activities and the conversion of content to digital format are all contributing to the growing obsolescence of analog media content control systems, creating new technological challenges in media content protection.

Web Interface, Internet Navigation and e-Commerce As advances in technology are transforming the Internet into a ubiquitous platform for commerce, traditional "bricks and mortar" businesses are being challenged to bridge their existing methods for marketing and selling with new on-line marketing models. According to Forrester Research, U.S. per capita advertising spending, including print, TV,

radio and the Internet, will be over $700 this year, and the U.S. per capita online advertising portion will grow from $40 in 1999 to $195 in 2004. A MarketFacts survey indicates that in 1998 approximately 62% of current Internet users visited a Web site after seeing it mentioned in a magazine or newspaper and approximately 53% visited a site because of a product's packaging. Currently these users must use the discontinuous method of search engines, or at best look for an advertiser's Internet address within the fine print at the bottom of the page, to find their intended destination. As a result, traditional print advertising such as magazine ads, couponing, packaging and direct mail does not fully tap the communications capabilities of the Internet, because these approaches do not provide a direct link driving potential customers to the e-commerce point-of- sale.

The growth of the Internet has created a large amount of unstructured information which, according to eMarketer, consists of hundreds of millions of Web sites and hundreds of millions of Web pages, with 1.5 million Web pages being added per day. Many corporate Web sites now have thousands of pages, which often makes finding relevant information within a particular site frustrating and time-consuming. As a result, Internet users using conventional search and directory services often experience difficulty in retrieving information relevant to specific products and services, potentially causing e-commerce vendors to lose sales opportunities. According to a study conducted by the Georgia Institute of Technology, approximately 70% of online shoppers abandon a Web site because they have problems locating specific products or services. Search engines currently available are generally inefficient. According to data gathered by NEC, the most comprehensive search engine indexes less than 16% of the Web, a decrease from previous periods. The NEC also estimates that the top 11 search engines combined currently index only 42% of the Web.

Counterfeiting and Piracy in the Digital Age The access to advanced technology that allows users to easily create high- quality digital content has lowered the barriers to entry for professional counterfeiters, counterfeiters engaged in crimes of opportunity and unknowing copyright infringers. This has exacerbated the difficulties of tracking and managing proprietary content such as movies and photographic or artistic images. The International Intellectual Property Alliance estimates that U.S. copyright industries lost at least $12.4 billion worldwide due to copyright piracy in 1998. Traditional commercial merchandise or services, financial instruments and government-issued documents are also affected. The European Commission estimates that more than 5% of world trade is lost to counterfeiting. The expediency and reach of the Internet fuels the rate at which this harm is being done.

The first visual content providers to utilize our digital watermarking for protection of their copyrights were photographers. Shortly thereafter, the movie industry formed an anti-piracy initiative focused on digital watermarking technologies. The lack of an effective DVD security method led major motion picture studios to engage in a multi-year digital watermarking specifications program that is still underway. Although current Internet speeds are not fast enough to support the practical transmission of video, future broadband technology improvements may allow for this transmission. Currently, the Motion Picture Association of America estimates that American motion picture companies lose approximately $2.5 billion per year to video piracy, and the potential loss after Internet distribution of movies becomes widely available could be much greater.

Financial instruments and government-issued documents are frequent targets of illegal counterfeiting enabled by digital technology. In recent Congressional testimony, the U.S. Treasury Department attributed the alarming increases in counterfeiting activity primarily to high-quality graphic devices such as color scanners and printers. The U.S. Treasury Department reported that the advanced technology of today's PCs and peripheral devices was responsible for 43% of all counterfeit banknotes passed and seized in 1998, up from 0.5% in 1995. The U.S. Treasury Department also reported that the amount of U.S. counterfeit banknotes produced increased over 30% during the twelve months ended September 1998.

Currency counterfeiting has wide-ranging implications that may involve, among other issues, undermining the confidence in a currency's stability, causing losses far greater than the aggregate face amount of the currency counterfeited. Digital imaging has contributed to the $615 million lost by U.S. banks each year due to fraudulent and counterfeit checks. We believe that the rise of digital counterfeiting and forgery of passports, driver's licenses and other photo identification is also responsible for substantial losses related to increases in identity theft and falsification of other valuable documents. According to the International Air Transport Association, airlines are fined in excess of $100 million each year for allowing passengers to travel with forged identity documents. Easy access to duplication technology has also put other high-value documents such as stocks, bonds, government obligations, traveler's checks, commercial checks, credit and debit cards and food stamps at risk for counterfeiting and substantial losses.

Many other forms of printed materials are also at risk. Counterfeiters have targeted traditional commercial merchandise and services by using high-quality scanners and laser printers to reproduce packaging, stamps, gift certificates and event tickets. These copies can be distributed over the Internet or on hard copy, CDs or disks. Event tickets in particular can be successfully duplicated and sold. Concerned over counterfeit tickets, organizers of the World Cup and Super Bowl recently adopted currency and check security techniques that required costly design and printing alterations. Product counterfeiting of branded clothing, perfumes, luxury items and other items is widespread, causing label and tag manufacturers to explore and implement similar security printing methods.

Existing solutions to combat counterfeiting and piracy have had limited success against advanced digital technology. Traditional analog security solutions for printed documents, such as special printing techniques, embedded holograms and microthreads, and the use of optically-variable inks, generally do not provide sufficient protection from digital counterfeiting. Network security measures, such as encryption, digital signatures, conditional access and digital containers, control access to digital content during electronic transmission but are ineffective for situations in which encryption or format conversion are involved. These measures also fail to communicate information regarding content copyright and are unable to operate outside of the digital environment. Digital certificates, which are specially prepared software files that act as verifiable electronic credentials, provide authentication and privacy capabilities for consumers and businesses conducting commerce over the Internet, but also do not convert to a non-digital format and do not identify copyright ownership. Without communication of copyright, there can be no foundation for the necessary image-commerce systems across the Internet.

Solutions

We are developing a fundamentally new way to access and use the Internet by embedding imperceptible digital code in traditional and digital media, including printed materials such as magazine advertisements, articles, covers and subscription cards; direct mailers; packaging; debit and credit cards; greeting cards; coupons; catalogues; tickets; business cards; and digital content such as video, images and other creative properties in digital form. This embedded code creates a bridge between those materials and the Internet that permits users to link directly to relevant Web destinations without any typing or mouse clicks. Thus, our patented technologies will give digital capabilities to physical media and allow new forms of interaction with the digital world, enhancing publishing, advertising and e-commerce.

We first used our patented digital watermarking technologies in a variety of applications that protect copyrights, promote image commerce and deter counterfeiting, piracy and other unauthorized uses of all forms of traditional and digital visual content. We believe that ours have become the most widely employed digital watermarking technologies in the image commerce and secure documents markets. We believe our applications offer strong advantages over other approaches because our digital watermarks are imperceptible, robust and format independent, allowing them to operate in both analog and digital environments.

Paper-as-Portal: Bridging the Physical and Digital Worlds and Enhancing the Use of the Internet Our technologies allow owners of visual content, such as printed materials and movies, to embed imperceptible digital code into the content itself. We have designed our reader technology to detect and read this code by cameras, scanners and other image capture devices connected to personal computers and other digital devices. When the code is read, our software is designed to initiate the display of Web destinations or launch Web-based applications specified by the creators of the visual content. We believe these Paper-as- Portal applications will benefit users by providing "no click" direct access to Internet-based information and e-commerce opportunities. For example, a magazine advertisement that has been embedded with our digital code will enable a user to hold the magazine page up to a digital camera enabled with our proprietary reader technology and be taken directly to the Web destination specified by the advertiser.

As online business models evolve and the amount of business transacted on the Internet increases, enterprises are seeking new Internet solutions that will enable them to develop, maintain and leverage relationships with consumers, users and affiliates. We believe our Paper-as-Portal applications will bridge the two separate commerce systems in place right now: traditional commerce and e-commerce. We believe Digimarc-enabled images will facilitate cost-effective integrated marketing by linking traditional marketing materials to the Internet, allowing print materials to become direct portals to the Internet and other digital processing environments.

We believe our ability to embed imperceptible digital code in traditional and digital visual content will benefit consumers, businesses and institutions in the following areas:

Benefits to Businesses. We believe our solutions will enable marketers to improve the return on their investment in conventional and Internet advertising. Because our embedded codes will direct users to a specified Web destination, advertisers can expect higher conversion rates and improved customer satisfaction and retention due to less customer frustration with searches and complicated Web pages. We intend to provide advertisers the flexibility to remotely redirect a marketing campaign by altering the Web destination linked by the embedded code in a particular advertisement. We believe businesses can lower the internal costs of call and e-mail centers by establishing self-service Web pages on maintenance or use that are linked to embedded content. Moreover, imperceptible digital code can be embedded with no visible design changes or material costs.

Benefits to Consumers. We believe consumers will benefit from our solutions through improved convenience and assured success in reaching the relevant Web destination. We intend to offer a direct path from a consumer's interest in an advertisement, editorial, package or label to an online research and buying opportunity, thus avoiding misdirected or overly broad searches on traditional search engines or portals.

Protecting Visual Content and Valuable Documents We also provide solutions to deter the counterfeiting, piracy and unauthorized alteration of media content. Major industries have endorsed digital watermarking generally as an important technology in controlling visual content and valuable documents, including commercial photography, movies, video, music, traditional merchandise and services, financial instruments and other high-value documents. Our digital watermarking solutions are compatible with a variety of Internet, computing and communications solutions because virtually any piece of visual content can contain our imperceptible digital watermarking code. We are able to digitally mark a diverse set of sensitive, high-value materials, including identity documents such as passports and drivers' licenses, commercial and traveler's checks, credit and debit cards, video or print images, currencies, stock certificates, stamps, personal checks, event tickets and clothing brand labels. Our solutions also provide the means to link an embedded code to human- and machine-readable information about a document to establish its authenticity, control its use and link it to the rightful owner. Our digital watermarking technologies can be applied to various types of applications for protecting content, including:

Counterfeiting Deterrence. We intend to use our digital watermarking technologies to provide issuers of high-value documents with the ability both to deter illegal or prohibited reproduction and to verify authenticity. We are forming partnerships with computer, software and peripheral vendors with the aim of having such entities embed or bundle our reader technology into their products. Once incorporated into their products, our reader technology will detect each of our digital watermarks embedded in images or documents the user attempts to process. Detection of the watermark can deter attempts to counterfeit high-value documents by preventing the computer processing of those documents.

Piracy Prevention. Our digital watermarking technologies provide the ability to prevent unauthorized reproduction of copyrighted or otherwise proprietary content. Our digital watermarks can be embedded in almost any form of visual content and can survive file and format changes to provide

persistent identification of the content. By enabling applications with our embedding and reader technologies, the imperceptible identity created by a digital watermark facilitates the communication of copyright and ownership information. Ultimately, these anti-piracy applications help owners of visual content to retain attribution and compensation for their proprietary content.

Document Integrity. We are developing applications using our digital watermarking technologies to deter unauthorized alteration of confidential or proprietary content and to ensure document integrity. Our self-authenticating technology will allow an access control device enabled with our reader technology to check for digital watermarking consistency in documents like passports to determine if a document has been altered. For instance, this capability could allow a plane ticket or travel document to be checked for authenticity. By checking to see if the data in the digital watermark matches information such as a ticket number, an access control device can determine if a document is authentic.

Image Commerce. Any form of visual intellectual property that can be put into a digital format can be marked with our digital watermarking technologies. Our digital watermarks represent a new feature in visual content because they can enhance any type of content, both as a form of protection that allows an owner of intellectual property to discourage its unauthorized distribution and as a method for owners to locate their property on the Internet. In this manner, we provide a fundamental component of image commerce systems and facilitate e-commerce.

Strategy

Our strategy focuses on establishing our technologies as the industry standard for all forms of visual content, contributing to systems designed to control its consumption and use, and enabling numerous new communications functions to enhance its value for producers and consumers. The key elements of our strategy are as follows:

Become the De Facto Standard for Digital Watermarking We believe that our proprietary technologies will emerge as standard digital watermarking technologies for anti-counterfeiting and for linking digital visual content with the physical world because of the advantages they offer over existing security and communications-enabling technologies. We intend to leverage our expertise, our customer and OEM relationships and our strong intellectual property position derived from our first-to-market position and robust portfolio of digital watermarking patents to extend our leadership position into other areas of opportunity for digital watermarking, including movies and video, traditional merchandise and services and high-value documents. We actively participate in a number of initiatives for establishing industry standards, including the Copy Protection Technical Working Group for video copy protection, the Secure Digital Music Initiative for secure music delivery and the Digital Imaging Group for promotion of digital imaging solutions in general. Through our participation in these groups, we hope to promote the role that digital watermarking technologies play in each of these industries. We believe the following characteristics provide a competitive advantage for establishing our technologies as standards:

Imperceptibility. The imperceptible nature of our digital watermarking signal distinguishes it from most other security technologies because it does not require a visible or audible change in content, thereby preserving the aesthetic value of the object.

Persistence and Format Independence. Our digital watermark survives file and format changes, including printing and scanning, to provide persistent identity. In addition, the embedded image is not restricted to specific channels or media.

Achieve Market Penetration Through an Integrated Focus on Infrastructure and Applications We are attempting to build long-term demand for our technologies through our efforts to achieve broad proliferation of our reader technology as a resident application on personal computers and related devices like digital cameras, printers and scanners. Simultaneously, we are aggressively pursuing the development of applications that utilize our digital watermarking technologies. Our success in driving the proliferation of infrastructure enabled by our digital watermarking reader technology will reinforce our technology's applicability to, and is expected to generate demand for, related applications. In a complementary fashion, the successful implementation of applications should drive the availability and demand for our reader technology. We plan to focus efforts in each of these key areas as follows:

Drive Proliferation of Our Reader Technology. We are working with major infrastructure companies, including Adobe, Be Incorporated, 3Com, Logitech and Hewlett Packard, to broaden and extend the penetration of our reader technology into scanners, digital cameras, graphics editing and photo-processing software, printers, Web browsers and other areas of the digital infrastructure. Our reader technology is currently bundled with image- editing applications from leading vendors. To drive adoption, we will continue working with these and other leading infrastructure companies through joint research and development efforts and assistance in product development to influence the establishment of technical standards.

Develop New Applications. We intend to continue developing applications for our digital watermarking technologies through strategic relationships and consulting efforts with leading consumer and business brands and governmental agencies. Through our efforts with consumer brand leaders, we hope to incorporate our watermarking technologies into applications that span all forms of content, including still images and video.

Establish Paper-as-Portal as a Leading Internet Access and Navigation Technology We believe our b'doop solution will serve as a fundamental new interface to digital devices and the Internet, while also enhancing e-commerce. Our Paper- as-Portal technology is intended to bridge the analog and digital formats by embedding imperceptible digital data in printed materials, making those materials Web-enabled. To promote our Paper-as-Portal applications, we intend to establish strategic relationships with leading consumer brands and publishers of printed media as well as infrastructure partners. We believe that our applications offer distinct advantages over existing Internet-based alternatives for facilitating e-commerce, including ease of use, disintermediation of directories and search engines and enhanced market research. We also intend to facilitate e-commerce through our Paper-as-Portal applications by: enabling licensing and distribution of content; promoting e- commerce through digital and printed imagery; protecting the financial instruments used to pay for Internet goods and services; and establishing greater confidence in personal identity systems.

Continue Intellectual Property Leadership We were an early developer of the core technologies that we believe will become the standard in both digital image commerce and other e-commerce enabling applications. Since our patent filings commenced in 1993, we believe that we have established one of the world's most extensive patent portfolios in the field of digital watermarking, holding 15 U.S. issued patents, with at least an additional 49 U.S. patent applications currently on file, of which 3 have received notices of allowance, and at least 17 foreign patent applications pending, including Patent Cooperation Treaty applications. We intend to maintain our technology leadership by creating new products and services, concentrating heavily on research and development, and emphasizing intellectual property protection in all of our activities. We believe our dedication to innovation will also enable us to respond to the challenges presented by the ever-increasing access to sophisticated technology in the areas of piracy and counterfeiting, as well as address the opportunities emerging from the growth of e-commerce.

Promote Our Brand

To enhance industry and public awareness of our solutions, we are pursuing an aggressive brand development strategy through mass market and targeted advertising, promotions and public relations. Our industry branding strategy promotes the broad utility of our technologies across numerous content types, distribution channels and applications. We believe that building our brand will foster continued adoption of our solutions by leading companies in relevant markets and, as appropriate, educate consumers about the new features in media content that we enable. We also believe that a strong brand will increase licensing opportunities with corporate customers, contributing to revenue growth and diversification.

Products

We offer patented digital watermarking solutions, including software, tools and services that allow users to embed, and subsequently read, imperceptible digital data in visual content. This embedded data is imperceptible during normal use but detectable by our software or hardware. We believe that this embedded data can be used to identify, authenticate, track, manage and enhance content, as well as facilitate traditional and e-commerce.

Our initial products addressed the growing concerns of photographers, illustrators and graphic designers who began to use the Web and CD-ROM as central marketing and distribution tools for their portfolios, but who had become increasingly concerned by the use of digital imaging tools to produce high fidelity copies of their images. Our initial products addressed the copyright concerns of these image owners, and ultimately fostered commercial relations between them, by communicating ownership information and helping an image owner to retain attribution and compensation for a copyrighted work. The Advertising Photographers of America expressed concern to Adobe and other major vendors that tools like Photoshop were providing greater availability of new forms of copyright infringement. In response, vendors began to bundle our digital watermarking applications in Photoshop and other leading imaging applications. In addition, by working with the Picture Agency

Council of America, and leading agencies such as MasterFile, we developed products to address the needs of stock photo agencies, which use CD-ROM technology for image distribution and the Web for marketing their image collections, but which often do not directly hold image copyrights.

We have worked closely with our customers to develop applications for our digital watermarking technologies with other media forms, distribution channels and applications like DVD and the Internet. For instance, our initial customers sought to track uses of copyrighted images. This market demand led us to develop MarcSpider, our service to track images on the Internet. Other industries, including media companies such as Time Inc. and National Geographic Television, began to use digital means to distribute and promote large image collections, and as a result, they also sought to develop a system of image asset management. Our image asset management applications allow customers to use our digital watermarking as a de facto digital asset tag, discouraging an image's unauthorized distribution and ultimately generating revenue and extending brand recognition by increasing the likelihood of the licensing of marked images.

The dual goals of copyright protection and revenue and brand enhancement inspired two system improvements: the addition of transactional watermarking and the construction of an image commerce platform. Working with large stock photo collections, notably Corbis and Getty Images, we developed and licensed systems to dynamically embed digital watermarks in images as they are downloaded to customers. Corbis marked more than a million images, many of which became available through AltaVista's search engine. Getty added our digital watermarking to the Tony Stone Web site, the online source for their premium images. National Geographic Television began using our digital watermarking for advertising images used with partners. In addition, we are continuing to develop the image commerce system in cooperation with our customers and business partners, reaching further into the image publishing work flow. By using our digital watermarking to link an image to a server, distributors can offer licensing and image search functions within products like Photoshop. Virtual content bundling being contemplated will further extend the reach for distributors while adding substantial value to an image user.

Our products continue to adapt to the technological needs of our customers. Applications like b'doop are intended to allow our customers to link virtually any physical content with the online world of computing, multimedia and the Internet. We believe that this new method for Web-enabling printed materials will have many potential product applications in direct marketing, merchandising and promotion, packaging, service and support, community building, brand enhancement, news, entertainment and education.

Together with the evolution of our product offerings, we believe that our fundamental embedding and reader technologies will continue to find increased applicability. For example, counterfeiting constitutes a growing threat to the security of the world's currencies. The proliferation of high-resolution color copiers, scanners and printers, and increasingly powerful computers and image-processing software has made it possible for relatively unsophisticated users to produce counterfeit banknotes that pass as authentic in many environments. These developments have made casual

counterfeiting a more attractive crime of opportunity, leading to a substantially increased burden on law agencies. In response to these threats, a number of leading central banks have decided to add new anti-counterfeiting features to their currencies using our digital watermarking technologies.

Our current and planned products are grouped along three lines of business: secure documents, copyright protection and image commerce, and Paper-as-Portal. Each product line consists of embedders to place our digital watermarks into content, and reader technology to detect, read and respond to the embedded data.

Secure Documents

Our planned document security products will use digital watermarking to authenticate original documents, detect fraudulent documents and deter unauthorized duplication or alteration of high-value documents such as passports, tax stamps, tickets and financial instruments like securities, traveler's checks and currencies. We have relationships with a number of financial institutions that are involved in the creation or protection of high- value documents. These relationships include a development and license agreement with a consortium of leading central banks related to anti-counterfeiting of currencies that has accounted for more than half of our revenue in 1998 and is expected to account for substantially all of our revenue until we develop new sources of revenue from new products like b'doop.

Copyright Protection and Image Commerce Our copyright protection and image commerce products provide a range of solutions, including copyright communication, asset management and business-to-business image commerce solutions. Our solutions are enabled by digital watermarking tools provided to content owners, and software modules provided to manufacturers and software vendors for reading the embedded codes and facilitating the appropriate responses to them. Our products and services include those listed below.

Still Images. Copyright protection solution customers can benefit from our solutions by using a number of applications. Image creators can use Digimarc plug-ins that are bundled with a number of leading image editing applications from companies such as Adobe Systems, Corel, Micrografx and JASC Software. The Digimarc batch embedder is a stand-alone tool that processes the embedding of digital watermarks in large collections of digital images. The Digimarc digital watermarking software development kit (SDK) provides a programmatic interface to digital watermark embedding, detection and reading, designed for integration into client and server products. Our SDK application includes real-time server-based watermarking, where digital watermarks carrying transactional data are added to images as they are delivered to customers. Our MarcCentre service is a central repository of registered ownership information that is accessible by a Web user who views Digimarc-enhanced proprietary content with our patented reader technology. This service allows any user to view the information that the content owner wishes to register in MarcCentre. Our MarcSpider service searches the public Web for images containing our digital watermarks and produces reports on where and when such images are found. This service allows Web content developers, photographers, stock photography agencies and publishers of entertainment, sports and news images to track their works on the Web.

Video. Using a unique approach to digital watermarking, Digimarc, Macrovision and Philips engineers have developed prototypes of technology that can protect program material on videocassettes, DVDs, cable or satellite transmissions from unauthorized copying to recordable DVDs, DVHS and multimedia personal computers. The resulting system would complement Macrovision's widely-adopted existing video copy protection technology. Detectors can be cost effectively deployed in hardware or software to meet real-time play and record control requirements in a wide range of DVD platforms.

Paper-as-Portal

We anticipate that our Paper-as-Portal products will provide the ability for printed documents to be identified by personal computers and similar devices through digital images in the documents enhanced with our watermarks that are generally imperceptible to users which will link the computer to a targeted Web destination. We believe that these enhanced images and associated reader technology will enable a variety of potential applications, the first of which is b'doop.

b'doop is an application we are developing based on our patented core technology. b'doop will create new communications capabilities for visual content that promote and enhance e-commerce. b'doop will be a fundamentally new way to access and use the Internet by embedding imperceptible digital code in printed materials, including, among other things, magazine advertisements, articles, covers and subscription cards, direct mailers, packaging, debit and credit cards, greeting cards, coupons, catalogues, tickets and business cards that can be read by digital devices enabled by our patented reader technology. We expect to begin marketing b'doop in the second half of 2000. The same technology can be used to permit video, images and other creative properties in digital form to interact with the digital world.

Technology and Intellectual Property Digimarc's watermarking technologies embed digital codes in images and video that is imperceptible during normal use but readable by computers and software. The science of creating these imperceptible codes is known as digital watermarking. We are a leading owner of intellectual property relating to digital watermarks and pioneer in the commercial application of digital watermarking. Our technologies are supported by a broad patent portfolio covering a wide range of methods and applications for digital watermarking.

Our core technology incorporates a method for embedding codes within visual images in digital formats, such as computer files, and physical representations, such as print or film. Our primary system embeds a message in an image by making subtle changes to the brightness of the pixels, creating a message that can be detected and decoded by hardware that has been enabled with our patented reader technology. Our embedding process adjusts to the unique characteristics of the content, placing a stronger watermark signal in areas with rich detail and a weaker watermark signal in areas with little detail. Because the message is carried by the image's pixels, it is file-format independent. The message can survive most normal image edits, rotation, scaling, file-format transformations, copying, scanning and printing.

The structure of the information in our digital watermark is modeled along the lines of a network protocol. The watermark protocol consists of protocol structure information, such as the type of message and protocol version, the actual message data and error correction data. The protocol can be

upgraded to readily accommodate new message types in the future, while maintaining backwards compatibility. The message in our watermarked content can carry identifying information, attributes and instructions. This message is typically short in length so that it can be replicated throughout the image content many times. The information in the message can uniquely identify the content, link to Web destinations or databases, communicate information about the content, enable tracking of the content or convey instructions for software or devices.

Our technologies allow messages in our watermarked images to survive through a variety of changes to the underlying image, including scaling and rotation of the image. The ability to be rotation independent is particularly important for images that are acquired through digital scanners or cameras because the input image is rarely at the exact same orientation as the original image. We achieve rotation independence through a patented process that incorporates orientation information into our digital watermark, which allows our watermarks to be read regardless of their orientation relative to the scanner or camera. Using this orientation information, our reader technology can recover an image's embedded message after scale changes of as much as .6x to 2x the original image size. We believe these features will be important for communicating the embedded messages through changes from digital to physical form and back again. We believe these features will be especially critical for applications that include printing and scanning, or recording a digital video to VHS and back to DVD.

To protect our significant efforts in creating these technologies, we have implemented an extensive intellectual property protection program which relies upon a combination of patent, copyright, trademark and trade secret laws, nondisclosure agreements and other contractual provisions. We have adopted an aggressive patent strategy. We believe that we have established one of the world's most extensive patent portfolios in the field of digital watermarking, holding 15 U.S. issued patents, with at least 49 U.S. patent applications currently on file, of which 3 have received notices of allowance, and at least 17 foreign patent applications pending, including Patent Cooperation Treaty applications. We also believe, based on published patents, that we hold some of the earliest invention dates on issued patents in the field of digital watermarking and that some of these early patents may be of significant value to our competitive position. We also own certain registered trademarks in both the U.S. and other countries and have applied for other trademarks and have licensed rights to certain other technologies. We seek to protect new product applications through both existing patents and filings for new patents.

We are not currently involved in any proceedings and are not currently aware of any claims regarding our intellectual property rights. Although we devote significant resources to developing and protecting our technologies, and periodically evaluate potential competitors of our technologies for infringement of our intellectual property rights, such infringements may nonetheless go undetected or may arise in the future. We expect that infringement claims may increase as companies become more concerned with protecting their content from electronic copying.

Customers and Strategic Relationships Since the introduction of our first product in 1996, we have built a broad technology platform that we believe has a range of applications. Our initial customers were copyright owners concerned with the use of digital imaging tools in producing unauthorized high-quality copies of their images. We have helped corporate users to generate revenue and extend

their brands through image commerce initiatives. We later developed image commerce applications allowing customers to persistently identify their protected properties or locate those properties on the Internet and thereby discourage the unauthorized distribution or use of those properties. Our strategic partners use our image commerce applications to offer licensing and image search functions within image-editing products. While our applications continue to develop to address changing technological trends, our fundamental embedding and reader technologies continue to find increased applicability.

Customers

Digimarc has been awarded a multi-year contract to develop a system to deter the use of personal computer systems in the counterfeiting of currency. The contract is funded by a consortium of leading central banks. The identities of the participating banks, design of the system and timetable for deployment are confidential. The central banks have acquired an exclusive license to Digimarc's technologies for deterring the counterfeiting of currency. Digimarc has retained the exclusive right to use the technologies developed for the system in other applications, subject to approval by the banks.

Digimarc's current customers also include leaders in the sports, entertainment, news and publishing fields, as well as leading image creators, such as National Geographic Television, Corbis, Getty Communications, Time, Inc. and Fox Broadcasting. Our target markets include photographers, Web designers and OEMs, such as Adobe, Corel and Micrografx. Our stock photo agency customers account for 75% of all stock photo collections, which include more than 60 million high-quality photographs.

The following case studies provide illustrations of how selected customers have used our products and services to address their copyright concerns:

. NASA's Lunar and Planetary Institute (LPI). LPI was looking for a way to announce its copyrights on the unique images in its 3-D Tour of the Solar System CD-ROM. LPI also wanted to remind viewers that these images could not be copied without permission. After much study, LPI took a dual approach by adding a "do not copy" warning to the packaging and Digimarc-enhancing all of the images. LPI used the Digimarc Plug-ins bundled with Adobe Photoshop to mark the images on the CD-ROM, as well as the images on the LPI Web site. To date, LPI has discovered no misuse of the images, and it has indicated to us that it plans to use Digimarc- enhanced images on future projects to communicate image copyrights.

. National Geographic Television. National Geographic Television uses Digimarc software to add "digital asset tags" to assist with tracking and management of the computer-generated original content it uses in its television programming. National Geographic Television's graphic designers Digimarc-enhance digital art used in their productions prior to sharing the work with outside production facilities or other groups within the National Geographic Society.

Strategic Relationships . Macrovision and Philips. In 1997, we entered a joint marketing and development agreement with Macrovision, our largest shareholder. Under this arrangement, we have agreed to develop with Macrovision a system to control copying of DVD and play control video content for all forms of distribution. In 1998, Philips NV joined the partnership. Macrovision and Philips have been developing the video copy prevention and play control solution, with Digimarc

contributing intellectual property and technical assistance. In addition, Macrovision has exclusive marketing rights for the video copy prevention and play control solution for a number of years, subject to payment of minimum royalties. Between December 1997 and June 1999, Macrovision purchased shares of our preferred stock that upon the closing of this offering will be converted into 1,848,951 shares of our common stock.

. Logitech. In September 1999, we entered into a non-binding letter of intent to establish a strategic partnership with Logitech, Inc. In this letter of intent, Logitech expressed its intention to enter into an agreement with Digimarc to include b'doop with Logitech's tethered PC camera software and to prominently mark each package with the Digimarc logo beginning no later than six months after the first commercial availability of b'doop.

. 3Com. In September 1999, we entered a non-binding letter of intent to establish a strategic partnership with 3Com Corporation. In this letter of intent, 3Com expressed its intention to enter a bundling agreement with Digimarc that will provide for the bundling of b'doop with 3Com's tethered PC cameras and to prominently mark each package with the Digimarc logo beginning no later than six months after Digimarc's first commercial shipment of b'doop.

. Be Incorporated. In August 1999, we entered a non-binding letter of intent to establish a strategic partner relationship with Be Incorporated for use of our b'doop software as a standard feature of their operating system. In exchange, Digimarc will grant a royalty free, non-exclusive license to Be Incorporated to offer b'doop to licensees of its operating system.

. Adobe. In 1996, Digimarc granted a ten-year license to Adobe to use Digimarc's watermarking technologies in its Photoshop application, a leading professional image editing application. Simultaneously, Adobe granted Digimarc a ten-year license which allows us to use their software code to develop new applications that are compatible with Adobe's technology. In the same year, Adobe incorporated Digimarc's technology into Adobe's ImageReady application, an image processing application designed specifically for the needs of Web publishers. Between July 1996 and June 1999, Adobe Ventures L.P. purchased shares of our preferred stock that upon consummation of this offering will be converted into 1,693,385 shares of our common stock.

. Hewlett-Packard. In June 1999, Hewlett-Packard made an investment in Digimarc by purchasing $1.5 million of our preferred stock to help us foster new advancements in our digital watermarking technologies and image commerce applications. Upon the closing of this offering, Hewlett- Packard's preferred stock will be converted into 600,000 shares of our common stock.

. Corbis. In 1998, Digimarc granted a three-year enterprise-wide license to Corbis for the use of Digimarc image commerce solutions across Corbis' image collections. Since that time, Corbis and Digimarc have cooperated in defining market requirements and advancing standards that promote the industry-wide use of Digimarc watermarking. In addition, in 1998, Digimarc purchased certain intellectual property relating to digital watermarking from Corbis.

Competition

The markets in which we compete are emerging, highly competitive, fragmented and characterized by rapidly changing technology and evolving standards. We face competition in the overall digital watermarking market as well as in each of the market segments where our products and services compete. We believe that the principal competitive factors in the markets for our products are functionality, interoperability with major hardware and software platforms, and the costs, time to implementation and support services associated with the installation of new products and services. We have experienced and expect to continue to experience increased competition from enterprises in high-technology industries that are developing watermarking capabilities of their own, many of whom have significantly greater financial, technical and marketing resources than we have.

Digimarc's major competition comes from the internal development efforts at high-technology companies. Internal technology departments have staffed projects to build their own watermarking systems utilizing a variety of tools. In some cases, these internal-development projects have been successful in satisfying the needs of an organization. The competitive factors in this area require that we generate a product that conforms to the customer's technology standards, scales to meet the needs of large enterprises, operates globally and costs less than the results of an internal development effort.

Our video copy prevention and play control solution for DVD faces intense competition. Our consortium, comprised of Digimarc, Macrovision and Philips, directly competes with a larger consortium comprised of IBM, NEC, Sony, Hitachi and Pioneer.

Most competition in the secure documents market comes from traditional security features, such as holograms, security threads, special inks, and laminates which compete for the portion of the production budget reserved for security features, and machine-readable features, such as Scrambled Indicia, two dimensional barcodes, Glyphs from Xerox and data-carrying magnetic stripes.

Our Internet-based technology faces competition from companies that provide Internet portals, and search and directory services. For example, we compete with search engines, including Excite@Home, Inktomi and AltaVista, for the traffic generated by Internet users seeking links to third-party content to address their online information needs. We also compete with directory services, such as Yahoo! and LookSmart, because they provide alternative ways for users to obtain the desired information.

Our current and potential competitors, irrespective of the technology they use or intend to use, may have well-established relationships with current and potential customers of ours, extensive knowledge of the markets targeted by us, better name recognition than us and more extensive financial, development, sales and marketing resources than us. Therefore, our competitors' products may achieve greater market acceptance than those offered by us. The development and marketing of competing software may reduce the marketability of our products and therefore may harm our business, operating results and financial condition.

Our business is characterized by extensive research efforts and rapid technological progress. To remain competitive, we will be required to expand and enhance the functionality of our watermarking software and reader technologies. New developments are expected to continue, and there can be no assurance that discoveries by others, including current and potential competitors and internal development efforts, will not render our services and products noncompetitive. Because of rapid

technological change, we may be required to expend greater amounts in the development of each new product than currently anticipated, which in turn will require greater revenue to recoup such expenditures.

Employees

As of September 20, 1999, we had 51 full-time employees, including 12 in sales and marketing, 27 in research and development and 12 in finance, administration and corporate communications. Our future success will depend, in part, on our ability to continue to attract, retain and motivate highly qualified technical and management personnel, for whom competition is intense. Our employees are not covered by any collective bargaining agreement, and we have never experienced a work stoppage. We believe that our relations with our employees are good.

Facilities

Our principal administrative, sales, marketing, support and research and development facility is currently located in Lake Oswego, Oregon. This facility occupies a total of approximately 6,000 square feet under a sub-lease that expires in October 2000. We have signed a five-year lease on approximately 16,500 square feet of space in Tualatin, Oregon, and intend to locate our principal facility there in October 1999. We believe our current facilities are adequate to meet our needs for the foreseeable future.

Legal Proceedings

We may from time to time become a party to various legal proceedings arising in the ordinary course of our business. However, we are not currently subject to any material legal proceedings.

Management

Officers and Directors The following table sets forth certain information regarding our executive officers, corporate officers and directors as of September 20, 1999:

Name Age Position

Executive Officers Bruce Davis..... 47 President, Chief Executive Officer and Director Geoffrey Rhoads..... 36 Chief Technology Officer, Secretary and Director E. K. Ranjit..... 49 Chief Financial Officer J. Scott Carr..... 37 Vice President and General Manager, Secure Documents Corporate Officers Burt W. Perry..... 44 Vice President of Engineering Kathy S. Brogdon..... 46 Vice President of Finance and Operations William Y. Conwell..... 40 Vice President of Intellectual Property Directors Philip J. Monego, Sr.... 52 Chairman of the Board Brian J. Grossi..... 49 Director John Taysom..... 45 Director Executive Officers Bruce Davis has served as our president, chief executive officer and director since December 1997. Prior to joining us, Mr. Davis served as president of Titan Broadband Communications, a provider of information technology and satellite communications systems and services, from April 1997 to December 1997. Prior to that, Mr. Davis served as president of Prevue Networks, Inc., a supplier of electronic program guides and program promotion services for the cable

and satellite television markets, from July 1996 to February 1997. Prior to that, Mr. Davis founded and served as president of TV Guide On Screen, a joint venture of News Corporation and TCI which supplied electronic program guides and navigational software for the cable television market, from January 1993 to July 1996. Mr. Davis received a B.S. in accounting and psychology and an M.A. in criminal justice from the State University of New York at Albany, and a J.D. from Columbia University.

Geoffrey Rhoads founded Digimarc in 1995 and now serves as chief technology officer, secretary and director. Previously, Mr. Rhoads served as our interim president from September to November 1995, and as chairman of the board of directors from January 1995 to March 1996. Prior to that, Mr. Rhoads was the founder and president of Pinecone Imaging Corporation, a company which develops imaging systems for telescopes, since 1992. Mr. Rhoads received his B.A. in physics from the University of Oregon.

E. K. Ranjit has served as our chief financial officer since August 1999. Prior to that, he served as vice president of finance and treasurer of TriQuint Semiconductor, Inc., a supplier of integrated circuits for the wireless communications, telecommunications, data communications and aerospace markets from July 1996 to August 1999, and as its corporate controller from May 1991 to June 1996. Mr. Ranjit received a B.S. from the University of Texas at Dallas and an M.B.A. from Pepperdine University.

J. Scott Carr has served as our vice president and general manager of secure documents since June 1999. Prior to that, he served as our vice president of marketing and business development from January 1998 to May 1999, and director of business development from May 1996 to December 1997. Prior to joining us, Mr. Carr served as vice president of marketing at nCUBE Corporation, a manufacturer of video servers, from July 1995 to May 1996. Prior to that, Mr. Carr worked as a staff architect at Sequent Computer Systems, Inc., a computer equipment manufacturer, from August 1992 to July 1995. Mr. Carr received his B.S. in computer science from Oregon State University.

Corporate Officers

Burt W. Perry has served as our vice president of engineering since July 1996 and served as interim co-president from August through December 1997. Prior to that, Mr. Perry worked as an engineering manager at Intel, designing and managing technology and software development, from June 1993 to July 1996. Mr. Perry received a B.S. in computer science from the University of Delaware.

Kathy S. Brogdon has served as our vice president of finance and operations since October 1996 and served as interim co-president from August through December 1997. Prior to joining us, Ms. Brogdon served as vice president of finance and operations at Active Arts, Inc., a multimedia company, from December 1995 to October 1996. Ms. Brogdon worked as the controller and a partner at Nova Northwest, Inc., a lending, leasing and financial advisory company, from September 1990 to December 1995. Ms. Brogdon received a B.A. in accounting and quantitative methods from the University of Oregon and became a Certified Public Accountant in Oregon in 1978.

William Y. Conwell has served as our vice president of intellectual property since July 1999. Prior to joining us, Mr. Conwell was a patent attorney at Klarquist Sparkman Campbell Leigh & Whinston, LLP since 1984, and became a partner in January 1990. Mr. Conwell received a bachelor's degree in

Electrical Engineering from Georgia Institute of Technology and a J.D. from Emory University School of Law.

Directors

Philip J. Monego, Sr. has been chairman of our board of directors since 1996. Mr. Monego has served as chief executive officer and chairman of the board of directors of Voquette, Inc., an Internet media portal company, since May 1999. Prior to that, Mr. Monego was co-founder, president and chief executive officer of NetChannel, Inc., an Internet information delivery service, from May 1996 to June 1998. Prior to that, Mr. Monego was interim president and chief executive officer of Yahoo! Corporation from April 1995 to September 1995. In addition to his position as chairman of Digimarc, Mr. Monego is currently a director of Women.com Networks. He is an early investor in several new media startups and also currently a venture partner in the Media Technology Venture fund. Mr. Monego received a B.A. in management from LaSalle University.

Brian J. Grossi has served as one of our directors since July 1996. Mr. Grossi co-founded AVI Capital, a venture capital firm specializing in high- technology companies, in 1994. Prior to that, Mr. Grossi was a general partner with Alpha Partners, a venture capital firm, from 1982 to 1992. Prior to that, he worked at the Stanford Research Institute as a research engineer and project leader from 1976 to 1982. Currently, Mr. Grossi serves as a director of Apptitude, Inc., Aptia, Inc., Intraspect Software, Inc., InVisio, Inc., nCommand, Inc., Vivant! Corporation and Pointbase, Inc. Mr. Grossi received a B.S. and an M.S. in mechanical engineering from Stanford University.

John Taysom has served as one of our directors since December 1997. Mr. Taysom has been employed by Reuters, a worldwide television and news agency, since 1982 and is currently the Managing Director of the Reuters Greenhouse Fund. Mr. Taysom also serves on the board of directors of TIBCO Software Inc. and is the Reuters board observer at Infoseek Corporation. Mr. Taysom received a B.Sc. in economics from Bath University.

Upon consummation of this offering, our board of directors will be divided into three classes. One class of directors will be elected each year for a three-year term and until their successors are selected and qualified or until their earlier resignation or removal. Mr. Taysom will serve until our 2000 annual meeting of shareholders; Messrs. Monego and Rhoads will serve until our 2001 annual meeting of shareholders; and Messrs. Davis and Grossi will serve until our 2002 annual meeting of shareholders. Executive officers are elected by and serve at the discretion of the board of directors.

Board Committees

The board of directors has established a compensation committee and an audit committee. The compensation committee, consisting of Messrs. Monego and Grossi, exercises the authority of the board of directors on all compensation matters, including both cash and equity incentive compensation, and administers our employee benefit plans.

The audit committee, consisting of Messrs. Monego and Grossi, recommends the selection of independent public accountants to the board of directors, reviews the scope and results of the audit and other services provided by our independent accountants and reviews our accounting practices and

systems of internal accounting controls.

Director Compensation Directors who are also employees of Digimarc receive no additional compensation for their services as directors. Directors who are not employees of Digimarc do not receive a fee for attendance in person at meetings of the board of directors or committees of the board of directors, but they are reimbursed for travel expenses and other out-of-pocket costs incurred in connection with their attendance of meetings. Non-employee directors have also been granted stock options in the past. After the closing of this offering, we will adopt an option program for our non-employee directors. See "Management-- Employee Benefit Plans--1999 Non-Employee Director Option Program."

Compensation Committee Interlocks and Insider Participation No member of our compensation committee was at any time during the fiscal year ended December 31, 1998 an officer or employee of Digimarc. No member of our compensation committee serves as a member of the board of directors or compensation committee of any entity that has any executive officer serving as a member of our board of directors or compensation committee.

Summary Compensation Table The following table contains information in summary form concerning the compensation paid to our chief executive officer and each of our most highly compensated executive officers, which we refer to in this prospectus as the named executive officers, whose total salary, bonus and other compensation exceeded $100,000 during the years ended December 31, 1996, 1997 and 1998.

The salary information shown for Messrs. Davis and Carr reflects compensation paid to each in his principal position commencing on December 1997 and May 1996, respectively.

		Annual Compensation		Long-Term Compensation	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Securities Underlying Options (#)	All Other Compensation ($)
Bruce Davis(1) ..... President and Chief Executive Officer	1998	208,124	75,000	--	65,529
	1997	2,596	--	800,000	--
	1996	--	--	--	--
Geoffrey Rhoads(2) .... Chief Technology Officer and Secretary	1998	123,542	75,000	--	--
	1997	90,101	--	--	--
	1996	78,700	--	--	302,505
J. Scott Carr ..... Vice President and General Manager-- Secure Documents	1998	109,167	45,000	--	--
	1997	90,000	--	100,000	--
	1996	55,625	--	120,000	--

(1) The $65,529 of other compensation represents reimbursement for relocation expenses. (2) In July 1996, Geoffrey Rhoads and his spouse granted us an option to purchase a maximum of 1,403,260 shares of our common stock owned by them at an exercise price of $0.01 per share for a one-time cash payment of $217,505.30. The number of shares subject to the option lapsed on a monthly basis, and

the option could only be exercised by us upon Mr. Rhoads' voluntary departure or his termination for cause. As of July 30, 1999, our rights under this option lapsed. In July 1996, we also repurchased 340,000 shares of our common stock from Mr. Rhoads for an aggregate purchase price of $85,000.

Aggregate Option Exercises in Last Fiscal Year and Fiscal Year-End Values The following table provides summary information, as to the named executive officers, concerning stock options exercised during 1998 and the number of shares subject to both exercisable and unexercisable stock options as of December 31, 1998. The value of unexercised options at year-end is based on an assumed fair market value of our common stock at December 31, 1998 of $0.25 per share less the exercise price.

			Number of Securities Underlying Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options at Fiscal Year-End ($)	
Name	Shares Acquired on Exercise (#)	Value Realized ($)	Exercisable	Unexercisable	Exercisable	Unexercisable
Bruce Davis.....	--	--	200,000	600,000	0	0
Geoffrey Rhoads.....	--	--	--	--	--	--
J. Scott Carr.....	--	--	133,328	86,672	17,500	3,500

Employment Arrangements In July 1999, we adopted a policy regarding the vesting of stock options for all our officers, including prior grants. All shares subject to their options that have not vested will immediately vest if the following two conditions are met:

. we merge with another company and there is a change of control of our company or we sell substantially all of our assets to another company; and . any officer's employment is terminated, or constructively terminated, within twelve months thereafter.

Employee Benefit Plans 1995 Stock Incentive Plan The 1995 plan was approved by our board of directors in October 1995 and by our shareholders in March 1996. Initially, a total of 1,000,000 shares of common stock were reserved for issuance under the 1995 plan. This reserve was amended several times to reserve a total of 5,600,000 shares of common stock for issuance under the plan. As of September 20, 1999, options to purchase 793,864 shares of common stock granted had been exercised, options to purchase 4,431,923 shares of common stock were outstanding, and options to purchase 374,213 shares of common stock remained available for grant. The outstanding options were exercisable at a weighted average exercise price of $0.58 per share. Outstanding options to purchase an aggregate of 1,161,923 shares were held by employees and consultants who are not officers or directors of our company.

All options granted under the 1995 plan that expire after the date of the 1995 plan amendment without having been exercised are cancelled and are no longer available for grant under the 1995 plan. The 1995 plan will terminate in 2005, unless terminated earlier by our board of directors. Awards under the 1995 plan may consist of restricted stock, incentive stock options, which are stock options that qualify under Section 422 of the Internal Revenue Code, or non-qualified stock options, which are stock options that do not qualify under that provision.

The board may grant incentive stock options to employees, including officers and directors who are employees. Non-qualified stock options and restricted stock may be granted to employees, including officers and directors who are employees, or consultants. The compensation committee may set the terms of such grants, subject to the restrictions in the 1995 plan.

During an optionee's lifetime, only the optionee can exercise an option. The optionee cannot transfer such options other than by will or the laws of descent and distribution. If an optionee's status as an employee or consultant terminates for any reason other than death or disability, the optionee may exercise their exercisable options within the three-month period following the termination. In the event the optionee becomes disabled or dies while the optionee is an employee or consultant of our company, the options vested as of the date of disability or death may be exercised prior to the earlier of their expiration date or 12 months from the date of the optionee's disability or death. In November 1997, we amended the plan to adjust certain exercise periods, which affects all grants made after that time. Under this amendment, the time to exercise after termination was reduced from three months to one month and the time to exercise after death or disability was reduced from 12 months to four months.

In the event of a proposed sale of all or substantially all of our assets or a merger by us with or into another company, every option outstanding under the 1995 plan may be assumed or substituted with an equivalent option by the successor company, or its parent or subsidiary. However, our board of directors may determine, in lieu of assumption or substitution, that an optionee is entitled to exercise their options, including options which would not otherwise be exercisable within thirty days of this determination by the board. Our officers' stock option grant agreements provide for accelerated vesting of their options in the event of a change of control. If we liquidate or dissolve, the options will terminate immediately prior to the completion of the dissolution or liquidation. However, our board may in its sole discretion declare that any option terminates on a date fixed by the board and give the optionees the right to exercise their options, including options which would not otherwise be exercisable.

The 1995 plan will terminate automatically in 2005 unless terminated earlier by our board of directors. The board of directors has the authority to amend or terminate the 1995 plan, subject to stockholder approval of certain amendments. However, no action may be taken which will affect any shares of common stock previously issued and sold or any option previously granted under the 1995 plan, without the optionee's consent. We do not anticipate granting options under this plan after completion of this offering.

1999 Stock Incentive Plan Our 1999 Stock Incentive Plan was approved by our board of directors in , 1999. We will be submitting it for approval by our stockholders prior to the closing of this offering. After the completion of this offering, we anticipate all further option grants will be made solely under the 1999 Stock Incentive Plan. Initially, we reserved 3,000,000 shares of our common stock for issuance under the 1999 Stock Incentive Plan. The number of shares initially reserved will be increased by the number of shares reserved under our 1995 Stock Incentive Plan, but not granted as of the date of the completion of this offering, and represented by awards under the 1995 Stock Incentive Plan that

are forfeited, expire or are cancelled following the adoption of the 1999 Stock Incentive Plan. Commencing on the first day of our fiscal year beginning in 2001, the number of shares of stock reserved for issuance under the 1999 Stock Incentive Plan will be increased annually by a number equal to the lesser of 3% of the fully-diluted number of shares outstanding as of that date or a lesser number of shares determined by the board. However, the maximum number of shares available for issuance as incentive stock options shall be increased by the lesser of 1,250,000 shares, 3% of the number of fully-diluted shares outstanding as of that date or a lesser number of shares determined by the board.

No options to purchase shares of our common stock under the 1999 Stock Incentive Plan have been exercised, no options to purchase shares of common stock are outstanding, and options to purchase 3,000,000 shares of common stock remained available for grant prior to this offering.

The purpose of the 1999 Stock Incentive Plan is to attract and retain the best available personnel, to provide additional incentive to our employees, directors and consultants and our related entities and to promote the success of our business. The 1999 Stock Incentive Plan provides for the granting to employees of incentive stock options, and the granting to our employees, directors and consultants and our related entities of non-statutory stock options, stock appreciation rights, dividend equivalent rights, restricted stock, performance units, performance shares and other equity-based rights.

Under the 1999 Stock Incentive Plan, our board of directors, or a committee designated by the board made up of two or more non-employee directors, administers the granting of stock and options to directors and officers in a way that allows these grants of stock to be exempt from Section 16(b) of the Securities Exchange Act and determines the provisions, terms and conditions of each award. When stock or options are granted to other participants in the 1999 Stock Incentive Plan, our board, or a committee designated by our board administers these awards and determines the provisions, terms and conditions of each award.

During their lifetime, those who hold the incentive stock options granted under this plan cannot transfer these options. The options may be distributed by a will or the laws of descent upon the death of the option holder. No one is allowed to exercise the incentive stock options except the person to whom the options were first issued while that person is alive. Stock or options other than incentive stock options which are issued under the 1999 Stock Incentive Plan can be transferred to the extent agreed upon at the time of the award.

The term of 1999 Stock Incentive Plan awards will be determined by the board. The exercise price or purchase price, if any, of 1999 Stock Incentive Plan awards that are not incentive stock options will be determined by the board, but will not be less than 85% of the fair market value of the stock. The form of payment for the shares of common stock when options are exercised or stock is purchased under a 1999 Stock Incentive Plan award will be determined by the board and may include cash, check, shares of common stock or the assignment of part of the proceeds from the sale of shares acquired upon exercise or purchase of the award.

Where the award agreement permits the exercise or purchase of an award for a certain period of time following the recipient's termination of service with us, disability or death, that award will terminate to the extent not exercised or purchased on the last day of the specified period or the last day of the original term of such award, whichever occurs first.

If a third party acquires us through the purchase of all or substantially all of our assets, a merger or other business combination, all unexercised options will terminate unless assumed by the successor corporation. Unless terminated sooner, the 1999 Stock Incentive Plan will terminate automatically in 2009. The board has the authority to amend, suspend or terminate the 1999 Stock Incentive Plan, subject to stockholder approval of certain amendments. However, no action may be taken which will affect awards previously granted under the 1999 Stock Incentive Plan unless agreed to by the affected grantees.

1999 Non-Employee Director Option Program Our 1999 Non-Employee Director Option Program was adopted pursuant to the 1999 Stock Incentive Plan and is subject to the terms and conditions of the 1999 Stock Incentive Plan. Our 1999 Non-Employee Director Stock Option Program was approved by our board of directors in 1999. The 1999 Non-Employee Director Stock Option Program is effective as of the effective date of this prospectus, and no awards will be made under this program until that time.

The purpose of the 1999 Non-Employee Director Stock Option Program is to enhance our ability to attract and retain the best available non-employee directors, to provide them additional incentives and, therefore, to promote the success of our business.

The 1999 Non-Employee Director Stock Option Program establishes an automatic option grant program for the grant of awards to non-employee directors. Under this program, each then-existing non-employee director upon the effective date of this prospectus and each non-employee director first elected to our board of directors following the closing of this offering will automatically be granted an option to acquire 20,000 shares of our common stock at an exercise price per share equal to the fair market value of our common stock at the date of grant. These options will vest and become exercisable in four equal installments on each anniversary of the grant date. Upon the date of each annual stockholders' meeting, each non-employee director who has been a member of our board of directors for at least six months prior to the date of the stockholders' meeting will receive an automatic grant of options to acquire 5,000 shares of our common stock at an exercise price equal to the fair market value of our common stock at the date of grant. Such options will vest and become fully exercisable on the first anniversary of the grant date.

The term of each automatic option grant and the extent to which it will be transferable will be provided in the agreement evidencing the option. The consideration for the option may consist of cash, check, shares of our common stock, the assignment of part of the proceeds from the sale of shares acquired upon exercise of the option or any combination thereof.

The 1999 Non-Employee Director Stock Option Program is administered by the board or a committee designated by the board made up of two or more non- employee directors so that such awards would be exempt from Section 16(b) of the Exchange Act. The program administrator shall determine the terms

and conditions of awards, and construe and interpret the terms of the program and awards granted pursuant thereto. Non-employee directors may also be granted additional incentives, subject to the discretion of the board or such committee.

Unless terminated sooner, the 1999 Non-Employee Director Stock Option Program will terminate automatically in 2009 when the 1999 Stock Incentive Plan terminates. Our board of directors has the authority to amend, suspend or terminate the 1999 Non-Employee Director Stock Option Program provided that no such action may affect awards to non-employee directors previously granted under the program unless agreed to by the affected non-employee directors.

1999 Employee Stock Purchase Plan Our 1999 Employee Stock Purchase Plan was approved on , 1999. We will be submitting it for approval by our stockholders prior to the closing of this offering. The 1999 Employee Stock Purchase Plan is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code in order to provide our employees with an opportunity to purchase common stock through payroll deductions. The 1999 Employee Stock Purchase Plan will be administered by our board of directors or a committee designated by our board, which will have the authority to terminate or amend the 1999 Employee Stock Purchase Plan, subject to specified restrictions, and otherwise to administer the 1999 Employee Stock Purchase Plan and to resolve all questions relating to its administration.

Initially, we reserved 1,250,000 shares of our common stock for issuance and made them available for purchase under the 1999 Employee Stock Purchase Plan, subject to adjustment in the event of a stock split, stock dividend or other similar change in our common stock or our capital structure. Commencing on the first day of our fiscal year beginning in 2001, the number of shares of stock reserved for issuance under this plan will be increased annually by a number equal to the lesser of 1% of the fully-diluted number of shares outstanding as of that date, 500,000 shares or a lesser number of shares determined by the board.

All employees of our company and of our subsidiaries whose customary employment is for more than five months in any calendar year and 20 hours or more per week are eligible to participate in our 1999 Employee Stock Purchase Plan. Employees hired after the closing of our initial public offering are eligible to participate in our 1999 Employee Stock Purchase Plan, subject to a ten-day waiting period after hiring. Non-employee directors, consultants and employees subject to the rules or laws of a foreign jurisdiction that prohibit or make impractical their participation in the 1999 Employee Stock Purchase Plan are not eligible to participate in our 1999 Employee Stock Purchase Plan.

The 1999 Employee Stock Purchase Plan designates the periods when the stock is offered, when it can be purchased, and the exercise dates for options. Offer periods are generally overlapping periods of 24 months. The initial offer period begins on the effective date of this prospectus, and ends on January 31, 2002. Additional offer periods will commence each February 1 and August 1. Purchase periods are generally six-month periods, with the initial purchase period commencing on the effective date of this prospectus and ending on July 31, 2000. After the effective date of this prospectus, purchase periods will commence each February 1 and August 1. Exercise dates are the last day of each purchase period. If we merge with or into another corporation, sell all or substantially all of our assets or enter into other

transactions in which our shareholders before the transaction own less than 50% of the total combined voting power of our outstanding securities following the transaction, the board may elect to shorten the offer period then in progress.

On the first day of each offer period, a participating employee is granted a purchase right. A purchase right is a form of option to be exercised automatically on the forthcoming exercise dates within the offer period. During the offer period, authorized deductions from the pay of participants are credited to their accounts under the 1999 Employee Stock Purchase Plan. When the purchase right is exercised, the participant's withheld salary is used to purchase shares of common stock. The price per share at which shares of common stock are to be purchased under the 1999 Employee Stock Purchase Plan during any purchase period is the lesser of 85% of the fair market value of the common stock on the date of the grant of the option, which is the beginning of the offer period, or 85% of the fair market value of the common stock on the exercise date. The participant's purchase right is exercised in this manner on each exercise date arising in the offer period unless, on the first day of any purchase period, the fair market value of the common stock is lower than the fair market value of the common stock on the first day of the offer period. If it is, the participant's participation in the original offer period is terminated, and the participant is automatically enrolled in the new offer period effective the same date with an exercise price equal to the fair market value of the stock on the first day of the new offer period.

Payroll deductions may range from 1% to 10% in whole percentage increments of a participant's regular base pay, including cash payments for commissions, overtime, bonuses, annual awards and other cash incentive payments. Participants may not make direct cash payments to their accounts. The maximum number of shares of common stock that any employee may purchase under the 1999 Employee Stock Purchase Plan during a purchase period is 1,000 shares. The Internal Revenue Code imposes additional limitations on the amount of common stock that may be purchased during any calendar year.

401(k) Plan

In 1997, we implemented a 401(k) Plan covering certain of our employees who are at least 21 years old and have been employed at least four months. Pursuant to the 401(k) Plan, eligible employees may elect to reduce their current compensation by up to the lesser of 15% of their compensation or the prescribed annual limit ($10,000 in 1999) and contribute these amounts to the 401(k) Plan. We may make contributions to the 401(k) Plan on behalf of eligible employees. Employees become 25% vested in these contributions after one year of service, and increase their vested percentages by an additional 25% for each year of additional service. The 401(k) Plan is intended to qualify under Section 401 of the Internal Revenue Code so that contributions by employees or by us to the 401(k) Plan, and income earned on the 401(k) Plan contributions, are not taxable to employees until withdrawn from the 401(k) Plan, and so that contributions by us, if any, will be deductible by us when made. The trustee under the 401(k) Plan, at the direction of each participant, invests the 401(k) Plan employee salary deferrals in selected investment options. We made no contributions to the 401(k) Plan in 1995, 1996, 1997 or 1998. We do not presently expect to make any contributions to the 401(k) Plan during fiscal 1999.

Limitation of Liability and Indemnification Matters We intend to reincorporate in the State of Delaware immediately prior to this offering. Our certificate of incorporation and bylaws will provide that we will indemnify all directors and officers of Digimarc to the fullest extent permitted by Delaware law. Our certificate of incorporation and bylaws also will authorize us to indemnify our employees and other agents, at our option, to the fullest extent permitted by Delaware law. We intend to enter into agreements to indemnify our directors and officers, in addition to indemnification provided for in our charter documents. These agreements, among other things, will provide for the indemnification of our directors and officers for certain expenses (including attorneys' fees), judgments, fines and settlement amounts incurred by any such person in any action or proceeding, including any action by or in the right of Digimarc, arising out of such person's services as a director or officer of Digimarc or any other company or enterprise to which such person provides services at the request of Digimarc to the fullest extent permitted by applicable law. We believe that these provisions and agreements will assist us in attracting and retaining qualified persons to serve as directors and officers.

Delaware law permits a corporation to provide in its certificate of incorporation that a director of the corporation shall not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability for any breach of the director's duty of loyalty to the corporation or its stockholders, for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law for liability arising under Section 174 of the General Corporation Law of the State of Delaware, or for any transaction from which the director derived an improper personal benefit. Our certificate of incorporation provides for the elimination of personal liability of a director for breach of fiduciary duty, as permitted by Delaware law.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of Digimarc pursuant to the provisions contained in our charter documents, Delaware law or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission this indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. If a claim for indemnification against such liabilities (other than the payment by Digimarc of expenses incurred or paid by a director, officer or controlling person of Digimarc in the successful defense of any action, suit, or proceeding) is asserted by such director, officer or controlling person, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by us is against public policy as expressed in the Securities Act and we will follow the court's determination.

We intend to purchase and maintain insurance on behalf of the officers and directors, insuring them against liabilities that they may incur in such capacities or arising out of such status.

Related Party Transactions

Reincorporation

Prior to the closing of this offering, we will reincorporate in Delaware and our existing stockholders will receive shares of common stock and preferred stock of the Delaware corporation in exchange for their shares of common stock and preferred stock of the Oregon corporation. In connection with the closing of this offering, each share of Series A and Series B preferred stock will automatically convert into two shares of common stock of the Delaware corporation and each share of Series C, Series D and Series D-X preferred stock will automatically convert into one share of common stock of the Delaware corporation.

Private Placement Transactions Since our inception, we have issued in private placement transactions shares of preferred stock as follows:

. an aggregate of 302,822 shares of Series A-1 preferred stock at $1.25 per share in June 1996 to eight investors;

. an aggregate of 22,178 shares of Series A-1 preferred stock at $2.25 per share in June 1996 to two investors;

. an aggregate of 1,804,000 shares of Series B-1 preferred stock at $2.50 per share in July 1996 to seven investors, including Adobe Ventures L.P., AVI Capital L.P. and affiliates whose general partner, Brian Grossi, is a member of our board of directors, Justsystem, Inc. and Softbank Ventures, Inc.;

. an aggregate of 4,059,573 shares of Series C-1 preferred stock at $1.43 per share in December 1997 to 16 investors, including Philip Monego, Sr., chairman of our board of directors, Adobe Ventures L.P., AVI Capital L.P. and affiliates, Macrovision Corporation, Reuters, Ltd., a general manager of which is John Taysom, a member of our board of directors, and Justsystem, Inc.;

. an aggregate of 2,532,000 shares of Series D preferred stock at $2.50 per share in June 1999 to 14 investors, including Philip Monego, Sr., Adobe Ventures L.P., AVI Capital L.P. and affiliates, Macrovision Corporation and Reuters Holdings Switzerland, S.A.; and . an aggregate of 320,000 shares of Series D-X preferred stock at $2.50 per share in August 1999 to three investors, including Philip Monego, Sr.

The following table sets forth the number of shares of Series A-1, Series B- 1, Series C-1, Series D and Series D-X preferred stock purchased by our directors, five percent stockholders and their respective affiliates.

Holders	Series A-1 Preferred	Series B-1 Preferred	Series C-1 Preferred	Series D Preferred	Series D-X Preferred
Macrovision Corporation..	--	--	1,048,951	800,000	--
Reuters Group.....	--	--	1,398,601	400,000	--
AVI Capital L.P. and affiliates.....	--	504,000	467,098	300,000	--
Adobe Ventures L.P.....	--	500,000	463,385	230,000	--
Philip Monego, Sr.....	32,000	--	69,930	100,000	80,000
Justsystem, Inc.....	--	400,000	174,825	--	--
Softbank Ventures, Inc...	--	400,000	--	--	--

Investors' Rights Agreement Certain holders of common stock and preferred stock have registration rights with respect to their shares of common stock, including common stock issuable upon conversion of their preferred stock. See "Description of Capital Stock-- Registration Rights of Certain Holders."

Transactions with Directors and Executive Officers In July 1996, we repurchased 340,000 shares of our common stock from Mr. Rhoads for an aggregate purchase price of $85,000.

See "Management--Executive Compensation" for a description of stock transactions entered into with our directors and executive officers.

Transactions with Affiliates In September 1996, we entered into a software development and distribution agreement with Adobe Systems Incorporated under which we granted a non- exclusive license to Adobe for the use of our licensed software to be bundled with Adobe products in exchange for a non-exclusive license to certain of Adobe's intellectual property. Under the agreement, Adobe agreed to pay us a one-time engineering fee of $100,000 for the development of the licensed software and for support and maintenance fees.

We believe that all of the transactions set forth above were made on terms no less favorable to us than could have been obtained from unaffiliated third parties. We intend that all future transactions, including loans, between us and our officers, directors, principal shareholders and their affiliates will be approved by the board of directors, including a majority of the disinterested outside directors on the board of directors, and will be on terms no less favorable to us than could be obtained from unaffiliated third parties.

Principal Stockholders

The following table sets forth the beneficial ownership of our common stock as of September 20, 1999 and as adjusted to reflect the sale of the shares of common stock in this offering by:

. each person or entity known by us to own beneficially more than five percent of our common stock;

. our chief executive officer, each of the other named executive officers and each of our directors; and . all of our executive officers and directors as a group.

The beneficial ownership is calculated based on 15,966,512 shares of our common stock outstanding as of September 20, 1999 and shares immediately following the closing of this offering. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Unless otherwise indicated, each person or entity named in the table has sole voting power and investment power, or shares voting and investment power with his or her spouse, with respect to all shares of capital stock listed as owned by such person. Shares issuable upon the exercise of options that are currently exercisable or become exercisable within sixty days of September 20, 1999 are considered outstanding for the purpose of calculating the percentage of outstanding shares of our common stock held by the individual, but not for the purpose of calculating the percentage of outstanding shares of our common stock held by any other individual.

The address of each of the executive officers and directors is c/o Digimarc Corporation, One Centerpointe Drive, Suite 500, Lake Oswego, Oregon 97035-8615.

Name and Address	Number of Shares Beneficially Owned	Percentage of Shares Beneficially Owned: Prior to the Offering	Percentage of Shares Beneficially Owned: After the Offering

5% Stockholders Macrovision Corporation ..... 1,848,951 11.6% 1341 Orleans Drive Sunnyvale, California 94089 Reuters Ltd.(1)..... 1,798,601 11.3% 85 Fleet Street London, EC4P 4AJ England AVI Capital L.P. and affiliates(2)..... 1,775,098 11.1% One First Street Los Altos, California 94022 Adobe Ventures, L.P. ..... 1,693,385 10.6% One Bush Street, 15th Floor San Francisco, California 94104 Justsystem, Inc..... 974,825 6.1% 2460 Sand Hill Road, Suite 201 Menlo Park, California 94025 Softbank Ventures, Inc. ..... 800,000 5.0% 333 West San Carlos Avenue, Suite 1225 San Jose, California 95110

Name and Address	Number of Shares Beneficially Owned	Percentage of Shares Beneficially Owned: Prior to the Offering	Percentage of Shares Beneficially Owned: After the Offering
Named Executive Officers and Directors			
Philip J. Monego, Sr.(3)...	493,930	3.1%	
Bruce Davis(4).....	350,000	2.2%	
Geoffrey Rhoads(5).....	1,508,560	9.4%	
J. Scott Carr(6).....	174,167	1.1%	
Brian J. Grossi(7).....	1,775,098	11.1%	
John Taysom(8).....	1,798,601	11.3%	
All executive officers and directors as a group (6 persons)(9).....	6,100,356	36.8%	

* Less than 1%. (1) Represents 1,398,601 shares held by Reuters, Ltd. and 400,000 shares held by Reuters Holdings Switzerland, S.A., an affiliate of Reuters, Ltd. (2) Represents 1,509,062 shares held by AVI Capital, L.P., 208,651 shares held by Associated Venture Investors III, L.P., 42,904 shares held by AVI Partners Growth Fund II, L.P. and 14,481 shares held by AVI Silicon Valley Partners, L.P., entities affiliated with AVI Capital L.P. (3) Includes options for 180,000 shares of common stock exercisable within 60 days of September 20, 1999. (4) Includes options for 270,000 shares exercisable within 60 days of September 20, 1999 and 10,000 shares owned by Gary and Kimberly Davis, 10,000 shares owned by Joseph and Barbara Davis, 10,000 shares owned by Thomas and Donna Davis, 10,000 shares owned by George and Candace Richard, 10,000 shares owned by John and Halene Richard, 10,000 shares owned by Robert Bradford, Jr. and Grace Richard, 10,000 shares owned by Robert Bradford III and Darcy Richard and 10,000 shares owned by Gary and Karen Gorney, all of whom are relatives of Bruce Davis. Mr. Davis disclaims beneficial ownership of these shares owned by his relatives. (5) Includes 26,000 shares owned by Amanda Rhoads Trust, 26,000 shares owned by Hudson Rhoads Trust, 2,100 shares owned by Craig and Laura Mikkelson, 20,420 shares owned by Barbara K. Rhoads, 1,700 shares owned by Bryan Gurrie Rhoads, 1,900 shares owned by Cynthia Brooke Rhoads, 89,480 shares owned by Gurrie and Alice Rhoads, 200 shares owned by Nicole Rhoads-- Trustee for the

Children of Geoffrey and Nicole Rhoads, 26,000 shares owned by Trevor Rhoads Trust, 1,500 shares owned by Mittie Hellmich, 1,500 shares owned by Taylor James Pierce and 1,500 shares owned by Dirk Pierce, all of whom are relatives of Geoffrey Rhoads or trusts established for their benefit. Mr. Rhoads disclaims beneficial ownership of these shares owned by his relatives. (6) Represents options for 174,167 shares of common stock exercisable within 60 days of September 20, 1999. (7) Represents shares held by AVI Capital L.P. and affiliates of which Mr. Grossi is a general partner. Mr. Grossi disclaims beneficial ownership of these shares except to the extent of his pecuniary interest as a general partner. (8) Represents shares held by Reuters Group. Mr. Taysom disclaims beneficial ownership of these shares. (9) Includes options for 624,167 shares of common stock exercisable within 60 days of September 20, 1999.

Description of Capital Stock

Following the closing of this offering, our authorized capital stock will consist of 60,000,000 shares of common stock and 10,000,000 shares of undesignated preferred stock. The following description of our capital stock does not purport to be complete and is subject to, and qualified in its entirety by, the provisions of our certificate of incorporation and bylaws, which are included as exhibits to the registration statement of which this prospectus is a part, and by the provisions of applicable law.

Common Stock

As of September 20, 1999, there were 4,796,939 shares of common stock outstanding that were held of record by approximately 94 shareholders. Based on the shares outstanding as of September 20, 1999, there will be shares of common stock outstanding, assuming no exercise of the underwriters' over- allotment option and no exercise of outstanding options, after giving effect to the sale of the common stock we are offering.

The holders of our common stock are entitled to one vote for each share held of record on all matters submitted to a vote of the stockholders, including the election of directors. Subject to preferences that may be granted to any then outstanding preferred stock, holders of common stock are entitled to receive ratably such dividends as may be declared by the board of directors out of funds legally available for such purpose, as well as any distributions to the stockholders. In the event of our liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in all of our assets remaining after payment of liabilities and the liquidation preference of any then outstanding preferred stock. Holders of common stock have no preemptive or other subscription or conversion rights. There are no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of common stock are fully paid and non-assessable.

Preferred Stock

As of September 20, 1999, there were 9,040,573 shares of preferred stock outstanding and held of record by 24 stockholders. In connection with the consummation of this offering, all outstanding shares of Series A and Series B preferred stock will automatically be converted into common stock on a two-for- one basis, and all outstanding shares of Series C, Series D and Series D-X preferred stock will

automatically be converted into common stock on a one-for- one basis, and all these shares of preferred stock will be cancelled. From and after the consummation of this offering, we will be authorized to issue 10,000,000 shares of preferred stock that will not be designated as a particular class. Our board of directors will have the authority to issue the undesignated preferred stock in one or more series and to determine the powers, preferences and rights and the qualifications, limitations or restrictions granted to or imposed upon any wholly unissued series of undesignated preferred stock and to fix the number of shares constituting any series and the designation of such series, without any further vote or action by the stockholders. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change of control of our company without further action by the stockholders and may adversely affect the voting and other rights of the holders of common stock. At present, we have no plans to issue any shares of preferred stock.

Registration Rights of Certain Holders After this offering, and assuming we comply with other requirements, the holders of approximately 11,169,573 shares of common stock will have the right to cause us to register their shares under the Securities Act. These rights are held under the terms of an investors' rights agreement between us and the holders of these registrable securities. Under the terms of this agreement, if we propose to register any of our securities under the Securities Act, we must give the holders of these registrable securities 30 days' prior notice of registration and include a portion of their shares of common stock in the registration. Additionally, upon written demand of holders of more than 50% of the then-outstanding registrable securities, we will use our best efforts to promptly register the securities that the holders request to be registered, provided, among other limitations, that the aggregate offering price to the public exceeds $10 million. We are not required to register securities more than twice under the holders' rights to demand such registrations. We will be required to file a registration statement on form S-3 or any similar short-form registration statement if requested to do so by any of these holders, provided that the aggregate offering price for the securities to be sold is more than $1,000,000. Furthermore, we are only required to effect one demand registration on form S-3 within any 12-month period. The holders cannot demand that we file a registration statement prior to the date 180 days following the effective date of any registration statement filed by us.

All expenses in effecting these registrations will be borne by us, excluding underwriting discounts, selling commissions and stock transfer taxes, which shall be borne proportionately by the holders of the securities that have been registered. These registration rights are subject to certain conditions and limitations, among them the right of the underwriters of an offering to limit the number of shares included in the registration. We have agreed to indemnify the holders of these registration rights, and each selling holder has agreed to indemnify us, against liabilities under the Securities Act, the Securities Exchange Act or other applicable federal or state law.

Anti-Takeover Provisions Delaware Takeover Statute Following our reincorporation in the State of Delaware, we will be subject to the provisions of Section 203 of the Delaware General Corporation Law, as amended from time to time. Section 203 provides, with certain exceptions, that a publicly-held corporation is prohibited from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless:

. prior to such date, the board of directors of the corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder; or . upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding those shares owned by persons who are directors and also officers, and by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or . at or subsequent to such date, the business combination is approved by the board of directors and authorized at an annual or special meeting of stockholder, and not by written consent, by the affirmative vote of at least 66 2/3% of the outstanding voting stock that is not owned by the interested stockholder.

A "business combination" includes the following:

. any merger or consolidation involving the corporation and the interested stockholder;

. any sale, transfer, pledge or other disposition of 10% or more of the assets of the corporation involving the interested stockholder;

. subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested stockholder;

. any transaction involving the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation beneficially owned by the interested stockholder; or . the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.

Subject to certain exceptions, an "interested stockholder" is a person who, together with affiliates and associates, owns, or within three years did own, 15% or more of the corporation's voting stock. The Delaware takeover statute may render the removal of directors and management more difficult.

Certificate of Incorporation and Bylaws Our certificate of incorporation and bylaws contain provisions that could have the effect of discouraging potential acquisition proposals or making a tender offer or delaying or preventing a change in control of Digimarc. In particular, our certificate of incorporation and bylaws, as applicable, among other things, will:

. Provide that our board of directors will be divided into three classes of directors (disregarding the effect of any voting rights of holders of convertible preferred stock), as nearly equal in number as is reasonably possible, serving staggered terms so that directors' initial terms will expire at the first, second and third succeeding annual meeting of the stockholders following our initial public offering, respectively. At each such succeeding annual meeting, directors elected to succeed those directors whose terms are expiring at such meeting shall be elected for a three-year term of office. A vote of at least 80% of our capital stock would be required to amend such provision.

. Provide that special meetings of the stockholders may be called only by our president, by our secretary or at the direction of the board. Advance written notice is required, which generally must be received by the secretary not less than 30 days nor more than 60 days prior to the meeting, by a stockholder of a proposal or director nomination which such stockholder desires to present at a meeting of stockholders. Any amendment of this provision would require a vote of at least 80% of our capital stock.

. Not include a provision for cumulative voting in the election of directors. Under cumulative voting, a minority stockholder holding a sufficient number of shares may be able to ensure the election of one or more directors. The absence of cumulative voting may have the effect of limiting the ability of minority stockholders to effect changes in the board and, as a result, may have the effect of deterring a hostile takeover or delaying or preventing changes in control or management of Digimarc.

. Provide that vacancies on our board may be filled by a majority of directors in office, although less than a quorum, and not by the stockholders.

. Allow us to issue up to 10,000,000 shares of undesignated preferred stock with rights senior to those of the common stock and that otherwise could adversely affect the rights and powers, including voting rights, of the holders of common stock. In certain circumstances, such issuance could have the effect of decreasing the market price of the common stock, as well as having the anti-takeover effect discussed above.

These provisions are intended to enhance the likelihood of continuity and stability in the composition of our board and in the policies formulated by them, and to discourage certain types of transactions that may involve an actual or threatened change in control of Digimarc. These provisions are designed to reduce our vulnerability to an unsolicited acquisition proposal and to discourage certain tactics that may be used in proxy fights. However, such provisions could have the effect of discouraging others from making tender offers for our shares that could result from actual or rumored takeover attempts. Such provision also may have the effect of preventing changes in our management.

Transfer Agent and Registrar

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  The transfer agent and registrar for our common stock is            . Its
address is                          , and its telephone number is (    )    -
    .
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Shares Eligible for Future Sale

Excluding the shares of common stock offered hereby (which will be freely tradable) and assuming no exercise of the underwriters' over- allotment option, as of the effective date of the registration statement, there will be 15,966,512 shares of common stock outstanding, of which are "restricted" shares under the Securities Act. of the restricted shares and shares underlying options are subject to lock-up agreements with the underwriters pursuant to which the holders of the restricted shares have agreed not to sell, pledge or otherwise dispose of such shares for a period of 180 days after the date of

this prospectus. BancBoston Robertson Stephens Inc. may release the shares subject to the lock-up agreements in whole or in part at any time with or without notice. However, BancBoston Robertson Stephens Inc. has no current plans to do so.

The following table indicates approximately when the 15,966,512 shares of our common stock that are not being sold in the offering but that will be outstanding at the time the offering is complete will be eligible for sale in the public market:

Eligibility of Restricted Shares for Sale in Public Market At effective date..... 90 days after effective date..... 180 days after effective date..... After 180 days post-effective date.....

Approximately of the restricted shares that will become available for sale in the public market beginning 180 days after the effective date will be subject to certain volume and other resale restrictions pursuant to Rule 144 because the holders are affiliates of Digimarc. In general, a person who has beneficially owned restricted shares for at least one year, will be entitled to sell in any three-month period a number of shares that does not exceed the greater of . 1% of the then outstanding shares of the common stock, approximately shares immediately after this offering, or . the average weekly trading volume during the four calendar weeks preceding the date on which notice of the sale is filed with the SEC.

Sales pursuant to Rule 144 are subject to requirements relating to manner of sale, notice and availability of current public information about Digimarc. A person who is not deemed to have been an affiliate of Digimarc at any time during the 90 days immediately preceding the sale and who has beneficially owned his or her shares for at least two years is entitled to sell such shares pursuant to Rule 144(k) without regard to the limitations described above.

Any employee, officer or director of or consultant to Digimarc who purchased his or her shares prior to the Effective Date or who holds vested options as of that date pursuant to a written compensatory plan or contract is entitled to rely on the resale provisions of Rule 701, which permits non-affiliates to sell their Rule 701 shares without having to comply with the public-information, holding-period, volume-limitation or notice provisions of Rule 144 and permits affiliates to sell their Rule 701 shares without having to comply with Rule 144's holding-period restrictions, in each case commencing 90 days after the Effective Date. However, we and our officers, directors and a majority of our other stockholders have agreed not to sell or otherwise dispose of any shares of our common stock for the 180-day period after the date of this prospectus without the prior written consent of the underwriters. See "Underwriting."

As soon as practicable after the Effective Date, we intend to file a registration statement on Form S-8 under the Securities Act to register the 9,850,000 shares of common stock reserved for issuance under the 1995 stock incentive plan, the 1999 stock incentive plan and the 1999 employee stock purchase plan, thus permitting the resale of such shares by non-affiliates in the public market without restriction under the Securities Act. As of June 30, 1999, options to purchase 3,443,175 shares of common stock

were outstanding. However, holders of approximately of the shares that will be registered have agreed with BancBoston Robertson Stephens Inc. not to sell their shares into the public market during the 180-day period after the effective date of the registration statement.

Lock-Up Agreements

All officers and directors and a majority of holders of common stock and options to purchase common stock have agreed pursuant to certain "lock-up" agreements that they will not offer, sell, contract to sell, pledge, grant any option to sell, or otherwise dispose of any shares of common stock or securities convertible into common stock, or warrants or other rights to purchase common stock, for a period of 180 days after the date of this prospectus without the prior written consent of BancBoston Robertson Stephens Inc.

Underwriting

The underwriters named below, acting through their representatives, BancBoston Robertson Stephens Inc., Hambrecht & Quist LLC and U.S. Bancorp Piper Jaffray Inc., have severally agreed with us, subject to the terms and conditions of the underwriting agreement, to purchase from us the number of shares of common stock indicated opposite their names below. The underwriters are committed to purchase and pay for all of the shares if any are purchased.

Number Of Underwriters Shares BancBoston Robertson Stephens Inc..... Hambrecht & Quist LLC..... U.S. Bancorp Piper Jaffray Inc. ..... Total.....

We have been advised that the underwriters propose to offer the shares of common stock to the public at the public offering price located on the cover page of this prospectus and to dealers at that price less a concession of not in excess of $ per share, of which $ may be reallowed to their dealers. After the initial public offering, the public offering price, concession and reallowance to dealers may be reduced by the representatives. No reduction in this price will change the amount of proceeds to be received by us as indicated on the cover page of this prospectus.

The underwriters do not intend to confirm sales to any accounts over which they exercise discretionary authority.

Over-Allotment Option. We have granted to the underwriters an option, exercisable during the 30-day period after the date of this prospectus, to purchase up to additional shares of common stock at the same price per share as we will receive for the shares that the underwriters have agreed to purchase. To the extent that the underwriters exercise this option, each of the underwriters will have a firm commitment to purchase approximately the same percentage of these additional shares that the number of shares of common stock to be purchased by it shown in the above table represents as a percentage of the shares offered by this prospectus. If purchased, such additional shares will be sold by the underwriters on the same terms as those on which the shares are being sold. We will be obligated,

under this option, to sell shares to the extent the option is exercised. The underwriters may exercise the option only to cover over-allotments made in connection with the sale of the shares of common stock offered by this prospectus.

The following table shows the per share and total underwriting discounts and commissions to be paid by us to the underwriters. This information is presented assuming either no exercise or full exercise by the underwriters of their over- allotment option.

	Per Share	Without Option	With Option
Public offering price	$	$	$
Underwriting discounts and commissions	$	$	$
Proceeds, before expenses, to us	$	$	$

The expenses of the offering are estimated at $ and are payable entirely by us. BancBoston Robertson Stephens Inc. expects to deliver the shares of common stock to purchasers on , 1999.

We estimate that expenses payable by us in connection with this offering, other than the underwriting discounts and commissions referred to above, will be approximately $.

Indemnity. The underwriting agreement contains covenants of indemnity among the underwriters and us against certain civil liabilities, including liabilities under the Securities Act and liabilities arising from breaches of representations and warranties contained in the underwriting agreement.

Lock-Up Agreements. All of our executive officers and directors, and a majority of our stockholders, optionholders and warrantholders have agreed, for a period of 180 days after the date of this prospectus, not to offer to sell, contract to sell or otherwise sell, dispose of, loan, pledge or grant any rights to, any shares of common stock, any options or warrants to purchase any shares of common stock or any securities convertible into or exchangeable for shares of common stock owned as of the date of this prospectus or subsequently acquired directly by the holders or to which they have or subsequently acquire the power of disposition, without the prior written consent of BancBoston Robertson Stephens Inc. However, BancBoston Robertson Stephens Inc., in some instances may, in its sole discretion and at any time without notice, release all or any portion of the securities subject to lock-up agreements. There are no agreements between the representatives and any of our stockholders providing consent by the representatives to the sale of shares prior to the expiration of the period of 180 days after the date of this prospectus.

Future Sales. In addition, we have agreed that during the period of 180 days after this prospectus, we will not, subject to certain exceptions, without the prior written consent of BancBoston Robertson Stephens Inc.:

. Consent to the disposition of any shares held by stockholders prior to the expiration of the period of 180 days after this prospectus; or . Issue, sell, contract to sell or otherwise dispose of any shares of common stock, any options or warrants to purchase any shares of common stock or any securities convertible into, exercisable for or exchangeable for shares of common stock other than (1) the sale of

shares in this offering, (2) the issuance of common stock upon the exercise or conversion of outstanding options, warrants or convertible securities, (3) our issuance of stock options under existing stock option plans and (4) our issuance of common stock under the Employee Stock Purchase Plan.

See "Shares Eligible for Future Sale."

Listing. We have applied to have our common stock quoted on the Nasdaq National Market under the symbol DMRC.

No Prior Public Market. Prior to this offering, there has been no public market for our common stock. Consequently, the initial public offering price for the common stock offered hereby was determined through negotiations between us and the representatives. Among the factors considered in such negotiations were prevailing market conditions, certain of our financial information, market valuations of other companies that we and the representatives believed to be comparable to us, estimates of our business potential, the present state of our development and other factors deemed relevant.

Stabilization. The representatives have advised us that, pursuant to Regulation M under the Securities Act, some participants in the offering may engage in transactions, including stabilizing bids, syndicate covering transactions or the imposition of penalty bids, that may have the effect of stabilizing or maintaining the market price of the common stock at a level above that which might otherwise prevail in the open market. A "stabilizing bid" is a bid for or the purchase of the common stock on behalf of the underwriters for the purpose of fixing or maintaining the price of the common stock. A "syndicate covering transaction" is a bid for or the purchase of the common stock on behalf of the underwriters to reduce a short position incurred by the underwriters in connection with this offering. A "penalty bid" is an arrangement permitting the representatives to reclaim the selling concession otherwise accruing to an underwriter or syndicate member in connection with this offering if the common stock originally sold by such underwriter or syndicate member is purchased by the representatives in a syndicate covering transaction and has therefore not been effectively placed by these underwriter or syndicate member. The representatives have advised us that these transactions may be effected on the Nasdaq National Market or otherwise and, if commenced, may be discontinued at any time.

Directed Share Program. We have requested that the underwriters have reserved up to 350,000 shares of common stock to be issued by us and offered hereby for sale, at the initial public offering price, to directors, officers, employees, business associates and related persons of Digimarc. The number of shares of common stock available for sale to the general public will be reduced to the extent such individuals purchase such reserved shares. Any reserved shares which are not so purchased will be offered by the underwriters to the general public on the same basis as the other shares offered hereby.

In August 1999, Bayview Investors, Ltd., an affiliate of BancBoston Robertson Stephens Inc., purchased 120,000 shares of our Series D-X preferred stock for $2.50 per share on the same terms and conditions as the other purchasers of Series D-X preferred stock. All of these shares will automatically convert into common stock upon the closing of this offering.

Legal Matters

The validity of the common stock offered hereby will be passed upon for us by Morrison & Foerster LLP, San Francisco, California. Certain legal matters in connection with the offering will be passed upon for the underwriters by Wilson Sonsini Goodrich & Rosati, Professional Corporation, Palo Alto, California.

Attorneys employed by Morrison & Foerster LLP or investment partnerships of which they are the beneficial owners hold approximately 120,000 shares of common stock.

Experts

The financial statements of Digimarc as of December 31, 1997 and 1998, and for each of the years in the three-year period ended December 31, 1998 have been included herein and in the registration statement in reliance upon the report of KPMG LLP, independent certified public accountants, upon the authority of the firm as experts in accounting and auditing.

Where You Can Find Additional Information

We have filed with the Commission a registration statement on Form S-1 under the Securities Act with respect to the common stock offered in this prospectus. This prospectus does not contain all of the information in the registration statement and its exhibits and schedules, portions of which have been omitted as permitted by the rules and regulations of the SEC. For further information about us and the common stock, we refer you to the registration statement and to its exhibits and schedules. Statements in this prospectus about the contents of any contract, agreement or other document are not necessarily complete and, in each instance, we refer you to the copy of such contract, agreement or document filed as an exhibit to the registration statement. Each such statement is qualified in all respects by reference to the document to which it refers. Anyone may inspect the registration statement and its exhibits and schedules without charge at the public reference facilities the SEC maintains at 450 Fifth Street, N.W., Washington, D.C. 20549, and at the regional offices of the SEC located at 7 World Trade Center, Suite 1300, New York, New York 10048, and 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. You may obtain copies of all or any part of these materials from the SEC upon the payment of fees prescribed by the SEC. You may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0300. You may also inspect these reports and other information without charge at a Web site maintained by the SEC. The address of this site is http://www.sec.gov.

Upon completion of this offering, we will become subject to the informational requirements of the Exchange Act and, in accordance therewith, file reports, proxy statements and other information with the SEC. You will be able to inspect and copy these reports, proxy statements and other information at the public reference facilities maintained by the SEC and at the SEC's regional offices at the addresses noted above. You also will be able to obtain copies of this material from the Public Reference Room of the SEC as described above, or inspect them without charge at the SEC's Web site. We have applied to

have our common stock quoted on the Nasdaq National Market. If our common stock is approved for quotation on the Nasdaq National Market, you will be able to inspect reports, proxy and information statements and other information concerning us at the National Association of Securities Dealers, Inc. at 1735 K Street, N.W., Washington, D.C. 20006.

Digimarc Corporation

Index to Financial Statements

Page

Report of KPMG LLP..... F-2 Balance Sheets..... F-3 Statements of Operations..... F-4 Statements of Stockholders' Equity (Deficit)..... F-5 Statements of Cash Flows..... F-6 Notes to Financial Statements..... F-7

Independent Auditors' Report

The Board of Directors Digimarc Corporation:

We have audited the accompanying balance sheets of Digimarc Corporation as of December 31, 1997 and 1998, and the related statements of operations, stockholders' equity (deficit), and cash flows for each of the years in the three-year period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Digimarc Corporation as of December 31, 1997 and 1998, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1998 in conformity with generally accepted accounting principles.

/s/ KPMG LLP

Portland, Oregon March 9, 1999

Digimarc Corporation

BALANCE SHEETS (In thousands, except share and per share data) December 31, 1997 1998 June 30, 1999 (unaudited) (unaudited) (Pro Forma) ASSETS

Current assets:			
Cash and cash equivalents.....	$ 5,638	$ 2,137	$ 6,169
Trade accounts receivable, net.....	102	298	1,556
Prepaid expenses and other current assets.....	81	98	403
Total current assets.....	5,821	2,533	8,128
Property and equipment, net.....	251	329	439
Other assets, net.....	96	116	56
Total assets.....	$ 6,168	$ 2,978	$ 8,623

LIABILITIES, REDEEMABLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT) Current liabilities: Short-term borrowings..... $ 400 $ 250 $ -- Accounts payable..... 335 228 433 Current portion of capital lease obligations..... 79 124 163 Accrued payroll and related costs... 186 390 276 Deferred revenue..... 190 345 344 Current portion of notes payable to stockholders..... -- -- 305 Total current liabilities..... 1,190 1,337 1,521 Capital lease obligations, less current portion..... 111 171 178 Notes payable to stockholders, less current portion..... 284 298 -- Other long-term liabilities..... 78 82 82 Total liabilities..... 1,663 1,888 1,781 Convertible redeemable preferred stock; 21,748,000 shares authorized; 5,863,573 shares issued and outstanding at December 31, 1997 and 1998 and 8,395,573 shares outstanding at June 30, 1999; aggregate liquidation preference $10,315 and $16,645 at December 31, 1998 and June 30, 1999, respectively (unaudited); pro forma no shares issued and outstanding..... 10,185 10,185 16,476 $ -- Commitments and contingencies Stockholders' equity (deficit): Convertible preferred stock; 650,000 shares authorized; aggregate liquidation preference $429: Series A-1, $.001 par value; issued and outstanding 325,000 shares at December 31, 1997 and 1998 and June 30, 1999; pro forma no shares issued and outstanding..... -- -- -- -- Series A-N, $.001 par value; no shares issued and outstanding..... -- -- -- -- Common stock, $.001 par value; authorized 25,000,000 shares; issued and outstanding 4,505,986 and 4,627,247 and 4,775,374 shares at December 31, 1997 and 1998, and June 30, 1999, respectively; pro forma 15,624,947 shares issued and outstanding..... 2 2 2 13 Additional paid-in capital..... 851 878 1,118 17,583 Deferred compensation..... -- -- (202) (202) Accumulated deficit..... (6,533) (9,975) (10,552) (10,552) Total stockholders' equity (deficit)..... (5,680) (9,095) (9,634) $ 6,842 Total liabilities, convertible redeemable preferred stock and stockholders' equity (deficit).... $ 6,168 $ 2,978 $ 8,623 See accompanying notes to financial statements.

Digimarc Corporation

STATEMENTS OF OPERATIONS (in thousands, except share and per share data)

Years Ended December 31,			Six Months Ended June 30,	
1996	1997	1998	1998	1999
			(unaudited)	

Revenue:					
License and subscription	$ 236	$ 161	$ 484	$ 282	$ 116
Service	--	25	500	125	1,939
Total revenue	236	186	984	407	2,055
Cost of revenue:					
License and subscription	7	126	114	62	57
Service	--	--	1,466	467	878
Total cost of revenue	7	126	1,580	529	935
Operating expenses:					
Sales and marketing	376	1,330	825	498	394
Research and development	690	1,387	658	415	247
General and administrative	834	1,282	1,407	606	1,028
Total operating expenses	1,900	3,999	2,890	1,519	1,669
Operating loss	(1,671)	(3,939)	(3,486)	(1,641)	(549)
Other income (expense):					
Interest income	68	76	189	118	25
Interest expense	(71)	(86)	(119)	(61)	(54)
Other	96	(30)	(26)	(25)	1
Loss before provision for income taxes	(1,578)	(3,979)	(3,442)	(1,609)	(577)
Provision for income taxes	--	--	--	--	--
Net loss	$ (1,578)	$ (3,979)	$ (3,442)	$ (1,609)	$ (577)
Net loss per share--basic and diluted	$ (0.35)	$ (0.94)	$ (0.75)	$ (0.35)	$ (0.12)
Weighted average shares used in computing net loss per share--basic and diluted	4,453,038	4,240,955	4,576,884	4,564,061	4,657,874

See accompanying notes to financial statements.

Digimarc Corporation

STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) (In thousands, except share and per share data)

	Convertible preferred stock		Common stock		Additional			Total
	Shares	Amount	Shares	Amount	paid-in capital	Deferred compensation	Accumulated deficit	stockholders' deficit
BALANCE AT DECEMBER 31, 1995	--	$ --	4,094,728	$ 2	$ 182	$ --	$ (874)	$ (690)
Issuance of common stock through conversion of note payable	--	--	544,000	--	41	--	--	41
Repurchase and cancellation of common stock previously issued	--	--	(576,680)	--	--	--	(102)	(102)
Issuance of common stock in exchange for services	--	--	72,738	--	5	--	--	5
Issuance of Series A-1 preferred stock, net	325,000	--	--	--	439	--	--	439
Net loss	--	--	--	--	--	--	--	(1,578)
BALANCE AT DECEMBER 31, 1996	325,000	--	4,134,786	2	667	--	(2,554)	(1,885)

Exercise of stock options.....	--	--	125,200	--	13	--		13
Repurchase and cancellation of common stock previously issued.....	--	--	(112,000)	--	(8)	--	--	(8)
Common stock issued for the acquisition of a business.....	--	--	358,000	--	179	--	--	179
Net loss.....	--	--	--	--	--	--	(3,979)	(3,979)
BALANCE AT DECEMBER 31, 1997.....	325,000	--	4,505,986	2	851	--	(6,533)	(5,680)
Stock issued.....	--	--	54,289	--	13	--	--	13
Exercise of stock options.....	--	--	66,972	--	14	--	--	14
Net loss.....	--	--	--	--	--	--	(3,442)	(3,442)
BALANCE AT DECEMBER 31, 1998.....	325,000	--	4,627,247	2	878	--	(9,975)	(9,095)
Exercise of stock options (unaudited)....	--	--	148,127	--	38	--	--	38
Deferred compensation related to stock options (unaudited).....	--	--	--	--	202	(202)	--	--
Net loss (unaudited)....	--	--	--	--	--	--	(577)	(577)
BALANCE AT JUNE 30, 1999 (unaudited).....	325,000	$ --	4,775,374	$ 2	$1,118	$(202)	$(10,552)	$(9,634)

See accompanying notes to financial statements.

Digimarc Corporation

STATEMENTS OF CASH FLOWS (in thousands, except share and per share data)

Years Ended December 31,			Six Months Ended June 30,	
1996	1997	1998	1998	1999
				(unaudited)

Cash flows from operating activities: Net loss..... $(1,578) $(3,979) $(3,442) $(1,609) $ (577) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation and amortization.. 23 100 178 78 121 Amortization of discount on note payable..... 19 13 14 7 7 Asset impairment..... -- 453 -- -- -- Non-cash expenses..... 15 27 20 14 -- Gain on forgiveness of debt.... (96) (33) -- -- -- Changes in assets and liabilities: Trade accounts receivable..... -- (102) (196) (27) (1,258) Prepaid expenses and other assets..... (54) (36) (33) (41) (278) Accounts

payable..... 118 43 (107) (40) 205 Accrued payroll and related costs..... 32 199 204 (65) (114) Deferred revenue..... (26) 173 152 407 (1) Net cash used in operating activities..... (1,547) (3,142) (3,210) (1,276) (1,895) Cash flows from investing activities: Purchase of property and equipment..... (165) (23) (8) (9) (82) Purchases of patents..... -- -- (50) (40) -- Sale of tradename..... -- -- -- -- 10 Acquisition of a business..... -- (417) -- -- -- Net cash used in investing activities..... (165) (440) (58) (49) (72) Cash flows from financing activities: Proceeds (repayment) of short- term borrowings..... -- 400 (150) -- (250) Net proceeds from issuance of preferred stock..... 4,510 5,744 -- (3) 6,329 Net proceeds from issuance of common stock..... -- 13 14 7 -- Proceeds from issuance of notes payable..... 350 -- -- -- -- Principal payments of notes payable..... (111) -- -- -- -- Proceeds from sale-leaseback.... 142 -- -- -- -- Repurchase of common stock previously issued..... (102) (8) -- -- -- Principal payments under capital lease obligations..... (10) (42) (97) (42) (80) Net cash provided by (used in) financing activities..... 4,779 6,107 (233) (38) 5,999 Net (decrease) increase in cash and cash equivalents..... 3,067 2,525 (3,501) (1,363) 4,032 Cash and cash equivalents at beginning of period..... 46 3,113 5,638 5,638 2,137 Cash and cash equivalents at end of period..... $ 3,113 $ 5,638 $ 2,137 $ 4,275 $ 6,169 Supplemental disclosure of cash flow information: Cash paid for interest..... $ 3 $ 38 $ 125 $ 47 $ 54 Summary of non-cash investing and financing activities: Conversion of note payable to common stock..... $ 41 $ -- $ -- $ -- $ -- Equipment acquired or exchanged under capital lease obligations..... 40 64 202 115 127 Common stock issued for the acquisition of a business..... -- 179 -- -- -- See accompanying notes to financial statements.

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS (In thousands, except share and per share data) (1) Summary of Significant Accounting Policies (a) The Company Digimarc Corporation (the Company) was incorporated on January 3, 1995. The Company has developed digital watermarking technology used to identify, track, manage and enhance visual communications. Digitally watermarked images contain hidden messages which are imperceptible during normal use but detectable by software or other devices.

(b) Interim Financial Statements The financial information included herein for the six-month periods ended June 30, 1998 and 1999 is unaudited; however, such information reflects all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The interim consolidated financial statements should be read in conjunction with the financial statements and the notes included in the financial statements. The results of operations for the interim period presented are not necessarily indicative of the results to be expected for the full year.

(c) Accounts Receivable Trade accounts receivable are shown net of allowance for doubtful accounts of $17 and $2 at December 31, 1997 and 1998, respectively.

(d) Property and Equipment Property and equipment are stated at cost. Property and equipment under capital lease obligations are stated at the lower of the present value of minimum lease payments at the beginning of the lease term or fair value of the leased assets at the inception of the lease. Repairs and maintenance are charged to expense when incurred.

Depreciation on property and equipment is calculated by the straight-line method over the estimated useful lives of the assets, generally three to five years. Property and equipment held under capital leases are amortized by the straight-line method over the lease term. Amortization of property and equipment under capital lease is included in depreciation expense.

(e) Software Development Costs Under Statement of Financial Accounting Standards No. 86 (SFAS No. 86), software development costs are to be capitalized beginning when a product's technological feasibility has been established and ending when a product is made available for general release to customers. To date, the establishment of technological feasibility of the Company's products has occurred shortly before general release and, therefore, software development costs qualifying for capitalization have been immaterial. Accordingly, the Company has not capitalized any software development costs and has charged all such costs to research and development expense.

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) (f) Funded Research and Development Revenues recognized under vendor and end-user funding arrangements totaled $500 for the year ended December 31, 1998 and $1,872 for the six months ended June 30, 1999 (unaudited). Direct costs allocated to the arrangement were $1,466 for the year ended December 31, 1998 and $878 for the six months ended June 30, 1999 (unaudited). There were no such revenues recognized or cost incurred related to a funding arrangement in 1996 or 1997.

(g) Other Assets

Other assets consist primarily of the costs of acquired patents and trademarks, and are amortized by the straight-line method over a useful life of three to five years. They are shown net of accumulated amortization of $16 and $63 at December 31, 1997 and 1998, respectively.

(h) Advertising Costs Advertising costs are expensed as incurred. Total advertising expenses were $13, $157 and $135 for the years ended December 31, 1996, 1997 and 1998, respectively.

(i) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of The Company accounts for long-lived assets in accordance with the provisions of SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. This Statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are

considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(j) Revenue Recognition In October 1997, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) No. 97-2, Software Revenue Recognition. Subsequently, in March 1998, the Financial Accounting Standards Board (FASB) approved SOP 98-4, Deferral of the Effective Date of a Provision of 97-2, Software Revenue Recognition. SOP 98-4 defers for one year the application of several paragraphs and examples in SOP 97-2 that limit the definition of vendor specific objective evidence (VSOE) of the fair value of various elements in a multiple-element arrangement. SOP 97-2 generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on VSOE of the relative fair values of each element in the arrangement.

The provisions of SOPs 97-2 and 98-4 have been applied by the Company to transactions entered into beginning January 1, 1998. Prior to 1997, the Company's revenue policy was in accordance with the preceding authoritative guidance provided by SOP No. 91-1, Software Revenue Recognition.

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) Software license revenue consists of fees for licenses of the Company's software products. Revenue allocated to software licenses is recognized upon delivery of software, assuming no significant obligations or customer acceptance rights exist.

Revenue allocated to subscriptions are paid in advance and revenues are recognized ratably over the term of the subscription. Revenue allocated to contracted professional services is recognized as the services are performed. Deferred revenue consists of payments received in advance for consulting services and subscriptions to the Company's internet service for service and support not yet performed.

In December 1998, the AICPA issued SOP 98-9, Modification of SOP 97-2 Software Revenue Recognition, with Respect to Certain Transactions. This SOP amends SOP 97-2 to require recognition of revenue using the "residual method" in circumstances outlined in the SOP. Under the residual method, revenue is recognized as follows: (1) the total fair value of undelivered elements, as indicated by VSOE, is deferred and subsequently recognized in accordance with the relevant sections of SOP 97-2 and (2) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

SOP 98-9 is effective for fiscal years beginning after March 15, 1999. Also the provisions of SOP 97-2 that were deferred by SOP 98-4 will continue to be deferred until the date SOP 98-9 becomes effective.

(k) Use of Estimates

Generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets, liabilities and contingencies at the date of the financial statements and the reported amounts of revenues and expense during the reporting periods. Actual results could differ from those estimates.

(l) Income Taxes

The Company accounts for income taxes under the asset and liability method. Under the asset and liability method, deferred income taxes reflect the future tax consequences of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce tax assets to the amount expected to be realized.

(m) Concentrations of Credit Risk Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and trade receivables. The credit risk associated with cash is minimal. The Company had accounts receivable from three customers representing approximately 83% of trade

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) accounts receivable at December 31, 1998. Loss of or non-performance by these significant customers could adversely affect the Company's financial position, liquidity or results of operations.

(n) Fair Value of Financial Instruments The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and accrued payroll approximate fair value due to the short- term nature of these instruments. The carrying amounts of capital leases and notes payable approximate fair value as the stated interest rates reflect current market rates. Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument when available. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(o) Stock-Based Employee Compensation The Company adopted SFAS No. 123, Accounting for Stock-Based Compensation, which permits entities to recognize expense over the vesting period based on the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 also allows entities to continue to apply the provisions of Accounting Principles Board (APB) Opinion No. 25 and provide pro forma net income and pro forma earnings per share disclosures as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123.

(p) Contingencies and Factors that Could Affect Future Results A portion of the Company's revenues each year is generated from licensing of technology. In the extremely competitive industry environment in which the Company operates, such product generation, development and marketing processes are uncertain and complex, requiring accurate prediction of demand as well as successful management of various development risks inherent in technology development. In light of these dependencies, it is possible that failure to successfully manage future changes in technology with respect to the Company's technology could have long-term impact on the Company's growth and results of operations.

(q) Net Income (Loss) Per Share In 1997, the Company adopted SFAS No. 128 "Earnings Per Share" which provides that "basic net income (loss) per share" and "diluted net income (loss) per share" for all prior periods presented are to be computed using the weighted average number of common shares outstanding during each period, with diluted net income per share including the effect of potentially dilutive common shares.

Common stock equivalents related to stock options of 360,521, 1,281,714, and 2,654,852 are antidilutive in a net loss year and, therefore, are not included in 1996, 1997 and 1998 diluted net loss per share, respectively.

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) (2) Acquisition of a Business In July 1997, the Company acquired substantially all of the assets of NetRights, LLC (NetRights) for approximately $417 and 358,000 shares of common stock. NetRights was developing a software product which would provide direct access to remote information, initiate direct connections to Web sites and commerce services and automate communications between suppliers of digitized creative works and consumers through the digital content pictures themselves. Assets acquired by the Company included certain office equipment, certain trademarks and tradenames, and all engineering drawings, designs and documentation, including patent applications.

The acquisition has been accounted for as a purchase. The purchase accounting allocations resulted in capitalization of purchased technology and goodwill of $453, capitalization of office equipment of $48, and patent and tradename capitalizations of $95, which are being amortized over three years. Subsequent to the acquisition a decision was made not to use the purchased technology, and as a result the goodwill and purchased technology were considered impaired and written off. Results of operations are only included from the date of acquisition forward.

(3) Cash and Cash Equivalents For purposes of the statements of cash flows, the Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents.

Cash and cash equivalents include various money market instruments and investments in government bonds totaling $125 and $2,137 at December 31, 1997 and 1998, respectively. Cash equivalents are carried at cost, which approximates market.

(4) Property and Equipment December 31, 1997 1998

Furniture and fixtures	$ 38	$ 51
Office equipment	311	504
Leasehold improvements	--	4
	349	559
Less accumulated depreciation and amortization	(98)	(230)
	$251	$ 329

(5) Leases

The Company leases certain office equipment under long-term capital leases, which expire over the next four years. At December 31, 1997 and 1998, the cost of these assets was $245 and $447, respectively, and accumulated amortization was $68 and $168, respectively.

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) Future minimum lease payments under non-cancelable operating leases and the present value of future minimum capital lease payments are as follows:

Year ending December 31:	Capital leases	Operating leases
1999	$156	$107
2000	114	73
2001	65	--
2002	9	--
Total minimum lease payments	344	$180
Less amount representing interest	49	
	295	
Less current portion of capital lease	124	
	$171	

Rent expense on the operating leases for the years ended December 31, 1996, 1997 and 1998 totaled $22, $62 and $71, respectively.

(6) Notes Payable

December 31, 1997 1998 Notes payable to stockholders, net of unamortized discount of $100 and $86 at December 31, 1997 and 1998, respectively, interest at 7% beginning in 1998, due and payable May 2005 or earlier under certain conditions, unsecured..... $ 284 $ 298 284 298 Less current portion..... -- -- $ 284 $ 298 (7) Short-term Borrowings The Company has a $400 revolving line of credit with a bank which matures on August 20, 1999 and is secured by the assets of the Company. The line bears interest at the prime rate plus 1%. The interest rate on short-term borrowings during 1997 and 1998 was 11.5% and 8.75%, respectively. At December 31, 1997 and 1998, $400 and $250, respectively, was outstanding on this line. See note 14.

(8) Defined Contribution Pension Plan The Company has an employee savings plan (the Plan) which qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Employees become eligible to participate in the Plan after four months of service. Employees may

contribute up to 15% of their pay to the Plan, subject to the limitations of the Internal Revenue Code. The Company made no contributions to the Plan during 1996, 1997 or 1998.

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) (9) Convertible Redeemable Preferred Stock The Company has authorized several series of convertible redeemable preferred stock. The title, carrying amount, and number of shares issued and outstanding are as follows:

December 31, ---------- June 30, 1997 1998 1999 (unaudited) Series B-1, $.001 par value; issued and outstanding 1,804,000 shares at December 31, 1997 and 1998; liquidation preference $4,510.. $ 4,441 $ 4,441 $ 4,441 Series B-N, $.001 par value; no shares issued and outstanding..... Series C-1, $.001 par value; issued and outstanding 4,059,573 shares at December 31, 1997 and 1998; liquidation preference $5,805.. 5,744 5,744 5,744 Series C-N, $.001 par value; no shares issued and outstanding..... Series D, $.001 par value; issued and outstanding 2,532,000 shares at June 30, 1999; liquidation preference $6,330: (unaudited).... -- -- 6,291 Total convertible redeemable preferred stock... $10,185 $10,185 $16,476 Preferred Series B and Series C stock is subject to certain mandatory redemption features following the affirmative vote of at least 60% of the outstanding shares of the Series B and Series C preferred stock, effective no earlier than June 30, 2001. The Company shall redeem all of the then outstanding Series B and Series C preferred stock or an amount determined by the Company for which funds are available for redemption. The per share redemption price for the Series B and Series C preferred stock is equal to its per share issue price, plus any undeclared and unpaid dividends. Each Series B and Series C preferred stockholder may, but is not obligated to, participate in the Series B and Series C redemption up to that holder's pro rata share of the total number of shares specified in the redemption request. See note 10 for additional features of convertible redeemable preferred stock. See note 14.

(10) Stockholders' Equity (a) Stockholders' Agreement The Company and its stockholders have an agreement that includes restrictions on the purchase and sale of the Company's common stock. Except for expressly provided exceptions, no stockholder is allowed to transfer ownership of common stock without the prior written consent of the Company. If a stockholder desires to sell any shares, the stockholder must first offer to sell those shares to the Company or its designee before offering shares to a third party. These restrictions lapse upon the effectiveness of a registration of common stock under the Securities Act of 1933, as amended, and the consummation of the sale of common stock pursuant to that registration statement.

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) (b) Preferred Stock The Company has issued Series A-1, Series B-1 and Series C-1 preferred stock. In addition, the Company is also authorized to issue Series A-N, Series B-N and Series C-N preferred

stock. The terms for each series of preferred stock are similar and are summarized below:

Dividends

Preferred stockholders are entitled to receive dividends when and if declared by the Board of Directors at an annual rate of $.125 per share for Series A-1 and A-N, $.25 per share for Series B-1 and B-N and $.143 per share for Series C-1 and C-N. The right to receive dividends on preferred stock is not cumulative and no right to receive dividends shall accrue to holders of the preferred stock in the event the Board of Directors does not declare dividends. No dividends may be declared or paid on common stock until equal dividends on preferred stock have been declared and paid. After payment of all dividends on preferred stock, the holders of preferred stock are entitled to participate, on an as-converted basis, with the outstanding common stock as to any dividends paid on such common stock. As of December 31, 1998, no dividends had been declared or paid.

Liquidation Preferences Upon dissolution, liquidation, or winding-up of the affairs of the Company (Liquidation), either voluntary or involuntary, the preferred stockholders receive preference over the common stockholders of the Company. The liquidation value for each outstanding share is $1.25 for Series A-1 and A-N (Series A), $2.50 for Series B-1 and B-N (Series B) and $1.43 for Series C-1 and C-N (Series C), adjusted for any stock dividends. If upon liquidation the assets of the Company available for distribution are insufficient to pay the holders of preferred stock the full preference, then the entire assets and funds of the Company legally available for distribution to its stockholders will be distributed ratably among all holders of preferred stock. After paying the full preference, any assets of the Company remaining available for distribution to stockholders upon liquidation will be distributed ratably among all holders of common and preferred stock in proportion to the amount of common stock each stockholder holds, treating each holder of Series B and Series C preferred stock as if such stock were converted into common stock at the existing conversion price. Series A preferred stock automatically converts to common stock prior to a liquidation, if as a result of the conversion the consideration per share to be received with respect to the preferred stock would be larger than the Series A preferred stock preference. The conversion price for Series A-1, Series B-1 and Series C-1 is $.625, $1.25 and $1.43, respectively, at December 31, 1998.

Voting

The holder of each share of each series of preferred stock shall have the right to the number of votes such holders would be entitled to if the shares of preferred stock were converted to common stock.

Conversion

Each share of preferred stock is voluntarily convertible into common stock at any time after the date of issuance at a rate that equals the original issue price divided by the conversion price at the time in effect, subject to certain adjustments as set forth in the purchase agreements. Automatic

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) conversion of the Series A preferred into common stock at the then effective conversion rate will occur upon the closing and issuance of shares following the effectiveness of a registration statement under the Securities Act of 1933, or upon the approval of the conversion by holders of a majority of the originally issued shares of Series A preferred stock, or approval of the conversion by 67% of the originally outstanding shares of all series of preferred stock, or in the case of a liquidation where the consideration per share to be received with respect to the preferred stock would be larger than the Series A preferred stock preference. Automatic conversion of the Series B preferred into common stock at the then effective conversion rate will occur upon the closing of the issuance shares following the effectiveness of a registration statement under the Securities Act of 1933 in which the aggregate price to the public equals or exceeds $10,000 and in which the public offering price per share of common stock equals or exceeds $5, or on the approval of the conversion by holders of 67% of the outstanding shares of preferred stock. Automatic conversion of the Series C preferred into common stock at the then effective conversion rate will occur upon the consummation of a designated initial public offering, or on the approval of conversion by the holders of 67% of the outstanding shares of preferred stock.

As of December 31, 1998, the Company has reserved a total of 8,317,573 shares of its common stock pursuant to the conversion privileges of preferred stock.

(c) Stock Incentive Plan The Company has a Stock Incentive Plan (the Plan). Pursuant to the terms of the Plan, the Board of Directors is authorized to grant incentive stock options, non-qualified stock options and restricted stock to employees or consultants. Prices for all options or stock granted under the Plan are determined by the Board of Directors. Option prices for incentive stock options are set at not less than the fair market value of the common stock at the date of grant. Options vest over periods determined by the Board of Directors. Options are contingent upon continued employment with the Company and, unless otherwise specified, expire ten years from the date of grant. The Company has reserved 3,600,000 shares of its common stock for issuance under the Plan.

SFAS No. 123 "Accounting for Stock-Based Compensation" defines a fair value based method of accounting for an employee stock option and similar equity instrument. As is permitted under SFAS No. 123, the Company has elected to continue to account for its stock-based compensation plans under APB Opinion No. 25. The Company has computed, for pro forma disclosure purposes, the value of all options granted during 1996, 1997 and 1998 using the Black-Scholes option pricing model as prescribed by SFAS No. 123 with the following weighted average assumption for grants:

1996 1997 1998

Risk-free interest rate	6.0%	6.25%	6.0%
Expected dividend yield	--	--	--
Expected life (in years)	4	4	4
Expected volatility	100%	100%	100%

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) Using the Black-Scholes methodology, the total value of options granted during 1996, 1997 and 1998 was $86, $97 and $175, respectively, which would be amortized on a pro forma basis over the vesting period of the options. The weighted average fair value of options granted during 1996, 1997 and 1998 was $.109, $.154 and $.180 per share, respectively. If the Company had accounted for its stock-based compensation plans in accordance with SFAS No. 123, the Company's net income (loss) and net income (loss) per share would approximate the pro forma disclosures below:

Years Ended December 31, 1996 1997 1998

Net loss	$ (1,578)	$(3,979)	$(3,442)
Pro forma net loss	(1,613)	(4,053)	(3,552)
Net loss per share	(.35)	(.94)	(.75)
Pro forma net loss per share	(.36)	(.96)	(.78)

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. SFAS No. 123 does not apply to awards prior to January 1, 1995, and additional awards are anticipated in future years.

Transactions involving the Plan are summarized as follows:

Weighted average Number of exercise shares price

Options outstanding, December 31, 1995	294,000	$.075
Granted	1,053,100	.16
Exercised	--	--
Canceled	(192,000)	.075
Options outstanding, December 31, 1996	1,155,100	.15
Granted	833,800	.25
Exercised	(125,200)	.11
Canceled	(39,300)	.25
Options outstanding, December 31, 1997	1,824,400	.20
Granted	1,293,600	.25
Exercised	(66,972)	.25
Canceled	(441,428)	.25
Options outstanding, December 31, 1998	2,609,600	.21
Granted (unaudited)	1,098,000	.72
Exercised (unaudited)	(148,127)	.25
Canceled (unaudited)	(116,298)	.19

Options outstanding, June 30, 1999 (unaudited)..... 3,443,175 $.37

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) At December 31, 1998, the range of exercise prices and the weighted average remaining contractual life of outstanding options were $.075-$.25 and nine years, respectively.

At December 31, 1997 and 1998, options to purchase 449,337 and 772,274 shares of common stock, respectively, were exercisable. The weighted average exercise price of those options was $.13 and $.15 at December 31, 1997 and 1998, respectively, and 366,228 shares were available for grant at December 31, 1998.

(11) Income Taxes

The Company incurred a loss for both financial reporting and tax return purposes and, as such, there was no current or deferred tax provision for the years ended December 31, 1996, 1997 and 1998.

The actual income tax expense differs from the expected tax expense (computed by applying the U.S. federal corporate income tax rate of 34% to net income (loss) before income taxes) as follows:

Years Ended December 31, 1996 1997 1998

Computed expected income tax (benefit) expense	(34)%	(34)%	(34)%
Increase (reduction) in income tax expense (benefit) resulting from:			
State income tax (benefit) expense	(4)	(4)	(4)
Increase in valuation allowance	39	39	40
Other	(1)	(1)	(2)
Income tax expense	-- %	-- %	-- %

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31 are as follows:

1997 1998

Deferred tax assets:		
Net operating loss carryforwards	$ 1,865	$ 3,284
Capitalized research and experimentation costs	326	238
Tax basis intangible assets, due to differences in amortization	104	82
Research and experimentation credits	42	113
Other	25	22
Total gross deferred tax assets	2,362	3,739
Less valuation allowance	(2,314)	(3,699)
Net deferred tax assets	48	40
Deferred tax liabilities:		
Unamortized discount on notes payable	10	33
Plant and equipment, due to differences in depreciation	38	7
Total deferred tax liabilities	48	40
Net deferred tax liability (asset)	$ --	$ --

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) The valuation allowance for deferred tax assets as of December 31, 1998 was approximately $3.7 million. The net change in the total valuation allowance for the years ended December 31, 1996, 1997 and 1998 was an increase (decrease) of approximately $896, $1,418 and $1,385, respectively.

At December 31, 1998, the Company had net operating loss carryforwards of approximately $8,562 to offset against future income for federal and state tax purposes, and research and experimentation credits of $113. These carryforwards expire through 2018.

A provision of the Internal Revenue Code requires that the utilization of net operating losses and research and experimentation credits be limited when there is a change of more than 50% in ownership of the Company. Such a change occurred with the sale of preferred stock Series A in June 1996 and the sale of preferred stock Series B in July 1996. Accordingly, the utilization of the net operating loss carryforwards generated from periods prior to July of 1996 is limited; the amount subject to limitation is approximately $915.

(12) Subsequent Event In January 1999, the Company sold the trademark associated with NetRights, LLC. The sales price approximated the net book value of the trademark. This transaction is not expected to have a material effect on the financial position, results of operations or liquidity of the Company.

(13) Segment Information (a) Geographic Information Digimarc derives its revenue from a single operating segment, digital watermarking applications. Revenue is generated in this segment through licensing and subscription of its products and the delivery of contracted and consulting services.

The Company operates solely within the United States, and all assets are located within the United States.

(b) Major Customers

Two customers represented approximately 78% and 30% of total net revenues for the years ended December 31, 1996 and 1997. One customer represented approximately 51% of total net revenues for the year ended December 31, 1998. One customer represented approximately 91% of total revenues for the six months ended June 30, 1999 (unaudited).

No single customer accounted for more than 10% of trade accounts receivable outstanding at December 31, 1997. The Company had accounts receivable from three customers representing approximately 83% of trade accounts receivable at December 31, 1998. Accounts receivable from one customer represented 98% of trade receivables at June 30, 1999 (unaudited).

Digimarc Corporation

NOTES TO FINANCIAL STATEMENTS--(Continued) (In thousands, except share and per share data) (14) Unaudited Recent Developments (a) Issuance of Preferred Stock On June 30, 1999, the Company authorized 2,800,000 shares of Series D-1 convertible redeemable preferred stock. The terms of the Series D-1 stock are substantially identical to the Series B-1 and C-1 stock as described in note 10. There were 2,532,000 shares of Series D-1 stock outstanding at June 30, 1999.

On August 26, 1999, the Company issued 320,000 shares of Series D-X convertible redeemable preferred stock at $2.50 per share. The terms of the Series D-X stock are substantially identical to the Series B and C stock as described in note 10.

(b) Lease Transactions On June 22, 1999, the Company entered into a five-year operating lease agreement for office space. The lease requires a letter of credit in lieu of a cash security deposit in the amount of $350 which was entered into in August 1999. The letter of credit is secured by a certificate of deposit in the amount of $350. The letter of credit is to be released over two years in increments upon the Company's meeting certain milestones.

(c) Short-term Borrowings In August 1999, the Company's bank extended the maturity date on the Company's revolving line of credit. As a result, the revolving line of credit currently expires on November 20, 1999.

(d) Stock Incentive Plan In April 1999, the Company increased the number of common shares reserved for issuance under the Stock Incentive Plan to 5.6 million shares.

[THE DIGIMARC CORPORATION LOGO WITH IMAGES OF A BANK CARD, A DRIVER'S LICENSE, AN ACCESS CARD AND A PASSPORT, AND INCLUDING THE FOLLOWING TEXT: "SELF- AUTHENTICATING IDENTITY DOCUMENTS" AND "COMBAT PHOTO SWAPPING AND DEFEND AGAINST DOCUMENT ALTERATION."]

[The Digimarc Corporation Logo and Web Address.]

Part Ii

Information Not Required in Prospectus

Item 13. Other Expenses of Issuance and Distribution The expenses to be paid by the Registrant in connection with the distribution of the securities being registered, other than underwriting discounts and commissions, are as follows:

Amount*

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Securities and Exchange Commission Filing Fee..... $9,730
NASD Filing Fee.....  4,000
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Nasdaq National Market Listing Fee	**
Accounting Fees and Expenses	**
Blue Sky Fees and Expenses	**
Legal Fees and Expenses	**
Transfer Agent and Registrar Fees and Expenses	**
Printing Expenses	**
Miscellaneous Expenses	**
Total	$ **

* All amounts are estimates except the SEC filing fee, the NASD filing fee and the Nasdaq National Market listing fee. ** To be filed by amendment.

Item 14. Indemnification of Directors and Officers Section 145 of the Delaware General Corporation Law authorizes a court to award, or a corporation's board of directors to grant, indemnity to officers, director and other corporate agents under certain circumstances and subject to certain limitations. Digimarc's certificate of incorporation and bylaws provide that Digimarc shall indemnify its directors, officers, employees and agents to the full extent permitted by Delaware General Corporation Law, including in circumstances in which indemnification is otherwise discretionary under Delaware law. In addition, Digimarc intends to enter into separate indemnification agreements with its directors, officers and certain employees which would require Digimarc, among other things, to indemnify them against certain liabilities which may arise by reason of their status as directors, officers or certain other employees. Digimarc also intends to maintain director and officer liability insurance, if available on reasonable terms.

These indemnification provisions and the indemnification agreement to be entered into between Digimarc and its officers and directors may be sufficiently broad to permit indemnification of Digimarc officers and directors for liabilities (including reimbursement of expenses incurred) arising under the Securities Act.

The underwriting agreement, which is Exhibit 1.1 to this registration statement, provides for indemnification by our underwriters and their officers and directors for certain liabilities arising under the Securities Act or otherwise.

Item 15. Recent Sales of Unregistered Securities Since January 1, 1996, the Registrant has issued and sold the following unregistered securities:

1. Between January 1, 1996 and August 25, 1999, the Registrant granted 5,002,500 shares of restricted common stock and options to purchase shares of common stock at prices ranging from $0.075 to $1.25 to employees, directors and consultants pursuant to its 1995 Stock Incentive Plan.

. In May 1996, the Registrant issued an aggregate of 72,738 shares of its common stock to Alliance Consulting Group, Inc., Hugh Mackworth and Clay Davidson in exchange for services rendered.

3. In June 1996, the Registrant issued and sold an aggregate of 325,000 shares of its Series A-1 preferred stock to a total of 10 investors for an aggregate purchase price of $428,428.

4. In July 1996, the Registrant issued and sold an aggregate of 1,804,000 shares of its Series B-1 preferred stock to a total of seven investors for an aggregate purchase price of $4,510,000.

5. In July 1997, the Registrant issued an aggregate of 358,000 shares of its common stock in connection with its acquisition of certain assets of NetRights, LLC.

6. In December 1997, the Registrant issued and sold an aggregate of 4,059,573 shares of its Series C-1 preferred stock to a total of 16 investors for an aggregate purchase price of $5,805,189.39.

7. In December 1997, the Registrant issued an aggregate of 27,140 shares of its common stock to each of Sandra Kinsler and Daniel Romano in exchange for the release of certain claims against the Registrant.

8. In June 1999, the Registrant issued and sold an aggregate of 2,532,000 shares of its Series D preferred stock to a total of 14 investors for an aggregate purchase price of $6,330,000.

9. In August 1999, the Registrant issued and sold an aggregate of 320,000 shares of its Series D-X preferred stock to a total of 3 investors for an aggregate purchase price of $800,000.

The issuances of the securities in the transactions above were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act or Regulation D promulgated thereunder as transactions by an issuer not involving a public offering, where the purchasers represented their intention to acquire the securities for investment only and not with a view to distribution and received or had access to adequate information about the Registrant, or Rule 701 promulgated under the Securities Act as transactions pursuant to a compensatory benefit plan or a written contract relating to compensation.

Appropriate legends were affixed to the stock certificates issued in the above transactions. Similar legends were imposed in connection with any subsequent sales of any such securities. No underwriters were employed in any of the above transactions.

Item 16. Exhibits and Financial Statement Schedules (a) Exhibits The exhibits are as set forth in the Exhibit Index.

(b) Financial Statement Schedules All schedules have been omitted since they are not required or are not applicable or the required information is shown in the financial statements or related notes.

Item 17. Undertakings The Registrant hereby undertakes to provide to the underwriters at the closing specified in the Underwriting Agreement certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will,

unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The Registrant hereby undertakes that:

(1) For purposes of any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Signatures

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in Lake Oswego, State of Oregon, on the 21st day of September 1999.

Digimarc Corporation

/s/ Bruce Davis By: _____ Bruce Davis President and Chief Executive Officer

Power of Attorney

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Bruce Davis and E.K. Ranjit, and each of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Registration Statement, and to sign any registration statement for the same offering covered by the Registration Statement that is to be effective upon filing pursuant to Rule 462(b) promulgated under the Securities Act of 1933 and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in- fact and agents, or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities and on the dates indicated:

Signature Title Date

/s/ Bruce Davis (Bruce Davis)	President, Chief Executive Officer and Director (Principal Executive Officer)	September 21, 1999

/s/ E. K. Ranjit Chief Financial Officer (Principal September 21, 1999 _____ Accounting Officer) (E. K. Ranjit) /s/ Geoffrey Rhoads Chief Technology Officer, Secretary September 21, 1999 _____ and Director (Geoffrey Rhoads) /s/ Philip Monego, Sr. Chairman of the Board of Directors September 20, 1999 (Philip Monego, Sr.)

/s/ Brian J. Grossi Director September 21, 1999 (Brian J. Grossi) /s/ John Taysom Director September 21, 1999 (John Taysom) Exhibit Index Exhibit Number Document

1.1*	Form of Underwriting Agreement
3.1*	Certificate of Incorporation of the Registrant
3.2*	Bylaws of the Registrant
4.1	Reference is made to Exhibits 3.1 and 3.2
4.2*	Second Amended and Restated Investor Rights Agreement, dated as of ,1999, between the Registrant and the holders of the Registrant's preferred stock
4.3*	Specimen Stock Certificate of the Registrant
5.1*	Opinion of Morrison & Foerster LLP as to the legality of the common stock
10.1*	Form of Indemnification Agreement between the Registrant and each of its executive officers and directors
10.2	Registrant's 1995 Stock Incentive Plan, as amended
10.3*	Registrant's 1999 Stock Incentive Plan, including forms of agreements thereunder
10.4*	Registrant's 1999 Employee Stock Purchase Plan, including forms of agreements thereunder
10.5	Office Lease Agreement, dated as of April 16, 1998, between the Registrant and Property Reserve, Inc.
10.6	Sublease, dated as of April 23, 1998, between the Registrant and Southern Pacific Funding Corporation
10.7	Sublease, dated as of April 27, 1998, between the Registrant and Southern Pacific Funding Corporation
10.8	Lease Agreement, dated as of June 25, 1999, between the Registrant and Southplace Associates LLC
23.1*	Consent of Morrison & Foerster LLP. Reference is made to Exhibit 5.1
23.2	Consent of KPMG LLP, Independent Certified Public Accountants
24.1	Powers of Attorney. Reference is made to Page II-4
27.1	Financial Data Schedule

* To be filed by amendment </TEXT>