SONIC FOUNDRY INC
Form 10-Q
May 02, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly period ended March 31, 2013

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	**39-1783372**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

222 West Washington Ave, Madison, WI 53703

(Address of principal executive offices)

(608) 443-1600

(Registrant s telephone number including area code)

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 x 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 x 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	x

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

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

Class	Outstanding April 25, 2013
Common Stock, $0.01 par value	3,923,014

TABLE OF CONTENTS

Table of Contents

Item 1

Sonic Foundry, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except for share data)

(Unaudited)

	March 31, 2013	September 30, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 3,676	$ 4,478
Accounts receivable, net of allowances of $85	5,653	5,578
Inventories	1,030	1,053
Prepaid expenses and other current assets	915	757
Total current assets	11,274	11,866
Property and equipment:		
Leasehold improvements	852	852
Computer equipment	4,557	3,851
Furniture and fixtures	865	865
Total property and equipment	6,274	5,568
Less accumulated depreciation and amortization	3,154	2,624
Net property and equipment	3,120	2,944
Other assets:		
Goodwill	7,576	7,576
Investment in Mediasite KK	588	420
Software development costs	458	
Other intangibles, net of amortization of $190 and $180	5	15
Total assets	$ 23,021	$ 22,821
Liabilities and stockholders equity		
Current liabilities:		
Revolving line of credit	$	$
Accounts payable	1,305	1,604
Accrued liabilities	761	850
Unearned revenue	5,725	5,284
Current portion of capital lease obligation	184	129
Current portion of notes payable	667	667
Total current liabilities	8,642	8,534
Long-term portion of unearned revenue	363	349
Long-term portion of capital lease obligation	174	131
Long-term portion of notes payable	433	766
Leasehold improvement liability	488	532
Deferred tax liability	2,090	1,970

Total liabilities	12,190	12,282
Stockholders equity:		
Preferred stock, $.01 par value, authorized 500,000 shares; none issued		
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; 3,932,730 and 3,909,040 shares issued and 3,920,014 and 3,896,324 shares outstanding	39	39
Additional paid-in capital	189,917	189,459
Accumulated deficit	(178,930)	(178,764)
Receivable for common stock issued	(26)	(26)
Treasury stock, at cost, 12,716 shares	(169)	(169)
Total stockholders equity	10,831	10,539
Total liabilities and stockholders equity	$ 23,021	$ 22,821

See accompanying notes to the condensed consolidated financial statements

Table of Contents

Sonic Foundry, Inc.

Condensed Consolidated Statements of Operations

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

(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012	Six Months Ended March 31, 2013	Six Months Ended March 31, 2012
Revenue:				
Product	$ 2,958	$ 2,617	$ 5,799	$ 5,216
Services	3,415	3,250	7,055	6,750
Other	57	61	128	147
Total revenue	6,430	5,928	12,982	12,113
Cost of revenue:				
Product	1,360	1,354	2,674	2,616
Services	380	290	751	706
Total cost of revenue	1,740	1,644	3,425	3,322
Gross margin	4,690	4,284	9,557	8,791
Operating expenses:				
Selling and marketing	3,022	2,704	6,029	5,477
General and administrative	834	650	1,649	1,475
Product development	868	962	2,044	1,944
Total operating expenses	4,724	4,316	9,722	8,896
Loss from operations	(34)	(32)	(165)	(105)
Equity in earnings from investment in Mediasite KK	90		168	
Other expense, net	(23)	(23)	(49)	(75)
Income (loss) before income taxes	33	(55)	(46)	(180)
Provision for income taxes	(60)	(60)	(120)	(120)
Net loss	$ (27)	$ (115)	$ (166)	$ (300)
Net loss per common share:				
basic	$ (0.01)	$ (0.03)	$ (0.04)	$ (0.08)
diluted	$ (0.01)	$ (0.03)	$ (0.04)	$ (0.08)
Weighted average common shares				
basic	3,910,237	3,852,664	3,903,991	3,846,251
diluted	3,910,237	3,852,664	3,903,991	3,846,251

See accompanying notes to the condensed consolidated financial statements

Table of Contents

Sonic Foundry, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Six months ended March 31, 2013	Six months ended March 31, 2012
Operating activities		
Net loss	$ (166)	$ (300)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Equity in earnings from investment in Mediasite KK	(168)	
Software development costs	(458)	
Amortization of other intangibles	10	33
Amortization of debt discount		32
Depreciation and amortization of property and equipment	530	386
Deferred taxes	120	120
Stock-based compensation expense related to stock options	346	415
Provision for doubtful accounts		(5)
Changes in operating assets and liabilities:		
Accounts receivable	(75)	1,286
Inventories	23	(630)
Prepaid expenses and other current assets	(158)	(181)
Accounts payable and accrued liabilities	(388)	(778)
Other long-term liabilities	(44)	(37)
Unearned revenue	455	(880)
Net cash provided by (used in) operating activities	27	(539)
Investing activities		
Purchases of property and equipment	(531)	(825)
Net cash used in investing activities	(531)	(825)
Financing activities		
Proceeds from notes payable		1,200
Payments on notes payable	(333)	(1,025)
Proceeds from exercise of common stock options and warrants	89	55
Proceeds from issuance of common stock	23	63
Payments on capital lease obligations	(77)	(44)
Net cash provided by (used in) financing activities	(298)	249
Net decrease in cash and cash equivalents	(802)	(1,115)
Cash and cash equivalents at beginning of period	4,478	5,515
Cash and cash equivalents at end of period	$ 3,676	$ 4,400
Non-cash transactions:		
Property and equipment financed by accrued liabilities, capital lease obligation and other long-term liabilities	$ 175	$ 613

See accompanying notes to the condensed consolidated financial statements

Table of Contents

Sonic Foundry, Inc.

Notes to Condensed Consolidated Financial Statements

March 31, 2013

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

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

Interim Financial Data

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of adjustments of a normal and recurring nature) considered necessary for fair presentation of the results of operations have been included. For the periods presented, net income (loss) equaled comprehensive income (loss) as there were no items of comprehensive income. Operating results for the three month period ended March 31, 2013 are not necessarily indicative of the results that might be expected for the year ending September 30, 2013.

The condensed consolidated balance sheet at September 30, 2012 has been derived from audited financial statements at that date, but does not include all of the information and disclosures required by GAAP. For a more complete discussion of accounting policies and certain other information, refer to the Company s annual report filed on Form 10-K for the fiscal year ended September 30, 2012.

Revenue Recognition

General

Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed and 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 our server software and other software licenses. If a license is time-based, the revenue is recognized over the term of the license agreement.

Services

The Company sells support and content hosting contracts to its customers, typically one year in length and records the related revenue ratably over the contractual period. 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 the Company contracts with to build the units provides a limited one-year warranty on the hardware. The Company also sells 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. Service amounts invoiced to customers in excess of revenue recognized are recorded as deferred revenue until the revenue recognition criteria are met.

6

Table of Contents

Revenue Arrangements that Include Multiple Elements

The Company has historically applied the software revenue recognition rules as prescribed by Accounting Standards Codification (ASC) Subtopic 985-605. In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) Number 2009-14, Certain Revenue Arrangements That Include Software Elements, which amended ASC Subtopic 985-605. This ASU removes tangible products containing software components and non-software components that function together to deliver the product s essential functionality from the scope of the software revenue recognition rules. In the case of the Company s hardware products with embedded software, the Company has determined that the hardware and software components function together to deliver the product s essential functionality, and therefore, the revenue from the sale of these products no longer falls within the scope of the software revenue recognition rules. Revenue from the sale of software-only products remains within the scope of the software revenue recognition rules. Installation, training, and post customer support no longer fall within the scope of the software revenue recognition rules, except when they are sold with and relate to a software-only product. Revenue recognition for products that no longer fall under the scope of the software revenue recognition rules is similar to that for other tangible products. ASU Number 2009-13, Multiple-Deliverable Revenue Arrangements, which amended ASC Topic 605 and was also issued in October 2009, is applicable for multiple-deliverable revenue arrangements. ASU 2009-13 allows companies to allocate revenue in a multiple-deliverable arrangement in a manner that better reflects the transaction s economics. ASU 2009-13 and 2009-14 were adopted and are effective for revenue arrangements entered into or materially modified beginning in the Company s fiscal year 2011.

Under the software revenue recognition rules, the fee from a multiple-deliverable arrangement is allocated to each of the undelivered elements based upon vendor-specific objective evidence (VSOE), which is limited to the price charged when the same deliverable is sold separately, with the residual value from the arrangement allocated to the delivered element. The portion of the fee that is allocated to each deliverable is then recognized as revenue when the criteria for revenue recognition are met with respect to that deliverable. If VSOE does not exist for all of the undelivered elements, then all revenue from the arrangement is typically deferred until all elements have been delivered to the customer. All revenue arrangements, with the exception of hosting contracts, entered into prior to October 1, 2010 and the sale of all software-only products and associated services have been accounted for under this guidance.

Under the revenue recognition rules for tangible products as amended by ASU 2009-13, the fee from a multiple-deliverable arrangement is allocated to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. A delivered item that does not qualify as a separate unit of accounting is combined with the other undelivered items in the arrangement and revenue is recognized for those combined deliverables as a single unit of accounting. The selling price used for each deliverable is based upon VSOE if available, third-party evidence (TPE) if VSOE is not available, and best estimate of selling price (ESP) if neither VSOE nor TPE are available. TPE is the price of the Company s or any competitor s largely interchangeable products or services in stand-alone sales to similarly situated customers. ESP is the price at which the Company would sell the deliverable if it were sold regularly on a stand-alone basis, considering market conditions and entity-specific factors. All revenue arrangements negotiated after September 30, 2010, excluding the sale of all software-only products and associated services, have been accounted for under this guidance.

The selling prices used in the relative selling price allocation method are as follows: (1) the Company s products and services are based upon VSOE and (2) hardware products with embedded software, for which VSOE does not exist, are based upon ESP. The Company does not believe TPE exists for any of these products and services because they are differentiated from competing products and services in terms of functionality and performance and there are no competing products or services that are largely interchangeable. Management establishes ESP for hardware products with embedded software using a cost plus margin approach with consideration for market conditions, such as the impact of competition and geographic considerations, and entity-specific factors, such as the cost of the product and the Company s profit objectives. Management believes that ESP is reflective of reasonable pricing of that deliverable as if priced on a stand-alone basis. When a sales transaction includes deliverables that are divided between ASC Topic 605 and ASC Subtopic 985-605, the Company allocates the selling price using the relative selling price method whereas value is allocated using an ESP for software developed using a percent of list price approach. The other deliverables are valued using ESP or VSOE as previously discussed.

Table of Contents

While the pricing model, currently in use, captures all critical variables, unforeseen changes due to external market forces may result in a revision of the inputs. These modifications may result in the consideration allocation differing from the one presently in use. Absent a significant change in the pricing inputs or the way in which the industry structures its deals, future changes in the pricing model are not expected to materially affect our allocation of arrangement consideration.

Management has established VSOE for hosting services. Billings for hosting are spread ratably over the term of the hosting agreement, with the typical hosting agreement having a term of 12 months, with renewal on an annual basis. The Company sells most hosting contracts without the inclusion of products. When the hosting arrangement is sold in conjunction with product, the product revenue is recognized immediately while the remaining hosting revenue is spread ratably over the term of the hosting agreement. The selling price is allocated between these elements using the relative selling price method. The Company uses ESP for development of the selling price for hardware products with embedded software.

The Company also offers hosting services bundled with events services. The Company uses VSOE to establish relative selling prices for its events services. The Company recognizes events revenue when the event takes place and recognizes the hosting revenue over the term of the hosting agreement. The total amount of the arrangement is allocated to each element based on the relative selling price method.

Reserves

The Company reserves for stock rotations, price adjustments, rebates, and sales incentives to reduce revenue and accounts receivable for these and other credits granted 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 the Company determines that it can no longer accurately estimate amounts for stock rotations and sales incentives, the Company 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 assess the realization of our receivables by performing ongoing credit evaluations of our customers financial condition. Through these evaluations, we may become aware of a situation where a customer may not be able to meet its financial obligations due to deterioration of its financial viability, credit ratings or bankruptcy. Our reserve requirements are based on the best facts available to us and are reevaluated and adjusted as additional information is received. Our reserves are also based on amounts determined by using percentages applied to certain aged receivable categories. These percentages are determined by a variety of factors including, but not limited to, current economic trends, historical payment and bad debt write-off experience. Allowance for doubtful accounts for accounts receivable was $85,000 at March 31, 2013 and September 30, 2012.

Table of Contents

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.

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):

	March 31, 2013	September 30, 2012
Raw materials and supplies	$ 162	$ 216
Finished goods	868	837
	$ 1,030	$ 1,053

Capitalized Software Development Costs

The Company applies the principles of ASC Subtopic 985-20, Software Costs of Software to Be Sold, Leased, or Marketed, which requires that software development costs incurred in conjunction with product development be charged to research and development expense until technological feasibility is established. Thereafter, until the product is released for sale, software development costs must be capitalized and reported at the net realizable value of the related product. Typically the period between achieving technological feasibility of the Company s products and the general availability of the products has been short. Consequently, software development costs qualifying for capitalization are typically immaterial and are generally expensed to research and development costs. Upon product release, the amortization of software development costs is determined annually as the greater of the amount computed using the ratio of current gross revenues for the products to their total of current and anticipated future gross revenues or the straight-line method over the estimated economic life of the products, expected to be three years. Amortization expense of software development costs will be included in Cost of Revenue Product. The amount of capitalized external and internal development costs for the three and six month periods ended March 31, 2013 was $458 thousand. There were no development costs capitalized in the three and six months periods ended March 31, 2012.

Equity in earnings from investment in Mediasite KK

The Company s investment in Mediasite KK is accounted for under the equity method of accounting using a one quarter timing lag. Our ownership percentage increased last quarter from approximately 23% of their common stock to approximately 29% of their common stock after Mediasite KK repurchased some of its shares from one of its previous stockholders. The Company recorded equity in earnings of $90 thousand and $168 thousand for the three and six month periods ended March 31, 2013, respectively. The recorded value of this investment is $588 thousand as of March 31, 2013 and $420 thousand as of September 30, 2012. The results of operations for Mediasite KK for their three and six month periods ended December 31, 2012 are listed in the table below. Comparable prior three and six month period results of operations for Mediasite KK are not presented as they were insignificant to the Company s financial statements.

	Three Months ended December 31, 2012	Six Months ended December 31, 2012
Revenue	$ 2,245,000	$ 4,427,000
Gross margin	1,746,000	3,371,000
Income from operations	521,000	1,024,000
Net income	314,000	621,000

Stock Based Compensation

The Company uses a lattice valuation model to account for all employee stock options granted. 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

Table of Contents

of the Company s stock. 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. Forfeitures are based on actual behavior patterns.

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

	Six months ended March 31,	
	2013	**2012**
Expected life	4.8 years	4.8 years
Risk-free interest rate	0.37%-.42%	0.4%
Expected volatility	47.7%-49.3%	56.9%-64.0%
Expected forfeiture rate	11.8%-12.3%	12.2%
Expected exercise factor	1.36	1.34-1.35
Expected dividend yield	0%	0%

A summary of option activity as of March 31, 2013 and changes during the six months then ended is presented below:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Period
Outstanding at October 1, 2012	846,280	$ 11.28	6.4
Granted	297,100	7.57	9.7
Exercised	(19,100)	4.67	1.7
Forfeited	(51,328)	11.79	6.9
Outstanding at March 31, 2013	1,072,952	10.34	6.9
Exercisable at March 31, 2013	597,234	11.75	5.3

A summary of the status of the Company s non-vested shares and changes during the six month period ended March 31, 2013 is presented below:

Non-vested Shares	**Shares**	**Weighted-Average Grant Date Fair Value**
Non-vested at October 1, 2012	291,145	$ 4.40
Granted	297,100	2.58
Vested	(88,527)	3.81
Forfeited	(24,000)	4.50
Non-vested at March 31, 2013	475,718	$ 3.37

The weighted average grant date fair value of options granted during the three months ended March 31, 2013 was $2.58. As of March 31, 2013, there was $1.0 million of total unrecognized compensation cost related to non-vested stock-based compensation, including $150 thousand of estimated forfeitures. The cost is expected to be recognized over a weighted-average remaining life of 2.1 years.

Table of Contents

Stock-based compensation recorded in the three month period ended March 31, 2013 of $164 thousand was allocated $108 thousand to selling and marketing expenses, $10 thousand to general and administrative expenses, and $46 thousand to product development expenses. Stock-based compensation recorded in the six month period ended March 31, 2013 of $346 thousand was allocated $226 thousand to selling and marketing expenses, $20 thousand to general and administrative expenses, and $100 thousand to product development expenses. Stock-based compensation recorded in the three month period ended March 31, 2012 of $183 thousand was allocated $119 thousand to selling and marketing expenses, $11 thousand to general and administrative expenses, and $53 thousand to product development expenses. Stock-based compensation recorded in the six month period ended March 31, 2012 of $415 thousand was allocated $276 thousand to selling and marketing expenses, $25 thousand to general and administrative expenses, and $114 thousand to product development expenses. Cash received from exercises under all stock option plans and warrants for the three and six month periods ended March 31, 2013 was $61 thousand and $89 thousand, respectively. Cash received from exercises under all stock option plans and warrants for the three and six month periods ended March 31, 2012 was $3 thousand and $55 thousand, respectively. There were no tax benefits realized for tax deductions from option exercises in either of the six month periods ended March 31, 2013 or 2012. The Company currently expects to satisfy share-based awards with registered shares available to be issued.

The Company also has an Employee Stock Purchase Plan (Purchase Plan) under which an aggregate of 100,000 common shares may be issued. The Shareholders approved an amendment to increase the number of shares of common stock subject to the plan from 50,000 to 100,000 at the Company s annual meeting in March 2011. All employees who have completed 90 days of employment with the Company on the first day of each offering period and customarily work twenty hours per week or more 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. A total of 24,818 shares are available to be issued under the plan. There were 4,590 shares purchased by employees for the six month offering ended December 31, 2012 which were issued in January 2013. The Company recorded stock compensation expense under this plan for the three and six month periods ended March 31, 2013 of $6 thousand and $9 thousand, respectively. The Company recorded stock compensation expense under this plan for the three and six month periods ended March 31, 2012 of $9 and $15 thousand, respectively.

Per share computation

Basic and diluted net income (loss) per share information for all periods is presented under the requirements of FASB ASC 260-10. Basic earnings (loss) 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. In periods where the Company reports net income, diluted earnings per share is 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:

Table of Contents

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Denominator				
Denominator for basic earnings per share weighted average common shares	3,910,237	3,852,664	3,903,991	3,846,251
Effect of dilutive options and warrants (treasury method)				
Denominator for diluted earnings per share adjusted weighted average common shares	3,910,237	3,852,664	3,903,991	3,846,251
Options and warrants outstanding during each period, but not included in the computation of diluted earnings per share because they are antidilutive	1,072,952	883,805	1,072,952	883,805

New Accounting Pronouncements

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 consolidated financial statements upon adoption.

2. Related Party Transactions

During the three and six month periods ended March 31, 2013, the Company incurred fees of $50 thousand and $97 thousand, respectively, to a law firm, a partner of which is a director and stockholder of the Company. The Company incurred similar fees of $54 thousand and $109 thousand, respectively, during the three and six month periods ended March 31, 2012. The Company had accrued liabilities for unbilled services of $16 thousand at March 31, 2013 and $30 thousand at September 30, 2012, respectively, to the same law firm.

During the three and six month periods ended March 31, 2013, the Company recorded Mediasite product and customer support revenue of $654 thousand and $884 thousand, respectively, to Mediasite KK, a Japanese reseller in which the Company has an equity interest. The Company recorded revenue of $272 thousand and $609 thousand, respectively, in the three and six month periods ended March 31, 2012. Mediasite KK owed the Company $271 thousand at March 31, 2013 and $240 thousand at September 30, 2012.

As of March 31, 2013 and September 30, 2012, the Company had a loan outstanding to an executive totaling $26 thousand. This loan is collateralized by Company stock.

3. Commitments

Inventory Purchase Commitments

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. At March 31, 2013, the Company has an obligation to purchase $2.6 million of Mediasite product, which is not recorded on the Company s Condensed Consolidated Balance Sheet.

Operating Leases

In November 2011, the Company occupied office space related to a lease agreement entered into on June 28, 2011. The lease term is from November 2011 through December 2018. The lease includes a tenant improvement allowance of $613 thousand that was recorded as a leasehold improvement liability and is being amortized as a credit to rent expense on a straight-line basis over the lease term. At March 31, 2013, the unamortized balance is $488 thousand.

Table of Contents

4. Borrowing Arrangements

Silicon Valley Bank

On June 27, 2011, the Company and its wholly owned subsidiary, Sonic Foundry Media Systems, Inc. (the Companies) entered into the Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank (the Second Amended Agreement). Under the Second Amended Agreement, the revolving line of credit has a maximum principal amount of $3,000,000. Interest accrues on the revolving line of credit at the per annum rate of one percent (1.0%) above the Prime Rate (as defined), provided that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) of greater than 2.0 to 1.0, or one-and-one half percent (1.5%) above the Prime Rate, if Sonic Foundry does not maintain an Adjusted Quick Ratio of greater than 2.0 to 1.0. The Second Amended Agreement does not provide for a minimum interest rate on the revolving loan. The Second Amended Agreement also provides for an increase in the advance rate on domestic receivables from 75% to 80%, and extends the facility maturity date to October 1, 2013. Under the Second Amended Agreement, the existing 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 Bank s prime rate; or (ii) eight and three quarters percent (8.75%). In addition, a new term loan can be issued in multiple draws provided that the total term loan from Silicon Valley Bank shall not exceed $2,000,000 and provided further that total term debt shall not exceed $2,400,000. Under the Second Amended Agreement, any new draws on the term loan will accrue interest at a per annum rate equal to the Prime Rate plus three-and-three quarters percent (3.75%), or three-and-one quarter percent (3.25%.) above the Prime rate if Sonic Foundry maintains an Adjusted Quick Ratio of greater than 2.0 to 1.0. The Second Amended Agreement does not provide for a minimum interest rate on the new term loan. Each draw on the new term loan will be amortized over a 36-month period. The Second Amended Agreement also requires Sonic Foundry to continue to comply with certain financial covenants, including covenants to maintain an Adjusted Quick Ratio (as defined) of at least 1.75 to 1.00 and Debt Service Coverage Ratio of at least 1.25 to 1.00, the latter of which will be waived if certain funds are reserved against the availability under the revolving line of credit.

At March 31, 2013, a balance of $1.1 million was outstanding on the term loans with Silicon Valley Bank, with an effective interest rate of six-and-one half percent (6.5%), and no balance was outstanding on the revolving line of credit. At September 30, 2012, a balance of $1.4 million was outstanding on the term loans with Silicon Valley Bank and no balance was outstanding on the revolving line of credit. At March 31, 2013, there was $2.7 million available under this credit facility for advances. At March 31, 2013, the Company was in compliance with all covenants in the Second Amended Agreement.

The Second Amended 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 Second Amended Agreement.

Pursuant to the Second Amended Agreement, the Companies pledged as collateral to Silicon Valley Bank substantially all non-intellectual property business assets. The Companies also entered into an Intellectual Property Security Agreement in which it pledged substantially all intellectual property assets.

5. Income Taxes

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.

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, as a result of the Company s past history of losses.

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.

The difference between the book and tax balance of Goodwill creates a Deferred Tax Liability and an annual tax expense. Because of the long term nature of the goodwill timing difference, tax planning strategies cannot be utilized with respect to the Deferred Tax Liability. The balance of the Deferred Tax Liability at March 31, 2013 was $2.09 million and at September 30, 2012 was $1.97 million.

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 Condensed Consolidated Balance Sheets at September 30, 2012 or March 31, 2013, and has not recognized any interest or penalties in the Condensed Consolidated Statements of Operations for either of the three month periods ended March 31, 2013 or 2012. The Company s tax rate differs from the expected tax rate each reporting period as a result of the aforementioned items.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Risks and Uncertainties

The following discussion of the consolidated financial position and results of operations of the Company should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Form 10-Q and the Company s annual report filed on Form 10-K for the fiscal year ended September 30, 2012. In addition to historical information, this discussion contains forward-looking statements such as statements of the Company s expectations, plans, objectives and beliefs. These statements use such words as may, will, expect, anticipate, believe, plan, and other similar terminology.

Actual results could differ materially from expectations due to changes in the market acceptance of our products, competition, market introduction or product development delays; all of which would impact our strategy to develop a network of inside regional sales managers and distribution partners that target customer opportunities for multi-unit and repeat purchases. If the Company does not achieve multi-unit and repeat purchases, our business will be harmed.

Our future success will continue to depend upon our ability to develop new products, product enhancements or service offerings that address the 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 depends 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 timely develop innovative new products, product enhancements or service offerings which address the needs of our customers or prospective customers or if our current or future competitors develop such new products, product enhancements or service offerings more timely or do so in a way that causes our customers or prospective customers to buy our competitors products instead of our products.

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.

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.

We subcontract the manufacture of our recorders to one 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 our contract manufacturer, a disruption of supply of component parts or completed products, even if short term, would have a material negative impact on our revenues. Many component parts currently have long delivery lead times or cease production of certain components with limited notice in which to evaluate or obtain alternate supply, requiring careful estimation of production requirements. Lengthening lead times, product design changes and other third party manufacturing disruptions have caused delays in delivery. 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 substantially larger quantities of inventory than in the past. Many of these strategies have 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.

Other factors that may impact actual results include: our ability to effectively integrate acquired businesses, length of time necessary to close on sales leads to multi-unit purchasers, our ability to service existing accounts, global and local business conditions, legislation and governmental regulations, competition, our ability to effectively maintain and update our product portfolio, shifts in technology, political or economic instability in local markets, and currency and exchange rate fluctuations, as well as other issues which may be identified from time to time in Sonic Foundry s Securities and Exchange Commission filings and other public announcements.

Overview

Sonic Foundry, Inc. is a technology leader in the emerging web communications marketplace, providing video content management and distribution for education, business and government. Using the Mediasite webcasting platform and webcast services of the Company s events team, the Company empowers our customers to advance how they share knowledge online, using video webcasts to bridge time and distance, enhance learning outcomes and improve performance.

New Accounting Pronouncements

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.

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;
- Accounting for stock-based compensation; and
- Capitalized software development costs.

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.

Table of Contents

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 our server software and other software licenses. If a license is time-based, the revenue is recognized over the term of the license agreement.

Services

The Company sells support and content hosting contracts to its customers, typically one year in length, and records 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. 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

The Company has historically applied the software revenue recognition rules as prescribed by Accounting Standards Codification (ASC) Subtopic 985-605. In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) Number 2009-14, Certain Revenue Arrangements That Include Software Elements, which amended ASC Subtopic 985-605. This ASU removes tangible products containing software components and non-software components that function together to deliver the product s essential functionality from the scope of the software revenue recognition rules. In the case of the Company s hardware products with embedded software, the Company has determined that the hardware and software components function together to deliver the product s essential functionality, and therefore, the revenue from the sale of these products no longer falls within the scope of the software revenue recognition rules. Revenue from the sale of software-only products remains within the scope of the software revenue recognition rules. Installation, training, and post customer support no longer fall within the scope of the software revenue recognition rules, except when they are sold with and relate to a software-only product. Revenue recognition for products that no longer fall under the scope of the software revenue recognition rules is similar to that for other tangible products. ASU Number 2009-13, Multiple-Deliverable Revenue Arrangements, which amended ASC Topic 605 and was also issued in October 2009, is applicable for multiple-deliverable revenue arrangements. ASU 2009-13 allows companies to allocate revenue in a multiple-deliverable arrangement in a manner that better reflects the transaction s economics. ASU 2009-13 and 2009-14 were adopted and are effective for revenue arrangements entered into or materially modified beginning in the Company s fiscal year 2011.

Under the software revenue recognition rules, the fee from a multiple-deliverable arrangement is allocated to each of the undelivered elements based upon vendor-specific objective evidence (VSOE), which is limited to the price charged when the same deliverable is sold separately, with the residual value from the arrangement allocated to the delivered element. The portion of the fee that is allocated to each deliverable is then recognized as revenue when the criteria for revenue recognition are met with respect to that deliverable. If VSOE does not exist for all of the undelivered elements, then all revenue from the arrangement is typically deferred until all elements have been delivered to the customer. All revenue arrangements, with the exception of hosting contracts, entered into prior to October 1, 2010 and the sale of all software-only products and associated services have been accounted for under this guidance.

Under the revenue recognition rules for tangible products as amended by ASU 2009-13, the fee from a multiple-deliverable arrangement is allocated to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. A delivered item that does not qualify as a separate unit of accounting is combined with the other undelivered items in the arrangement and revenue is recognized for those combined deliverables as a single unit of accounting. The selling price used for each deliverable is based upon VSOE if available, third-party evidence (TPE) if VSOE is not available, and best estimate of selling price (ESP) if neither VSOE nor TPE are available. TPE is the price of the Company s or any competitor s largely interchangeable products or services in stand-alone sales to similarly situated customers. ESP is the price at which the Company would sell the deliverable if it were sold regularly on a stand-alone basis, considering market conditions and entity-specific factors. All revenue arrangements negotiated after September 30, 2010, excluding the sale of all software-only products and associated services, have been accounted for under this guidance.

Table of Contents

The selling prices used in the relative selling price allocation method are as follows: (1) the Company s products and services are based upon VSOE and (2) hardware products with embedded software, for which VSOE does not exist, are based upon ESP. The Company does not believe TPE exists for any of these products and services because they are differentiated from competing products and services in terms of functionality and performance and there are no competing products or services that are largely interchangeable. Management establishes ESP for hardware products with embedded software using a cost plus margin approach with consideration for market conditions, such as the impact of competition and geographic considerations, and entity-specific factors, such as the cost of the product and the Company s profit objectives. Management believes that ESP is reflective of reasonable pricing of that deliverable as if priced on a stand-alone basis. When a sales transaction includes deliverables that are divided between ASC Topic 605 and ASC Subtopic 985-605, the Company allocates the selling price using the relative selling price method whereas value is allocated using an ESP for software developed using a percent of list price approach. The other deliverables are valued using ESP or VSOE as previously discussed.

While the pricing model, currently in use, captures all critical variables, unforeseen changes due to external market forces may result in a revision of the inputs. These modifications may result in the consideration allocation differing from the one presently in use. Absent a significant change in the pricing inputs or the way in which the industry structures its deals, future changes in the pricing model are not expected to materially affect our allocation of arrangement consideration.

Management has established VSOE for hosting services. Billings for hosting are spread ratably over the term of the hosting agreement, with the typical hosting agreement having a term of 12 months, with renewal on an annual basis. The Company sells most hosting contracts without the inclusion of products. When the hosting arrangement is sold in conjunction with product, the product revenue is recognized immediately while the remaining hosting revenue is spread ratably over the term of the hosting agreement. The selling price is allocated between these elements using the relative selling price method. The Company uses ESP for development of the selling price for hardware products with embedded software.

The Company also offers hosting services bundled with events services. The Company uses VSOE to establish relative selling prices for its events services. The Company recognizes events revenue when the event takes place and recognizes the hosting revenue over the term of the hosting agreement. The total amount of the arrangement is allocated to each element based on the relative selling price method.

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 resellers sell the inventory to the final end user.

Credit Evaluation and Allowance for Doubtful Accounts

We assess the realization of our receivables by performing ongoing credit evaluations of our customers financial condition. Through these evaluations, we may become aware of a situation where a customer may not be able to meet its financial obligations due to deterioration of its financial viability, credit ratings or bankruptcy. Our reserve requirements are based on the best facts available to us and are reevaluated and adjusted as additional information is received. Our reserves are also based on amounts determined by using percentages applied to certain aged receivable categories. These percentages are determined by a variety of factors including, but not limited to, current economic trends, historical payment and bad debt write-off experience. Allowance for doubtful accounts for accounts receivable was $85,000 at March 31, 2013 and September 30, 2012.

Table of Contents

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. Effective beginning in fiscal 2012 with the adoption of ASU 2011-08, Testing Goodwill for Impairment , we first assessed qualitative factors related to goodwill to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Using the qualitative assessment, we determined that the fair value of goodwill is more likely than not greater than its carrying amount thus step two was not deemed necessary to perform. The Company has recognized no impairment charges as of March 31, 2013.

If we had determined 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 have then measured 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 have recorded an impairment charge for the difference.

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.

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

The Company uses a lattice valuation model to account for all stock options granted. The lattice valuation model provides a 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 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. Forfeitures are based on actual behavior patterns.

Capitalized Software Development Costs

The Company applies the principles of ASC Subtopic 985-20, Software Costs of Software to Be Sold, Leased, or Marketed, which requires that software development costs incurred in conjunction with product development be charged to research and development expense until technological feasibility is established. Thereafter, until the product is released for sale, software development costs must be capitalized and reported at the net realizable value of the related product. Typically the period between achieving technological feasibility of the Company s products and the general availability of the products has been short. Consequently, software development costs qualifying for capitalization are typically immaterial and are generally expensed to research and development costs. Upon product release, the amortization of software development costs is determined annually as the greater of the amount computed using the ratio of current gross revenues for the products to their total of current and anticipated future gross revenues or the straight-line method over the estimated economic life of the products, expected to be three years. Amortization expense of software development costs will be included in Cost of Revenue Product.

Table of Contents

Results of Continuing Operations

Revenue

Revenue from our business includes the sale of Mediasite recorders and server software products and related services contracts, such as customer support, installation, training, content hosting and event services. 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.

Q2-2013 compared to Q2-2012

Revenue in Q2-2013 increased $502 thousand, or 8% from Q2-2012 revenue of $5.9 million to $6.4 million. Revenue consisted of the following:

Product revenue from sale of Mediasite recorder units and server software increased from $2.6 million in Q2-2012 to $3.0 million in Q2-2013 primarily as a result of a $376 thousand increase in product sales to a related party, Mediasite KK, to support higher education demand in Japan.

	Q2-2013	Q2-2012
Recorders sold	302	249
Rack units to mobile units ratio	3.0 to 1	1.3 to 1
Average sales price, excluding service (000 s)	$ 9.2	$ 9.4
Refresh Units	117	107

Services revenue represents the portion of fees charged for Mediasite customer support 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 $3.3 million in Q2-2012 to $3.4 million in Q2-2013 primarily due to an increase in hosting and support contracts billings. At March 31, 2013, $6.1 million of revenue was deferred, of which we expect to recognize $5.7 million in the next twelve months, including approximately $2.5 million in the quarter ending June 30, 2013. At September 30, 2012, $5.6 million of revenue was deferred.

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

YTD-2013 (six months) compared to YTD-2012 (six months)

Revenues for YTD-2013 totaled $13.0 million compared to YTD-2012 revenues of $12.1 million. Revenues included the following:

$5.8 million product revenue from the sale of 572 Mediasite recorders and software versus $5.2 million from the sale of 491 Mediasite recorders and software in 2012. This increase was partially due to a $262 thousand increase in sales to a related party, Mediasite KK, to support higher education demand in Japan. The remaining in product revenue increase relates to an increase in recorders sold to international and domestic higher education customers and an increase in discounted upgrade recorders sold to customers whose product had reached the end of hardware warranty eligibility.

$7.1 million from Mediasite customer support contracts, installation, training, event and hosting services versus $6.8 million in 2011. Services revenue increased primarily due to an increase in hosting and customer support contracts billings on Mediasite recorder units.

20

Table of Contents

Gross Margin

Q2-2013 compared to Q2-2012

Gross margin for Q2-2013 was $4.7 million or 73% of revenue compared to Q2-2012 of $4.3 million or 72%. Gross margin increased due to operational efficiencies in recorder and services costs. These improvements were partially offset by a greater volume of discounted upgrade units for customers whose product had reached the end of hardware warranty eligibility. The significant components of cost of revenue include:

Material and freight costs for the Mediasite recorders. Costs for Q2-2013 Mediasite recorder hardware and other costs totaled $1.0 million, along with $78 thousand of freight costs, and $236 thousand of labor and allocated costs compared to Q2-2012 Mediasite recorder costs of $1.1 million for hardware and other costs, $82 thousand for freight and $193 thousand of labor and allocated costs.

Services costs. Staff wages and other costs allocated to cost of service revenue were $380 thousand in Q2-2013 and $290 thousand in Q2-2012, resulting in gross margin on services of 89% in Q2-2013 and 91% in Q2-2012. The increase in service costs relates to an increase in headcount and higher outside service labor costs.

YTD-2013 (six months) compared to YTD-2012 (six months)

Gross margin for YTD-2013 was $9.6 million or 74% of revenue compared to YTD-2012 of $8.8 million or 73%. Gross margin increased due to operational efficiencies in recorder and services costs. These improvements were partially offset by a greater volume of discounted upgrade units for customers whose product had reached the end of hardware warranty eligibility. The significant components of cost of revenue include:

Material and freight costs for the Mediasite recorders. Costs for YTD-2013 Mediasite recorder hardware and other costs totaled $2.0 million, along with $182 thousand of freight costs, and $465 thousand of labor and allocated costs compared to YTD-2012 Mediasite recorder costs of $2.0 million for hardware and other costs, $190 thousand for freight and $435 thousand of labor and allocated costs.

Services costs. Staff wages and other costs allocated to cost of service revenue were $751 thousand in YTD-2013 and $706 thousand in YTD-2012, resulting in gross margin on services of 89% in YTD-2013 and 90% in YTD-2012.

Operating Expenses

Selling and Marketing Expenses

Selling and marketing expenses include wages and commissions for sales, marketing and business development 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 or entrance into new markets, or participation in major tradeshows.

Q2-2013 compared to Q2-2012

Selling and marketing expenses increased $318 thousand or 12% from $2.7 million in Q2-2012 to $3.0 million in Q2-2013. Major components of the change include:

Increased salary, incentive compensation and benefits of $117 thousand due to slightly higher staff levels and a nineteen percent increase in sales and related commission compensation compared to Q2-2012.

- Tradeshows, sponsorships and travel increased by $111 thousand due to an increase in the number of sponsorships and tradeshow participation.

- Costs allocated from General and Administrative increased by $57 thousand primarily as a result of higher facilities and depreciation expense.

YTD-2013 compared to YTD-2012

Selling and marketing expenses increased $552 thousand or 10% from $5.5 million in YTD-2012 to $6.0 million in YTD-2013. YTD increases in the major categories include:

- YTD-2013 salary, incentive compensation and benefits increased $250 thousand from YTD-2012 due to slightly higher staff levels in 2013 and an increase in sales and related commission compensation compared to 2012.

- YTD-2013 facilities expense allocated to selling and marketing increased by $101 thousand from YTD-2012 primarily due to higher facilities expense and depreciation expense.

- YTD-2013 tradeshow, sponsorships, market research and travel expense increased by $135 thousand from YTD-2012.

21

Table of Contents

We anticipate selling and marketing headcount to increase slightly throughout the remainder of the fiscal year.

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.

Q2-2013 compared to Q2-2012

G&A expenses increased $184 thousand or 28% from $650 thousand in Q2-2012 to $834 thousand in Q2-2013. Differences in the major categories include:

Professional services increase of $84 thousand due to legal costs and consulting fees related to our investment in Mediasite KK.

Increase in bad debt expense of $88 thousand due to a decrease in the age of certain accounts in Q2-2012

YTD-2013 compared to YTD-2012

G&A increased $174 thousand or 12% from $1.5 million in YTD-2012 to $1.6 million in YTD-2013. YTD increases in the major categories include:

The increase is due to an increase in compensation and benefits of $14 thousand.

Increase in bad debt expense of $24 thousand compared to YTD-2012

Professional services increase of $114 thousand, mainly due to legal costs and annual consulting fees related to our investment in Mediasite KK.

We anticipate general and administrative headcount to slightly increase during the remainder of the fiscal year.

Product Development Expenses

Product development expenses include salaries and wages of the software research and development staff and an allocation of benefits, facility and administrative expenses.

Q2-2013 compared to Q2-2012

Product development expenses decreased $94 thousand, or 10% from $962 thousand in Q2-2012 to $868 thousand in Q2-2013 resulting primarily from a $121 thousand decrease in compensation and benefits. We capitalized $237 thousand of software development internal labor, which was partially offset by an otherwise net increase in compensation and benefits of $116 thousand related primarily to an increase in headcount. In addition to internal labor, $221 thousand of third party design and testing costs were capitalized. Costs allocated from General and Administrative increased by $17 thousand primarily as a result of higher facilities and depreciation expense. No software development costs were capitalized in Q2-2012.

YTD-2013 compared to YTD-2012

Product development expenses increased $100 thousand, or 5% from $1.9 million in YTD-2012 to $2.0 million in YTD-2013. YTD increases in the major categories include:

Increase in compensation and benefits of $28 thousand related to an increase in headcount net of $237 thousand of software development labor capitalized in the quarter. In addition to internal labor, $221 thousand of third party design and testing costs were capitalized. No software development costs, including internal labor or third party design and testing costs, were capitalized in YTD-2012.

Costs allocated from General and Administrative increased by $81 thousand primarily as a result of higher facilities and depreciation expense.

Table of Contents

We anticipate product development headcount to be consistent during the remainder of the fiscal year. We anticipate more software development efforts related to the same product release will qualify for capitalization in Q3-2013 at a lower amount than we experienced in Q2-2013. These costs are related to software version 6.1.7 released in April 2013.

Other Expense, Net

Under the equity method of accounting, we record our proportional share of earnings in Mediasite KK on a one quarter lag. Our ownership percentage increased last quarter from approximately 23% of their common stock to approximately 29% of their common stock after Mediasite KK repurchased some of its shares from one of its previous stockholders. During the three and six month periods ended March 31, 2013, we recorded net equity in earnings of $90 thousand and $168 thousand, respectively. No equity in earnings were recorded in the three and six month periods ended March 31, 2012. Other expense primarily consists of interest costs related to outstanding debt. Other income is primarily interest income from overnight investment vehicles.

Liquidity and Capital Resources

Cash provided by operating activities was $27 thousand in YTD-2013 compared to cash used of $539 thousand in YTD-2012, a increase of $566 thousand. Cash provided by operating activities in YTD-2013 increased partly due to the positive effects of a $134 thousand decrease in net loss, from a net loss of $300 thousand in YTD-2012 to a net loss of $166 thousand in YTD-2013. Working capital and other changes included the positive effects of $346 thousand of stock based compensation, $530 thousand of depreciation expense and a $455 thousand increase in unearned revenue. These were partially offset by the negative effects of a $388 decrease in accounts payable and accrued liabilities, $458 thousand of software development capitalized costs, an increase in $158 thousand of prepaid expenses and other current assets, and $168 thousand of equity in earnings from investment in Mediasite KK. In YTD-2012, working capital and other changes included the positive effects of a $1.3 million decrease in accounts receivable, $415 thousand of stock based compensation, and $386 thousand of depreciation expense. These were more than offset by the negative effects of decreases in accounts payable and accrued liabilities of $778 thousand, a decrease in unearned revenue of $880 thousand and an increase in inventory of $630 thousand.

Cash used in investing activities was $531 thousand in YTD-2013 compared to a use of $825 thousand inYTD-2012 for the purchase of property and equipment.

Cash used in financing activities was $298 thousand in YTD-2013 compared to cash provided by financing activities of $249 thousand in YTD-2012. Cash used in YTD-2013 was due primarily to $410 thousand of cash used for payments on notes payable and capital leases. This was partially offset by $89 thousand proceeds from exercise of common stock options and $23 thousand proceeds from issuance of common stock. Cash provided in YTD-2012 was due primarily to $1.2 million from proceeds from notes payable, $55 thousand proceeds from exercise of common stock options, and $63 thousand proceeds from issuance of common stock. This was mostly offset by $1.1 million of cash used for payments on notes payable and capital leases.

The Company believes its cash position is adequate to accomplish its business plan through at least the next twelve months. We will likely evaluate 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. We may also 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 June 27, 2011, the Company and its wholly owned subsidiary, Sonic Foundry Media Systems, Inc. (the Companies) entered into the Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank (the Second Amended Agreement). Under the Second Amended Agreement, the revolving line of credit has a maximum principal amount of $3,000,000. Interest accrues on the revolving line of credit at the per annum rate of one percent (1.0%) above the Prime Rate (as defined), provided that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) of greater than 2.0 to 1.0, or one-and-one half percent (1.5%) above the Prime Rate, if Sonic Foundry does not maintain an Adjusted Quick Ratio of greater than 2.0 to 1.0. The Second Amended Agreement does not provide for a minimum interest rate on the revolving loan. The Second Amended Agreement also provides for an increase in the advance rate on domestic receivables from 75% to 80%, and extends the facility maturity date to October 1, 2013. Under the Second Amended Agreement, the existing 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 Bank s prime rate; or (ii) eight and three quarters percent (8.75%). In addition, a new term loan can be issued in multiple draws provided that the total term loan from Silicon Valley Bank shall not exceed $2,000,000 and provided further that total term debt shall not exceed $2,400,000. Under the Second Amended Agreement, any new draws on the term loan will accrue interest at a per annum rate equal to the Prime Rate plus three and three quarters percent (3.75%), or three-and-one quarter percent (3.25%) above the Prime Rate if Sonic Foundry maintains an Adjusted Quick Ratio of greater than 2.0 to 1.0. The Second Amended Agreement does not provide for a minimum interest rate on the new term loan. Each draw on the new term loan will be amortized over a 36-month period. The Second Amended Agreement also requires Sonic Foundry to continue to comply with certain financial covenants, including covenants to maintain an Adjusted Quick Ratio (as defined) of at least 1.75 to 1.00 and Debt Service Coverage Ratio of at least 1.25 to 1.00, the latter of which will be waived if certain funds are reserved against the availability under the revolving line of credit.

At March 31, 2013, a balance of $1.1 million was outstanding on the term loans with Silicon Valley Bank, with an effective interest rate of six-and-one half percent (6.5%), and no balance was outstanding on the revolving line of credit. At September 30, 2012, a balance of $1.4 million was outstanding on the term loans with Silicon Valley Bank and no balance was outstanding on the revolving line of credit. At March 31, 2013, there was $2.7 million available under this credit facility for advances. At March 31, 2013 the Company was in compliance with all covenants in the Second Amended Agreement.

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. At March 31, 2013, the Company has an obligation to purchase $2.6 million of Mediasite product, which is not recorded on the Company s Condensed Consolidated Balance Sheet.

Table of Contents

ITEM 3. 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, which consist of overnight money market funds, are subject to interest rate fluctuations, however, we believe this risk is minimal due to the short-term nature of these investments.

At March 31, 2013, all of our $1.1 million of debt outstanding is variable 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.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Based on evaluations at March 31, 2013, our principal executive officer and principal financial officer, with the participation of our management team, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15 (e) and 15d-15 (e) under the Securities Exchange Act). Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that material information relating to the Company is accumulated and communicated to management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective as of March 31, 2013 solely because we identified two related material weaknesses in internal control over financial reporting related to review controls that did not operate effectively over general ledger setup of new product in our accounting system and missing review, policy and amortization controls over accounting treatment for internal software development efforts. We determined that the possibility exists for general ledger setup of product to be modified in our accounting system without independent review. We also determined that we were missing controls around the capitalization of internal software development efforts.

In light of the material weaknesses described above, additional procedures were performed by our management to ensure that the condensed consolidated financial statements included in this quarterly report on Form 10-Q were prepared in accordance with U.S. generally accepted accounting principles. No material errors or adjustments were identified during our normal financial statement closing process or through those additional procedures.

In order to remediate these material weaknesses, we immediately undertook steps to ensure that general ledger setup modifications outside of our normal business processes are properly reviewed and approved and that policies and controls over internal software development efforts and amortization are reviewed for proper accounting treatment. While we expect these steps to remediate these material weaknesses, the impact of our remediation efforts will not be fully known until these controls have been in place and operating effectively for a sufficient period of time.

Table of Contents

Changes in Internal Controls

During the period covered by this quarterly report on Form 10-Q, the Company has not made any changes to its internal control over financial reporting (as referred to in Paragraph 4(b) of the Certifications of the Company s principal executive officer and principal financial officer included as exhibits to this report) that have materially affected, or are reasonably likely to affect the Company s internal control over financial reporting.

Table of Contents

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 26, 2012, a complaint was filed by Astute Technology, LLC (Astute) against Learners Digest International, LLC (Learners Digest), one of our customers, in the United States District Court for the Eastern District of Texas (Case No. 2:012-cv-689). The complaint alleges patent infringement. Because Learners Digest is a customer, we have agreed to indemnify them from costs and damages in connection with the litigation. We believe the complaint is without merit and intend to defend the lawsuit vigorously.

On February 5, 2013, we filed a complaint against Astute in the Western District of Wisconsin (Case No. 13-cv-87). The complaint is for declaratory judgment of non-infringement and invalidity of three Unites States patents held by Astute.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in our Form 10-K for the fiscal year ended September 30, 2012 filed with the SEC.

Table of Contents

ITEM 6. EXHIBITS

NUMBER	DESCRIPTION
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. 3.1 to the Form 8-K filed on October 11, 2011, and hereby incorporated by reference.
10.1*	Amended and Restated Employment Agreement between Registrant and Gary Weis dated as of September 30, 2011, filed as Exhibit 10.1 to the Form 8-K filed on October 4, 2011, and hereby incorporated by reference.
10.2*	Employment Agreement between Registrant and Rimas Buinevicius dated as of March 31, 2011, filed as Exhibit 10.1 to the form 8-K on April 4, 2011, and hereby incorporated by reference.
10.3*	Employment Agreement between Registrant and Gary Weis dated as of March 31, 2011, filed as Exhibit 10.2 to the Form 8-K filed on April 4, 2011, and hereby incorporated by reference.
10.4*	Consulting Agreement between Registrant and Monty R. Schmidt dated as of March 31, 2011, filed as Exhibit 10.3 to the Form 8-K filed on April 4, 2011, and hereby incorporated by reference.
10.5*	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.
10.6	Intellectual Property Security Agreement dated May 2, 2007, between Sonic Foundry, Inc. and Silicon Valley Bank filed as Exhibit 10.2 to the Form 8-K on May 7, 2007, and hereby incorporated by reference.
10.7	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.
10.8*	Employment Agreement dated October 31, 2007 between Sonic Foundry, Inc. and Kenneth A. Minor, filed as Exhibit 10.1 to the Form 8-K filed on November 2, 2007, and hereby incorporated by reference.
10.9	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 the Form 8-K filed on June 20, 2008, and hereby incorporated by reference.
10.10*	Employment Agreement dated August 4, 2008 between Sonic Foundry, Inc. and Robert M. Lipps, filed as Exhibit 10.1 to the Form 8-K filed on August 6, 2008, and hereby incorporated by reference.
10.11	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 Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on April 15, 2009, and hereby incorporated by reference.

10.12*	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.
10.13*	Registrant s 2008 Non-Employee Directors Stock Option Plan, as amended, filed as Exhibit 10.13 to the Form 10-Q filed on May 1, 2012, 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, as amended, filed as Exhibit 10.15 to the Form 10-Q filed on May 1, 2012, 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 the 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 the 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 the 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 the Form 8-K filed on March 10, 2010, and hereby incorporated by reference.
10.20	Lease Agreement between Registrant, as tenant, and West Washington Associates, LLC as landlord, dated June 28, 2011, filed as Exhibit 10.1 to the Form 8-K filed on July 1, 2011, and hereby incorporated by reference.
10.21	Second Amended and Restated Loan and Security Agreement dated June 27, 2011 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.2 to the Form 8-K filed on July 1, 2011, and hereby incorporated by reference.
10.22	Consent and Modification No. 1 to Loan and Security Agreement entered into as of June 28, 2011, among Partners for Growth II, L.P., Registrant and Sonic Foundry Media Systems, Inc. filed as Exhibit 10.3 to the Form 8-K filed on July 1, 2011, and hereby incorporated by reference.
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer and Secretary
32	Section 906 Certification of Chief Executive Officer and Chief Financial Officer and Secretary
101	The following materials from the Sonic Foundry, Inc. Form 10-Q for the quarter ended March 31, 2013 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations, (ii) the Condensed Consolidated Balance Sheets, (iii) Condensed Consolidated Statements of Cash Flows and (iv) Notes to Condensed Consolidated Financial Statements.

Registrant will furnish upon request to the Securities and Exchange Commission a copy of all exhibits, annexes and schedules attached to each contract referenced in item 10.

* Compensatory Plan or Arrangement

Table of Contents

SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Sonic Foundry, Inc.
	(Registrant)
May 2, 2013	By: /s/ Gary R. Weis Gary R. Weis Chief Executive Officer
May 2, 2013	By: /s/ Kenneth A. Minor Kenneth A. Minor Chief Financial Officer and Secretary