

SONIC FOUNDRY INC  
Form 10-Q  
May 05, 2008  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the Quarterly period ended March 31, 2008

OR

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

Commission File Number 1-14007

**SONIC FOUNDRY, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

**MARYLAND**  
(State or other jurisdiction of  
incorporation or organization)  
**222 West Washington Ave, Madison, WI 53703**  
(Address of principal executive offices)  
**(608) 443-1600**  
(Registrant's telephone number including area code)

**39-1783372**  
(I.R.S. Employer  
Identification No.)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (see definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

State the number of shares outstanding of each of the issuer's common equity as of the last practicable date:

Class	Outstanding April 30, 2008
Common Stock, \$0.01 par value	35,581,670

**Table of Contents**

**TABLE OF CONTENTS**

	<b>PAGE NO.</b>
<b><i>PART I FINANCIAL INFORMATION</i></b>	
Item 1. Consolidated Financial Statements	
<u>Consolidated Balance Sheets (Unaudited) March 31, 2008 and September 30, 2007</u>	3
<u>Consolidated Statements of Operations (Unaudited) Three months and six months ended ended March 31, 2008 and 2007</u>	4
<u>Consolidated Statements of Cash Flows (Unaudited) Six months ended March 31, 2008 and 2007</u>	5
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	20
Item 4. <u>Controls and Procedures</u>	20
<b><i>PART II OTHER INFORMATION</i></b>	
Item 1. <u>Legal Proceedings</u>	21
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	21
Item 3. <u>Defaults Upon Senior Securities</u>	21
Item 4. <u>Submission Of Matters To A Vote Of Security Holders</u>	21
Item 5. <u>Other Information</u>	22
Item 6. <u>Exhibits</u>	22

**Table of Contents****Sonic Foundry, Inc.****Consolidated Balance Sheets****(in thousands, except for share data)****(Unaudited)**

	<b>March 31, 2008</b>	<b>September 30, 2007</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,786	\$ 8,008
Accounts receivable, net of allowances of \$190 and \$270	4,098	5,001
Inventories	77	204
Prepaid expenses and other current assets	623	975
<b>Total current assets</b>	<b>8,584</b>	<b>14,188</b>
Property and equipment:		
Leasehold improvements	980	975
Computer equipment	2,367	2,267
Furniture and fixtures	461	461
<b>Total property and equipment</b>	<b>3,808</b>	<b>3,703</b>
Less accumulated depreciation	1,857	1,520
<b>Net property and equipment</b>	<b>1,951</b>	<b>2,183</b>
Other assets:		
Goodwill and other intangibles, net of amortization of \$1,662 and \$1,656	7,604	7,610
<b>Total assets</b>	<b>\$ 18,139</b>	<b>\$ 23,981</b>
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 1,127	\$ 1,512
Accrued liabilities	958	1,023
Unearned revenue	3,464	3,314
Current portion of notes payable	333	333
Current portion of capital lease obligation	59	66
<b>Total current liabilities</b>	<b>5,941</b>	<b>6,248</b>
Long-term portion of notes payable	389	556
Long-term portion of capital lease obligations	44	69
Other liabilities	302	348
<b>Total liabilities</b>	<b>6,676</b>	<b>7,221</b>
Stockholders equity:		
Preferred stock, \$.01 par value, authorized 5,000,000 shares; none issued and outstanding		
5% preferred stock, Series B, voting, cumulative, convertible, \$.01 par value (liquidation preference at par), authorized 10,000,000 shares, none issued and outstanding		
Common stock, \$.01 par value, authorized 100,000,000 shares; 35,708,837 and 35,684,503 shares issued and 35,581,670 and 35,557,336 shares outstanding	357	357
Additional paid-in capital	184,049	183,528
Accumulated deficit	(172,748)	(166,930)

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

Receivable for common stock issued	(26)	(26)
Treasury stock, at cost, 127,167 shares	(169)	(169)
Total stockholders' equity	11,463	16,760
<b>Total liabilities and stockholders' equity</b>	<b>\$ 18,139</b>	<b>\$ 23,981</b>

See accompanying notes

**Table of Contents****Sonic Foundry, Inc.****Consolidated Statements of Operations**

(in thousands, except for share and per share data)

(Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
<b>Revenue:</b>				
Product	\$ 2,182	\$ 2,898	\$ 3,124	\$ 5,484
Services	1,719	913	3,277	1,791
Other	28	10	48	19
Total revenue	3,929	3,821	6,449	7,294
<b>Cost of revenue:</b>				
Product	1,030	790	1,540	1,533
Services	124	101	236	131
Total cost of revenue	1,154	891	1,776	1,664
<b>Gross margin</b>	2,775	2,930	4,673	5,630
<b>Operating expenses:</b>				
Selling and marketing	3,330	3,043	6,876	5,547
General and administrative	736	1,104	1,714	2,074
Product development	982	806	1,928	1,481
Total operating expenses	5,048	4,953	10,518	9,102
<b>Loss from operations</b>	(2,273)	(2,023)	(5,845)	(3,472)
Other income (expense), net	(5)	111	27	131
<b>Net loss</b>	\$ (2,278)	\$ (1,912)	\$ (5,818)	\$ (3,341)
<b>Net loss per common share:</b>				
basic and diluted	\$ (0.06)	\$ (0.05)	\$ (0.16)	\$ (0.10)
<b>Weighted average common shares</b>				
basic and diluted	35,572,140	35,368,667	35,566,949	33,881,848

See accompanying notes

**Table of Contents****Sonic Foundry, Inc.****Consolidated Statements of Cash Flows****(in thousands)****(Unaudited)**

	<b>Six months ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities</b>		
Net loss	\$ (5,818)	\$ (3,341)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of other intangibles	6	53
Depreciation and amortization of property and equipment	337	312
Loss on sale of fixed assets	5	
Other non-cash items	90	(26)
Share-based compensation expense related to stock warrants and options	492	388
Provision for doubtful accounts	(80)	50
Changes in operating assets and liabilities:		
Accounts receivable	983	(1,178)
Inventories	127	81
Prepaid expenses and other current assets	177	(284)
Accounts payable and accrued liabilities	(450)	(493)
Other long-term liabilities	(46)	(47)
Unearned revenue	235	225
Net cash used in operating activities	(3,942)	(4,260)
<b>Investing activities</b>		
Purchases of property and equipment	(110)	(272)
Net cash used in investing activities	(110)	(272)
<b>Financing activities</b>		
Payments on notes payable	(167)	
Proceeds from issuance of common stock, net of issuance costs		10,641
Proceeds from issuance of common stock options	29	
Payments on capital leases	(32)	(19)
Net cash provided by (used in) financing activities	(170)	10,622
Net increase (decrease) in cash	(4,222)	6,090
Cash and cash equivalents at beginning of period	8,008	2,751
Cash and cash equivalents at end of period	\$ 3,786	\$ 8,841

See accompanying notes

**Table of Contents**

**Sonic Foundry, Inc.**

**Notes to Consolidated Financial Statements**

**March 31, 2008**

**(Unaudited)**

**1. Basis of Presentation and Significant Accounting Policies**

Sonic Foundry, Inc. (the Company) is in the business of providing enterprise solutions and services for the web communications market.

***Interim Financial Data***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States ( GAAP ) for complete financial statements and should be read in conjunction with the Company's annual report filed on Form 10-K for the fiscal year ended September 30, 2007. In the opinion of management, all adjustments (consisting only of adjustments of a normal and recurring nature) considered necessary for a fair presentation of the results of operations have been included. Operating results for the three and six month periods ended March 31, 2008 are not necessarily indicative of the results that might be expected for the year ending September 30, 2008.

***Revenue Recognition***

**General**

Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectibility is reasonably assured. Revenue is deferred when undelivered products or services are essential to the functionality of delivered products, customer acceptance is uncertain, significant obligations remain, or the fair value of undelivered elements is unknown. The Company does not offer customers the right to return product, other than for warranty repairs. The Company's policy is to reduce revenue if it incurs an obligation for price rebates or other such programs during the period the obligation is reasonably estimated to occur. The following policies apply to the Company's major categories of revenue transactions.

**Products**

Products are considered delivered, and revenue is recognized, when title and risk of loss have been transferred to the customer. Under the terms and conditions of the sale, this occurs at the time of shipment to the customer. Product revenue currently represents sales of our Mediasite recorders, server software, and other Mediasite related products.

**Services**

We sell support contracts to our Mediasite customers, typically one year in length and record the related revenue ratably over the contractual period. Our support contracts cover phone and electronic technical support availability over and above the level provided by our distributors, software upgrades, advance replacement and an extension of the standard hardware warranty from 90 days to one year. The manufacturer we contract with to build the units performs hardware warranty service. We also provide installation, training and event services as well as services to host customer Mediasite content. Revenue for those services is recognized when performed in the case of installation, training and event services and is recognized ratably over the contract period for hosting services. Service amounts invoiced to customers in excess of revenue recognized are recorded as deferred revenue until the revenue recognition criteria are met.



## **Table of Contents**

### Other

Other revenue consists of non-Mediasite related software licensing, custom software development performed under time and materials or fixed fee arrangements and shipping and handling. Software licensing is recorded when persuasive evidence of an arrangement exists, delivery occurs, the sales price is fixed or determinable and collectibility is reasonably assured. Shipping and handling is recorded at the time of shipment to the customer.

### Revenue Arrangements that Include Multiple Elements

Revenue for transactions that include multiple elements such as hardware, software, training, support or content hosting agreements is allocated to each element based on vendor-specific objective evidence of the fair value VSOE and recognized for each element when the revenue recognition criteria have been met for that element. VSOE is based on the price charged when the element is sold separately. If VSOE of fair value does not exist for all elements in a multiple element arrangement, revenue is allocated first to the fair value of the undelivered elements and the residual revenue to the delivered elements. The Company recognizes revenue for delivered elements only when all of the following criteria are satisfied: undelivered elements are not essential to the functionality of delivered elements, uncertainties regarding customer acceptance are resolved, and the fair value for all undelivered elements is known.

### Reserves

We record reserves for stock rotations, rebates, and sales incentives to reduce revenue and accounts receivable for these and other credits we may grant to resellers. Such reserves are recorded at the time of sale and are calculated based on historical information (such as rates of product stock rotations) and the specific terms of sales programs, taking into account any other known information about likely reseller behavior. If actual reseller behavior differs from our expectations, additional reserves may be required. Also, if we determine that we can no longer accurately estimate amounts for stock rotations and sales incentives, we would not be able to recognize revenue until resellers sell the inventory to the final end user.

### Shipping and Handling

The Company's shipping and handling costs billed to customers are included in other revenue. Costs related to shipping and handling are included in cost of revenue and are recorded at the time of shipment to the customer.

### Concentration of Credit Risk and Other Risks and Uncertainties

The Company's cash and cash equivalents are deposited with two major financial institutions. At times, deposits in these institutions exceed the amount of insurance provided on such deposits. The Company has not experienced any losses on such amounts and believes that it is not exposed to any significant risk on these balances.

We perform ongoing credit evaluations of our customers' financial condition and generally do not require collateral. We maintain allowances for potential credit losses and such losses have been within our expectations.

### *Cash and Cash Equivalents*

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

**Table of Contents**

*Inventory Valuation*

Inventory consists of raw materials and supplies used in the assembly of Mediasite recorders and finished Mediasite recorders. Inven