

SONIC FOUNDRY INC
Form 10-K
November 22, 2010
Table of Contents

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

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal period ended September 30, 2010

OR

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

Commission File Number 000-30407

SONIC FOUNDRY, INC.

(Exact name of registrant as specified in its charter)

MARYLAND
(State or other jurisdiction of
incorporation or organization)

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

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

222 W. Washington Ave, Madison, WI 53703
(Address of principal executive offices)

(608) 443-1600
(Issuer's telephone number)

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

None

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

Common stock par value \$0.01 per share

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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 Act). Yes No

The aggregate market value of the registrant's common stock held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the Registrant's most recently completed second fiscal quarter was approximately \$23,566,000.

The number of shares outstanding of the registrant's common equity was 3,641,107 as of November 18, 2010.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2010 Annual Meeting of Stockholders are incorporated by reference into Part III. A definitive Proxy Statement pursuant to Regulation 14A will be filed with the Commission no later than January 28, 2011.

Table of Contents**TABLE OF CONTENTS**

	PAGE NO.
<u>PART I</u>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	17
Item 1B. <u>Unresolved Staff Comments</u>	28
Item 2. <u>Properties</u>	28
Item 3. <u>Legal Proceedings</u>	28
<u>PART II</u>	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	29
Item 6. <u>Selected Consolidated Financial Data</u>	32
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	33
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
Item 8. <u>Consolidated Financial Statements and Supplementary Data:</u>	41
<u>Report of Grant Thornton LLP, Independent Registered Public Accounting Firm</u>	41
<u>Consolidated Balance Sheets</u>	42
<u>Consolidated Statements of Operations</u>	43
<u>Consolidated Statements of Stockholders' Equity</u>	44
<u>Consolidated Statements of Cash Flows</u>	45
<u>Notes to Consolidated Financial Statements</u>	46
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	60
Item 9A. <u>Controls and Procedures</u>	60
Item 9B. <u>Other Information</u>	60
<u>PART III</u>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	61
Item 11. <u>Executive Compensation</u>	61
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	61
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	61
Item 14. <u>Principal Accounting Fees and Services</u>	62
<u>PART IV</u>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	62
Explanatory Note:	

Effective November 16, 2009, Sonic Foundry, Inc. implemented a one-for-ten reverse split of its stock. All share amounts and per share data in this Annual Report on Form 10-K have been adjusted to reflect this reverse stock split.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

When used in this Report, the words anticipate , expect , plan , believe , seek , estimate and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include, but are not limited to, statements about the features, benefits and performance of our Rich Media products, our ability to introduce new product offerings and increase revenue from existing products, expected expenses including those related to selling and marketing, product development and general and administrative, our beliefs regarding the health and growth of the market for our products, anticipated increase in our customer base, expansion of our products functionalities, expected revenue levels and sources of revenue, expected impact, if any, of legal proceedings, the adequacy of liquidity and capital resources, and expected growth in business. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, market acceptance for our products, our ability to attract and retain customers and distribution partners for existing and new products, our ability to control our expenses, our ability to recruit and retain employees, the ability of distribution partners to successfully sell our products, legislation and government regulation, shifts in technology, global and local business conditions, our ability to effectively maintain and update our products and service portfolio, the strength of competitive offerings, the prices being charged by those competitors, and the risks discussed elsewhere herein. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

PART I

ITEM 1. BUSINESS

Who We Are

Sonic Foundry, Inc. is a web communications technology leader, providing webcasting, lecture capture and knowledge management solutions for higher education institutions, businesses and government agencies worldwide. Powered by our patented webcasting platform, Mediasite®, Sonic Foundry empowers people to transform the way they communicate. We help our customers connect within a dynamic, evolving world of shared knowledge and envision a future where learners and workers around the globe use webcasting to bridge time and distance; accelerate research, productivity and growth; and reduce the environmental impact of traditional education and business communications.

Sonic Foundry solutions include:

Mediasite Recorders for capturing multimedia presentations

Mediasite EX Server platform for streaming, archiving and managing online presentation content

Sonic Foundry Event Services for turnkey event webcasting based on the Mediasite platform

Sonic Foundry Services for hosting, installation, training and custom development

Mediasite Customer Assurance for annual hardware and software maintenance and technical support

Today, nearly 2,000 customers using more than 4,500 Mediasite Recorders in presentation venues around the world are capturing hundreds of thousands of multimedia presentations with millions of viewers.

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Sonic Foundry, Inc. was founded in 1991, incorporated in Wisconsin in March 1994 and merged into a Maryland corporation of the same name in October 1996. Our executive offices are located at 222 West Washington Ave., Madison, Wisconsin 53703 and our telephone number is (608) 443-1600. Our corporate website is www.sonicfoundry.com. In the Investor Information section of our website we make available, free of charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to reports required to be filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after the filing of such reports with the Securities and Exchange Commission.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Challenges We Address

Every organization faces a fundamental need to communicate information efficiently to individuals who need it. Universities and colleges need to connect lecturers with students for advanced learning. Corporations strive for successful communication and collaboration among colleagues to provide value to customers. Government agencies must keep partners, stakeholders and constituents informed to operate effectively. And yet, communication and e-learning challenges remain, including:

Ensuring students' academic and professional success

Enabling learners to watch or review course material to improve retention and positively impact grades

Providing distance learners with the same quality education as on-campus students

Helping students balance education, career and family commitments

Increasing enrollment without the expense of new classrooms and facilities

Capturing complex graphics where visual clarity is essential for learning
Connecting with a geographically-dispersed audience

Simultaneously addressing people in multiple locations

Holding meetings, conferences and events when it is not feasible for everyone to attend

Transmitting timely information that is crucial for all to receive

Requiring employees, regardless of time zone or schedule, to attend training
Improving productivity and overall organizational knowledge

Avoiding the need for participants to leave their desks to attend a conference, meeting or training

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Maintaining productivity while in training

Reducing time to train new hires

Increasing retention by avoiding distractions, interruptions or absence

Keeping everyone on the same page to prevent false starts and forgotten directives

Documenting meeting content for later review

Extending the life of annual conferences and regional meetings

Maintaining a rich library of organizational knowledge

Documenting and preserving expertise from a retiring workforce
Reducing logistical and financial impacts

Cutting travel expenses and carbon footprints

Eliminating repetition of the same presentation to different audiences

Reducing repeated costs for printing, mailing and meeting expenses

Enabling individuals to attend professional conferences in light of travel bans and budget cuts
Avoiding cumbersome and restrictive technologies

Maintaining the way presenters present without requiring technical expertise in presentation systems

Capturing and sharing knowledge in real-time without pre-authoring or pre-uploading of content or needing substantial post-production time

Removing significant time and specialized expertise to manage presentation systems

Sonic Foundry Solutions

Sonic Foundry is changing the way organizations share and use information. Our solutions include:

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Mediasite Recorders for capturing multimedia presentations

Mediasite EX Server platform for streaming, archiving and managing online presentation content

Sonic Foundry Event Services for turnkey event webcasting based on the Mediasite platform

Sonic Foundry Services for hosting, installation, training and custom development

Mediasite Customer Assurance for annual hardware and software maintenance and technical support

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Mediasite Recorders are designed with presenters in mind. They automatically record what presenters say and show, without changing how they present, and webcast it online. Mediasite Recorders streamline the capture and delivery of any presenters' video and any presentation images shown from any presentation source such as a laptop, tablet PC, document camera, whiteboard or even medical instrumentation. The result is high resolution, interactive presentations that can be immediately watched via the web—live or on-demand. With the industry's simplest workflow, Mediasite Recorders eliminate time-consuming authoring, slide uploads and post-production work. Plus, seamless integration with existing audio/video and educational technology means organizations can confidently scale multimedia webcasting throughout their academic or corporate enterprise.

We offer Mediasite Recorders for the following environments:

A room-based Mediasite Recorder (RL Series) for presentation facilities like conference and training rooms, lecture halls, auditoriums and classrooms

A mobile Mediasite Recorder (ML Series) for portability to off-site events, conferences, trade shows or multiple venues throughout an organization

Accompanying all Mediasite Recorders is the Mediasite Editor, a desktop software tool allowing users to edit their presentations, if desired, before publishing them to the web.

Mediasite EX Server is a powerful platform for delivering and managing live and on-demand webcasts. It greatly simplifies content management by providing a single system to schedule, catalog, customize, secure, track and integrate recorded presentations. It brings order and control to valuable content libraries by making it easy to manage hundreds of system users, thousands of recorded hours and as many viewers as needed.

Mediasite EX Server allows organizations to:

Save time and staffing by scheduling presentations to be automatically recorded without an operator

Automatically create customizable and searchable online content catalogs without web development or integration skills

Secure presentations and Mediasite system access for authorized users

Customize and brand their presentation content

Incorporate audience interactivity through polls and Q&A

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Support closed captions to provide viewers a richer presentation experience while meeting federal or state accessibility mandates

Track and report on viewing activity to see who is watching what presentations when and to analyze viewing patterns that may correlate to improved learning outcomes, increased performance or program effectiveness

Centrally monitor and control the recording functions of multiple Mediasite Recorders for increased operator efficiency

Integrate Mediasite content into other course/learning/content management systems, portals, blogs or online communities

Leverage existing network technologies for content distribution efficiency and performance

Reliably scale to meet the webcasting needs of departmental and enterprise-wide implementations alike

Choose the deployment model that best suits their environment, whether on-premise or hosted in the Sonic Foundry datacenter
Sonic Foundry Event Services equips customers with a team of trained technicians who work on-site to webcast conferences and events. Event webcasting:

Enhances attendee experience with online presentation catalogs

Reaches a wider audience, making presentations available to those not able to attend

Brands presentations using organization logos, colors and messages

Provides a real-time record of what took place

Links handout materials with the full presentation, including audio, video and graphics

Offers sample content to entice new attendees to participate

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Sonic Foundry Services enable organizations to quickly and easily take advantage of the Mediasite platform, without having to wade through the IT or network complexities associated with their own infrastructure. Sonic Foundry Services include:

Hosting or Software as a Service (SaaS): Our pay-as-you-go service offerings provide content hosting, delivery and management of Mediasite content using Sonic Foundry's data center and infrastructure. These managed services allow organizations of all sizes to jump start their web communications initiatives quickly and simply. They provide a low-risk way to implement online multimedia communications before bringing hosting requirements in-house and can offer a hassle-free long-term solution.

Installation: Sonic Foundry provides onsite consulting and installation services to help customers optimize their deployment and efficiently integrate Mediasite within their existing AV and IT infrastructures, processes and workflows.

Training: To maximize customers' return on investments, skilled trainers provide the necessary knowledge transfer so organizations feel confident in using, managing and leveraging Mediasite's capabilities. On-site training is customized to specific requirements and skill levels, while online training provides convenient anytime access to a web-based catalog of training modules.

Custom Development: Sonic Foundry streamlines how Mediasite interfaces with a customer's specific technologies, internal policies, workflow or content delivery systems through project-based development.

Mediasite Customer Assurance provides customers annually renewable maintenance and support plans for their Mediasite solutions giving them access to Sonic Foundry technical expertise and Mediasite software updates. With a Mediasite Customer Assurance contract, customers are entitled to:

Software upgrades and updates for Mediasite Recorders and Servers

Unlimited technical support assistance

Extension of their recorder hardware warranty

Advanced recorder hardware replacement

Authorized access to the Mediasite Customer Assurance Portal where they can access software downloads, documentation, knowledge base articles, tutorials, online training and technical resources at any time.

Nearly all our customers purchase a Customer Assurance plan when they purchase Mediasite Recorders or Servers.

What Sets Mediasite Apart?

Market Leadership Two leading industry analyst firms recognize Sonic Foundry's Mediasite as the leading, best-of-breed platform for lecture capture. Frost & Sullivan awarded Sonic Foundry three consecutive Market Share Leadership Awards for Lecture Capture in 2010, 2009 and 2007 (no report was published in 2008). The Frost & Sullivan Award for Market Share Leadership is presented to the company that demonstrates excellence in capturing the highest market share within its industry and recognizes the company's leadership position in terms of revenues or units. Wainhouse Research also recognizes Mediasite as a streaming and lecture capture market leader for distance education and e-learning in their report, *The Distance Education and e-Learning Landscape V2* (December 2008). Among Wainhouse's evaluation criteria are innovation, market understanding, overall viability, product strategy and customer experience. According to the report, Sonic Foundry ranks highest from the perspective of product offering depth and ranks among the leaders in its ability to execute.

Ease of use We believe that presenters should not need to know anything about the technology that is facilitating their online communication. Automated or schedule-based recording simplifies what has previously been a technical and complex workflow. As a result, presenters can present as they normally do, which enables non-technical, line of business and subject matter experts to feel comfortable communicating via Mediasite. Similarly, viewers need nothing more than a web browser to watch Mediasite presentations.

Comprehensive content management We understand the need to bring order to a growing presentation library so content can be found, used and re-purposed to derive maximum value. Organizations must find ways to manage that content, and Sonic Foundry believes a complete solution focuses not only on the recording of knowledge, but also the retention and management of that knowledge in a system specifically designed for rich media. Mediasite automatically creates searchable online catalogs that index and organize presentations with customizable playback experiences. With integration support for leading enterprise directories, all content can be secured to allow/deny access to specific groups or individuals based on roles and permissions. Mediasite also allows organizations to track and generate reports for every presentation and/or user of the system, letting them see exactly who is watching what, when and how long.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Reliability Whether starting at the department level with a couple rooms or at the enterprise level with a campus- or company-wide implementation, Mediasite was developed to be the single platform to confidently and reliably scale to organizations' webcasting needs. Nearly 2,000 customers around the world depend on Mediasite and its proven design to webcast critical information, enrich daily communications and retain their organizational knowledge.

Dynamic multimedia experience The Mediasite experience takes into account different individual learning styles—auditory, visual and kinesthetic—providing an interactive format that engages the viewer via different modalities to increase content comprehension and retention. Many other webcast solutions focus on PowerPoint as the predominant or only source of content and may not support video. We understand that learning materials and supporting visuals come in many different forms, and Mediasite Recorders' flexible capture options support input from any laptop application, tablet PC, whiteboard, document camera, medical instrumentation and more. In November 2006, the United States Patent and Trademark Office granted Sonic Foundry a patent on Mediasite's unique method to capture and automatically index and synchronize what the presenter says (audio and video) with visual aids (RGB-based presentation content) and instantly stream them both over the Internet. Mediasite is also the first lecture capture solution to offer a fully Microsoft® Silverlight®-enabled Player which provides a more dynamic, user-controlled viewing experience. Adding to Mediasite's interactivity is the ability to incorporate polls, Q&A or links to other related reference materials supporting the learning process. Support for video closed captioning benefits those with hearing disabilities, but also allows all users to use keyword search to pinpoint and play back content of interest within a Mediasite presentation.

Software as a Service (SaaS) deployment option To minimize IT challenges, network infrastructure issues and expertise required to install, configure and maintain Mediasite within the enterprise, Sonic Foundry hosting provides organizations a low-risk method of using the complete Mediasite platform within a state-of-the-art datacenter.

Customer support Sonic Foundry and the growing Mediasite community provide a reliable, collaborative support network for all Mediasite customers. Our breadth of field-based system engineers and responsive customer care ensure that customers have readily available resources committed to their success. The Mediasite User Group (MUG) is one of the most vibrant, diverse and rapidly expanding user communities for lecture capture, online training and e-learning. MUG members share ideas and get feedback year-round from community experts through online forum discussions, participate in live quarterly meetings to exchange best practices and network at UNLEASH, the annual Mediasite User Conference.

Sonic Foundry Solutions in Higher Education and the Enterprise

Sonic Foundry solutions are rapidly emerging as the standard for recording, delivering and managing one-to-many multimedia webcasts for higher education and corporate, healthcare or government enterprises

Sonic Foundry solutions in higher education:

Among post-secondary institutions, Mediasite is used for:

Online lectures (blended/hybrid learning): students review content outside of in-class instruction

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Distance learning: off-campus students learn remotely online

Continuing education: professionals learn online or supplement classroom experiences

Faculty training and development

Research and collaboration: faculty document and present findings

Recruitment and orientation: campus tours, financial aid instructions

Special events: commencement, guest speakers, sporting events

University business: leadership meetings, alumni relations, outreach

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Through interviews, many higher education institutions report that Mediasite:

Improves student learning outcomes

Lets students watch and re-watch presentations at their convenience, boosting information retention

Replicates the in-class experience for online students or those unable to attend class

Contributes to enhanced grades

Caters to different learning modalities

Enables their institution to remain competitive

Allows quick development and delivery of cost-effective online programs

Supports higher enrollment and/or tuition without new classrooms

Improves student retention and matriculation

Helps attract students and faculty

Empowers faculty

Allows them to teach as usual without learning new technology

Promotes greater in-class interactivity rather than copious note-taking

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Improves student outcomes

Enables knowledge sharing and collaboration with colleagues

Supports time-shifting, letting faculty travel to conferences or present findings without missing class

Boosts campus outreach

Bolsters recruitment efforts

Increases awareness and reach of campus events

Enhances alumni relations

Given the technology pedigree of today's college students, this move to online learning makes perfect sense as most of these students have never known a world without personal computers and the web. The delivery options for a modern education are akin to the electronic delivery of music that emerged several years ago. Students demand immediate access to their coursework regardless of time or place.

Recent trends such as the slowing economy and lingering high fuel prices continue to drive more students, particularly adult learners, to online education through enrollment in blended or hybrid courses with a traditional on-campus component or through fully online distance learning programs. Historically, graduate programs and STEM (science, technology, engineering and math)-oriented degree programs in schools of medicine, nursing, engineering or business have comprised the majority of the Company's academic customer base. We are now experiencing heightened market demand for lecture capture within undergraduate and community college programs as well.

According to the Sloan Consortium report, *Learning on Demand: Online Education in the United States, 2009*, online enrollments the past several years have been growing considerably. The 17 percent growth rate for online enrollments far exceeds the 1.2 percent growth of the overall higher education student population. In the 2008 fall term, over 4.6 million, or more than one in four college and university students, were taking at least one online course, a 17 percent increase over the previous year. The economic downturn has also increased demand for online courses, with 66 percent of institutions reporting increased demand for new courses and programs, and 73 percent seeing increased demand for existing online courses and programs. Of public institutions, 74 percent believe that online education is critical for their long-term strategy, along with half of private for-profit and private nonprofit institutions.

Community colleges, specifically, have significantly increased their number of blended or hybrid and web-enhanced courses. The Instructional Technology Council's 2009 Distance Education Survey Results: *Trends in eLearning: Tracking the Impact of eLearning at Community Colleges* (March 2010) reported a 22 percent increase for distance learning enrollments, substantially higher than overall national campus enrollments, which averaged less than two percent nationally. The study also showed that overall, 74 percent of community colleges offer audio/video streaming, and another 15 percent plan to offer over the next two years. Over half of community colleges plan to increase the number of blended/hybrid courses.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

According to the 2009 *Campus Computing* survey, more than half of all universities already have a strategic plan for lecture capture or are working on one. And analysts predict the lecture capture market will more than triple over the next six years. Frost & Sullivan analysts estimate lecture capture revenues will reach over \$192 million by 2016, exhibiting a nearly 22 percent compound annual growth rate (CAGR) for the six-year period (*World Lecture Capture Solutions Markets* report, 2010).

In September 2008, Sonic Foundry sponsored a research project with the University of Wisconsin E-Business Institute which resulted in the study, *Insights Regarding Undergraduate Preference for Lecture Capture*. A survey was sent to 29,078 undergraduate and graduate students at the University of Wisconsin-Madison in April 2008. Average response rate exceeded 25 percent. Of the survey participants, a significant number of undergraduates (47 percent) have taken a class in which lectures were recorded and made available online. Eighty-two percent of the undergraduates in the sample strongly preferred a course that records and streams lecture content online versus a course that only features in-room instruction. Students reported better retention, improved ability to review for exams and greater engagement during classes with lecture capture. Over half of the undergraduates indicated that, even after course completion, having course material available online would be important and that there was interest in accessing online material in their professional lives. Over 60 percent of the sample was willing to pay for lecture capture services. Of those willing to pay, the majority of undergraduates (69 percent) expressed a preference to pay on a course-by-course basis rather than having lecture capture fees bundled with existing technology fees.

Several universities have conducted their own independent studies to assess the impact of Mediasite on student performance. Penn State Hershey Medical Center and College of Medicine, a Mediasite campus since January 2004, deployed a pilot program at the onset of the 2007-2008 academic year to record lectures to first year medical students. During this academic year, lectures were viewed a total of 22,451 times, averaging 59.1 views per lecture by a class of 154 students. Mediasite use increased throughout the academic year, with 97 percent of students using Mediasite to review lectures by the semester's end. Almost half of the students surveyed (41 percent) cited reviewing complicated material as the number one motivator for using Mediasite. The majority (88 percent) agreed that Mediasite helps them achieve their educational goals. Much fewer (25 percent) said podcasting had the same effect. Faculty members reported that recording their lectures did not decrease class attendance. The survey also revealed a correlation between the grading method and the use of Mediasite. Students watch lectures more often via Mediasite for classes where grades are awarded as honors, high pass, pass and fail versus simply pass/fail.

The Paul Merage School of Business at the University of California, Irvine, surveyed students in its 2007-2008 MBA for Executives and MBA for Health Care Executives programs. Ninety-one percent used Mediasite to view lectures, 71 percent found they were more engaged in lectures when they didn't have to focus on taking copious notes and 83 percent said they learned more in courses when lectures were available on demand. The survey also determined that 93 percent of the students would choose an MBA program that produces Mediasite course content over a school with traditional in-class instruction alone. Furthermore, 82 percent would pay higher tuition for a program that streams and archives instruction, with almost half willing to pay between \$2,000 and \$5,000 more for their two-year degree.

During the spring semester of 2008, the University of New Mexico surveyed almost a thousand undergraduate and distance education students about their Mediasite usage and found:

90 percent of respondents agreed or strongly agreed that Mediasite should be available for other courses

62 percent of students used Mediasite at least half of the time or more to review or watch lectures

77 percent had good or excellent experiences using Mediasite, and 77 percent of respondents agreed or strongly agreed that Mediasite was easy to use

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

85 percent described the quality of the Mediasite recordings as good or excellent

42 percent used Mediasite to review lectures due to absence, but several students noted they never missed class

54 percent used Mediasite to review for quizzes and exams often or always with 30 percent always using to review

67 percent responded they agreed or strongly agreed that Mediasite improved their overall learning of course content

56 percent responded they agreed or strongly agreed that Mediasite improved their overall grade in the course

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

The Dental School at the University of Maryland, Baltimore, also surveyed its dental and dental hygiene students in the fall of 2007 and found:

91 percent responded strongly agree or agree that lecture capture made it easier for them to learn

While students expressed a slight preference for using Mediasite and attending lectures on occasion, performance was equal to or better than straight lecture attendance

To remain relevant, colleges and universities are striving to differentiate themselves through technical leadership as a means to attract these tech-savvy students, while balancing their campus technology improvements with systems that faculty will embrace and adopt. As a result, the education market is beginning to restructure and increase investments around online learning. We believe the visible integration of multimedia learning content into core university applications and the success of bundled online learning technology solutions are two healthy indicators for the widespread adoption of online campus lectures.

To date, Sonic Foundry has installed Mediasite in the larger lecture halls and classrooms of campuses nationwide. We now see more and broader expansions and integrations of Mediasite at the campus-wide level. Course and learning management systems like Blackboard®, Moodle, Desire2Learn®, Angel, or Sakai are ubiquitous in the education enterprise. As the foundation for e-learning, these systems are rapidly moving beyond simply aggregating related course documents (handouts, assignments, course syllabi) to becoming students' single-source portal for all course-related materials including recorded multimedia content like online lectures. Mediasite's packaged integrations for Blackboard and Moodle, the leading course management systems used in higher education, address the need to make learning content accessible to students when and where they need it.

Sonic Foundry Solutions in the Enterprise:

Within medium to large corporate, healthcare and government enterprises, Mediasite has numerous applications.

In corporate enterprises it is used for:

Executive communications: state of the enterprise speeches, all-hands meetings

Workforce development: training, HR briefings, policy documentation

Sales and marketing: demonstrations, product announcements, webinars, channel relations

Internal knowledge repositories: technical training, research collaboration, user-generated content

Customer support: product tutorials, self-guided troubleshooting

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Investor relations: earnings calls, analyst briefings, annual reports

Conferences and events: user group, sales and annual meetings

In health-related enterprises it is used for:

Education: continuing medical education, grand rounds, seminars, student/patient simulations

On-demand medical information

Caregiver training

Emergency response coordination

Public health announcements

Research and collaboration

Conferences and events

In government agencies it is used for:

Program management: relief work, military coordination, emergency preparedness

Community outreach: committee meetings, public safety announcements

Training, workshops and events

Executive and legislative communications: constituent relations, public speeches, debates

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Through interviews across these verticals, enterprise customers report that Mediasite:

Expands training and communications opportunities

Enables them to offer training to more and larger audiences

Captures knowledge from a retiring workforce

Supports the creation and sharing of user-generated content

Aides in building a knowledge library

Extends the life of conferences and events

Cuts travel and meeting expenses

Eliminates redundant speaking engagements

Opens communication channels with dispersed audiences regardless of location or time zone

Provides the ability to address everyone at once

Boosts efficiency

Enables immediate communication of time-sensitive information

Delivers the message directly to the desktop to reduce downtime

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Allows participants to watch when it's convenient to avoid interruptions and increase retention

Reduces new hire training time

Helps build stronger teams

Fosters direct management/employee communications

Supports more frequent, clearer communication with colleagues and staff

Keeps all employees aligned

Cultivates team morale and collaboration

Less than a decade ago, the only people in the enterprise talking openly about online multimedia were audiovisual specialists in information technology or media services units, and even these people were skeptical about what benefits streaming would hold for the enterprise. Now, knowledge workers, executives, event planners and people in training, sales, human resources and research and development are pushing for online multimedia and webcasting as part of their e-learning initiatives. They have a business need to be seen and heard by their colleagues, and the return on investment (ROI) for multimedia online learning is real and measurable.

Claire Schooley, senior analyst with Forrester Research, Inc., wrote in the April 2009 report, *The ROI of eLearning*. Online learning earns companies a positive ROI in less than a year. If you have a business that is spread across many locations, it makes good business sense to implement an online learning program as a replacement for some face-to-face learning and as a complement to other instructor-led training in the form of blended learning. Whether employees take compliance training, desktop skills development, or leadership training, online learning is flexible, consistent, and repeatable with minimal travel costs. The keys to success include excellent eLearning content that engages the learner; good change management plans for this new way of learning; and technology that is scalable and easy to use to manage the learning. She goes on to state that Outside of subject areas where face-to-face interaction is necessary, recent research indicates that no significant differences exist in the effectiveness of learning through classroom, online, or self-study. Self-paced eLearning allows learners to assimilate content at their own speed often 20% to 50% faster than in a classroom

Gartner vice president and distinguished analyst, Carol Rozwell, echoes the value of e-learning in the January 2009 report, *Key Issues for Corporate Learning Systems, 2009*. She states, Getting people up to speed quickly and efficiently is critical for all roles, but especially for those positions with a high turnover rate, such as sales and customer support. Reducing time to competency demands that employees, customers and business partners are connected to high-quality learning content so they can achieve workplace performance objectives. In times of financial stress, interest in e-learning increases. It gives learners the opportunity for training without the expense of travel and it allows the company to support green initiatives.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

The technology market for enterprise webcasting solutions that support many e-learning and business communications initiatives is growing as well. In Wainhouse Research's, *Enterprise Streaming Products Market Size and Forecast (May 2010)*, senior analyst and partner, Ira Weinstein, estimates the enterprise streaming products market (which includes content capture and management solutions and related services for installation, training and support) to be \$406 million in 2010. This market will expand to \$1.175 billion by 2014 with Weinstein projecting a CAGR for the period around 30 percent. In the September 2010 *Enterprise Webcasting Services Market Size and Forecast* also by Wainhouse Research, Weinstein estimates the 2010 market for hosted streaming application platforms supporting live virtual events (specifically excluding web conferencing offerings and consumer-focused video streaming services) to be \$313 million. By 2015, Weinstein predicts the market will expand to \$1.116 billion, exhibiting a 29 percent CAGR over the five-year period, driven by increasing awareness of webcasting as a business application and growing acceptance of SaaS/hosted webcasting offerings.

Future Directions

Because webcasting and lecture capture are becoming an everyday part of the way people work and learn, we are driven to shorten the time it takes people not only to capture and share their information but also to find the information they need. Today, leading universities use Mediasite for lecture capture and corporations webcast training, executive communications and events. We envision a future where people around the globe use webcasting to bridge time and distance; accelerate research, productivity and growth; and reduce the environmental impact of traditional education and business communications. As a company, we are helping create the libraries of tomorrow with technology that does not compound the world's information overload. We are working to put a human face on all online knowledge, and we believe the world will be more knowledgeable and more connected as a result.

Supporting this vision, our ongoing innovations center on:

Developing deployment options to meet the webcasting needs for organizations of all sizes. This includes:

Significant investment, development and evolution of our current Mediasite hosting platform to provide Software as a Service (SaaS). This alternative to traditional on-premise deployments provides an ideal way to minimize IT challenges and potential webcasting risks while affordably extending high performance, fault tolerant webcasting to small and large customers alike.

Content capture solutions that economically scale across entire organizations, allowing anyone to record and share their knowledge or expertise.

Evolving Mediasite's content management capabilities to accommodate organizations' existing digital video assets.

Integrating with and embedding Mediasite content into enterprise portals, learning and course management systems, content management repositories, blogs or online communities.

Enabling context-based viewing of webcasts within online environments that enable and encourage discussion around the content.

Supporting content playback on popular mobile devices.

Incorporating keyword search within rich media presentations and across presentation libraries.

Segment Information

We have determined that in accordance with FASB ASC 280-10, we operate in only one segment as we do not disaggregate profit and loss information on a segment basis for internal management reporting purposes to our chief operating decision maker. Therefore, such information is not presented.

We have included the cash effect of billings not recorded as revenue, which are deferred for GAAP purposes, in arriving at non-GAAP net income or loss. Our services are typically billed and collected in advance of providing the service which requires minimal cost to perform in the future. Billings are a better indicator of customer activity and cash flow than revenue is, in management's opinion, and is therefore used by management as a key operational indicator. Billings is computed by combining revenue with the change in unearned revenue. Total billings for Mediasite product and support outside the United States totaled 19 percent and 28 percent in 2010 and 2009, respectively.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Our largest individual customers are typically value added resellers (VARs) and distributors since the majority of our end users require additional complementary products and services which we do not provide. Accordingly, in fiscal 2010 and 2009 one master distributor, Synnex Corporation (Synnex), contributed 32 percent and 29 percent, respectively, of total world-wide billings. A second master distributor, Starin Marketing, Inc. (Starin), contributed 22 percent and almost 10 percent of total world-wide billings in fiscal 2010 and 2009, respectively. As master distributors, Synnex and Starin fulfill transactions to VARs, end users and other distributors. No other customer represented over 10 percent in 2010 or 2009.

Sales

We sell and market our offerings through a sales force that manages a channel of value-added resellers, system integrators, consultants and distributors. These third party representatives specialize in understanding both audio/video systems and IT networking. In fiscal 2010, we utilized two master distributors in the U.S. and nearly 150 resellers, and sold our products to over 1,000 total end users. Our focus has been primarily in the United States and primarily to customers we have identified as having the greatest potential for high use; that is, organizations with presenters, trainers, lecturers, marketers, event planners and leaders who have a routine need to communicate to many people in higher education, government, health and certain corporate markets. Despite our primary attention on the United States market, reseller and customer interest outside the United States has grown and accordingly, we allocated five sales professionals to address international demand. To date, we have sold our products to customers in over 40 countries outside the United States. Total billings for Mediasite product and support outside the United States totaled 19 percent and 28 percent in fiscal 2010 and 2009, respectively.

Vertical market expansion: Over half our revenue is realized from the education market. Recent trends such as the slowing economy are driving more students, particularly adult learners, to seek online education options. Similarly, demand for lecture capture within undergraduate, community college and blended learning programs is beginning to demonstrate growth. This development represents an emerging trend beyond the traditional academic customer base for the company, which has primarily consisted of graduate, distance learning and technical degree programs.

For our higher education as well as corporate, government and association clients, we anticipate weakening economic conditions will expand market demand for more outsourced services versus licensed sales. Over the last two years, the company has made extensive capital and technology investments to advance its services model with turnkey event webcasting, comprehensive hosting/Software as a Service (SaaS), and e-commerce capabilities that position us well to deliver more diversified business services.

With our Event Services group, we continue to see growing demand for conference and event webcasting. These event-based communication, education and training applications, combined with outsourced webcasting services, are expected to drive the company's corporate sales activities going forward.

Repeat orders: Many customers initially purchase a small number of Mediasite Recorders to test or pilot in a department, school or business unit. A successful pilot project and the associated increase in webcasting demand from other departments or schools leads to follow up, multiple Recorder orders as well as increased Mediasite Server capacity. In fiscal 2010, 70 percent of billings were to preexisting customers compared to 62 percent in fiscal 2009.

Renewals: As is typical in the industry, we offer annual support and maintenance service contract extensions for a fee to our customer base. Nearly all customers purchase a Customer Assurance plan with their initial Mediasite Recorders and Servers, and the majority renew their contracts annually.

Marketing

Marketing efforts span the spectrum of product demonstrations, webinars, tradeshow, websites, public relations, social media, direct mail, e-mail campaigns, newsletters, print and online advertising, sponsorships, Mediasite User Group community building, annual user conference, brochures, white papers and analyst relations. We often request and receive press release quotes and written or multimedia testimonials from

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

satisfied, high-profile reference customers, particularly those that demonstrate innovative and valuable uses of the Mediasite platform and Event Services. We solicit respected industry magazines and trade organizations to review our product and use advisors as introductions to new channels or customers. We have a large, growing database of potential customers in the education, government and corporate marketplaces and have established a process of targeting specific verticals that have a direct and demonstrated need for our offerings.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Operations

We contract with third parties to build the hardware of our Mediasite Recorders and purchase quantities sufficient to fill specific customer orders, including purchases of inventory by resellers. Quantities are maintained in inventory by the third party providers and shipped directly to the end customer or reseller. The hardware manufacturers provide a limited one-year warranty on the hardware, which we pass on to our customers who purchase a Mediasite Customer Assurance support and maintenance plan. We have alternative sources of manufacturing for some of the products we produce and believe there are numerous additional sources and alternatives to the existing production process. We have experienced delays in production of our products and component parts used in our products in the past and expect to seek secondary sources of supply and maintain greater quantities of inventory in the future to mitigate the risk of such delays. To date, we have not experienced any material returns due to product defects.

OTHER INFORMATION

Competition

In the lecture capture and webcasting market we face competition from various companies that provide related, but different, communication technologies. These include:

Web conferencing solutions (e.g. Adobe, Cisco/WebEx, Microsoft and Citrix). Although part of the overall online multimedia communications landscape, these solutions are designed primarily for collaborative communications versus one-to-many communications like Mediasite. Many organizations acknowledge that they need both technologies – one-to-many webcasting and collaborative web conferencing – to appropriately address their different communication requirements.

Video conferencing solutions (e.g. Polycom, TANDBERG (now Cisco) and Sony). These solutions are designed primarily for one-to-one or group communications with high levels of interactivity and collaboration. Like web conferencing, many organizations use both video conferencing and webcasting. Mediasite integrates with videoconferencing endpoints from Polycom and TANDBERG to record and manage interactive meetings, discussions and distance learning courses alongside other Mediasite content.

Authoring tools (e.g. Accordent PresenterPLUS, Camtasia Studio and Microsoft Producer). Unlike webcasting, web conferencing or video conferencing, which are forms of online multimedia communication that capture and distribute/stream content, these solutions are production-oriented tools designed to create and edit multimedia content only. Some organizations will use these desktop tools to create training content by manually integrating existing audio, video, images, branding and other visual elements into a multimedia presentation which can then be published to a web or streaming server for distribution. This process can require a significant amount of production effort and user expertise in presentation authoring.

Online video services and virtual meeting platforms (e.g. INXPO, Livestream, ON24, Onstream Media, InterCall, Thomson Reuters, Unisfair and Wall Street Webcasting). These companies offer services or SaaS-based platforms that either allow audio and video to be captured from a presenter's computer (often with supporting materials uploaded in advance), produced streaming video services or 2D/3D virtual environments that may or may not include rich media webcasts.

Other vendors such as Echo360, Tegrity, Accordent Technologies and Panopto, provide lecture capture or webcasting capabilities, but differ in their technology approach, particularly in the lecture capture arena. Mediasite is an appliance- or room-based platform for lecture capture. It

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

provides a full integrated system designed around an automated purpose-built recording appliance to capture, publish and manage rich media content. This transparent recording automation means no presenter intervention which leads to the broadest end-user adoption across campuses. Room-based appliances are capable of streaming live or on-demand and can leverage the full breadth of in-room audio/visual technology. A room-based platform like Mediasite also includes complete content management for captured multimedia presentations.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Other lecture capture solutions are implemented as software applications designed to capture and publish rich media content, but dependent upon a third-party content management platform, typically the institution's course management system. Software applications for lecture capture support on-demand streaming only and require in-room PC integration with varying levels of presenter intervention and recording knowledge which may lead to lower adoption rates throughout the campus.

Lastly, laptop-resident desktop tools capture and publish non-rich media (limited video and presentation graphics) and like software applications support only on-demand streaming and require a third-party content management platform. Desktop tools require the greatest degree of presenter intervention, technical confidence and support. While prevalent on many campuses, these three factors limit the practicality for campus-wide adoption.

Some current and potential customers have developed their own home-grown webcasting or lecture capture solutions which may compete with Mediasite. However, we often find many of these organizations are now looking for a solution that requires less internal maintenance and effort, offers comprehensive management capabilities and a less cumbersome workflow.

The more successful we are in the growing market for lecture capture and webcasting, the more competitors are likely to emerge. We believe that the principal competitive factors in our market include:

Ease of use and application transparency to the user

Content management and scalability to address enterprise requirements

Reliability and performance

Price

Flexibility to choose live or on-demand webcasting or both

Security of content, applications and services

Ability to integrate with third-party solutions and services

Flexible deployment and acquisition options to suit various budgets

Customer service and support

A significant reference-able customer base

Ability to introduce new products and services to the market in a timely manner

Intellectual Property

The status of United States patent protection in the Internet industry is not well defined and will evolve as the U.S. Patent and Trademark Office grants additional patents. Currently two U.S patents that have been issued to us, and four U.S. patent applications are pending. We may seek additional patents in the future. We do not know if our pending patent applications or any future patent application will result in any patents being issued with the scope of the claims we seek, if such patents are issued at all. We do not know whether the patents which were recently approved or any patents we may receive in the future will be challenged, invalidated or be of any value. It is difficult to monitor unauthorized use of technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States, and our competitors may independently develop technology similar to ours. We will continue to seek patent and other intellectual property protections, when appropriate, for those aspects of our technology that we believe constitute innovations providing significant competitive advantages. Our pending, and any future, patent applications may not result in the issuance of valid patents.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Our success depends in part upon our rights to proprietary technology. We rely on a combination of copyright, trade secret, trademark and contractual protection to establish and protect our proprietary rights. We have registered eight U.S. and four foreign country trademarks. We require our employees to enter into confidentiality and nondisclosure agreements upon commencement of employment. Before we will disclose any confidential aspects of our services, technology or business plans to customers, potential business distribution partners and other non-employees, we routinely require such persons to enter into confidentiality and nondisclosure agreements. In addition, we require all employees, and those consultants involved in the deployment of our services, to agree to assign to us any proprietary information, inventions or other intellectual property they generate, or come to possess, while employed by us. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our services or technology. These precautions may not prevent misappropriation or infringement of our intellectual property.

Third parties may infringe or misappropriate our copyrights, trademarks and similar proprietary rights. In addition, we may be subject to claims of alleged infringement of patents and other intellectual property rights of third parties. We may be unaware of filed patent applications which have not yet been made public and which relate to our services.

Intellectual property claims may be asserted against us in the future. Intellectual property litigation is expensive and time-consuming and could divert management's attention away from running our business. Intellectual property litigation could also require us to develop non-infringing technology or enter into royalty or license agreements. These royalty or license agreements, if required, may not be available on acceptable terms, if at all. Our failure or inability to develop non-infringing technology or license the proprietary rights on a timely basis would harm our business.

Research and Development

We believe that our future success will depend in part on our ability to continue to develop new business, and to enhance our existing business. Accordingly, we invest a significant amount of our resources in research and development activities. During each of the fiscal years ended September 30, 2010 and 2009, we spent \$3.1 million and \$3.5 million, respectively, on internal research and development activities in our business. These amounts represent 15% and 19%, respectively, of total revenue in each of those years.

Employees

As of September 30, 2010 and 2009, we had 90 and 93 full-time employees, respectively. Our employees are not represented by a labor union, nor are they subject to a collective bargaining agreement. We have never experienced a work stoppage and believe that our employee relations are satisfactory.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

ITEM 1A. RISK FACTORS

YOU SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED BELOW BEFORE MAKING AN INVESTMENT DECISION. THE RISKS DESCRIBED BELOW ARE NOT THE ONLY ONES WE FACE. ADDITIONAL RISKS THAT WE ARE NOT PRESENTLY AWARE OF OR THAT WE CURRENTLY BELIEVE ARE IMMATERIAL MAY ALSO IMPAIR OUR BUSINESS OPERATIONS. OUR BUSINESS COULD BE HARMED BY ANY OR ALL OF THESE RISKS. THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE SIGNIFICANTLY DUE TO ANY OF THESE RISKS, AND YOU MAY LOSE ALL OR PART OF YOUR INVESTMENT. IN ASSESSING THESE RISKS, YOU SHOULD ALSO REFER TO THE OTHER INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS ANNUAL REPORT ON FORM 10-K, INCLUDING OUR CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES.

Economic conditions could materially adversely affect the Company.

The global economic crisis experienced since 2008 and any continuing unfavorable economic conditions have negatively affected, and could continue to negatively affect, our business, operating results or financial condition, which could in turn affect our stock price. Weak economic conditions and the resulting impact on the availability of public funds along with the possibility of state and local budget cuts and reduced university enrollment could lead to a reduction in demand for our products and services. In addition, a prolonged economic downturn could cause insolvency of key suppliers resulting in product delays, inability of customers to obtain credit to finance purchases of the Company's products and inability or delay of our channel partners and other customers to pay accounts receivable owed to us.

Economic conditions may have a disproportionate effect on the sale of our products.

Many of our customers will look at the total A/V equipment and labor cost to outfit a typical conference room or lecture hall as one amount for budgetary purposes. Consequently, although our products represent only a portion of the total cost, the cost of the entire project of outfitting a room or conference hall may be considered excessive and may not survive budgetary constraints. Alternatively, our resellers may modify their quotes to end customers by eliminating our products or substituting less expensive competitive products in order to win opportunities within budget constraints. Event service partners may similarly suggest that customers eliminate recording and webcasting as a means of reducing event cost. Consequently, declines in spending by government, educational or corporate institutions due to budgetary constraints may have a disproportionate impact on the Company and result in a material adverse impact on our financial condition.

Multiple unit deals needed for continued success.

We need to sell multiple units to educational, corporate and government institutions in order to sell most efficiently and remain profitable. In fiscal 2010, 70% of revenue was to existing customers compared to 62% in fiscal 2009. In particular, sales of multiple units to corporate customers have lagged behind results achieved in the higher education market; consequently, we have allocated more resources to the higher education market. While we have addressed a strategy to leverage existing customers and close multiple unit transactions, a customer may choose not to make expected purchases of our products. The failure of our customers to make expected purchases will harm our business.

Manufacturing disruption or capacity constraints would harm our business.

We subcontract the manufacture of our recorders to one third-party contract manufacturer and subcontract the manufacture of our rack-unit recorder and a proprietary component of our recorders to another third-party contract manufacturer. Although we believe there are multiple sources of supply from other contract manufacturers as well as multiple suppliers of component parts required by the contract manufacturers, a disruption of supply of component parts or completed products, even if short term, would have a negative impact on our revenues. Many component parts currently have long delivery lead times, requiring careful estimation of production requirements. Lengthening lead times, product design changes and other third party manufacturing disruptions have caused delays in delivery in fiscal 2010. In order to compensate for supply delays, we have sourced components from off-shore sources, used cross component parts, paid for expediting and currently hold

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

substantially larger quantities of inventory than we previously held. Each of these strategies has increased our costs and may not be sufficient to ensure against production delays. We depend on our subcontract manufacturers to produce our products efficiently while maintaining high levels of quality. Any manufacturing defects, delay in production or changes in product features will likely cause customer dissatisfaction and may harm our reputation. Moreover, any incapacitation of the manufacturing site due to destruction, natural disaster or similar events could result in a loss of product inventory. As a result of any of the foregoing, we may not be able to meet demand for our products, which could negatively affect revenues in the quarter of the disruption or longer depending upon the magnitude of the event, and could harm our reputation.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

We may need to raise additional capital.

At September 30, 2010 we had cash of \$3.4 million and availability under our line of credit facility with Silicon Valley Bank of \$2.9 million. The Company has historically financed its operations primarily through cash from sales of equity securities, cash from operations, and to a limited extent, through bank credit facilities. The Company has a history of operating losses and prior to fiscal 2010 had historically used cash in operations. The Company has significantly reduced its operating expenses over the last two fiscal years, and anticipates operating expenses to grow at less than the anticipated rate of increase in revenues in fiscal 2011. The Company believes its cash position and available credit is adequate to accomplish its business plan through at least the next twelve months.

We may evaluate further operating or capital lease opportunities to finance equipment purchases in the future and may utilize the Company's revolving line of credit to support working capital needs. While the Company anticipates that it will be in compliance with all provisions of the agreement, there can be no assurance that the existing Loan Agreement will be available to the Company or that additional financing will be available or on terms acceptable to the Company.

The business environment is not currently conducive to raising additional debt or equity financing and may not improve in the near term. If we borrow money, we may incur significant interest charges, which could harm our profitability. Holders of debt would also have rights, preferences or privileges senior to those of existing holders of our common stock. If we raise additional equity, the terms of such financing may dilute the ownership interests of current investors and cause our stock price to fall significantly. We may not be able to secure financing upon acceptable terms, if at all. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, which could seriously harm our business, operating results, and financial condition.

We have only recently achieved profitability.

While we reached profitability during the last half of fiscal 2010 and generated cash from operations of \$593 thousand, we may not realize sufficient revenues to sustain profitability on a quarterly or annual basis. For the year ended September 30, 2010, we had a gross margin of \$15.4 million on revenue of \$20.5 million with which to cover selling, marketing, product development and general and administrative costs. Our selling, marketing, product development and general and administration costs have historically been a significant percentage of our revenue, due partly to the expense of developing leads and the relatively long period required to convert leads into sales associated with selling products that are not yet considered mainstream technology investments. Fluctuations in profitability or failure to maintain profitability will likely impact the price of our stock.

We could lose revenues if there are changes in the spending policies or budget priorities for government funding of colleges, universities, schools and other education providers.

Most of our customers and potential customers are public colleges, universities, schools and other education providers who depend substantially on government funding. Accordingly, any general decrease, delay or change in federal, state or local funding for colleges, universities, schools and other education providers could cause our current and potential customers to reduce their purchases of our products and services, or to decide not to renew service contracts, either of which could cause us to lose revenues. In addition, a specific reduction in governmental funding support for products such as ours would also cause us to lose revenues. The severe economic downturn experienced in the U.S. and globally has caused many of our clients to experience severe budgetary pressures, which has and will likely continue to have a negative impact on sales of our products. Continuing unfavorable economic conditions may result in further budget cuts and lead to lower overall spending, including information technology spending, by our current and potential clients, which may cause our revenues to decrease.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

If a sufficient number of customers do not accept our products, our business may not succeed.

We cannot predict how the market for our products will develop, and part of our strategic challenge will be to convince enterprise customers of the productivity, improved communications, cost savings, suitability and other benefits of our products. Our future revenue and revenue growth rates will depend in large part on our success in delivering these products effectively, creating market acceptance for these products and meeting customer's needs for new or enhanced products. If we fail to do so, our products will not achieve widespread market acceptance, and we may not generate sufficient revenue to offset our product development and selling and marketing costs, which will hurt our business.

We may not be able to innovate to meet the needs of our target market.

Our future success will continue to depend upon our ability to develop new products, product enhancements or service offerings that address future needs of our target markets and to respond to these changing standards and practices. The success of new products, product enhancements or service offerings depend on several factors, including the timely completion, quality and market acceptance of the product, enhancement or service. Our revenue could be reduced if we do not capitalize on our current market leadership by timely developing innovative new products, product enhancements or service offerings that will increase the likelihood that our products and services will be accepted in preference to the products and services of our current and future competitors.

If our marketing and lead generation efforts are not successful, our business will be harmed.

We believe that continued marketing efforts will be critical to achieve widespread acceptance of our products. Our marketing campaigns may not be successful given the expense required. For example, failure to adequately generate and develop sales leads could cause our future revenue growth to decrease. In addition, our inability to generate and cultivate sales leads into large organizations, where there is the potential for significant use of our products, could have a material effect on our business. We may not be able to identify and secure the number of strategic sales leads necessary to help generate marketplace acceptance of our products. If our marketing or lead-generation efforts are not successful, our business and operating results will be harmed.

The length of our sales and deployment cycle is uncertain, which may cause our revenue and operating results to vary significantly from quarter to quarter and year to year.

During our sales cycle, we spend considerable time and expense providing information to prospective customers about the use and benefits of our products without generating corresponding revenue. Our expense levels are relatively fixed in the short-term and based in part on our expectations of future revenue. Therefore, any delay in our sales cycle could cause significant variations in our operating results, particularly because a relatively small number of customer orders represent a large portion of our revenue.

Our largest potential sources of revenue are educational institutions, large corporations and government entities that often require long testing and approval processes before making a decision to purchase our products, particularly when evaluating our products for inclusion in new buildings under construction or high dollar transactions. In general, the process of selling our products to a potential customer may involve lengthy negotiations, collaborations with consultants, designers and architects, time consuming installation processes and changes in network infrastructure in excess of what we or our VARs are able to provide. As a result, our sales cycle is unpredictable. Our sales cycle is also subject to delays as a result of customer-specific factors over which we have little or no control, including budgetary constraints and internal approval procedures, particularly with customers or potential customers that rely on government funding.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Our products are aimed toward a broadened user base within our key markets and these products are relatively early in their product life cycles. We cannot predict how the market for our products will develop and part of our strategic challenge will be to convince targeted users of the productivity, improved communications, cost savings and other benefits. Accordingly, it is likely that delays in our sales cycles with these products will occur and this could cause significant variations in our operating results.

Sales of some of our products have experienced seasonal fluctuations which have affected sequential growth rates for these products, particularly in our first fiscal quarter. For example, there is generally a slowdown for sales of our products in the higher education and corporate markets in the first fiscal quarter of each year. Seasonal fluctuations could negatively affect our business, which could cause our operating results to fall short of anticipated results for such quarters. As such, we believe that quarter-to-quarter comparisons of our revenues, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

Our operating results are hard to predict as a significant amount of our sales typically occur at the end of a quarter and the mix of product and service orders may vary significantly.

Revenue for any particular quarter is extremely difficult to predict with any degree of certainty. We typically ship products within a short time after we receive an order and therefore, we typically do not have an order backlog with which to estimate future revenue. In addition, orders from our channel partners are based on the level of demand from end-user customers. Any decline or uncertainty in end-user demand could negatively impact end-user orders, which could in turn significantly negatively affect orders from our channel partners in any given quarter. Accordingly, our expectations for both short and long-term future revenue is based almost exclusively on our own estimate of future demand based on the pipeline of sales opportunities we manage, rather than on firm channel partner orders. Our expense levels are based largely on these estimates. In addition, the majority of our orders are received in the last month of a quarter; thus, the unpredictability of the receipt of these orders could negatively impact our future results. We historically have received all or nearly all our channel partner orders in the last month of a quarter and often in the last few days of the quarter. Accordingly, any significant shortfall in demand for our products in relation to our expectations, even if the result was a short term delay in orders, would have an adverse impact on our operating results.

We have experienced growing demand for our hosting and event services as well as a growing preference from our corporate customers in purchasing our software as a service (SaaS). As a result, we expect that service billings as a percentage of total billings will continue to grow which we believe will ultimately lead to higher gross margins and more recurring revenue. The percentage of billings represented by service is also likely to fluctuate from quarter to quarter due to seasonality of event services and other factors. Since services are typically billed in advance of providing the service, revenue is initially deferred, leading to reduced current period revenue with a corresponding negative impact to profits or losses in periods of significant increase in the percentage of our billings for deferred services.

We are subject to risks associated with our channel partners product inventories and product sell-through.

We sell a significant amount of our products to distributors such as Synnex Corporation and Starin Marketing, Inc., as well as other channel partners who maintain their own inventory of our products for sale to dealers and end-users. If these channel partners are unable to sell an adequate amount of their inventory of our products in a given quarter to dealers and end-users or if channel partners decide to decrease their inventories for any reason, such as a long-term continuation or increase, in global economic uncertainty and downturn in technology spending, the volume of our sales to these channel partners and our revenue would be negatively affected. In addition, if channel partners decide to purchase more inventory, due to product availability or other reasons, than is required to satisfy end-user demand or if end-user demand does not keep pace with the additional inventory purchases, channel inventory could grow in any particular quarter, which could adversely affect product revenue in the subsequent quarter. In addition, we also face the risk that some of our channel partners have inventory levels in excess of future anticipated sales. If such sales do not occur in the time frame anticipated by these channel partners for any reason, these channel partners may substantially decrease the amount of product they order from us in subsequent periods, which would harm our business.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

If stock balancing returns or price adjustments exceed our reserves, our operating results could be adversely affected.

We provide some of our distributors with stock balancing return rights, which generally permit our distributors to return products, subject to ordering an equal dollar amount of alternate products. We also provide price protection rights to most of our distributors. Price protection rights require that we grant retroactive price adjustments for inventories of our products held by distributors if we lower our prices for those products within a specified time period. To cover our exposure to these product returns and price adjustments, we establish reserves based on our evaluation of historical product trends and current marketing plans. However, we cannot be assured that our reserves will be sufficient to cover our future product returns and price adjustments. If we inadequately forecast reserves, our operating results could be adversely affected.

We depend in part on the success of our relationships with third-party resellers and integrators.

Our success depends on various third-party relationships, particularly with our international and events services operations. The relationships include third party resellers as well as system integrators that assist with implementations of our products and sourcing of our products and services. Identifying partners, negotiating and documenting relationships with them and maintaining their relationships require significant time and resources from us. In addition, our agreements with our resellers and integrators are typically non-exclusive and do not prohibit them from working with our competitors or from offering competing products or services. We have limited control, if any, as to whether these strategic partners devote adequate resources to promoting, selling and implementing our products as compared to our competitor's products. Our competitors may be effective in providing incentives to third parties to favor their products or services. If we are unsuccessful in establishing or maintaining our relationships with these third parties, our ability to compete in the marketplace or to maintain or grow our revenue could be impaired and our operating results would suffer.

Our cash flow could fluctuate due to the potential difficulty of collecting our receivables.

A significant portion of our sales are fulfilled by VARs, regional distributors or master distributors. As an example, 54% of our billings in 2010 were to Synnex Corporation and Starin Marketing Inc., two master distributors who fulfill demand from other distributors, VARs or end-users. While our distributors and VARs typically maintain payment terms consistent with other end-users, a delay in payment may occur as a result of a number of factors including changes in demand, general economic factors, financial performance, inventory levels or disputes over payments. Any delay from Synnex, Starin, or other large distributors or VARs, could have a material impact on the collections of our receivables during a particular quarter.

We have recently expanded the level of sales representation in Europe and Asia as well as other international regions. We offer credit terms to some of our international customers; however, payments tend to go beyond terms in certain countries and accounts receivable from most international customers are not eligible for borrowing under our revolving line of credit. Therefore, as Europe, Asia and other international regions grow as a percentage of our revenue, accounts receivable balances will likely increase as compared to previous years.

Accounting regulations and related interpretations and policies, particularly those related to revenue recognition, cause us to defer revenue recognition into future periods for portions of our products and services.

Revenue recognition for our products and services is complex and subject to multiple sources of authoritative guidance, some of which are new, as well as varied interpretations and implementation practices for such rules. These rules require us to apply judgment in determining revenue recognition in certain situations. Factors that are considered in revenue recognition include those such as vendor specific objective evidence (VSOE), the inclusion of other services and contingencies to payment terms. We expect that we will continue to defer portions of our product and service billings because of these factors, and to the extent that management's judgment is incorrect it could result in a significant increase in the amount of revenue deferred in any one period. The amounts deferred may also be significant and may vary from quarter to quarter depending on the mix of products sold or contractual terms.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Additional changes in authoritative guidance or changes in practice in applying such rules could also cause us to defer the recognition of revenue to future periods or recognize lower revenue.

Because most of our service contracts are renewable on an annual basis, a reduction in our service renewal rate could significantly reduce our revenues.

Our clients have no obligation to renew their content hosting agreements, customer support contracts or other annual service contracts after the expiration of the initial period, which is typically one year, and some clients have elected not to do so. A decline in renewal rates could cause our revenues to decline. We have limited historical data with respect to rates of renewals, so we cannot accurately predict future renewal rates. Our renewal rates may decline or fluctuate as a result of a number of factors, including client dissatisfaction with our products and services, our failure to update our products to maintain their attractiveness in the market, deteriorating economic conditions or budgetary constraints or changes in budget priorities faced by our clients.

Because we generally recognize revenues ratably over the term of our service contracts, downturns or upturns in service transactions will not be fully reflected in our operating results until future periods.

We recognize most of our revenues from service contracts monthly over the terms of their agreements, which are typically 12 months, although terms have ranged from less than one month to 48 months. As a result, much of the service revenue we report in each quarter is attributable to agreements entered into during previous quarters. Consequently, a decline in sales, client renewals or market acceptance of our products in any one quarter will not necessarily be fully reflected in the revenues in that quarter and will negatively affect our revenues and profitability in future quarters. This ratable revenue recognition also makes it difficult for us to rapidly increase our revenues through additional sales in any period, as revenues from new clients must be recognized over the applicable agreement term.

There is a great deal of competition in the market for our products, which could lower the demand for our products.

The market for our products and services is intensely competitive, dynamic and subject to rapid technological change. The intensity of the competition and the pace of change are expected to increase in the future. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business. Competitors vary in size and in the scope and breadth of the products and services offered, many of which have greater financial resources than we have. We encounter competition with respect to different aspects of our solution from a variety of sources including:

Web conferencing solutions (e.g. Adobe, Cisco/WebEx, Microsoft and Citrix). Although part of the overall online multimedia communications landscape, these solutions are designed primarily for collaborative communications versus one-to-many communications like Mediasite. Many organizations acknowledge that they need both technologies – one-to-many webcasting and collaborative web conferencing – to appropriately address their different communication requirements.

Video conferencing solutions (e.g. Polycom, TANDBERG (now Cisco) and Sony). These solutions are designed primarily for one-to-one or group-to-group communications with high levels of interactivity and collaboration. Like web conferencing, many organizations use both video conferencing and webcasting. Mediasite integrates with videoconferencing endpoints from Polycom and TANDBERG to record and manage interactive meetings, discussions and distance learning courses alongside other Mediasite content.

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Authoring tools solutions (e.g. Accordent PresenterPLUS, Camtasia Studio and Microsoft Producer). Unlike webcasting, web conferencing or video conferencing, which are forms of online multimedia communication that capture and distribute/stream content, these solutions are production-oriented tools designed to create and edit multimedia content only. Some organizations will use these desktop tools to create training content by manually integrating existing audio, video, images, branding and other visual elements into a multimedia presentation which can then be published to a web or streaming server for distribution. This process can require a significant amount of production effort and user expertise in presentation authoring.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Online video services and virtual meeting platforms (e.g. INXPO, Livestream, ON24, Onstream Media, InterCall, Thomson Reuters, Unisfair and Wall Street Webcasting). These companies offer services or SaaS-based platforms that either allow audio and video to be captured from a presenter's computer (often with supporting materials uploaded in advance), produced streaming video services or 2D/3D virtual environments that may or may not include rich media webcasts.

Other vendors such as Echo360, Tegrity, Accordent Technologies and Panopto, provide lecture capture or webcasting capabilities, but differ in their technology approach, particularly in the lecture capture arena. Mediasite is an appliance- or room-based platform for lecture capture. It provides a fully integrated system designed around an automated purpose-built recording appliance to capture, publish and manage rich media content. This transparent recording automation means no presenter intervention which leads to the broadest end-user adoption across campuses. Room-based appliances are capable of streaming live or on-demand and can leverage the full breadth of in-room audio/visual technology. A room-based platform like Mediasite also includes complete content management for captured multimedia presentations.

Other lecture capture solutions are implemented as software applications designed to capture and publish rich media content, but dependent upon a third-party content management platform, typically the institution's course management system. Software applications for lecture capture support on-demand streaming only and require in-room PC integration with varying levels of presenter intervention and recording knowledge which may lead to lower adoption rates throughout the campus.

Lastly, laptop-resident desktop tools capture and publish non-rich media (limited video and presentation graphics) and like software applications support only on-demand streaming and require a third-party content management platform. Desktop tools require the greatest degree of presenter intervention, technical confidence and support. While prevalent on many campuses, these three factors limit the practicality for campus-wide adoption.

If potential customers or competitors use open source software to develop products that are competitive with our products and services, we may face decreased demand and pressure to reduce the prices for our products.

The growing acceptance and prevalence of open source software may make it easier for competitors or potential competitors to develop software applications that compete with our products, or for customers and potential customers to internally develop software applications that they would otherwise have licensed from us. One of the aspects of open source software is that it can be modified or used to develop new software that competes with proprietary software applications, such as ours. Such competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. As open source offerings become more prevalent, customers may defer or forego purchases of our products, which could reduce our sales and lengthen the sales cycle for our products or result in the loss of current customers to open source solutions. If we are unable to differentiate our products from competitive products based on open source software, demand for our products and services may decline, and we may face pressure to reduce the prices of our products, which would hurt our profitability.

Our customers may use our products to share confidential and sensitive information, and if our system security is breached, our reputation could be harmed and we may lose customers.

Our customers may use our products and services to share confidential and sensitive information, the security of which is critical to their business. Third parties may attempt to breach our security for customer hosted content or the networks of our customers. Customers may take inadequate security precautions with their sensitive information and may inadvertently make that information public. We may be liable to our customers for any breach in security, and any breach could harm our reputation and cause us to lose customers. In addition, customers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We may be required to expend significant capital and other resources to further protect against security breaches or to resolve problems caused by any breach, including litigation-related expenses if we are sued.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Operational failures in our network infrastructure could disrupt our remote hosting services, cause us to lose clients and sales to potential clients and result in increased expenses and reduced revenues.

Unanticipated problems affecting our network systems could cause interruptions or delays in the delivery of the hosting services we provide to some of our clients. We are not equipped to provide full disaster recovery to all of our hosted clients. If there are operational failures in our network infrastructure that cause interruptions, slower response times, loss of data or extended loss of service for our remotely hosted clients, we may be required to issue credits or pay penalties, current clients may terminate their contracts or elect not to renew them and we may lose sales to potential clients. If we determine that we need additional hardware and systems, we may be required to make further investments in our network infrastructure.

The technology underlying our products and services is complex and may contain unknown defects that could harm our reputation, result in product liability or decrease market acceptance of our products.

The technology underlying our products is complex and includes software that is internally developed, software licensed from third parties and hardware purchased from third parties. These products have, and will in the future, contain errors or defects, particularly when first introduced or when new versions or enhancements are released. We may not discover defects that affect our current or new applications or enhancements until after they are sold and our insurance coverage may not be sufficient to cover our complete liability exposure. Any defects in our products and services could:

Damage our reputation

Cause our customers to initiate product liability suits against us

Increase our product development resources

Cause customers to cancel orders or potential customers to purchase competitive products or services

Delay market acceptance of our products

If we are viewed only as a commodity supplier, our margins and valuations will shrink.

We need to provide value-added services in order to avoid being viewed as a commodity supplier. This entails building long-term customer relationships and developing features that will distinguish our products. Our technology is complex and is often confused with other products and technologies in the market place, including video conferencing, streaming and collaboration. If we fail to build long-term customer relationships and develop features that distinguish our products in the market place, our margins will shrink and our stock may become less valuable to investors.

Our success depends upon the proprietary aspects of our technology.

Our success and ability to compete depend to a significant degree upon the protection of our proprietary technology. We currently have two U.S. patents that have been issued to us and four U.S. patent applications that are pending. We may seek additional patents in the future. Our current

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

patent applications cover different aspects of the technology used in our products which is important to our ability to compete. However, it is possible that:

Our pending patent applications may not result in the issuance of patents

Any patents acquired by or issued to us may not be broad enough to protect us

Any issued patent could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in those patents

Current and future competitors may independently develop similar technology, duplicate our services or design around any of our patents

Effective patent protection, including effective legal-enforcement mechanisms against those who violate our patent-related assets, may not be available in every country in which we do or plan to do business

We may not have the resources to enforce our patents or may determine the potential benefits are not worth the cost and risk of ultimately being unsuccessful

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

We also rely upon trademark, copyright and trade secret laws, which may not be sufficient to protect our intellectual property.

We also rely on a combination of laws, such as copyright, trademark and trade secret laws, and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our technology. We have registered eight U.S. and four foreign country trademarks. These forms of intellectual property protection are critically important to our ability to establish and maintain our competitive position. However, it is possible that:

Third parties may infringe or misappropriate our copyrights, trademarks and similar proprietary rights

Laws and contractual restrictions may not be sufficient to prevent misappropriation of our technology or to deter others from developing similar technologies

Effective trademark, copyright and trade secret protection, including effective legal-enforcement mechanisms against those who violate our trademark, copyright or trade secret assets, may be unavailable or limited in foreign countries

Contractual agreements may not provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information

Other companies may claim common law trademark rights based upon state or foreign laws that precede the federal registration of our marks

Policing unauthorized use of our services and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the extent of any unauthorized use

Reverse engineering, unauthorized copying or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it, which would significantly harm our business.

If other parties bring infringement or other claims against us, we may incur significant costs or lose customers.

Other companies may obtain patents or other proprietary rights that would limit our ability to conduct our business and could assert that our technologies infringe their proprietary rights. We could incur substantial costs to defend any legal proceedings, even if without merit, and intellectual property litigation could force us to cease using key technology, obtain a license or redesign our products. In the course of our business, we may sell certain systems to our customers, and in connection with such sale, we may agree to indemnify these customers from claims made against them by third parties for patent infringement related to these systems, which could harm our business.

If we lose key personnel or fail to integrate replacement personnel successfully, our ability to manage our business could be impaired.

Our future success depends upon the continued service of our key management, technical, sales and other critical personnel. Our officers and other key personnel are employees-at-will, and we cannot assure that we will be able to retain them. Key personnel have left our company in the past, sometimes to accept employment with companies that sell similar products or services to existing or potential customers of ours. There will

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

likely be additional departures of key personnel from time to time in the future and such departures could result in additional competition, loss of customers or confusion in the marketplace. As we seek to replace such departures, or expand our business, the hiring of qualified sales, technical and support personnel has been difficult due to the limited number of qualified professionals. The loss of any key employee could result in significant disruptions to our operations, including adversely affecting the timeliness of product releases, the successful implementation and completion of company initiatives and the results of our operations. In particular, the loss of the services of our Chief Executive Officer, Rimas Buinevicius, or our co-founder and Chief Technology Officer, Monty Schmidt, would harm our business. In addition, we do not have life insurance policies on any of our key employees. If we lose the services of any of our key employees, the integration of replacement personnel could be time consuming, may cause disruptions to our operations and may be unsuccessful.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Because our business is susceptible to risks associated with international operations, we may not be able to maintain or increase international sales of our products.

International product and service billings ranged from 19% to 28% of our total billings in each of the past three years and are expected to continue to account for a significant portion of our business in the future. However, in the future we may be unable to maintain or increase international sales of our products and services. International sales are subject to a variety of risks, including:

difficulties in establishing and managing international distribution channels;

difficulties in selling, servicing and supporting overseas products, translating products into foreign languages and compliance with local hardware requirements;

the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property or requirements for product certification or other restrictions;

multiple and possibly overlapping tax structures;

currency and exchange rate fluctuations;

difficulties in collecting accounts receivable in foreign countries, including complexities in documenting letters of credit; and

economic or political changes in international markets.

We face risks associated with government regulation of the internet and related legal uncertainties.

Currently, few existing laws or regulations specifically apply to the Internet, other than laws generally applicable to businesses. Many Internet-related laws and regulations, however, are pending and may be adopted in the United States, in individual states and local jurisdictions and in other countries. These laws may relate to many areas that impact our business, including encryption, network and information security, and the convergence of traditional communication services, such as telephone services, with Internet communications, taxes and wireless networks. These types of regulations could differ between countries and other political and geographic divisions both inside and outside the United States. Non-U.S. countries and political organizations may impose, or favor, more and different regulation than that which has been proposed in the United States, thus furthering the complexity of regulation. In addition, state and local governments within the United States may impose regulations in addition to, inconsistent with, or more strict than federal regulations. The adoption of such laws or regulations, and uncertainties associated with their validity, interpretation, applicability and enforcement, may affect the available distribution channels for, and the costs associated with, our products and services. The adoption of such laws and regulations may harm our business.

Exercise of outstanding options and warrants will result in further dilution.

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

The issuance of shares of common stock upon the exercise of our outstanding options and warrants will result in dilution to the interests of our stockholders, and may reduce the trading price of our common stock.

At September 30, 2010, we had 91 thousand of outstanding warrants and 765 thousand of outstanding stock options granted under our stock option plans, 556 thousand of which are immediately exercisable.

To the extent that these stock options or warrants are exercised, dilution to the interests of our stockholders will likely occur. Additional options and warrants may be issued in the future at prices not less than 85% of the fair market value of the underlying security on the date of grant. Exercises of these options or warrants, or even the potential of their exercise may have an adverse effect on the trading price of our common stock. The holders of our options or our warrants are likely to exercise them at times when the market price of the common stock exceeds the exercise price of the securities. Accordingly, the issuance of shares of common stock upon exercise of the options and warrants will likely result in dilution of the equity represented by the then outstanding shares of common stock held by other stockholders. Holders of our options and warrants can be expected to exercise or convert them at a time when we would, in all likelihood, be able to obtain any needed capital on terms, which are more favorable to us than the exercise terms provided, by these options and warrants.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

We may need to make acquisitions or form strategic alliances or partnerships in order to remain competitive in our market, and potential future acquisitions, strategic alliances or partnerships could be difficult to integrate, disrupt our business and dilute stockholder value.

We may acquire or form strategic alliances or partnerships with other businesses in the future in order to remain competitive or to acquire new technologies. As a result of these acquisitions, strategic alliances or partnerships, we may need to integrate products, technologies, widely dispersed operations and distinct corporate cultures. The products, services or technologies of the acquired companies may need to be altered or redesigned in order to be made compatible with our software products and services, or the software architecture of our customers. These integration efforts may not succeed or may distract our management from operating our existing business. Our failure to successfully manage future acquisitions, strategic alliances or partnerships could seriously harm our operating results. In addition, our stockholders would be diluted if we finance the acquisition, strategic alliances or partnerships by incurring convertible debt or issuing equity securities.

Our ability to utilize our net operating loss carryforwards may be limited.

The use of our net operating loss carryforwards may have limitations resulting from certain future ownership changes or other factors under Section 382 of the Internal Revenue Code.

If our net operating loss carryforwards are limited, and we have taxable income which exceeds the available net operating loss carryforwards for that period, we would incur an income tax liability even though net operating loss carryforwards may be available in future years prior to their expiration. Any such income tax liability may adversely affect our future cash flow, financial position and financial results.

Our business is subject to changing regulations regarding corporate governance and public disclosure that will increase both our costs and the risk of noncompliance.

As a publicly traded company we are subject to significant regulations, including the Sarbanes-Oxley Act of 2002. While we have developed and instituted a corporate compliance program based on what we believe are the current best practices and continue to update the program in response to newly implemented regulatory requirements and guidance, we cannot assure that we are or will be in compliance with all potentially applicable regulations. Although our non-affiliate market capitalization was less than \$75 million at March 31, 2010 and we were therefore not required to have an auditor attestation on our internal controls over financial reporting for fiscal 2010, SEC rules may in the future require us to have such an attestation if our non-affiliate market capitalization exceeds a certain threshold. We cannot assure that in the future our management or our auditors, will not find a material weakness in connection with our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act. We also cannot assure that we could correct any such weakness to allow our management to assess the effectiveness of our internal control over financial reporting as of the end of our fiscal year in time to enable our independent registered public accounting firm to attest that such assessment will have been fairly stated in our Annual Report on Form 10-K to be filed with the Securities and Exchange Commission or attest that we have maintained effective internal control over financial reporting as of the end of our fiscal year. If we fail to comply with any of these regulations, we could be subject to a range of regulatory actions, fines, or other sanctions or litigation. In addition, if we must disclose any material weakness in our internal control over financial reporting, our stock price may decline.

Provisions of our charter documents and Maryland law could also discourage an acquisition of our company that would benefit our stockholders.

Provisions of our articles of incorporation and by-laws may make it more difficult for a third party to acquire control of our company, even if a change in control would benefit our stockholders. Our articles of incorporation authorize our board of directors, without stockholder approval, to issue one or more series of preferred stock, which could have voting and conversion rights that adversely affect or dilute the voting power of the holders of common stock. Furthermore, our articles of incorporation provide for a classified board of directors, which means that our stockholders may vote upon the retention of only one or two of our seven directors each year. Moreover, Maryland corporate law restricts certain business combination transactions with interested stockholders and limits voting rights upon certain acquisitions of control shares.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

Our principal office is located in Madison, Wisconsin in a leased facility of approximately 19,000 square feet. The building serves as our corporate headquarters, accommodating our general and administrative, product development and selling and marketing departments. We believe this facility is adequate and suitable for our needs. The current lease term for this office expires on September 30, 2011.

ITEM 3. LEGAL PROCEEDINGS

None

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock was initially traded on the American Stock Exchange under the symbol SFO, beginning with our initial public offering in April of 1998. On April 24, 2000, our common stock began trading on the NASDAQ Global Market under the symbol SOFO. Effective September 16, 2009, we transferred the listing of our common stock to the NASDAQ Capital Market. The following table sets forth, for the periods indicated, the high and low sale prices per share of our common stock as reported on the NASDAQ Global or Capital Markets. All share and per share data have been adjusted for the one-for-ten reverse stock split which was effective on November 16, 2009.

	High	Low
Year Ended September 30, 2011:		
First Quarter (through November 18, 2010)	\$ 17.32	\$ 9.77
Year Ended September 30, 2010:		
First Quarter	7.50	4.50
Second Quarter	8.21	4.80
Third Quarter	7.99	5.84
Fourth Quarter	11.12	6.81
Year Ended September 30, 2009:		
First Quarter	6.50	3.21
Second Quarter	7.60	4.30
Third Quarter	8.90	6.30
Fourth Quarter	7.50	5.00

The Company has not paid any cash dividends and does not intend to pay any cash dividends in the foreseeable future. The Company is prohibited from paying any cash dividends pursuant to the terms of the loan and security agreement with Silicon Valley Bank.

At November 18, 2010 there were 454 common stockholders of record and approximately 7,600 total shareholders. Many shares are held by brokers and other institutions on behalf of shareholders.

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010****Equity Compensation Plan Information**

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance (c)
Equity compensation plans approved by security holders (1)	526,611	11.05	346,800
Equity compensation plans not approved by security holders (2)	238,107	10.82	
Total	764,718	10.98	346,800

(1) Consists of the 2009 Stock Incentive Plan, Employee Incentive Stock Option Plan and the Directors Stock Option Plans. For further information regarding these plans, reference is made to Note 5 of the financial statements.

(2) Consists of the Non-Qualified Stock Option Plan. For further information regarding this plan, reference is made to Note 5 of the financial statements.

The graph below compares the cumulative total stockholder return on our common stock from September 30, 2005 through and including September 30, 2010 with the cumulative total return on The NASDAQ Stock Market (US only) and the RDG Technology Composite. The graph assumes that \$100 was invested in our common stock on September 30, 2005 for each of the indexes and that all dividends were reinvested. Unless otherwise specified, all dates refer to the last day of each month presented. The comparisons in the graph below are based on historical data, with our common stock prices based on the closing price on the dates indicated, and are not intended to forecast the possible future performance of our common stock.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

(A) RECENT SALES OF UNREGISTERED SECURITIES

None

(B) USE OF PROCEEDS FROM REGISTERED SECURITIES

None

(C) ISSUER PURCHASES OF EQUITY SECURITIES

None

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010****ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

The selected financial and operating data were derived from our consolidated financial statements. The selected financial data set forth below is qualified in its entirety by, and should be read in conjunction with, Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and notes thereto appearing elsewhere in this annual report on Form 10-K (in thousands except per share data). All share and per share data have been adjusted for the one-for-ten reverse stock split which was effective on November 16, 2009.

	Years Ended September 30,				
	2010	2009	2008	2007	2006
Statement of Operations Data:					
Revenue	\$ 20,476	\$ 18,577	\$ 15,601	\$ 16,737	\$ 12,564
Cost of revenue	5,065	4,331	4,205	4,133	3,215
Gross margin	15,411	14,246	11,396	12,604	9,349
Operating expenses	15,138	16,724	19,279	19,222	12,909
Income (loss) from operations	273	(2,478)	(7,883)	(6,618)	(3,560)
Other income (expense), net	(170)	(25)	10	248	77
Provision for income taxes	(225)	(142)	(256)	(201)	(56)
Net loss	\$ (122)	\$ (2,645)	\$ (8,129)	\$ (6,571)	\$ (3,539)
Basic net loss per common share	\$ (0.03)	\$ (0.74)	\$ (2.28)	\$ (1.89)	\$ (1.10)
Diluted net loss per common share	\$ (0.03)	\$ (0.74)	\$ (2.28)	\$ (1.89)	\$ (1.10)
Weighted average common shares: - Basic	3,617,423	3,598,040	3,557,966	3,468,803	3,201,531
- Diluted	3,617,423	3,598,040	3,557,966	3,468,803	3,201,531
Balance Sheet Data at September 30:					
Cash and cash equivalents	\$ 3,358	\$ 2,598	\$ 3,560	\$ 8,008	\$ 2,751
Working capital	1,442	(344)	774	7,940	2,198
Total assets	18,267	16,173	17,474	23,981	16,912
Long-term liabilities	3,202	1,977	1,610	1,825	1,170
Stockholders' equity	7,137	6,601	8,455	15,908	10,950

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The financial and business analysis below provides information that Sonic Foundry, Inc. (the Company) believes is relevant to an assessment and understanding of the Company's consolidated financial position and results of operations. This financial and business analysis should be read in conjunction with the consolidated financial statements and related notes.

When used in this Report, the words "anticipate", "expect", "plan", "believe", "seek", "estimate" and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include, but are not limited to, statements about the features, benefits and performance of our products, our ability to introduce new product offerings and increase revenue from existing products, expected expenses including those related to selling and marketing, product development and general and administrative, our beliefs regarding the health and growth of the market for products, anticipated increase in our customer base, expansion of our products functionalities, expected revenue levels and sources of revenue, expected impact, if any, of legal proceedings, the adequacy of liquidity and capital resources, and expected growth in business. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, market acceptance for our products, our ability to attract and retain customers and distribution partners for existing and new products, our ability to control our expenses, our ability to recruit and retain employees, the ability of distribution partners to successfully sell our products, legislation and government regulation, shifts in technology, global and local business conditions, our ability to effectively maintain and update our products and service portfolio, the strength of competitive offerings, the prices being charged by those competitors, and the risks discussed elsewhere herein. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

Sonic Foundry, Inc. is a technology leader in the emerging web communications marketplace, providing enterprise solutions and services that link an information-driven world. The company's principal product line, Mediasite® is a web communication and content management system that automatically and cost-effectively webcasts lectures and presentations. Trusted by Fortune 500 companies, top education institutions and Federal, state and local government agencies for a variety of critical communication needs, Mediasite is the leading one-to-many multimedia communication solution for capturing knowledge and sharing it online.

Reverse Stock Split

Effective November 16, 2009, the Company implemented a one-for-ten reverse stock split of its stock. All shares and per share data in this report have been adjusted to reflect this reverse stock split.

Critical Accounting Policies

We have identified the following as critical accounting policies to our Company and have discussed the development, selection of estimates and the disclosure regarding them with the audit committee of the board of directors:

Revenue recognition, allowance for doubtful accounts, and reserves;

Impairment of long-lived assets;

Valuation allowance for net deferred tax assets; and

Accounting for stock-based compensation.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Revenue Recognition, Allowance for Doubtful Accounts and Reserves

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 collectability 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 exchange or repair pursuant to a warranty or stock rotation. 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 and Mediasite related products such as server software revenue.

Services

We sell support contracts to our 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 distribution partners, software upgrades on a when and if available basis, advance hardware replacement and an extension of the standard hardware warranty from 90 days to one year. The manufacturers we contract with to build the units provide a limited one-year warranty on the hardware. We also sell installation, training, event webcasting, and customer content hosting services. Revenue for those services is recognized when performed in the case of installation, training and event webcasting services and is recognized ratably over the contract period for content hosting services. Service amounts invoiced to customers in excess of revenue recognized are recorded as deferred revenue until the revenue recognition criteria are met.

Revenue Arrangements that Include Multiple Elements

Revenue for transactions that include multiple elements such as hardware, software, installation, training, and post customer support is allocated to each element based on vendor-specific objective evidence of the fair value - VSOE - in accordance with FASB ASC-985-605. Revenue is 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, price adjustments, rebates, and sales incentives to reduce revenue and accounts receivable for these and other credits we may grant to customers. 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 customer behavior. If actual customer 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 the customers exercise their rights, or such rights lapse, whichever is later.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Credit Evaluation and Allowance for Doubtful Accounts

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.

Impairment of long-lived assets

We assess the impairment of goodwill on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value.

If we determine that the fair value of goodwill is less than its carrying value, based upon the annual test or the existence of one or more indicators of impairment, we would then measure impairment based on a comparison of the implied fair value of goodwill with the carrying amount of goodwill. To the extent the carrying amount of goodwill is greater than the implied fair value of goodwill, we would record an impairment charge for the difference.

We evaluate all of our long-lived assets, including intangible assets other than goodwill, for impairment in accordance with the provisions of FASB ASC-360-10. Long-lived assets and intangible assets other than goodwill are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. Should events indicate that any of our long-lived assets are impaired; the amount of such impairment will be measured as the difference between the carrying value and the fair value of the impaired asset and recorded in earnings during the period of such impairment. We do not anticipate impairment of our long-lived assets in the near term based on the results of our evaluation.

Valuation allowance for net deferred tax assets

Deferred income taxes are provided for temporary differences between financial reporting and income tax basis of assets and liabilities, and are measured using currently enacted tax rates and laws. Deferred income taxes also arise from the future benefits of net operating loss carryforwards. A valuation allowance equal to 100% of the net deferred tax assets has been recognized due to uncertainty regarding future realization.

Accounting for stock-based compensation

Upon the adoption of FASB ASC-718, the Company changed its option valuation model from the Black-Scholes model to a lattice valuation model for all stock options granted subsequent to September 30, 2005. The lattice valuation model is a more flexible analysis to value employee options because of its ability to incorporate inputs that change over time, such as actual exercise behavior of option holders. The Company uses historical data to estimate the option exercise and employee departure behavior used in the lattice valuation model. Expected volatility is based on historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The Company considers all employees to have similar exercise behavior and therefore has not identified separate homogenous groups for valuation. The expected term of options granted is derived from the output of the option pricing model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant. Forfeitures are based on actual behavior patterns.

Recent Accounting Pronouncements

In October 2009, the FASB ratified ASC Update No. 2009-13, Multiple-Deliverable Revenue Arrangements (ASC 2009-13). ASC 2009-13 amends existing revenue recognition accounting pronouncements that are currently within the scope of FASB Accounting Standards Codification, or ASC, Subtopic 605-25, (previously included within EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables). This consensus provides for two significant changes to the existing multiple element revenue recognition guidance. First, this guidance deletes

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

the requirement to have objective and reliable evidence of fair value for undelivered elements in an arrangement and will result in more deliverables being treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

These changes may result in entities recognizing more revenue up-front, and entities will no longer be able to apply the residual method and defer the fair value of undelivered elements. Upon adoption of these new rules, each separate unit of accounting must have a selling price, which can be based on management's estimate when there is no other means to determine the fair value of that undelivered item, and the arrangement consideration is allocated based on the elements' relative selling price. This accounting guidance is effective no later than fiscal years beginning on or after June 15, 2010 but may be early adopted as of the first quarter of an entity's fiscal year. The Company does not believe this new standard will have a material impact on the financial statements.

In October 2009, the FASB ratified ASC No. 2009-14, *Applicability of SOP 97-2 to Certain Arrangements that Include Software Elements* (formerly EITF Issue No. 09-3, *Certain Revenue Arrangements that Include Software Elements*), which amends the existing accounting guidance for how entities account for arrangements that include both hardware and software, which typically resulted in the sale of hardware being accounted for under the software revenue recognition rules. This accounting guidance changes revenue recognition for tangible products containing software elements and non-software elements. The tangible element of the product is always outside of the scope of the software revenue recognition rules, and the software elements of tangible products when the software element and non-software elements function together to deliver the product's essential functionality are outside of the scope of the software rules. As a result, both the hardware and qualifying related software elements are excluded from the scope of the software revenue guidance and accounted for under the revised multiple-element revenue recognition guidance. This accounting guidance is effective for all fiscal years beginning on or after June 15, 2010 with early adoption permitted. Entities must adopt ASC 2009-14 and ASC 2009-13 in the same manner and at the same time. The Company does not believe this new accounting guidance will have a material impact on the financial statements, but the adoption will result in the Company's revenue being accounted for under ASC 605-25.

In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20). The standard amends ASC Topic 310, *Receivables* to enhance disclosures about the credit quality of financing receivables and the allowance for credit losses by requiring an entity to provide a greater level of disaggregated information and to disclose credit quality indicators, past due information, and modifications of its financing receivables.

ASU 2010-20 is effective for interim and annual fiscal years beginning after December 15, 2010 for public entities and for interim and annual fiscal years beginning after December 15, 2011 for nonpublic entities. The Company does not expect the adoption of ASU 2010-20 to have a material impact on its consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Company's financial statements upon adoption.

RESULTS OF OPERATIONS

You should read the following discussion of our results of operations and financial condition in conjunction with our consolidated financial statements and related notes thereto included in Item 8 of this Annual Report on Form 10-K.

Revenue

Revenue from our business include the sales of Mediasite recorders and server software products and related services contracts, such as customer support, installation, training, content hosting and event services sold separately. We market our products to educational institutions, corporations and government agencies that need to deploy, manage, index and distribute video content on Internet-based networks. We reach both our domestic and international markets through reseller networks, a direct sales effort and partnerships with system integrators.

Revenue in fiscal 2010 totaled \$20.5 million, compared to \$18.6 million in fiscal 2009, an increase of 10%. Revenue consisted of the following:

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Product revenue from the sale of Mediasite recorder units and server software increased from \$9.6 million in fiscal 2009 to \$10.5 million in fiscal 2010. The increase is due to an increase in units sold.

	2010	2009
Units sold	1,023	846
Rack to mobile ratio	1.9 to 1	2.1 to 1
Average sales price, excluding support (000 \$)	\$ 10.1	\$ 10.7

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Services revenue represent the portion of fees charged for Mediasite customer assurance service contracts amortized over the length of the contract, typically 12 months, as well as training, installation, event and content hosting services. Services revenue increased from \$8.8 million in fiscal 2009 to \$9.8 million in fiscal 2010 due primarily to an increase in support contracts on new Mediasite recorder units as well as renewals of support contracts entered into during prior years, sales of multi-year support contracts and an increase in event services. At September 30, 2010 \$6.1 million of revenue was deferred, of which we expect to recognize approximately \$2.2 million in the quarter ending December 31, 2010.

Other revenue relates to freight charges billed separately to our customers.

Gross Margin

Total gross margin in fiscal 2010 was \$15.4 million or 75% compared to \$14.2 million or 77% in fiscal 2009. Gross margin percentage decreased primarily due to a lower average selling price and a higher mix of lower margin recorders compared to server software. The significant components of cost of revenue include:

Material and freight costs for the Mediasite recorders. Costs for fiscal 2010 Mediasite recorder hardware and other costs totaled \$3.4 million compared to \$3.0 million in fiscal 2009. Freight costs were \$226 thousand and labor and allocated costs were \$712 thousand in fiscal 2010 compared to \$155 thousand and \$683 thousand in fiscal 2009.

Services costs. Staff wages and other costs allocated to cost of service revenues were \$720 thousand in fiscal 2010 and \$537 thousand in fiscal 2009, resulting in gross margin on services of 93% in fiscal 2010 and 94% in fiscal 2009.

Gross margin percentage is expected to increase in fiscal 2011 as total revenue increases and as the mix of revenue continues to reflect a significant percentage of higher margin services revenue. The Company is exploring opportunities to reduce the cost of manufacturing in fiscal 2011 which if successful, would further improve gross margin.

Operating Expenses

Selling and Marketing Expenses

Selling and marketing expenses include wages and commissions for sales, marketing, business development and technical support personnel, print advertising and various promotional expenses for our products. Timing of these costs may vary greatly depending on introduction of new products and services, entrance into new markets or participation in major tradeshows.

Selling and marketing expense decreased \$844 thousand, or 8% from \$10.4 million in fiscal 2009 to \$9.5 million in fiscal 2010. Significant differences include:

Salaries, incentive compensation, and benefits decreased \$519 thousand over prior year. The reduction reflects adjustments to the incentive compensation plan and benefits in fiscal 2010.

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Travel expenses decreased by \$72 thousand as a result of reduced travel requirements necessary to close transactions.

Costs allocated from General and Administrative also decreased by \$244 thousand as a result of lower stock compensation expense and lower bonus and depreciation expense.

As of September 30, 2010 we had 61 employees in Selling and Marketing, an increase from 60 employees at September 30, 2009. We expect our headcount to slightly increase in fiscal 2011 to support future growth.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

General and Administrative Expenses

General and administrative (G&A) expenses consist of personnel and related costs associated with the facilities, finance, legal, human resource and information technology departments, as well as other expenses not fully allocated to functional areas.

G&A expenses decreased \$368 thousand, or 13%, from \$2.9 million in fiscal 2009 to \$2.5 million in fiscal 2010. Major components of the change include:

A decrease in compensation and benefits of \$169 thousand associated with headcount reductions and adjustments to benefits

Professional fees decreased approximately \$163 thousand due primarily to the continued reduction of accounting and investor relations costs in fiscal 2010. We have closely evaluated and reduced outside investor relations costs by eliminating certain outsourced functions.

State and local franchise, sales and other taxes decreased in fiscal 2010 by approximately \$69 thousand.

As of September 30, 2010 we had 6 full-time employees in G&A, a decrease from 8 employees at September 30, 2009. We do not anticipate growth in G&A headcount in fiscal 2011.

Product Development Expenses

Product development (R&D) expenses include salaries and wages of the software research and development staff and an allocation of benefits, facility and administrative expenses. Fluctuations in product development expenses correlate directly to changes in headcount.

R&D expenses decreased \$374 thousand, or 11%, from \$3.5 million in fiscal 2009 to \$3.1 million in fiscal 2010. Some significant differences include:

Compensation and benefits decreased by \$219 thousand over prior year due to lower staffing levels.

Costs also decreased by \$128 thousand as a result of lower stock compensation expense and lower bonus and depreciation expense.

At September 30, 2010 we had 23 employees, excluding interns, in Product Development compared to 25 employees at September 30, 2009. We anticipate slight growth in R&D headcount in fiscal 2011. No fiscal 2010 software development efforts qualified for capitalization.

Other Expense, Net

Other income included primarily interest income from investments in certificates of deposit and overnight investment vehicles. Lower interest rates led to a decrease in interest income from \$47 thousand in fiscal 2009 to \$20 thousand in fiscal 2010. Other expense primarily consists of interest costs related to outstanding debt and amortization of a debt discount. An increased level of debt during the year increased interest expense from \$72 thousand in fiscal 2009 to \$190 thousand in fiscal 2010. Interest in fiscal 2010 includes \$37 thousand of non-cash interest

associated with the amortization of debt discount relating to the issuance of warrants.

Provisions Related to Income Taxes

The Company records a non-cash deferred tax liability related to goodwill acquired in 2001. The related income tax expense for fiscal 2010 was \$240 thousand compared to \$142 thousand in 2009. The Company netted an income tax refund of \$15 thousand against this amount for fiscal 2010.

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010****LIQUIDITY AND CAPITAL RESOURCES**

We have funded our operations to date primarily from public and private placement offerings of equity securities and debt. On September 30, 2010 and 2009, we had cash and cash equivalents of \$3.4 million and \$2.6 million, respectively.

Cash provided by operating activities totaled \$593 thousand in fiscal 2010 compared to cash used in operating activities of \$1.5 million in fiscal 2009, an improvement of \$2.1 million. Cash provided in fiscal 2010 was impacted by a decrease in the net loss of \$2.5 million from \$2.6 million to \$122 thousand and partially offset by changes in non-cash charges and working capital. Working capital changes included the negative effects of a \$1.3 million increase in accounts receivable and an increase in inventory of \$101 thousand. These were partially offset by the positive effects of increases in unearned revenue and accounts payable, accrued liabilities and other long-term liabilities of \$801 and \$122 thousand, respectively. During 2009, working capital adjustments included the positive effects of an increase in unearned revenue, and reductions in accounts receivable of \$614 thousand and \$168 thousand, respectively. These were offset by the negative effects of a decrease in accounts payable, accrued liabilities and other long-term liabilities of \$771 thousand.

Cash used in investing activities totaled \$464 thousand in fiscal 2010 compared to cash used in investing activities of \$237 thousand in fiscal 2009. Investing activities for each of these two years were due to purchases of property and equipment.

The Company has historically financed its operations primarily through cash from sales of equity securities, cash from operations, and to a limited extent, through bank credit facilities. Cash provided by financing activities in 2010 totaled \$631 thousand compared to \$753 thousand in 2009. During fiscal 2010, financing activities included proceeds from the issuance of a term note payable of \$1.25 million, which was reduced by a simultaneous payment on the revolving line of credit of \$300 thousand. The Company believes its cash position is adequate to accomplish its business plan through at least the next twelve months. We may evaluate operating or capital lease opportunities to finance equipment purchases in the future or utilization of the Company's revolving line of credit to support working capital needs. If we are unable to meet our covenants at any future date, we could seek additional equity financing, or issue additional shares previously registered in our available shelf registration, although we currently have no plans to do so.

On March 5, 2010, the Company executed the \$1,250,000 Loan and Security Agreement (the Term Loan) with Partners for Growth II, L.P. (PFG). The Term Loan bears interest at 11.75% per annum with principal due in 36 equal monthly payments of \$34,722 beginning April 1, 2011 and continuing through March 1, 2014 unless the combination of the Company's cash and availability falls below certain levels, at which point the principal will be due in equal payments over the remaining months left in the period ending 36 months from the date of the Term Loan. Coincident with closing of the Term Loan the Company repaid the outstanding balance of its revolving line of credit with Silicon Valley Bank (SVB). The Company maintains the revolving line of credit with SVB and has \$2.9 million available for borrowing at September 30, 2010.

Contractual Obligations

The following summarizes our contractual obligations at September 30, 2010 and the effect those obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	Total	Less than 1 Year	Years 2-3	Years 4-5	Over 5 years
Contractual Obligations:					
Product purchase commitments	\$ 934	\$ 934	\$	\$	\$
Operating lease obligations	509	509			
Notes payable (a)	2,138	727	1,197	214	

(a) Includes fixed and determinable interest payments

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Derivative Financial Instruments

We are not party to any derivative financial instruments or other financial instruments for which the fair value disclosure would be required under FASB ASC-815-10. Our cash equivalents consist of overnight investments in money market funds that are carried at fair value. Accordingly, we believe that the market risk of such investments is minimal.

Interest Rate Risk

Our cash equivalents are subject to interest rate fluctuations, however, we believe this risk is immaterial due to the short-term nature of these investments.

Our \$1.8 million of debt outstanding at September 30, 2010 is fixed rate. We do not expect that an increase in the level of interest rates would have a material impact on our Consolidated Financial Statements. We monitor our positions with, and the credit quality of, the financial institutions that are party to any of our financial transactions.

Foreign Currency Exchange Rate Risk

All international sales of our products are denominated in US dollars.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Sonic Foundry, Inc.

We have audited the accompanying consolidated balance sheets of Sonic Foundry, Inc. and subsidiary (a Maryland Corporation) as of September 30, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years then ended. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sonic Foundry, Inc. as of September 30, 2010 and 2009, and the results of its operations and its cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ GRANT THORNTON LLP

Madison, Wisconsin
November 22, 2010

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

	September 30,	
	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,358	\$ 2,598
Accounts receivable, net of allowances of \$105 and \$105	5,038	3,741
Inventories	541	440
Prepaid expenses and other current assets	433	472
Total current assets	9,370	7,251
Property and equipment:		
Leasehold improvements	980	980
Computer equipment	2,597	2,545
Furniture and fixtures	461	461
Total property and equipment	4,038	3,986
Less accumulated depreciation and amortization	2,801	2,670
Net property and equipment	1,237	1,316
Other assets:		
Goodwill	7,576	7,576
Other intangibles, net of amortization of \$71 and \$35	84	30
Total assets	\$ 18,267	\$ 16,173
Liabilities and stockholders equity		
Current liabilities:		
Revolving line of credit	\$	\$ 300
Accounts payable	1,138	636
Accrued liabilities	752	1,047
Unearned revenue	5,486	4,902
Current portion of capital lease obligations		24
Current portion of notes payable	552	316
Total current liabilities	7,928	7,225
Long-term portion of unearned revenue	587	370
Long-term portion of notes payable	1,040	557
Other liabilities	85	170
Deferred tax liability	1,490	1,250
Total liabilities	11,130	9,572
Commitments and contingencies		
Stockholders equity:		
Preferred stock, \$.01 par value, authorized 500,000 shares; none issued		

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

5% preferred stock, Series B, voting, cumulative, convertible, \$.01 par value (liquidation preference at par), authorized 1,000,000 shares, none issued

Common stock, \$.01 par value, authorized 10,000,000 shares; 3,650,823 and 3,619,638 shares issued and 3,638,107 and 3,606,922 shares outstanding	37	362
Additional paid-in capital	185,973	184,990
Accumulated deficit	(178,678)	(178,556)
Receivable for common stock issued	(26)	(26)
Treasury stock, at cost, 12,716 shares	(169)	(169)
 Total stockholders' equity	 7,137	 6,601
Total liabilities and stockholders' equity	\$ 18,267	\$ 16,173

See accompanying notes

Table of Contents**Sonic Foundry, Inc.****Consolidated Statements of Operations****(in thousands except for share and per share data)**

	Years Ended September 30,	
	2010	2009
Revenue:		
Product	\$ 10,477	\$ 9,644
Services	9,849	8,813
Other	150	120
Total revenue	20,476	18,577
Cost of revenue:		
Product	4,345	3,794
Services	720	537
Total cost of revenue	5,065	4,331
Gross margin	15,411	14,246
Operating expenses:		
Selling and marketing	9,506	10,350
General and administrative	2,542	2,910
Product development	3,090	3,464
Total operating expenses	15,138	16,724
Income (loss) from operations	273	(2,478)
Interest expense	(190)	(72)
Other income, net	20	47
Total other expense, net	(170)	(25)
Income (loss) before income taxes	103	(2,503)
Provision for income taxes	(225)	(142)
Net loss	\$ (122)	\$ (2,645)
Loss per common share:		
Basic net loss per common share	\$ (0.03)	\$ (0.74)
Diluted net loss per common share	\$ (0.03)	\$ (0.74)
Weighted average common shares		
Basic	3,617,423	3,598,040
Diluted	3,617,423	3,598,040

See accompanying notes

Table of Contents**Sonic Foundry, Inc.****Consolidated Statements of Stockholders' Equity****For the Year Ended September 30, 2010 and 2009****(in thousands)**

	Common stock	Additional paid-in capital	Accumulated Deficit	Receivable for common stock issued	Treasury stock	Total
Balance, September 30, 2008	\$ 357	\$ 184,204	\$ (175,911)	\$ (26)	\$ (169)	\$ 8,455
Stock compensation		584				584
Issuance of common stock	3	99				102
Exercise of common stock warrants and options	2	103				105
Net loss			(2,645)			(2,645)
Balance, September 30, 2009	362	184,990	(178,556)	(26)	(169)	6,601
One for ten reverse stock split	(325)	325				
Stock compensation		295				295
Issuance of common stock warrants and options		325				325
Exercise of common stock warrants and options		38				38
Net loss			(122)			(122)
Balance, September 30, 2010	\$ 37	\$ 185,973	\$ (178,678)	\$ (26)	\$ (169)	\$ 7,137

See accompanying notes

Table of Contents**Sonic Foundry, Inc.****Consolidated Statements of Cash Flows**

(in thousands)

	Years Ended September 30,	
	2010	2009
Operating activities		
Net loss	\$ (122)	\$ (2,645)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of other intangibles	73	16
Depreciation and amortization of property and equipment	543	615
Provision for doubtful accounts		(45)
Deferred taxes	240	142
Share-based compensation expense related to stock warrants and options	295	584
Other non-cash items		(3)
Changes in operating assets and liabilities:		
Accounts receivable	(1,297)	168
Inventories	(101)	(110)
Prepaid expenses and other assets	39	(43)
Accounts payable, accrued liabilities and other long-term liabilities	122	(771)
Unearned revenue	801	614
Net cash provided by (used in) operating activities	593	(1,478)
Investing activities		
Purchases of property and equipment	(464)	(237)
Net cash used in investing activities	(464)	(237)
Financing activities		
Net proceeds from (payments on) revolving line of credit	(300)	300
Proceeds from notes payable	1,250	638
Payments on notes payable	(313)	(321)
Payments of loan fees	(90)	(25)
Proceeds from issuance of common stock, net of issuance costs	70	102
Proceeds from exercise of common stock options	38	105
Payments on capital leases	(24)	(46)
Net cash provided by financing activities	631	753
Net increase (decrease) in cash and cash equivalents	760	(962)
Cash and cash equivalents at beginning of period	2,598	3,560
Cash and cash equivalents at end of period	\$ 3,358	\$ 2,598
Supplemental cash flow information:		
Interest paid	153	72
Non-cash transactions:		
Property and equipment financed by accounts payable or other accrued liabilities	63	10
See accompanying notes		

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

1. Basis of Presentation and Significant Accounting Policies

Business

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

Reverse Stock Split

Effective November 16, 2009, the Company implemented a one-for-ten reverse stock split of its stock. All shares and per share data in this report have been adjusted to reflect this reverse stock split.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Sonic Foundry Media Systems, Inc. All significant intercompany transactions and balances have been eliminated. In 2010 and 2009, net loss equaled comprehensive loss as there were no items of comprehensive income.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the period. Actual results could differ from those estimates.

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 collectability 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 exchange or repair pursuant to a warranty or stock rotation. 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 recorder and Mediasite related products such as server software revenue.

Services

We sell support contracts to our 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 on a when and if available basis, advance hardware 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 sell installation, training, event webcasting, and customer content hosting services. Revenue for those services is recognized when performed in the case of installation, training

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

and event webcasting services and is recognized ratably over the contract period for content 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

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

Revenue Arrangements that Include Multiple Elements

Revenue for transactions that include multiple elements such as hardware, software, installation, training, and post customer support is allocated to each element based on vendor-specific objective evidence of the fair value (VSOE) in accordance with FASB ASC-985-605. Revenue is 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, price adjustments, rebates, and sales incentives to reduce revenue and accounts receivable for these and other credits we may grant to customers. 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 customer behavior. If actual customer 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 credit 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. We had billings for Mediasite product and support services as a percentage of total billings to one distributor of approximately 32% in 2010 and 29% in 2009 and to a second distributor of approximately 22% in 2010 and almost 10% in 2009.

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.

Trade Accounts Receivable

The majority of the Company's accounts receivable are due from entities in, or distributors or value added resellers to, the education, corporate and government sectors. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are typically due within 30 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered to be past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Company writes-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. Interest is not accrued on past due receivables.

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010*****Inventory Valuation***

Inventory consists of raw materials and supplies used in the assembly of Mediasite recorders and finished units. Inventory of completed units and spare parts are carried at the lower of cost or market, with cost determined on a first-in, first-out basis.

Inventory consists of the following (in thousands):

	September 30,	
	2010	2009
Raw materials and supplies	\$ 10	\$ 10
Finished goods	531	430
	\$ 541	\$ 440

Software Development Costs

Internal software development costs are capitalized after technological feasibility is established. The capitalized cost is then amortized on a straight-line basis over the estimated product life, or on the ratio of current revenue to total projected product revenue, whichever is greater. To date, the period between achieving technological feasibility, which the Company has defined as the establishment of a working model, typically occurs when the beta testing commences, and the general availability of such software has been short and software development costs qualifying for capitalization have been insignificant. Accordingly, the Company has not capitalized any internal software development costs.

Property and Equipment

Property and equipment are recorded at cost and are depreciated using the straight-line method for financial reporting purposes. The estimated useful lives used to calculate depreciation are as follows:

	Years
Leasehold improvements	5 to 10 years
Computer equipment	3 to 5 years
Furniture and fixtures	5 to 7 years

Impairment of Long-Lived Assets

The Company reviews long-lived assets, including property and equipment, capitalized software development costs and other intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill is reviewed for impairment annually. Recoverability of an asset is measured by comparing its carrying value to the expected undiscounted cash flows. An impairment is measured by the amount by which the carrying value of the related asset or group of assets exceeds the expected undiscounted cash flows. The Company has recognized no such losses as of September 30, 2010.

Advertising Expense

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

Advertising costs included in selling and marketing, are expensed when the advertising first takes place. Advertising expense was \$156 and \$113 thousand for years 2010 and 2009, respectively.

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010*****Research and Development Costs***

Research and development costs are expensed in the period incurred.

Income Taxes

Deferred income taxes are provided for temporary differences between financial reporting and income tax basis of assets and liabilities, and are measured using currently enacted tax rates and laws. Deferred income taxes also arise from the future benefits of net operating loss carryforwards. A valuation allowance equal to 100% of the net deferred tax assets has been recognized due to uncertainty regarding the future realization of these assets, excluding the deferred tax liability for goodwill amortization.

The Company also accounts for the uncertainty in income taxes related to the recognition and measurement of a tax position and measurement of a tax position taken or expected to be taken in an income tax return. The Company follows the applicable accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition related to the uncertainty in income tax positions.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable and debt instruments. The book values of cash and cash equivalents, accounts receivable, debt and accounts payable are considered to be representative of their respective fair values. The carrying value of capital lease obligations, including the current portion, approximates fair market value as the fixed rate approximates the current market rate of interest available to the Company.

Stock-Based Compensation

The Company uses a lattice valuation model to account for all stock options granted subsequent to September 30, 2005. The lattice valuation model is a more flexible analysis to value options because of its ability to incorporate inputs that change over time, such as actual exercise behavior of option holders. The Company uses historical data to estimate the option exercise and employee departure behavior in the lattice valuation model. Expected volatility is based on historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The Company considers all employees to have similar exercise behavior and therefore has not identified separate homogenous groups for valuation. The expected term of options granted is derived from the output of the option pricing model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods the options are expected to be outstanding is based on the U.S. Treasury yields in effect at the time of grant.

The fair value of each option grant is estimated using the assumptions in the following table:

	Years Ending September 30,			
	2010		2009	
Expected life (years)	4.4	5.5 years	5.7	6.0 years
Risk-free interest rate	0.8% - 1.4%		1.3% - 1.7%	
Expected volatility	83.2% - 87.2%		80.2% - 87.0%	
Expected forfeiture rate	15.41% - 18.38%		12.64% - 14.32%	
Expected exercise factor	1.19	2.23	2.32	2.94
Expected dividend yield	0%		0%	

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010*****Per Share Computation***

Basic and diluted net loss per share information for all periods is presented under the requirements of FASB ASC-260-10. Basic earnings per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares that may be repurchased, and excludes any dilutive effects of options and warrants. If the Company had reported net income during the periods presented below, diluted net income per share would have been computed using common equivalent shares related to outstanding options and warrants to purchase common stock. The numerator for the calculation of basic and diluted earnings per share is net income (loss). The following table sets forth the computation of basic and diluted weighted average shares used in the earnings per share calculations:

	Years ended September 30,	
	2010	2009
Denominator for basic earnings per share		
- weighted average common shares	3,617,423	3,598,040
Effect of dilutive options and warrants (treasury method)		
Denominator for diluted earnings per share		
- adjusted weighted average common shares	3,617,423	3,598,040
Options and warrants outstanding during each year, but not included in the computation of diluted earnings per share because they are antidilutive	855,792	816,256

Reclassifications

Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation.

Recent Accounting Pronouncements

In October 2009, the FASB ratified ASC Update No. 2009-13, Multiple-Deliverable Revenue Arrangements (ASC 2009-13). ASC 2009-13 amends existing revenue recognition accounting pronouncements that are currently within the scope of FASB Accounting Standards Codification, or ASC, Subtopic 605-25, (previously included within EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables). This consensus provides for two significant changes to the existing multiple element revenue recognition guidance. First, this guidance deletes the requirement to have objective and reliable evidence of fair value for undelivered elements in an arrangement and will result in more deliverables being treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables.

These changes may result in entities recognizing more revenue up-front, and entities will no longer be able to apply the residual method and defer the fair value of undelivered elements. Upon adoption of these new rules, each separate unit of accounting must have a selling price, which can be based on management's estimate when there is no other means to determine the fair value of that undelivered item, and the arrangement consideration is allocated based on the elements' relative selling price. This accounting guidance is effective no later than fiscal years beginning on or after June 15, 2010 but may be early adopted as of the first quarter of an entity's fiscal year. The Company does not believe this new standard will have a material impact on the financial statements.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

In October 2009, the FASB ratified ASC No. 2009-14, *Applicability of SOP 97-2 to Certain Arrangements that Include Software Elements* (formerly EITF Issue No. 09-3, *Certain Revenue Arrangements that Include Software Elements*), which amends the existing accounting guidance for how entities account for arrangements that include both hardware and software, which typically resulted in the sale of hardware being accounted for under the software revenue recognition rules. This accounting guidance changes revenue recognition for tangible products containing software elements and non-software elements. The tangible element of the product is always outside of the scope of the software revenue recognition rules, and the software elements of tangible products when the software element and non-software elements function together to deliver the product's essential functionality are outside of the scope of the software rules. As a result, both the hardware and qualifying related software elements are excluded from the scope of the software revenue guidance and accounted for under the revised multiple-element revenue recognition guidance. This accounting guidance is effective for all fiscal years beginning on or after June 15, 2010 with early adoption permitted. Entities must adopt ASC 2009-14 and ASC 2009-13 in the same manner and at the same time. The Company does not believe this new accounting guidance will have a material impact on the financial statements; however, revenue will be accounted for under ASC 605-25.

In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20). The standard amends ASC Topic 310, *Receivables* to enhance disclosures about the credit quality of financing receivables and the allowance for credit losses by requiring an entity to provide a greater level of disaggregated information and to disclose credit quality indicators, past due information, and modifications of its financing receivables. ASU 2010-20 is effective for interim and annual fiscal years beginning after December 15, 2010 for public entities and for interim and annual fiscal years beginning after December 15, 2011 for nonpublic entities. The Company does not expect the adoption of ASU 2010-20 to have a material impact on its consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Company's financial statements upon adoption.

2. Commitments

The Company leases certain facilities and equipment under operating lease agreements expiring at various times through September 30, 2011. Total rent expense related to continuing operations on all operating leases was approximately \$501 thousand and \$484 thousand for the years ended September 30, 2010 and 2009, respectively. The Company has \$509 thousand due in minimum lease payments under operating leases through September 30, 2011.

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. The Company has an obligation to purchase \$934 thousand as of September 30, 2010, which is not recorded on the Company's Consolidated Balance Sheet.

The Company enters into license agreements that generally provide indemnification against intellectual property claims for its customers as well as indemnification agreements with certain service providers, landlords and other parties in the normal course of business. The Company has not incurred any material costs as a result of such indemnifications and has not accrued any liabilities related to such obligations in the consolidated financial statements.

3. Credit Arrangements

On June 16, 2008, the Company and its wholly-owned subsidiary, Sonic Foundry Media Systems, Inc. (collectively, the *Companies*) entered into an Amended and Restated Loan and Security Agreement (the *Amended Loan Agreement*) with Silicon Valley Bank providing for a credit facility in the form of a \$3,000,000 secured revolving line of credit and a \$1,000,000 term loan. The ability to borrow up to the maximum \$3,000,000 amount of the revolving line of credit is determined by applying an applicable percentage to eligible accounts receivable, which, is reduced by, among other things, a reserve. Prior to the First Amendment, discussed below, the reserve was equal to the balance of the term loan when EBITDA, as defined, would have been less than \$200,000 during the preceding six month period. The revolving line of credit accrues interest at a per annum rate equal to the following: (i) during such period that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) of

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

greater than 2.00 to 1.00, the greater of one percentage point (1.0%) above Silicon Valley's prime rate, or seven percent (7.0%); or (ii) during such period that Sonic Foundry maintains an Adjusted Quick Ratio equal to or less than 2.00 to 1.00, the greater of one and one-half percent (1.5%) above Silicon Valley's prime rate, or seven and one-half percent (7.5%). Under the Amended Agreement, the term loan will continue to accrue interest at a per annum rate equal to the greater of (i) one percentage point (1.0%) above Silicon Valley's prime rate; or (ii) eight and three quarters percent (8.75%). Prior to the First Amendment, the maturity of both the term loan and the revolving line of credit was June 1, 2010. At the maturity date all outstanding borrowings and any unpaid interest thereon must be repaid, and all outstanding letters of credit must be cash collateralized. Principal on the term loan is to be repaid in thirty-six (36) monthly installments, and prior to the First Amendment, was to be repaid in full on May 1, 2010.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

On April 14, 2009, the Company executed the First Amendment with Silicon Valley Bank. The First Amendment, among other things, a) refinanced the \$361,111 outstanding balance of the Term Loan with a new Term Loan 2 in the amount of \$1,000,000, due in 36 equal monthly installments of principal and interest; b) modified the method of determining the requirement for a reserve under the Revolving Line for the balance of the term loan to require a reserve unless, for three (3) consecutive monthly periods, the ratio of EBITDA to Debt Service, in each case for the three (3) month period then ending is greater than or equal to 1.25 to 1.00; c) modified the minimum requirements under the EBITDA covenant, but maintained the provision to override such covenant if the Company maintains a minimum Quick Ratio of 1.75 to 1.00; and d) extended the maturity date of the Revolving Line to October 1, 2011 and the Term Loan 2 to April 1, 2012. At September 30, 2010, a balance of \$559 thousand was remaining on the term loan and no balance was outstanding on the revolving line of credit. At September 30, 2010, there was \$2.9 million available under this credit facility for advances. The Company believes it can renew the Revolving Line for similar terms and amounts.

The Amended Loan Agreement contains certain financial covenants, including a covenant requiring the Companies to maintain certain of their depository, operating and securities accounts with Silicon Valley Bank, and a covenant relating to EBITDA (EBITDA Covenant); however, the EBITDA Covenant will not have to be satisfied provided that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) greater than or equal to 1.75 to 1.00. The Amended Loan Agreement also contains certain other restrictive loan covenants, including covenants limiting the Companies ability to dispose of assets, make acquisitions, be acquired, incur indebtedness, grant liens, make investments, pay dividends, and repurchase stock. At September 30, 2010 the Company was in compliance with all covenants in the Amended Loan Agreement, as amended by the First Amendment to the Amended and Restated Loan Agreement (First Amendment).

The Amended Loan Agreement contains events of default that include, among others, non-payment of principal or interest, inaccuracy of any representation or warranty, violation of covenants, bankruptcy and insolvency events, material judgments, cross defaults to certain other indebtedness, and material adverse changes. The occurrence of an event of default could result in the acceleration of the Companies obligations under the Amended Loan Agreement.

Pursuant to the Amended Loan Agreement, the Company and its wholly-owned subsidiary pledged as collateral to the Bank substantially all non-intellectual property business assets, and entered into an Intellectual Property Security Agreement with respect to intellectual property assets.

Partners for Growth

On March 5, 2010, Sonic Foundry, Inc., and its wholly-owned subsidiary, Sonic Foundry Media Systems, Inc. (SFMS) executed the \$1,250,000 Loan and Security Agreement (the Term Loan).

The Term Loan bears interest at 11.75% per annum with principal due in 36 equal monthly payments of \$34,722 beginning April 1, 2011 and continuing through March 1, 2014 unless the combination of the Company s cash and availability falls below certain levels, at which point the principal will be due in equal payments over the remaining months left in the period ending 36 months from the date of the Term Loan.

The Term Loan is collateralized by substantially all the Company s assets, including intellectual property, subject to a first lien held by Silicon Valley Bank and requires compliance with an adjusted quick ratio covenant of 1.75:1.00. As of September 30, 2010, the Company was in compliance with this covenant.

Coincident with execution of the Term Loan, the Company entered into a Warrant Purchase Agreement (Purchase Agreement) and a Warrant Agreement (Warrant) with PFG. Pursuant to the terms of the Purchase Agreement, PFG purchased a warrant to purchase up to 76,923 shares of common stock of the Company at an exercise price of \$6.25 per share, subject to certain adjustments, for a purchase price of \$3,333. PFG is entitled to exercise a warrant to purchase 48,077 shares of common stock at any time. The remaining warrant to purchase 28,846 shares of common stock is no longer exercisable as of September 30, 2010.

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010**

The Company valued the warrants issued pursuant to the Purchase Agreement using the Black-Scholes method assuming a 1) life of seven years; 2) volatility factor of 86.9%; 3) risk free interest rate of 1.38%, less \$3,333 proceeds received from PFG. The resulting \$255 thousand value of the warrants is treated as a debt discount and netted against the carrying value of the Term Loan on the consolidated balance sheet. The discount is amortized at a constant rate applied to the outstanding balance of the Term Loan with a corresponding increase to non-cash interest expense. At September 30, 2010 the remaining balance of the discount was \$217 thousand.

The annual principal payments on the term loans are as follows:

Fiscal Year (in thousands)	
2011	\$ 552
2012	631
2013	417
2014	209
Total	1,809
Debt discount	(217)
Net total	\$ 1,592

4. Common Stock Warrants

The Company has issued restricted common stock purchase warrants to various consultants and other third parties. Each warrant represents the right to purchase one share of common stock. All warrants are currently exercisable. The Company granted 48,077 warrants in fiscal 2010 and did not grant any warrants in fiscal 2009. All such warrants are either valued and expensed in full at the date of grant or valued at the date of grant and deferred over the term of the relevant contract for services.

Exercise Prices	Warrants Outstanding at September 30, 2010	Expiration Date
\$ 6.93	48,077	2017
9.90-14.60	32,447	2010 to 2011
15.40-37.10	10,550	2011 to 2012
	91,074	

5. Stock Options and Employee Stock Purchase Plan

On March 5, 2009, Stockholders approved adoption of the 2009 Stock Incentive Plan (the 2009 Plan). The 2009 Plan, beginning October 1, 2009, replaced two former employee stock option plans that terminated coincident with the effectiveness of the 2009 Plan. The Company also maintains a directors stock option plan under which options may be issued to purchase up to an aggregate of 50,000 shares of common stock. Each non-employee director, who is re-elected or who continues as a member of the board of directors on each annual meeting date and on each

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

subsequent meeting of Stockholders, will be granted options to purchase 2,000 shares of common stock under the directors' plan, or at other times or amounts at the discretion of the Board of Directors.

Each option entitles the holder to purchase one share of common stock at the specified option price. The exercise price of each option granted under the plans was set at the fair market value of the Company's common stock at the respective grant date. Options vest at various intervals and expire at the earlier of termination of employment, discontinuance of service on the board of directors, ten years from the grant date or at such times as are set by the Company at the date of grant.

Compensation cost for options will be recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period. There were no capitalized stock-based compensation costs at September 30, 2010.

Table of Contents

Sonic Foundry, Inc.
Annual Report on Form 10-K
For the Year Ended September 30, 2010

The number of shares available for grant under these plans at September 30 is as follows:

	Qualified Employee Stock Option Plans	Non- Qualified Stock Option Plan	Director Stock Option Plans
Shares available for grant at September 30, 2008	115,332	21,999	40,000
Options granted	(188,690)	(42,750)	(10,000)
Options forfeited	50,533	22,746	
Shareholder approval of 2009 Stock Incentive Plan	400,000		
Options remaining at expiration of plan	(1,775)	(1,995)	
Shares available for grant at September 30, 2009	375,400		30,000
Options granted	(52,250)		(10,500)
Options forfeited	4,150		
Shares available for grant at September 30, 2010	327,300		19,500

The following table summarizes information with respect to outstanding stock options.

	Years Ended September 30,			
	2010	Weighted Average Exercise Price	2009	Weighted Average Exercise Price
	Options		Options	
Outstanding at beginning of year	766,615	\$ 16.20	624,044	\$ 20.50
Granted	62,750	6.63	241,440	5.90
Exercised	(14,198)	8.22	(19,592)	5.30
Forfeited	(50,449)	85.41	(79,279)	21.00
Outstanding at end of year	764,718	10.98	766,615	\$ 16.20
Exercisable at end of year	555,587		466,434	
Weighted average fair value of options granted during the year	\$ 3.64		\$ 3.40	

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010**

The options outstanding at September 30, 2010 have been segregated into four ranges for additional disclosure as follows:

Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding at September 30, 2010	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable at September 30, 2010	Weighted Average Exercise Price
\$ 4.20 to \$9.90	357,023	8.0	\$ 6.18	176,609	\$ 6.15
10.00 to 14.70	259,904	2.6	11.67	251,236	11.70
15.50 to 19.40	97,558	6.2	16.22	78,761	16.39
20.00 to 46.90	50,233	5.6	31.29	48,978	31.52
	764,718			555,584	

As of September 30, 2010, there was \$437 thousand of total unrecognized compensation cost related to non-vested share-based compensation, net of \$103 thousand of estimated forfeitures. The cost is expected to be recognized over a weighted-average life of 1.5 years.

A summary of the status of the company's non-vested shares as of September 30, 2010 and for the year then ended is presented below:

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares at October 1, 2009	301,015	\$ 5.15
Granted	61,150	3.64
Vested	(128,335)	5.92
Forfeited	(24,699)	4.67
Non-vested shares at September 30, 2010	209,131	\$ 4.28

Stock-based compensation recorded in the year ended September 30, 2010 of \$295 thousand was allocated \$199 thousand to selling and marketing expenses, \$21 thousand to general and administrative expenses and \$75 thousand to product development expenses. Stock-based compensation recorded in the year ended September 30, 2009 of \$584 thousand was allocated \$375 thousand to selling and marketing expenses, \$52 thousand to general and administrative expenses and \$157 thousand to product development expenses. Cash received from option exercises under all stock option plans for the years ended September 30, 2010 and 2009 was \$38 thousand and \$105 thousand, respectively. There were no tax benefits realized for tax deductions from option exercises for the years ended September 30, 2010 and 2009. The Company currently expects to satisfy share-based awards with registered shares available to be issued.

6. Income Taxes

The provision for income taxes consists of the following (in thousands):

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

	Years Ended September 30,	
	2010	2009
Federal income tax	\$ 240	\$ 142
Federal income tax refundable research credit	(15)	
Deferred income tax expense (benefit)	1,373	(1,033)
Change in valuation allowance	(1,373)	1,033
Provision for income taxes	\$ 225	\$ 142

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010**

The reconciliation of income tax expense (benefit) computed at the U.S. federal statutory rate to income tax expense (benefit) is as follows (in thousands):

	Years Ended September 30,	
	2010	2009
Income tax expense (benefit) at U.S. statutory rate of 34%	\$ 35	\$ (851)
Federal income tax refundable research credit	(15)	
State income tax expense (benefit)	5	(130)
Permanent differences, net	13	14
Adjustment of temporary differences to income tax returns	1,560	76
Change in valuation allowance	(1,373)	1,033
Income tax expense	\$ 225	\$ 142

The significant components of the deferred tax accounts recognized for financial reporting purposes are as follows (in thousands):

	September 30,	
	2010	2009
Deferred tax assets:		
Net operating loss and other carryforwards	\$ 34,663	\$ 34,566
Common stock warrants	398	1,997
Allowance for doubtful accounts	41	41
Other	117	74
Total deferred tax assets	35,219	36,678
Valuation allowance	(35,219)	(36,678)
Goodwill amortization	(1,490)	(1,250)
Deferred tax liability for goodwill amortization	\$ (1,490)	\$ (1,250)

At September 30, 2010, the Company had net operating loss carryforwards of approximately \$88 million for both U.S. Federal and state tax purposes. For Federal tax purposes, the carryforwards expire in varying amounts between 2018 and 2030. For State tax purposes, the carryforwards expire in varying amounts between 2013 and 2025. Utilization of the Company's net operating loss may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization. In addition, the Company has research and development tax credit carryforwards of approximately \$530 thousand, which expire in varying amounts between 2017 and 2020. The Company's net deferred tax asset has been offset by a valuation allowance of the same amount. The valuation allowance has been recorded due to the uncertainty of realization of the deferred tax asset.

Beginning with an acquisition in fiscal year 2002, the Company has amortized Goodwill for tax purposes over a 15 year life. Goodwill is not amortized for book purposes. Annual impairment tests are performed for book purposes and the balance of goodwill is to be written down if impairment occurs. The impairment tests have not indicated any goodwill impairment.

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

In accordance with accounting guidance for uncertainty in income taxes, the Company has concluded that a reserve for income tax contingencies is not necessary. The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accruals for interest and penalties on the Company's Consolidated balance sheets at September 30, 2010 and 2009, and has not recognized any interest or penalties in the Consolidated statement of operations for the years ended September 30, 2010 or 2009.

The Company is subject to taxation in the U.S. and various state jurisdictions. All of the Company's tax years are subject to examination by the U.S. and state tax authorities due to the carryforward of unutilized net operating losses.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

7. Savings Plan

The Company's defined contribution 401(k) savings plan covers substantially all employees meeting certain minimum eligibility requirements. Participating employees can elect to defer a portion of their compensation and contribute it to the plan on a pretax basis. The Company may also match certain amounts and/or provide additional discretionary contributions, as defined. The Company made matching contributions of \$66 and \$307 thousand during the years ended September 30, 2010 and 2009, respectively. Effective January 1, 2010, the Company discontinued the matching contribution for the 2010 calendar year. The Company made no additional discretionary contributions during 2010 and 2009.

The Company also has an Employee Stock Purchase Plan (Purchase Plan) under which an aggregate of 50,000 common shares may be issued. All employees who have completed 90 days of employment with the company on the first day of each offering period are eligible to participate in the Purchase Plan. An employee who, after the grant of an option to purchase, would hold common stock and/or hold outstanding options to purchase stock possessing 5% or more of the total combined voting power or value of the company will not be eligible to participate. Eligible employees may make contributions through payroll deductions of up to 10% of their compensation. No participant in the Purchase Plan is permitted to purchase common stock under the Purchase Plan if such option would permit his or her rights to purchase stock under the Purchase Plan to accrue at a rate that exceeds \$25,000 of the fair market value of such shares, or that exceeds 1,000 shares, for each calendar year. The company makes a bi-annual offering to eligible employees of options to purchase shares of common stock under the Purchase Plan on the first trading day of January and July. Each offering period is for a period of six months from the date of the offering, and each eligible employee as of the date of offering is entitled to purchase shares of common stock at a purchase price equal to the lower of 85% of the fair market value of common stock on the first or last trading day of the offering period. There were 17,053 and 27,162 shares purchased by employees during fiscal 2010 and 2009, respectively. The Company recorded stock compensation expense of \$23 and \$57 thousand during fiscal 2010 and 2009, respectively. Cash received from issuance of stock under this plan was \$70 and \$102 thousand during fiscal 2010 and 2009, respectively.

8. Related-Party Transactions

The Company incurred fees of \$244 and \$255 thousand during the years ended September 30, 2010 and 2009, respectively, to a law firm whose partner is a director and stockholder of the Company. The Company had accrued liabilities for unbilled services to the same law firm of \$54 and \$19 thousand at September 30, 2010 and 2009, respectively.

The Company recorded Mediasite product and customer support revenue related to \$566 and \$600 thousand of billings during the years ended September 30, 2010 and 2009 to Mediasite KK, a Japanese reseller in which the Company has an equity interest. Mediasite KK owed the Company \$63 and \$128 thousand on such billings at September 30, 2010 and 2009, respectively. The Company accounts for its investment in Mediasite KK under the equity method. The recorded value as of September 30, 2010 and 2009 is zero.

During the years ended September 30, 2010 and 2009, the Company had a loan outstanding to an executive totaling \$26 thousand. The loan is collateralized by Company stock.

9. Goodwill and Other Intangible Assets

The Company accounts for goodwill and other intangible assets in accordance with FASB ASC-350 which requires that goodwill and intangible assets that have indefinite useful lives not be amortized but, instead, tested at least annually for impairment. We assess the impairment of goodwill and capitalized software development costs on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value.

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010**

If we determine that the fair value of goodwill is less than its carrying value, based upon the annual test or the existence of impairment, we would then measure impairment based on a comparison of the implied fair value of goodwill with the carrying amount of goodwill. To the extent the carrying amount of goodwill is greater than the implied fair value of goodwill, we would record an impairment charge for the difference.

The Company performed its annual goodwill impairment test as of July 1, 2010 and tested goodwill recognized in connection with the acquisition of Mediasite and determined it was not impaired. Subsequent impairment charges for Mediasite or other acquisitions, if any, will be reflected as an operating expense in the consolidated statement of operations.

The following tables present details of the Company's total intangible assets at September 30, 2010 and 2009:

(in thousands)	Life (years)	Gross	Accumulated Amortization at September 30, 2010	Balance at September 30, 2010
Amortizable:				
Loan origination fees	3	\$ 155	\$ 71	\$ 84
		155	71	84
Non-amortizable goodwill		7,576		7,576
Total		\$ 7,731	\$ 71	\$ 7,660

(in thousands)	Life (years)	Gross	Accumulated Amortization at September 30, 2009	Balance at September 30, 2009
Amortizable:				
Loan origination fees	3	\$ 65	\$ 35	\$ 30
		65	35	30
Non-amortizable goodwill		7,576		7,576
Total		\$ 7,641	\$ 35	\$ 7,606

Table of Contents**Sonic Foundry, Inc.****Annual Report on Form 10-K****For the Year Ended September 30, 2010****10. Segment Information**

The Company has determined that it operates in only one segment in accordance with FASB ASC-280-10 as it does not disaggregate profit and loss information on a segment basis for internal management reporting purposes to its chief operating decision maker.

The Company's long-lived assets maintained outside the United States are insignificant.

The following summarizes revenue by geographic region (in thousands):

	Years Ended September 30,	
	2010	2009
United States	\$ 16,559	\$ 13,372
Europe and Middle East	1,929	3,974
Asia	875	686
Other	1,113	545
Total	\$ 20,476	\$ 18,577

11. Customer Concentration

In the fiscal year ended September 30, 2010 and 2009, two distributors represented 54% and 39% of total revenue.

12. Quarterly Financial Data (unaudited)

The following table sets forth selected quarterly financial information for the years ended September 30, 2010 and 2009. The operating results are not necessarily indicative of results for any future period.

(in thousands except per share data)	Quarterly Financial Data							
	Q4- 10	Q3- 10	Q2- 10	Q1- 10	Q4- 09	Q3- 09	Q2- 09	Q1- 09
Revenue	\$ 5,439	\$ 5,626	\$ 4,909	\$ 4,502	\$ 4,128	\$ 5,027	\$ 5,413	\$ 4,009
Gross margin	4,070	4,183	3,676	3,482	3,113	3,932	4,083	3,118
Gain (loss) from operations	236	330	(43)	(250)	(952)	(151)	(144)	(1,231)
Net income (loss)	126	203	(131)	(320)	(983)	(197)	(188)	(1,276)
Basic and diluted net income (loss) per share	\$ 0.03	\$ 0.06	\$ (0.04)	\$ (0.09)	\$ (0.27)	\$ (0.05)	\$ (0.05)	\$ (0.36)

13. Subsequent Events

The Company evaluated subsequent events through November 22, 2010, the date of this filing, and identified no subsequent events that would require recognition or disclosure in the financial statements.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Based on evaluations as of the end of the period covered by this report, our principal executive officer and principal financial officer, with the participation of our management team, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e), and 15d-15(e) under the Securities Exchange Act) were effective.

Limitations on the effectiveness of Controls and Permitted Omission from Management's Assessment

Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can only provide reasonable assurance with respect to financial statement preparation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f).

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this evaluation, our management believes that, as of September 30, 2010, our internal control over financial reporting was effective based on those criteria.

Changes in Internal Control Over Financial Reporting

During the period covered by this report, we have not made any change to our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required by Item 10 of Form 10-K with respect to directors and executive officers is incorporated herein by reference to the information contained in the section entitled "Proposal One: Election of Directors" and "Executive Officers of Sonic", respectively, in the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the Company's 2010 Annual Meeting of Stockholders, which will be filed no later than January 28, 2011 (the "Proxy Statement").

Item 405 of Regulation S-K calls for disclosure of any known late filings or failure by an insider to file a report required by Section 16(a) of the Securities Act. This information is contained in the Section entitled "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement and is incorporated herein by reference.

Item 401 of Regulation S-K calls for disclosure of whether or not the Company has a financial expert serving on the audit committee of its Board of Directors, and if so who that individual is. This information is contained in the Section entitled "Meetings and Committees of Directors" in the Proxy Statement and is incorporated herein by reference.

Item 407 of Regulation S-K calls for disclosure of whether or not the Company has an audit committee and a financial expert serving on the audit committee of the Board of Directors, and if so, who that individual is. Item 407 also requires disclosure regarding the Company's nominating committee and the director nomination process. This information is contained in the section entitled "Meetings and Committees of Directors" in the Proxy Statement and is incorporated herein by reference.

Sonic Foundry has adopted a code of ethics that applies to all officers and employees, including Sonic Foundry's principal executive officer, its principal financial officer, and persons performing similar functions. This code of ethics is available, without charge, to any investor who requests it. Request should be addressed in writing to Mr. Kenneth A. Minor, Corporate Secretary, 222 West Washington Avenue, Madison, Wisconsin 53703.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 of Form 10-K is incorporated herein by reference to the information contained in the sections entitled "Directors Compensation", "Executive Compensation and Related Information" and "Compensation Committee Interlocks and Insider Participation" in the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 of Form 10-K is incorporated herein by reference to the information contained in the sections entitled "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement. Information related to equity compensation plans is set forth in Item 5 herein.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Edgar Filing: SONIC FOUNDRY INC - Form 10-K

The information required by Item 13 of Form 10-K is incorporated herein by reference to the information contained in the section entitled Certain Transactions and Meetings and Committees of Directors in the Proxy Statement.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 of Form 10-K is incorporated herein by reference to the information contained in the section entitled "Ratification of Appointment of Independent Auditors Fiscal 2009 and 2010 Audit Fee Summary" in the Proxy Statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following financial statements are filed as part of this report:

1. Financial Statements furnished are listed in the Table of Contents provided in response to Item 8.
2. Financial Statement Schedule II of the Company is included in this Report. All other Financial Statement Schedules have been omitted since they are either not required, not applicable or the information is otherwise included in the financial statements.
3. Exhibits.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

- 3.1 Articles of Amendment of Amended and Restated Articles of Incorporation, effective November 16, 2009, Amended and Restated Articles of Incorporation, effective January 26, 1998, and Articles of Amendment, effective April 9, 2000, filed as Exhibit No. 3.1 to the Annual Report on Form 10-K for the year ended September 30, 2009 and hereby incorporated by reference.
- 3.2 Amended and Restated By-Laws of the Registrant, filed as Exhibit No. 3.2 to Form 8-K filed on November 19, 2009, and hereby incorporated by reference.
- 10.1* Registrant's 1995 Stock Option Plan, as amended, filed as Exhibit No. 4.1 to the Registration Statement on Form S-8 on September 8, 2000, and hereby incorporated by reference.
- 10.2* Employment Agreement between Registrant and Rimas Buinevicius dated as of January 1, 2001, filed as Exhibit 10.4 to the Quarterly Report on Form 10-Q for the quarter ended December 31, 2000, and hereby incorporated by reference.
- 10.3* Employment Agreement between Registrant and Monty R. Schmidt dated as of January 1, 2001, filed as Exhibit 10.5 to the Quarterly Report on Form 10-Q for the quarter ended December 31, 2000, and hereby incorporated by reference.
- 10.4* Registrant's Amended 1999 Non-Qualified Plan, filed as Exhibit 4.1 to Form S-8 on December 21, 2001, and hereby incorporated by reference.
- 10.5 Commercial Lease between West Washington Associates LLC and Sonic Foundry, Inc. regarding 222 West Washington Ave., Suite 775, Madison, WI, dated August 1, 2003 filed as Exhibit 10.21 to Form 10-K filed on December 23, 2003 and hereby incorporated by reference.
- 10.6 Amendments to Commercial Lease between West Washington Associates LLC and Sonic Foundry, Inc. regarding 222 West Washington Ave., Suite 775, Madison, WI, dated May 17, 2006 and June 5, 2006, filed as Exhibit 10.7 to the Annual Report on Form 10-K for the year ended September 30, 2006 and hereby incorporated by reference.
- 10.7 Intellectual Property Security Agreement dated May 2, 2007, between Sonic Foundry, Inc. and Silicon Valley Bank filed as Exhibit 10.2 to Form 8-K on May 7, 2007, and hereby incorporated by reference.
- 10.8 Intellectual Property Security Agreement dated May 2, 2007, between Sonic Foundry Media Systems, Inc. and Silicon Valley Bank filed as Exhibit 10.3 to Form 8-K on May 7, 2007, and hereby incorporated by reference.
- 10.9 Employment Agreement dated October 31, 2007 between Sonic Foundry, Inc. and Kenneth A. Minor, filed as Exhibit 10.1 to Form 8-K filed on November 2, 2007, and hereby incorporated by reference.
- 10.10 Amended and Restated Loan and Security Agreement dated June 16, 2008 and entered into as of June 16, 2008 among Registrant, Sonic Foundry Media Services, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to Form 8-K filed on June 20, 2008, and hereby incorporated by reference.
- 10.11 Employment Agreement dated August 4, 2008 between Sonic Foundry, Inc. and Robert M. Lipps, filed as Exhibit 10.1 to Form 8-K filed on August 6, 2008, and hereby incorporated by reference.

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

10.12	First Amendment to the Amended and Restated Loan and Security Agreement executed as of April 14, 2009 and effective as of April 1, 2009, among Registrant, Sonic Foundry Media Services, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to Form 8-K filed on April 15, 2009, and hereby incorporated by reference.
10.13*	Registrant's 2008 Non-Employee Directors' Stock Option Plan filed as Exhibit B to Form 14A filed on January 28, 2008, and hereby incorporated by reference.
10.14*	Registrant's 2008 Employee Stock Purchase Plan filed as Exhibit C to Form 14A filed on January 28, 2008, and hereby incorporated by reference.
10.15*	Registrant's 2009 Stock Incentive Plan filed as Exhibit A to Form 14A filed on January 28, 2009, and hereby incorporated by reference.
10.16	Loan and Security Agreement executed as of March 5, 2010 among Registrant, Sonic Foundry Media Systems, Inc., and Partners for Growth II, L.P., filed as Exhibit 10.1 to Form 8-K filed on March 10, 2010, and hereby incorporated by reference.
10.17	Revolving Loan and Security Agreement executed as of March 5, 2010 among Registrant, Sonic Foundry Media Systems, Inc., and Partners for Growth II, L.P., filed as Exhibit 10.2 to Form 8-K filed on March 10, 2010, and hereby incorporated by reference.
10.18	Warrant Purchase Agreement executed as of March 5, 2010 among Registrant and Partners for Growth II, L.P., filed as Exhibit 10.3 to Form 8-K filed on March 10, 2010, and hereby incorporated by reference.
10.19	Warrant executed as of March 5, 2010 among Registrant and Partners for Growth II, L.P., filed as Exhibit 10.4 to Form 8-K filed on March 10, 2010, and hereby incorporated by reference.
21	List of Subsidiaries
23	Consent of Grant Thornton LLP, Independent Registered Public Accounting Firm
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32	Section 906 Certification of Chief Executive Officer and Chief Financial Officer

* Compensatory Plan or Arrangement

(b) Exhibits See exhibit index in Item 15(a)3 of this Report.

(c) Financial Statement Schedule see Item 15(a)2 of this Report

Table of Contents

Sonic Foundry, Inc.

Annual Report on Form 10-K

For the Year Ended September 30, 2010

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(In thousands)

	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions Write-offs	Balance at End of Period
<u>Year ended September 30, 2010</u>				
Accounts receivable reserve	\$ 105	\$ 29	\$ 29	\$ 105
<u>Year ended September 30, 2009</u>				
Accounts receivable reserve	\$ 150	\$ 7	\$ 52	\$ 105
<u>Year ended September 30, 2008</u>				
Accounts receivable reserve	\$ 270	\$ 7	\$ 127	\$ 150