SONIC FOUNDRY INC
Form 10-K
December 03, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal period ended September 30, 2007

OR

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

Commission File Number 1-14007

SONIC FOUNDRY, INC.

(Exact name of registrant as specified in its charter)

MARYLAND	**39-1783372**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
222 W. Washington Ave, Madison, WI 53703	**(608) 443-1600**
(Address of principal executive offices)	**(Issuer s telephone number)**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common stock par value $0.01 per share

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Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act.

Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Yes 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 x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ¨ No x

The aggregate market value of the registrant s common stock held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the Registrant s most recently completed second fiscal quarter was approximately $122,000,000.

The number of shares outstanding of the registrant s common equity was 35,567,336 as of November 26, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference into Part III. A definitive Proxy Statement pursuant to Regulation 14A will be filed with the Commission no later than January 28, 2008.

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

PART I

ITEM 1. BUSINESS

Who We Are

Sonic Foundry, Inc. (Sonic Foundry) is a technology leader in the emerging web communications marketplace, providing enterprise solutions and services that link an information-driven world. Our core solution, Mediasite®, is a web communication and content management system that automatically and cost-effectively lets organizations create affordable multimedia webcasts and gives them the tools to manage, monitor and secure their presentations. In the short time since we first introduced Mediasite, the system has set the standard as a transformational communications medium, changing the way organizations communicate via the web and how people around the globe receive vital information needed for work, professional advancement, safety and education. Trusted by Fortune 500 companies, top education institutions and Federal, state and local government agencies for a variety of critical communication needs, we believe Mediasite is the leading one-to-many multimedia communication solution for capturing knowledge and sharing it online.

The Mediasite solution family includes Mediasite Recorders to capture multimedia presentations; Mediasite Server Software to stream, archive and manage online presentation content; Sonic Foundry Services to provide managed services, event webcasting, training, installation and custom development; and SmartServe Services to provide annual software maintenance and technical support.

Currently, we have over two thousand Mediasite Recorders installed in presentation venues around the world. These Recorders are capturing hundreds of thousands of rich media presentation hours for our customers. We believe that these growing rich media repositories will continue to drive further interest in deploying future advanced search technology from Sonic Foundry, allowing information users to more easily find the content they need.

Sonic Foundry, Inc., the parent company of Sonic Foundry Media Systems, Inc., our web communications business, was founded in 1991, incorporated in Wisconsin in March 1994 and merged into a Maryland corporation of the same name in October 1996. Our executive offices are located at 222 West Washington Ave., Madison, Wisconsin, 53703 and our telephone number is (608) 443-1600. Our corporate website is http://www.sonicfoundry.com. We make available, free of charge, at the Investor Information section of our website, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports required to be filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after the filing of such reports with the Securities and Exchange Commission.

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Market Need

Every organization faces a fundamental need to communicate information efficiently to individuals who need it. Universities and colleges need to connect lecturers with students for advanced learning. Corporations strive for successful collaboration between colleagues to provide value to customers. Government agencies must keep partners, stakeholders and constituents informed to operate effectively.

And yet, significant communication challenges remain, including:

Connecting with a geographically-dispersed audience

- Simultaneously addressing people in multiple locations
- Holding meetings where it is not feasible for everyone to attend
- Transmitting timely information that is crucial for all employees to receive
- Requiring employees, regardless of time zone or schedule, to attend company training sessions

Improving productivity and corporate logistics

- Reducing corporate travel expenses
- Repeating the same presentation to different audiences
- Making participants leave their desks to go to a meeting space
- Diminishing employee productivity while in training
- Lack of retention due to distractions, interruptions or absence
- Incurring repeated costs for printing, mailing and meeting expenses

Coordinating multiple project teams

Keeping everyone on the same page at the same time

Requiring time off task to get new hires trained

Failure to document and review past meeting content

Watering down of organizational initiatives, leading to false starts and forgotten directives

Operating time-consuming, cumbersome and restrictive technologies

Requiring technological expertise to manage existing systems

Inability to create learning content in real-time

Additional preparation and training for presenters, including pre-loading and pre-production of content

Needing costly and time-intensive post-production

The Mediasite Solution

Sonic Foundry s technology is changing the way organizations share and use information. The Mediasite solution family includes:

Mediasite Recorders to capture multimedia presentations

Mediasite Server Software to stream, archive and manage online presentation content

Sonic Foundry Services to provide managed services, event webcasting, training, installation, and custom development

SmartServe Services to provide annual software maintenance and technical support

Mediasite Recorders streamline the recording and creation of multimedia presentations for people who need to share their information or message with others. Mediasite Recorders capture all the elements of a multimedia presentation video, audio and high-resolution presentation graphics and combine these into an interactive media-rich presentation that can be immediately viewed via the web. The simple workflow of the Mediasite Recorder is unobtrusive and instantaneous allowing presenters to share their knowledge online without changing how they normally present and without requiring time-consuming content production. We offer Mediasite Recorders for the following environments:

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

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

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

Mediasite Server Software provides a unified web communications platform to webcast presentations captured by Mediasite Recorders over the internet for live or on-demand access and to archive presentations in searchable online catalogs. Viewers playback Mediasite presentations live or on-demand anytime, anywhere using nothing more than a web browser. We believe that as online multimedia libraries grow, effective management and security of this institutional knowledge becomes critical. Mediasite Server allows organizations to:

Organize and index their content in searchable online catalogs

Secure presentations and Mediasite system access for authorized users

Customize and brand their presentation content and incorporate audience interactivity through polls and Q&A

Report on viewing activity to see who is watching what presentations, when and for how long

Enable closed captioning for users with hearing disabilities

Manage and remotely control Mediasite Recorders

Integrate Mediasite content into other learning or course management systems, content management systems or custom portals

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

Managed Services: the Company s pay-as-you-go service offerings provide hosting, delivery and management of online multimedia content using Sonic Foundry s hosting data center and infrastructure. Managed services allow organizations of all sizes to jump start their web communications initiatives quickly and simply. They provide a low-risk way to implement online multimedia communications before bringing hosting requirements in-house and can offer a hassle-free long-term solution.

Event Webcasting: Trained technicians work on-site or as project managers with event AV service providers to webcast rich media events, conferences and meetings.

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

Installation: Sonic Foundry integrates the Mediasite solution within the organizations existing AV and IT infrastructures.

Custom Development: Sonic Foundry streamlines how Mediasite interfaces with internal policies, workflow and content delivery systems.

SmartServe Services provide Mediasite customers annually renewable maintenance and support plans on their Mediasite solution giving them access to Sonic Foundry technical expertise and Mediasite software updates. With a SmartServe contract, customers are entitled to:

- Software upgrades and updates for Mediasite Recorders and Servers
- Unlimited technical support assistance
- Extension of their Recorder hardware warranty
- Advance Recorder hardware replacement
- Authorized access to the SmartServe Portal where they can access software downloads, documentation, knowledge base articles, tutorials, forums, online training and technical resources at any time.

The majority of our customers purchase SmartServe contracts when they purchase Mediasite recorders.

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What Sets Mediasite Apart?

Simplicity: Mediasite automates what has previously been a complex content production and authoring process requiring highly skilled staff. With Mediasite, presenters do not need to make any changes to the way they normally present. Non-technical presenters, line of business managers and subject matter experts can confidently walk into a room, turn on their laptop to start presenting and know that Mediasite is automatically recording everything. Viewers easily playback Mediasite presentations using nothing more than a web browser.

Quality rich media experience: Mediasite s patented recording technology automatically synchronizes audio, video and presentation graphics into interactive rich media experiences. The ability for Mediasite to capture and display presentation graphics at native resolution ensures audiences can see the most detailed presentation imagery.

Interactivity: Mediasite presentations combine visual, auditory and kinesthetic elements that engage the audience and aide knowledge transfer. Moderated Q&A and polling capabilities add an additional element of presenter-audience interaction.

Content navigation and search: Content is only as useful as the ability to find what is relevant. Keyword search and visual timeline navigation controls let users hone in on the exact information they need. Our advances in multi-modal search add yet another layer of confidence to finding media-based information quickly.

Content management focus: Other market solutions focus on the technology of recording, emphasizing custom formats, bitrates and compression standards of streaming information over the web. We believe enterprises are more interested in ease-of-use for presenters and viewers, which leads to webcasting becoming a mode of everyday business communication. As their number of webcasts expands, enterprises must find ways to manage that content. Mediasite automatically creates online content catalogs that enable users to organize, secure, search, customize and report on viewers access and use.

Security: For organizations facing intellectual property issues, or anyone who doesn t want their corporate video to end up on YouTube, there is a serious need to control access to both live and on-demand presentations. Mediasite effectively creates, manages and distributes content within strict security settings and leverages enterprises existing directory security infrastructures.

Reporting: Mediasite provides viewing statistics for all live and on-demand presentations allowing organizations to track exactly who has watched what, when and for how long.

Scalability: The Mediasite system makes it possible for organizations to start small and grow as needed, scaling to meet rising demand and confidently supporting hundreds to thousands of simultaneous users while maximizing their enterprise infrastructures.

Extensibility: Customers can extend the reach of Mediasite content with integration into other applications like course management, learning management and content management systems or portals.

Managed service offering: To minimize IT challenges, network infrastructure issues and technology expertise, we offer a pay-as-you-go option that provides organizations a low-risk method of using Mediasite from our hosted datacenter.

Customers and Applications

The Mediasite system is rapidly emerging as the standard for capturing, archiving and delivering one-to-many multimedia presentations online. Popular applications in our primary vertical markets include:

Higher education

Online lectures: students review content outside of in-class instruction

Distance learning: off-campus students learn remotely online

Continuing education: professionals learn online or supplement classroom experiences

Research and collaboration: present findings, facility training

Recruitment and orientation: campus tours, financial aid instructions

University business: leadership meetings, alumnae relations

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Corporate

- Executive communications: state of the enterprise speeches, all-hands meetings
- Workforce development: training, HR briefings, policy documentation
- Program management: technical training, research collaboration
- Sales and marketing: sales demonstrations, webinars, channel relations
- Customer support: product tutorials, self-guided troubleshooting
- Investor relations: earnings calls, analyst briefings, annual reports

Government

- Program management: relief work, military coordination, emergency preparedness
- Community outreach: committee meetings, public safety announcements
- Training, workshops and events: just-in-time, on-demand and remote learning
- Executive and legislative communications: constituent relations, public speeches, debates

Benefits and Value of Mediasite

In many cases, our customers have deployed Mediasite to easily and cost-effectively build large-scale knowledge libraries of presentations. Through interviews, many customers report the following benefits of Mediasite:

Cuts costs and boosts productivity

Reduces the need for travel and meeting accommodations

Eliminates the need to choose between meetings by allowing executives to time-shift

Decreases work interruption and downtime while increasing the reach, retention and availability of important information

Recaptures time that would have been spent repeating company information to multiple audiences

Keeps sales people informed while in the field interacting with customers

Enhances collaboration and morale

Creates opportunities for executive face time and interaction between management and employees

Fosters a level of direct communication not possible before as presenters convey the significance of their message first hand

Enables non-technical people to create their own webcasts through highly-automated equipment

Improves employee morale through efficient, more inclusive communication so audiences at home and abroad feel more a part of the team

Increases accuracy and comprehension

Staff and students can access presentations at their convenience, when they are less distracted, which leads to better retention

Allows managers to train employees consistently regardless of other day-to-day demands

Improves the reliability and frequency of internal and external communication

Enables quick and efficient briefing of employees with time-sensitive information, regardless of geographic location

Makes it possible to reuse and repurpose knowledge that could not otherwise be revisited

In August 2007, Forrester® Consulting (Forrester) conducted a commissioned study on behalf of Sonic Foundry titled The Total Economic Impact of Mediasite to examine the financial impact and potential return on investment (ROI) enterprises may realize by deploying Mediasite. Sonic Foundry selected Forrester for this project because of its industry expertise in elearning and its Total Economic Impact (TEI) methodology. Forrester s TEI helps companies demonstrate, justify and realize the tangible value of IT initiatives to both senior management and other key business stakeholders. It not only measures costs and cost reduction (areas that are typically accounted for within IT) but also weighs the enabling value of a technology in increasing the effectiveness of overall business processes.

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The study illustrates the financial impact of adopting Mediasite for a North American research and development organization with a focus on science-based technologies that support national security. The organization employs more than 10,000 employees and contractors on multiple campuses and has been using Mediasite since 2004 to create an enterprise-wide knowledge management system that integrates within its existing online environment. Based on in-depth interviews with the customer, Forrester constructed a TEI framework for a composite organization and found that the Mediasite webcasting platform yielded a 155% risk-adjusted ROI and paid for itself within 16 months of use.

According to the study, key factors driving this organization s Mediasite adoption include:

The ability to manage multimedia assets. End users can access content live or on-demand and have the flexibility to watch at their convenience and review as many times as they wish.

Improved content capturing. This allows the training team to communicate in real-time and to reduce the time to market for new materials and enhancements.

The ability to reduce the operational cost of training by reducing teleconferencing costs while improving the quality and relevance of training.

Market Demand

Web communication is coming of age, now regarded by education, business and government as an essential communication tool for the enterprise. We believe the recent surge in adoption is fueled by the lower cost of bandwidth and storage, as well as growing consumer awareness of internet video with the proliferation of online multimedia advertising and websites like YouTube and Google Video. We believe the market for this new medium will build at an increasing rate as more Mediasite systems are installed, more users begin webcasting and additional viewers come online.

Mediasite in education: We believe that adoption of web communications in educational enterprises is outpacing that in corporate enterprises. Given the technology pedigree of today s college students, this move to online learning makes perfect sense; as most of these students have never known a world without personal computers and the web. The delivery options for a modern education are akin to the electronic delivery of music that emerged approximately five years ago. Students want to get their courses as they get their music: go online, download what is needed and consume it on the go. They demand immediate access to their coursework regardless of time or place. Tomorrow s students may never actually miss a class because they will be able to watch it later on-demand with the added bonus of replaying the highlights if they need a refresher.

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

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

In addition, Mediasite is a featured technology in the Dell Intelligent Classroom, the foundation of Dell s academic computing solution. Mediasite is part of Dell s bundled suite of software, hardware and interactive

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technologies designed to create academic environments that aid collaboration and maximize student potential. With our inclusion under the Intelligent Classroom umbrella, institutions can purchase Mediasite along with other technology solutions through Dell s extensive network of industry leader partnerships. Our role in the Intelligent Classroom further benefits Sonic Foundry by extending to Mediasite the trust that the Dell brand inspires in its customers and prospects.

Mediasite in the enterprise: Less than a decade ago, the only people in the enterprise talking openly about online multimedia were technical specialists in AV, IT or media services units, and even these technical people were skeptical about what benefits streaming would hold for the enterprise. Now, knowledge workers and line of business managers, people in executive communications, training, sales, human resources, and research and development, are pushing for online multimedia communications because they have a business need to be seen and heard by their colleagues.

Claire Schooley, senior analyst with Forrester Research, Inc., writes in the January 2007 report. *Webcasting Grabs Corporate Attention*, The need for better, faster communications and learning opportunities will increase because of worker globalization and the desire to reach a broader customer base. Use webcasts to help your organization get its message out to a broad internal or external audience, increase revenue from new audiences, and control the costs of presentations, trainings, support, and travel. To be prepared, carry out the following: Develop the right content. Develop content that adapts well to the web and creates a compelling presentation. Don t forget content is still king; the technology is merely the delivery mechanism. Prepare for a mix of on-premise and services. Use a service vendor for the few large live external events your organization may conduct throughout the year, and look for on-premise technology support for employee webcasts and on-demand webcasts made available on your web sites. A new culture will embrace webcasts as an expected online resource. But a cultural change is happening quickly in the way information and knowledge is communicated. Within three years, webcasts will be an essential part of business productivity tools.

The Corporate Learning Factbook: Benchmarks and Analysis of U.S. Corporate Learning & Development, published by Bersin and Associates in May 2006, estimated that in 2006 US organizations spent $46.6 billion on training (including staff salaries), with $14.8 billion budgeted for external products and services. According to the publication, nearly 60% of training groups report using virtual classroom technologies, and approximately 40% report using application simulation and rapid e-learning tools.

While many enterprises begin their web communications with live events, the majority move to live and on-demand, or on-demand only, as their webcasting experience grows. With that move, they report a spike in comprehension, productivity, strategic alignment around business goals, even morale. We believe the feeling that the presenter is talking directly to the listener helps people feel more a part of the team and fosters more intimate communication between management and employees.

The Importance of Search

We believe search lies at the heart of efficient, web-based communication. Finding a specific document or phrase has become a necessary part of working and learning. Faced with thousands of hours of online streamed information, users could easily be overwhelmed with the need to find that one minute of content they require. Furthermore, organizations are not just going to need powerful tools to help workers internally find what they need, when they need it; leading businesses and education institutions will also want to be found by external audiences to help build their brands, customer base and reputation online.

Our growing presentation repositories are expected to drive further interest in deploying advanced search technology. Our work on search technology began back in the early 1990s through the initial efforts of Carnegie Mellon University and its Informedia project. Since then, we have continued to advance and commercialize the technology to its present state. In December 2005, Sonic Foundry launched Mediasite.com to showcase the public lectures, briefings and conference sessions of many education, government and corporate entities. Mediasite.com is the first search portal which aggregates publicly-available presentations of audio, video and graphic content, currently indexing over 12,000 public presentations containing over 9,000 hours of audio and over 260,000 presentation slides. Mediasite.com also serves as a beta testing environment for our new multi-modal search initiatives involving phonetic speech recognition, optical character recognition, language processing and contextual analysis to identify key words found within the graphics, audio and video of online multimedia presentations.

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In the last year, we added our first customers for multi-modal search. These customers comprise both existing Mediasite customers as well as organizations that want to leverage our search technology to index existing repositories of non-Mediasite video content.

Future Product Directions

Our ongoing engineering efforts center on expanding Mediasite s content intelligence, extensibility and scalability. Future Mediasite development is targeted toward:

Incorporating powerful, key-word searching within archived multimedia presentations and enhancing multimedia content navigation and personalization. Powering these solutions will be our in-house technologies for understanding and analyzing images, language and speech.

Evolving Mediasite s content management capabilities in order to provide services to organizations in managing their existing digital video libraries.

Integrating with other enterprise applications and allowing users to access Mediasite presentations from corporate portals, learning and course management systems and other content management repositories.

Supporting content playback experiences on additional platforms and popular portable computing devices.

Enhancing the scalability and performance of multimedia presentation recording, distribution and management in large and distributed implementations.

Further enabling Mediasite content to be accessible and meaningful to viewers with visual or hearing disabilities.

Providing Recorder hardware options that economically scale across large organizations.

Segment Information

We have determined that in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), we operate in only one segment as we do not disaggregate profit and loss information on a segment basis for internal management reporting purposes to our chief operating decision maker. Therefore, such information is not presented.

Total billings for Mediasite product and support outside the United States totaled 14%, 17% and 18% in 2007, 2006 and 2005, respectively.

Our largest individual customers are typically value added resellers (VARs) and distributors since the majority of our end users require additional products and services which we do not provide. Accordingly, in fiscal 2005 a VAR contributed 11% of total world-wide billings and in fiscal 2007 a master distributor, Synnex Corporation, contributed 46% of total world-wide billings. As a master distributor, Synnex fulfills transactions to VARs, end users and other distributors. No individual customer was over 10% in 2006.

Sales

We sell and market our offerings through a sales force that manages a reseller channel of value-added resellers, system integrators, consultants and distributors. These third party representatives have a unique specialization and understanding of both audio/video systems and IT networking. In fiscal 2007, we utilized one master distributor in the U.S. and over 100 resellers who demonstrated these qualifications and sold our products to nearly 700 total end users. Our focus has been primarily in the United States and primarily to customers we have identified as having the greatest potential for high use; that is, organizations with presenters, trainers, lecturers, marketers and leaders who have a routine need to communicate to many people in the higher education, government, health industry and certain corporate markets. Despite our primary attention on the North American market, reseller and customer interest outside of North America has grown and accordingly, we allocated five sales professionals to address international demand. To date, we have sold our products to customers in 33 countries outside the United States. Total billings for Mediasite product and support outside the United States totaled 14%, 17% and 18% in fiscal 2007, 2006 and 2005, respectively.

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Vertical market expansion: Currently, half our revenue is realized from the education and distance learning markets. Government and corporate markets lag education users in adoption of web communications, but revenue from corporate customers continue to increase at a rapid pace with an 88% increase in fiscal 2007 billings over fiscal 2006 billings. We believe each of our vertical markets will continue to grow and that ultimately, our corporate channel will narrow the gap with education and distance learning as market awareness of web presentation and conferencing solutions expand. Similarly, we are seeing expanded interest from associations, legal, medical, defense, engineering and marketing organizations and may use targeted programs to focus on such groups specifically to build new markets as others become more established.

Repeat orders: Most customers buy a single system, often a mobile unit, to test the full capability of the Mediasite system. Larger enterprises and facilities have followed up with multiple unit orders following a test of the capabilities of the system. For this reason, we have specifically targeted larger entities that have more than 500 employees and multiple offices and that have found service provider solutions in conferencing more costly. In fiscal 2007, 43% of billings were to preexisting customers compared to 42% in fiscal 2006 or 2005.

Renewals: As is typical in the industry, we offer annual support and maintenance service contract extensions for a fee to our customer base.

Marketing

Marketing efforts span the spectrum of reseller sales demonstrations, tradeshows, websites, webinars, brochures, direct mail, e-mail campaigns and newsletters, print and online advertising, sponsorships, white papers and analyst relations. We often request and receive press release quotes and written or multimedia testimonials from satisfied, high-profile reference customers, particularly those that demonstrate innovative and valuable uses of the Mediasite product. We solicit respected industry magazines and trade organizations to review our product and use advisors as introductions to new channels or customers. We have a large, growing database of potential customers in the education, government and corporate marketplaces and have established a selected process of targeting specific verticals that have a direct and demonstrated need for our offerings.

Operations

We contract with a third party to build the hardware of our Mediasite Recorder products and typically purchase quantities sufficient to fill specific customer orders, including purchases of inventory by resellers. Quantities are maintained in inventory by our third party provider and shipped directly to the end customer or reseller. The hardware manufacturer provides a limited one-year warranty on the hardware, which we pass on to our customers who purchase a SmartServe support and maintenance plan. We have an alternate source of manufacturing for some of the products we produce and believe there are numerous additional sources and alternatives to the existing production process. To date, we have not experienced any material difficulties or delays in the manufacture and assembly of our system products, or material returns due to product defects.

OTHER INFORMATION

Competition

The market for one-to-many multimedia web communication is relatively new, and we face competition from other companies that provide related digital media applications, such as Apple. Companies like WebEx (recently acquired by Cisco), Adobe, Microsoft and Citrix offer web conferencing applications. Although part of the overall online multimedia communications landscape, these solutions are designed primarily for collaborative communications versus one-to-many communications. Other vendors provide presentation authoring and capture capabilities, such as Accordent Technologies, Tegrity and Anystream, but we believe these companies currently lack the breadth or depth of content management capabilities required for online multimedia presentations in an enterprise-wide deployment. Current and potential customers may choose to develop their own home-grown web communications software and services which may compete with Mediasite. We may also compete indirectly with larger system integrators who embed or integrate competing technologies into their custom-built product offerings. It is possible that we may work with these larger integrators on one customer bid and compete with them on another.

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

- Ease of use and application transparency to the user
- Content management and scalability to address enterprise requirements
- Reliability and performance
- Security of content, applications and services
- Ability to integrate with third-party solutions and services
- Customer service and support
- A significant reference-able customer base
- Ability to introduce new products and services to the market in a timely manner
- Pricing

Intellectual Property

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

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

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

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

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Research and Development

We believe that our future success will depend in part on our ability to continue to develop new business, and to enhance our existing business. Accordingly, we invest a significant amount of our resources in research and development activities. During the fiscal years ended September 30, 2007, 2006 and 2005, we spent $3.1 million, $2.2 million and $1.8 million on internal research and development activities in our business. These amounts represent 19%, 18% and 22% of total revenue in each of those years.

Employees

As of September 30, 2007, 2006 and 2005, we had 108, 72, and 54 full-time employees, respectively. Our employees are not represented by a labor union, nor are they subject to a collective bargaining agreement. We have never experienced a work stoppage and believe that our employee relations are satisfactory.

ITEM 1A. RISK FACTORS

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

We may need to raise additional capital if we do not quickly become profitable.

Based on our cash balance at September 30, 2007 of $8.0 million and our expectation that we ll begin generating positive cash from operations in fiscal 2008, we anticipate having sufficient cash resources for at least the next twelve months. Despite our belief that we have sufficient cash to fund operations in 2008, we may decide to raise additional cash from the sale of new shares of common stock or issuance of debt in 2008. The business environment may not be conducive to raising additional debt or equity financing. If we borrow money, we may incur significant interest charges, which could harm our profitability. Holders of debt would also have rights, preferences or privileges senior to those of existing holders of our common stock. If we raise additional equity, the terms of such financing may dilute the ownership interests of current investors and cause our stock price to fall significantly. We may not be able to secure financing upon acceptable terms, if at all. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, which could seriously harm our business, operating results, and financial condition

***We have a history of losses*.**

For the year ended September 30, 2007, we had a gross margin of $12.6 million on revenue of $16.7 million with which to cover selling, marketing, product development and general administrative costs. Our selling, marketing, product development and general administration costs have historically been a significant percentage of our revenue, due partly to the expense of developing leads and the relatively long period required to convert leads into sales associated with selling products that are not yet considered mainstream technology investments. For the year ended September 30, 2007, our operating expenses exceeded our gross margin by 52%. Although we expect our operating losses as a percentage of revenue to continue to decline during fiscal 2008, we may never achieve profitability.

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

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

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

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

Multiple unit sales may fail to materialize.

We need to sell multiple units to educational, corporate and government institutions in order to sell most efficiently and become profitable. In fiscal 2007, 43% of recorder revenue were to existing customers compared to 42% in fiscal 2006. At September 30, 2007, 286 customers had purchased multiple units compared to 210 customers at September 30, 2006. In particular, selling multiple units to corporate customers has lagged results achieved in the higher education market, consequently, we have allocated more resources to the higher education market. While we have addressed a strategy to leverage existing customers and close multiple unit transactions, a customer may choose not to make expected purchases of our products. The failure of our customers to make expected purchases will harm our business.

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

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

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

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

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

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

Sales of some of our products have experienced seasonal fluctuations which have affected sequential growth rates for these products, particularly in our first fiscal quarter. For example, there is generally a slowdown for sales of our products in the higher education and corporate markets in the first fiscal quarter of each year. Seasonal fluctuations could negatively affect our business, which could cause our operating results to fall short of anticipated results for such quarters.

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

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

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

Increased variability in performance associated with the timing of large transactions and fluctuations in the mix of billings to include more services as a percentage of total billings in fiscal 2007 caused us to reevaluate the providing of financial guidance at that time. The lack of Company provided guidance makes it more difficult for analysts to reasonably predict expected results yet our stock price may decline if we fail to achieve their expectations.

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

We sell a significant amount of our products to VARs, distributors and other channel partners who maintain their own inventory of our products for sale to dealers and end-users. If these channel partners are unable to sell an adequate amount of their inventory of our products in a given quarter to dealers and end-users or if channel partners decide to decrease their inventories for any reason, such as a recurrence of global economic uncertainty and downturn in technology spending, the volume of our sales to these channel partners and our revenue would be

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negatively affected. In addition, if channel partners decide to purchase more inventory, due to product availability or other reasons, than is required to satisfy end-user demand or if end-user demand does not keep pace with the additional inventory purchases, channel inventory could grow in any particular quarter, which could adversely affect product revenue in the subsequent quarter. In addition, we also face the risk that some of our channel partners have inventory levels in excess of future anticipated sales. If such sales do not occur in the time frame anticipated by these channel partners for any reason, these channel partners may substantially decrease the amount of product they order from us in subsequent periods, which would harm our business.

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

A significant portion of our sales are fulfilled by VARs, regional distributors or master distributors. As an example, 46% of our billings in 2007 were to Synnex, a master distributor who fulfills demand from other distributors, VARs or end users. While our distributors and VARs typically maintain payment terms consistent with other end users, a delay in payment may occur as a result of a number of factors including changes in demand, general economic factors, financial performance, inventory levels or disputes over payments. Any delay from Synnex, or other large distributors or VARs could have a material impact on the collections of our receivables during a particular quarter.

Over the past year we ve begun to expand the level of sales representation in Europe and Asia as well as other international regions. We offer credit terms to some of our international customers; however, payments tend to go beyond terms in certain countries. Therefore, as Europe, Asia and other international regions grow as a percentage of our revenue, accounts receivable balances will likely increase as compared to previous years.

We are required to delay revenue recognition into future periods for portions of our products and services.

Our entire worldwide business is subject to United States generally accepted accounting principles, commonly referred to as U.S. GAAP. Under those rules, we are required to defer revenue recognition in certain situations. Factors that are considered in revenue recognition include those such as vendor specific objective evidence (VSOE), products under development, the inclusion of other services and contingencies to payment terms.

We expect that we will continue to defer portions of our service contract billings because of these factors. The amount of license fees deferred may be significant and will vary each quarter depending on the mix of products sold in each market and geography, as well as the actual contract terms.

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

The market for one-to-many multimedia web communication is relatively new, and we face competition from other companies that provide related digital media applications, such as Apple. Companies like WebEx, Microsoft and Citrix offer web conferencing applications. Although part of the overall web communications landscape, these solutions are designed primarily for smaller group collaborative communications versus one-to-many communications. Adobe, Accordent Technologies, Tegrity, Anystream and other vendors provide presentation authoring and capture capabilities, but currently we believe they lack the breadth or depth of content management capabilities required for online multimedia presentations in an enterprise-wide deployment. Current and potential customers may choose to develop their own home-grown web communications software and services which may compete with Mediasite. We may also compete indirectly with larger system integrators who embed or integrate competing technologies into their custom-built product offerings. If one of these alternative approaches is received more favorably in the marketplace, a new approach or technology is developed or an existing or new competitor markets more effectively than we do or we otherwise do not compete effectively, our business will be harmed. In addition, the more successful we are in the emerging markets our products address, the more competitors are likely to emerge, including turnkey media application, streaming media platform developers, digital music infrastructure providers, and digital media applications service providers (including for digital musical subscription). Many of our competitors have far greater financial resources than we do, and could easily overtake the marketplace and severely harm our business. We may also face competition from foreign suppliers and competition from Course Management Systems (CMS) or education information technology (IT) companies.

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The presence of these competitors could reduce the demand for our systems, and we may not have the financial resources to compete successfully.

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

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

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

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

- Damage our reputation;
- Cause our customers to initiate product liability suits against us;
- Increase our product development resources;
- Cause us to lose sales; and
- Delay market acceptance of our products.

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

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

Our success depends upon the proprietary aspects of our technology.

Our success and ability to compete depend to a significant degree upon the protection of our proprietary technology. We currently have two U.S. patents that have been issued to us and seven U.S. patent applications that are pending. We may seek additional patents in the future. Our current patent applications cover different aspects of the technology used in our products which is important to our ability to compete. However, it is possible that:

- our pending patent applications may not result in the issuance of patents;
- any patents acquired by or issued to us may not be broad enough to protect us;
- any issued patent could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in those patents;
- current and future competitors may independently develop similar technology, duplicate our services or design around any of our patents; and
- effective patent protection, including effective legal-enforcement mechanisms against those who violate our patent-related assets, may not be available in every country in which we do or plan to do business.

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We also rely upon trademarks, copyrights and trade secrets to protect our technology, which may not be sufficient to protect our intellectual property.

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

- third parties may infringe or misappropriate our copyrights, trademarks and similar proprietary rights;
- laws and contractual restrictions may not be sufficient to prevent misappropriation of our technology or to deter others from developing similar technologies;
- effective trademark, copyright and trade secret protection, including effective legal-enforcement mechanisms against those who violate our trademark, copyright or trade secret assets, may be unavailable or limited in foreign countries;
- other companies may claim common law trademark rights based upon state or foreign laws that precede the federal registration of our marks; and
- policing unauthorized use of our services and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the extent of any unauthorized use.

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

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

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

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

Our future success depends upon the continued service of our key management, technical, sales, and other critical personnel. Certain of our officers and certain of our other key personnel are employees-at-will, and we cannot assure that we will be able to retain them. Key personnel have left our company in the past and there likely will be additional departures of key personnel from time to time in the future. The loss of any key employee could result in significant disruptions to our operations, including adversely affecting the timeliness of product releases, the successful implementation and completion of company initiatives, and the results of our operations. In particular, the loss of the services of our

Chief Executive Officer, Rimas Buinevicius, or our co-founder and Chief Technology Officer, Monty Schmidt, would harm our business. Although we do have employment agreements with Messrs. Buinevicius and Schmidt, we do not have life insurance policies on any of our key employees. In addition, the integration of replacement personnel could be time consuming, may cause disruptions to our operations, and may be unsuccessful.

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

International product and service revenue ranged from 14% to 18% of our total billings in each of the past three years. Our international operations are expected to continue to account for a significant portion of our business in the future. However, in the future we may be unable to maintain or increase international sales of our products and services. International sales are subject to a variety of risks, including:

- difficulties in establishing and managing international distribution channels;
- difficulties in selling, servicing and supporting overseas products and in translating products into foreign languages;
- the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property;
- multiple and possibly overlapping tax structures;
- currency and exchange rate fluctuations; and
- economic or political changes in international markets.

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

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

The price of our stock has been volatile and we could be delisted from the Nasdaq Global Market.

Our common stock price, like that of many companies in the Internet industry, has been and may continue to be extremely volatile, and there is a risk we could be delisted from the Nasdaq Global Market. The market price of our common stock has been and may continue to be subject to significant fluctuations as a result of variations in our quarterly operating results and volatility in the financial markets. Our results may fail to meet analysts revenue or earnings estimates or we may lower or withdraw our own guidance. Our stock has traded below $1.00 on multiple occasions, including during fiscals 2006 and 2003, and we received in the past notices from the Nasdaq Global Market that we needed to comply with the requirements for continued listing on the Nasdaq Global Market or be delisted, although we demonstrated compliance and the hearing file was closed. If our stock trades below $1.00 for 30 consecutive business days, we may receive another notice from the Nasdaq Global Market that we need to comply with the requirements for continued listing on the Nasdaq Global Market within 90 calendar days from such notification or be delisted. If our stock is delisted from the Nasdaq Global Market, an investor could find it more difficult to dispose of, or to obtain accurate quotations as to the market value of, our common stock. Additionally, our stock may be subject to penny stock regulations if it delisted from the Nasdaq Global Market. If our common stock were subject to penny stock regulations, which apply to certain equity securities not traded on the Nasdaq Global Market which have a market price of less than $5.00 per share, subject to limited exceptions, additional disclosure would be required by broker-dealers in connection with any trades involving such stock.

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

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

At September 30, 2007, we had 559 thousand of outstanding warrants and 4.7 million of outstanding stock options granted under our 1995 Employee Stock Option Plan, our 1999 Non-Qualified Stock Option Plan and our Non-Employee Director Stock Option Plan, 4.2 million of which are immediately exercisable.

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

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

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

Our corporate compliance program cannot guarantee that we are in compliance with all potentially applicable regulations.

As a publicly traded company we are subject to significant regulations, including the Sarbanes-Oxley Act of 2002. While we have developed and instituted a corporate compliance program based on what we believe are the current best practices and continue to update the program in response to newly implemented regulatory requirements and guidance, we cannot assure that we are or will be in compliance with all potentially applicable regulations. Because our non-affiliate market capitalization was greater than $75 million at March 31, 2007, we are now required to be fully compliant with both the management assessment and auditor attestation as of September 30, 2007. We cannot assure that in the future our management will not find a material weakness in connection with its annual review of our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act. We also cannot assure that we could correct any such weakness to allow our management to assess the effectiveness of our internal control over financial reporting as of the end of our fiscal year in time to enable our independent registered public accounting firm to attest that such assessment will have been fairly stated in our Annual Report on Form 10-K to be filed with the Securities and Exchange Commission or attest that we have maintained effective internal control over financial reporting as of the end of our fiscal year. If we fail to comply with any of these regulations, we could be subject to a range of regulatory actions, fines, or other sanctions or litigation. In addition, if we must disclose any material weakness in our internal control over financial reporting, this may cause our stock price to decline.

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

Our principal office is located in Madison, Wisconsin in a leased facility of approximately 19,000 square feet. The building serves as our corporate headquarters, accommodating our general and administrative, product development and selling and marketing departments. We believe this facility is adequate and suitable for our needs. The current lease term for this office expires on October 1, 2011. In addition, we lease 2,500 square feet in a building in downtown Pittsburgh, Pennsylvania through January 31, 2010.

ITEM 3. LEGAL PROCEEDINGS

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter ended September 30, 2007.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock was initially traded on the American Stock Exchange under the symbol SFO, beginning with our initial public offering in April of 1998. On April 24, 2000, our common stock began trading on the Nasdaq Global Market under the symbol SOFO. The following table sets forth, for the periods indicated, the high and low sale prices per share of our common stock as reported on the Nasdaq Global Market.

	High	Low
Year Ended September 30, 2008:		
First Quarter (through November 26, 2007)	$ 2.84	$ 1.78
Year Ended September 30, 2007:		
First Quarter	5.15	2.24
Second Quarter	4.77	3.46
Third Quarter	4.08	2.02
Fourth Quarter	2.85	1.61
Year Ended September 30, 2006:		
First Quarter	1.34	0.98
Second Quarter	2.08	0.86
Third Quarter	2.50	1.57
Fourth Quarter	2.36	1.63

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

At November 26, 2007 there were 478 common stockholders of record and approximately 10,000 total shareholders. Many shares are held by brokers and other institutions on behalf of shareholders.

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Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance
	(a)	(b)	(c)
Equity compensation plans approved by security holders (1)	2,952,179	$ 3.11	2,260,316
Equity compensation plans not approved by security holders (2)	1,760,143	1.22	725,492
Total	4,712,322	$ 2.41	2,985,808

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

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

The graph below compares the cumulative total stockholder return on our common stock from September 30, 2002 through and including September 30, 2007 with the cumulative total return on The Nasdaq Stock Market (US only) and the RDG Technology Composite. The graph assumes that $100 was invested in our common stock on September 30, 2002 for each of the indexes and that all dividends were reinvested. Unless otherwise specified, all dates refer to the last day of each month presented. The comparisons in the graph below are based on historical data, with our common stock prices based on the closing price on the dates indicated, and are not intended to forecast the possible future performance of our common stock.

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(A) RECENT SALES OF UNREGISTERED SECURITIES
None

(B) USE OF PROCEEDS FROM REGISTERED SECURITIES
None

(C) ISSUER PURCHASES OF EQUITY SECURITIES
None

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The selected financial and operating data were derived from our consolidated financial statements. The selected financial data set forth below is qualified in its entirety by, and should be read in conjunction with, Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and notes thereto appearing elsewhere in this annual report on Form 10-K (in thousands except per share data).

	Years Ended September 30,				
	2007	**2006**	**2005**	**2004**	**2003**
Statement of Operations Data:					
Revenue	$ 16,737	$ 12,564	$ 8,342	$ 4,413	$ 1,264
Gross margin	12,604	9,349	5,588	2,654	376
Loss from operations	(6,618)	(3,560)	(4,356)	(5,607)	(7,530)
Loss from continuing operations	(6,370)	(3,483)	(4,169)	(5,508)	(7,549)
Loss from operations of discontinued operations					(2,930)
Gain on disposal of discontinued operations				132	11,932
Net income (loss)	(6,370)	(3,483)	(4,169)	(5,376)	1,453
Income (loss) per common share:					
Continuing operations	$ (0.18)	$ (0.11)	$ (0.14)	$ (0.18)	$ (0.27)
Discontinued operations					0.32
Basic net income (loss) per common share	$ (0.18)	$ (0.11)	$ (0.14)	$ (0.18)	$ 0.05
Diluted net income (loss) per common share	$ (0.18)	$ (0.11)	$ (0.14)	$ (0.18)	$ 0.05
Weighted average common shares: Basic	34,688	32,015	30,363	29,457	27,794
Diluted	34,688	32,015	30,363	29,457	28,375

	2007	**2006**	**2005**	**2004**	**2003**
Balance Sheet Data at September 30:					
Cash and cash equivalents	$ 8,008	$ 2,751	$ 4,271	$ 7,583	$ 12,623
Working capital	7,940	2,198	4,205	7,560	11,025
Total assets	23,981	16,912	16,245	18,631	22,801
Long-term liabilities	973	519	49		
Stockholders equity	16,760	11,601	13,121	16,566	20,231

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

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

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

Overview

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

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 and allowance for doubtful accounts;

Impairment of long-lived assets;