SONIC FOUNDRY INC
Form 10-Q
February 13, 2014
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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 December 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 February 6, 2014
Common Stock, $0.01 par value	4,232,300

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Item 1

Sonic Foundry, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except for share data)

(Unaudited)

	December 31, 2013	September 30, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 3,097	$ 3,482
Accounts receivable, net of allowances of $90	6,817	6,885
Inventories	1,592	1,447
Prepaid expenses and other current assets	1,443	805
Total current assets	12,949	12,619
Property and equipment:		
Leasehold improvements	852	852
Computer equipment	5,459	5,296
Furniture and fixtures	583	581
Total property and equipment	6,894	6,729
Less accumulated depreciation and amortization	3,744	3,449
Net property and equipment	3,150	3,280
Other assets:		
Goodwill	7,576	7,576
Investment in Mediasite KK	408	385
Software development costs, net of amortization of $119 and $75	414	458
Acquired goodwill and other intangible assets of MediaMission	1,293	
Other intangibles, net of amortization of $140 and $135	10	15
Total assets	$ 25,800	$ 24,333
Liabilities and stockholders equity		
Current liabilities:		
Revolving line of credit	$	$
Accounts payable	1,697	1,513
Accrued liabilities	2,143	1,204
Unearned revenue	6,143	6,470
Current portion of subordinated notes payable	229	
Current portion of capital lease obligation	158	223
Current portion of notes payable to bank	600	634

Total current liabilities		10,970		10,044
Long-term portion of unearned revenue		842		648
Long-term portion of subordinated note payable		458		
Long-term portion of capital lease obligation		160		149
Long-term portion of notes payable to bank				133
Leasehold improvement liability		423		445
Deferred tax liability		2,270		2,210
Total liabilities		15,123		13,629
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; 4,042,066 and 3,999,634 shares issued and 4,029,350 and 3,986,918 shares outstanding		40		40
Additional paid-in capital		191,317		190,653
Accumulated deficit		(180,246)		(179,556)
Accumulated other comprehensive loss		(239)		(238)
Receivable for common stock issued		(26)		(26)
Treasury stock, at cost, 12,716 shares		(169)		(169)
Total stockholders equity		10,677		10,704
Total liabilities and stockholders equity	$	25,800	$	24,333

See accompanying notes to the condensed consolidated financial statements

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Sonic Foundry, Inc.

Condensed Consolidated Statements of Operations

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

(Unaudited)

	Three Months Ended December 31, 2013	Three Months Ended December 31, 2012
Revenue:		
Product	$ 2,812	$ 2,841
Services	4,316	3,640
Other	78	71
Total revenue	7,206	6,552
Cost of revenue:		
Product	1,353	1,314
Services	457	371
Total cost of revenue	1,810	1,685
Gross margin	5,396	4,867
Operating expenses:		
Selling and marketing	3,376	3,007
General and administrative	960	815
Product development	1,236	1,176
Acquisition costs	450	
Total operating expenses	6,022	4,998
Loss from operations	(626)	(131)
Equity in earnings from investment in Mediasite KK	23	78
Other expense, net	(17)	(26)
Loss before income taxes	(620)	(79)
Provision for income taxes	(70)	(60)
Net loss	$ (690)	$ (139)
Net loss per common share:		
basic	$ (0.17)	$ (0.04)
diluted	$ (0.17)	$ (0.04)

Weighted average common shares		
basic	3,995,321	3,897,880
diluted	3,995,321	3,897,880

See accompanying notes to the condensed consolidated financial statements

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Sonic Foundry, Inc.

Consolidated Statements of Comprehensive Loss

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

(Unaudited)

	Three Months Ended December 31, 2013	2012
Net loss	$ (690)	$ (139)
Other comprehensive loss, net of taxes:		
Foreign currency translation adjustment	(1)	
Total other comprehensive loss	(1)	
Comprehensive loss	$ (691)	$ (139)

See accompanying notes to the condensed consolidated financial statements

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Sonic Foundry, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Three months ended December 31, 2013	2012
Operating activities		
Net loss	$ (690)	$ (139)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in earnings from investment in Mediasite KK	(23)	(78)
Amortization of other intangibles	5	5
Amortization of software development costs	44	
Depreciation and amortization of property and equipment	296	252
Deferred taxes	70	60
Stock-based compensation expense related to stock options	282	182
Changes in operating assets and liabilities:		
Accounts receivable	266	262
Inventories	(79)	(190)
Prepaid expenses and other current assets	(86)	(180)
Accounts payable and accrued liabilities	174	(351)
Other long-term liabilities	(22)	(22)
Unearned revenue	(199)	323
Net cash provided by operating activities	38	124
Investing activities		
Purchases of property and equipment	(117)	(143)
Cash paid for MediaMission acquisition, net of cash acquired	(119)	
Net cash used in investing activities	(236)	(143)
Financing activities		
Proceeds from notes payable		
Payments on notes payable	(167)	(166)
Proceeds from exercise of common stock options	35	28
Payments on capital lease obligations	(55)	(35)
Net cash used in financing activities	(187)	(173)
Net decrease in cash and cash equivalents	(385)	(192)
Cash and cash equivalents at beginning of period	3,482	4,478
Cash and cash equivalents at end of period	$ 3,097	$ 4,286

Non-cash transactions:		
Property and equipment financed by accounts payable, accrued liabilities or capital lease	$	$ 88
Comprehensive loss attributable to equity method investment in MSKK	(1)	
Subordinated note payable issuance for purchase of MediaMission	687	
Common stock issued for purchase of MediaMission	348	

See accompanying notes to the condensed consolidated financial statements

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Sonic Foundry, Inc.

Notes to Condensed Consolidated Financial Statements

December 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. Operating results for the three month period ended December 31, 2013 are not necessarily indicative of the results that might be expected for the year ending September 30, 2014.

The condensed consolidated balance sheet at September 30, 2013 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, 2013.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Sonic Foundry Media Systems, Inc. and MediaMission B.V. All significant intercompany transactions and balances have been eliminated.

Under the equity method of accounting, the Company s investment in unconsolidated affiliates are initially recorded as an investment in the stock of an investee at cost and are adjusted on a quarterly basis for the carrying amount of the investment to recognize the investor s share of changes in the net assets of the investee after the date of the initial investment.

Revenue Recognition

General

Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured. Revenue is deferred when undelivered products or services are essential to the functionality of delivered products, customer acceptance is uncertain, significant obligations remain, or the fair value of undelivered elements is unknown. The Company does not offer customers the right to return product, other than for exchange or repair pursuant to a warranty or stock rotation. The

Company s policy is to reduce revenue if it incurs an obligation for price rebates or other such programs during the period the obligation is reasonably estimated to occur. The following policies apply to the Company s major categories of revenue transactions.

Products

Products are considered delivered, and revenue is recognized, when title and risk of loss have been transferred to the customer. Under the terms and conditions of the sale, this occurs at the time of shipment to the customer. Product revenue currently represents sales of our Mediasite recorder and Mediasite related products such as our server software and other software licenses. If a license is time-based, the revenue is recognized over the term of the license agreement.

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Services

The Company sells support and content hosting contracts to our 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 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 manufacturers the Company contracts with to build the units provide 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.

Revenue Arrangements that Include Multiple Elements

Sales of software, with or without installation, training, and post customer support fall within the scope of the software revenue recognition rules. 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.

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 is accounted for under the revenue recognition rules for tangible products whereby 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.

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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 transactions, 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 $90,000 at December 31, 2013 and at September 30, 2013.

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.