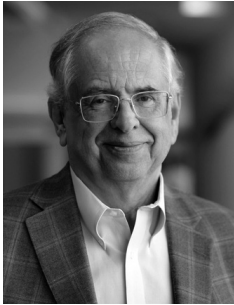


# Annual Report 2014

Sonic Foundry Annual Report 2014







## Dear Fellow Shareholders:

When Mediasite arrived in classrooms, training rooms and boardrooms more than a decade ago, it changed the business of education and communication. It did so by not only putting knowledge within reach of anyone with an internet connection, but also transformed it into searchable, indexed and secure living libraries. We predicted there would be a growing need to capture and manage vast amounts of rich video and make it easily discoverable in a time when very few people were using digital video.

I was excited when I took the helm to lead the team developing the next generation of Mediasite, our market-leading, award-winning video capture and management solution. The team has exceeded the company's development objectives, and has succeeded in producing the best solution in the world for video capture and management.

If our history in this market has taught us anything, it is that our greatest strength is the ability to scale our technology to meet the customers' needs. We also learned that implementation of large and complex solutions happens on the customers' schedules – not ours. This requires us to think and plan in terms of not only quarters, but also years.

The proliferation of digital video we predicted 10 years ago is now here. Deployments are larger, more complex and more strategic than ever, and as a result our customers are looking for us to lend our expertise even more to their video initiatives. We continue to lead the charge as the market-leading solution, dominating in lecture capture and in the other applications we serve.

### Several key milestones in 2014 shore up that claim:

- The world watched as Mediasite went live in 250 classrooms at University of Leeds in the United Kingdom, making it the largest fully-automated lecture capture deployment in the world today. Over the course of just the first four months, the university recorded more than 16,400 lectures with Mediasite that were viewed, in aggregate, more than 250,000 times. In preparation for their final exams, students were consuming video content in Mediasite at a rate of 35,000 views per week. As a result of their vast early success, University of Leeds has now paved the way for other prestigious institutions to invest in Mediasite.
- New York University, seeking consistency and reliability across their professional schools, invested in Mediasite Cloud for their U.S. campus, and standardized on Mediasite as their global video capture and management solution for their U.S. and Abu Dhabi campuses.
- Mediasite Events grew 28% year-over-year. Our turnkey capture and streaming services were selected for more than 700 events in 2014, showing a trend of increasing scale and complexity. One example is Dreamforce, the Salesforce.com global user conference in San Francisco, where our team captured 1,451 sessions from 72 rooms across 6 different properties in just four days.

- We laid the groundwork for one of the largest deployments in the Middle East, the benefits of which we expect to come to fruition in the second quarter of fiscal 2015.
- Our acquisitions of MediaMission B.V. in the Netherlands and Mediasite K.K. in Japan gave us a foothold to leverage global growth trends in enterprise video, expand our key markets, and work toward entering new geographies such as China, India and Latin America.
- Sonic Foundry continues to receive analyst accolades. The company was named the Global Lecture Capture Leader by Frost & Sullivan for the seventh straight year; a leader in the Aragon Research Globe for Video Content Management; a leader in Forrester's Enterprise Video Platform and Webcasting Waves; and a challenger in Gartner's Magic Quadrant for Enterprise Video Content Management.

These accomplishments were achieved in spite of the realities that we, and our customers, face: a shortage of construction labor delaying expected projects in Japan, significant fluctuations in currency conversion rates, and the uncertainty of timing surrounding large global deals tied directly to massive infrastructure projects. We can confidently say that we continue to operate from a balanced position of customer loyalty and strength of product offerings.

Our customers continue to reinvest in our vision, and therefore in our products. We continue to expand the capabilities of our award-winning Mediasite Enterprise Video Platform with the most control and flexibility to capture, create, upload, edit and publish rich video from any environment or device... to any environment or device.

In the year ahead our innovations and new initiatives will accelerate long-term revenue growth by:

- Seizing opportunities to introduce new capture and collaboration tools that meet the needs of an increasingly connected world.
- Continuing to pave the way for the most expansive, streamlined and flexible deployment options with enhanced cloud offerings and advanced integration services.
- Boldly expanding into new markets by leveraging our new partnerships and comprehensive product offerings.

As we look to the remainder of this year, I'm confident we're taking the right steps to meet our guidance for 2015 – billings of \$45 million, adjusted EBITDA of between \$4.5 and \$5.5 million, and net income of between \$1 million and \$2 million – and position the company for improved operational, sales and financial performance over time. It's a pleasure leading this organization and I believe we're on a sure path to improving shareholder value in 2015 and beyond.

Sincerely,

Gary Weis  
Chief Executive Officer



SONIC FOUNDRY, INC.  
222 West Washington Avenue  
Madison, Wisconsin 53703

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
To Be Held March 5, 2015**

The Annual Meeting of Stockholders of **SONIC FOUNDRY, INC.**, a Maryland corporation (“Sonic”) will be held at the Monona Terrace Community and Convention Center, One John Nolen Drive, Madison, Wisconsin 53703 on March 5, 2015 at 9:00 a.m. local time, for the following purposes:

1. To elect one director to hold office for a term of five years, and until his successor is duly elected and qualified.
2. To ratify the appointment of Baker Tilly Virchow Krause LLP as our independent auditors for the fiscal year ending September 30, 2015.
3. To transact such other business as may properly come before the meeting or any adjournments thereof.

All the above matters are more fully described in the accompanying Proxy Statement.

Only holders of record of Common Stock at the close of business on January 9, 2015 are entitled to notice of, and to vote at, this meeting or any adjournment or adjournments thereof.

Please complete and return the enclosed proxy in the envelope provided or follow the instructions on the proxy card to authorize a proxy by telephone or over the Internet, **whether or not** you intend to be present at the meeting in person.

By Order of the Board of Directors,

Kenneth A. Minor  
Secretary

Madison, Wisconsin  
January 27, 2015

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**If you cannot personally attend the meeting, it is earnestly requested that you promptly indicate your vote on the issues included on the enclosed proxy and date, sign and mail it in the enclosed self-addressed envelope, which requires no postage if mailed in the United States or, follow the instructions on the proxy card to authorize a proxy by telephone or over the Internet. Doing so will save us the expense of further mailings. If you sign and return your proxy card without marking choices, your shares will be voted in accordance with the recommendations of the Board of Directors.**

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**SONIC FOUNDRY, INC.  
222 W. Washington Avenue  
Madison, Wisconsin 53703**

January 27, 2015

**PROXY STATEMENT**

The Board of Directors of Sonic Foundry, Inc., a Maryland corporation ("Sonic"), hereby solicits the enclosed proxy. Unless instructed to the contrary on the proxy, it is the intention of the persons named in the proxy to vote the proxies:

**FOR** the election of Mark D. Burish for a term expiring in 2020;

**FOR** the ratification of the appointment of Baker Tilly Virchow Krause LLP as independent auditors of Sonic for the fiscal year ending September 30, 2015.

In the event that the nominee for director becomes unavailable to serve, which management does not expect, the persons named in the proxy reserve full discretion to vote for any other persons who may be nominated. Proxies may also be authorized by telephone or over the Internet by following the instructions on the proxy card. Any stockholder giving a proxy may revoke it at any time prior to the voting of such proxy. This Proxy Statement and the accompanying proxy are being mailed on or about February 2, 2015.

Each stockholder will be entitled to one vote for each share of Common Stock standing in his or her name on our books at the close of business on January 9, 2015 (the "Record Date"). Only holders of issued and outstanding shares of Sonic's common stock as of the close of business on the Record Date are entitled to notice of and to vote at the Annual Meeting, including any adjournment or postponement thereof. On that date, we had outstanding and entitled to vote 4,347,303 shares of Common Stock, held by approximately 4,800 stockholders, of which approximately 200 were held in street name.

**QUORUM; VOTES REQUIRED**

Votes cast by proxy or in person at the Annual Meeting will be tabulated by the inspector of elections appointed for the Annual Meeting and will determine whether or not a quorum is present. Where, as to any matter submitted to the stockholders for a vote, proxies are marked as abstentions (or stockholders appear in person but abstain from voting), such abstentions will be treated as shares that are present and entitled to vote for purposes of determining the presence of a quorum, but will not be treated as present and entitled to vote for any other purpose. If a broker indicates on the proxy that it does not have discretionary authority as to certain shares to vote on a particular matter and has not received instructions from the beneficial owner, which is known as a broker non-vote, such shares will also be considered present for purposes of a quorum, provided that the broker exercises discretionary authority on any other matter in the Proxy. A majority of the shares of Common Stock issued, outstanding and entitled to vote at the Annual Meeting, present in person or represented by proxy, shall constitute a quorum at the Annual Meeting. The election of the Director requires a plurality of the votes present and entitled to vote. Therefore, the director who receives the highest vote total will be elected. Neither an abstention nor a withheld vote will affect the outcome of the election. The ratification of the appointment of Baker Tilly Virchow Krause LLP requires the affirmative vote of the holders of a majority of the votes cast at the Annual Meeting. If you abstain or withhold your vote on this proposal, it will have no effect on the outcome of the proposal.

The New York Stock Exchange ("NYSE") has rules that govern brokers who have record ownership of listed company stock held in brokerage accounts for their clients who beneficially own the shares. Under these rules, brokers who do not receive voting instructions from their clients have the discretion to vote uninstructed shares on certain discretionary matters but do not have discretion to vote uninstructed shares as to certain other non-discretionary matters. A broker may return a proxy card on behalf of a beneficial owner from whom the broker has not received instructions that casts a vote with regard to discretionary matters but expressly states that the broker is not voting as to non-discretionary matters. The broker's inability to vote with respect to the non-discretionary matters with respect to which the broker has not received instructions from the beneficial owner is referred to as a

"broker non-vote". Under current NYSE interpretations, the proposal to ratify the appointment of Baker Tilly Virchow Krause, LLP as our independent auditor is considered a discretionary matter.

#### DATE, TIME AND PLACE OF ANNUAL MEETING

The Annual Meeting will be held on March 5, 2015 at 9:00 a.m. (Central time) at the Monona Terrace Community and Convention Center, One John Nolen Drive, Madison, Wisconsin 53703.

#### **PROPOSAL ONE: ELECTION OF DIRECTOR**

Our Amended and Restated Articles of Incorporation and Bylaws provide that the Board of Directors shall be divided into five classes, with each class having a five-year term. Directors are assigned to each class in accordance with a resolution or resolutions adopted by the Board of Directors. Vacancies on the Board of Directors resulting from death, resignation, disqualification, removal or other causes may be filled by either the affirmative vote of the holders of a majority of the then-outstanding shares or by the affirmative vote of a majority of the remaining directors then in office, even if less than a quorum of the Board of the Directors. Newly created directorships resulting from any increase in the number of directors may, unless the Board of Directors determines otherwise, be filled only by a majority vote of the entire Board of Directors. A director elected by the Board of Directors to fill a vacancy (including a vacancy created by an increase in the number of directors) shall serve until the next annual meeting of stockholders or until such director's successor is elected and qualified.

Our Amended and Restated Articles of Incorporation provide that the number of directors, which shall constitute the whole Board of Directors, shall be not be less than three or more than twelve. Following the death of Michael Janowiak in August 2014, we reduced the currently authorized number of directors from seven to six, and we re-designated the director classification of Brian T. Wiegand from a Class V Director, whose term would have expired in 2018, to a Class IV Director, whose term expires in 2017. The seat on the Board of Directors currently held by Mark D. Burish is designated as a Class II Board seat, with term expiring as of the Annual Meeting. The Board of Directors has nominated Mark D. Burish as Class II Director for election at the Annual Meeting.

If elected at the Annual Meeting, Mr. Burish would serve until the 2020 Annual Meeting and until his successor is elected and qualified or until his earlier death, resignation or removal.

#### **Nominee for Director for a Five-Year term expiring on the 2020 Annual Meeting**

##### **Mark D. Burish**

Mr. Burish, age 61, has been a director since March 2010 and has served as Non-Executive Chair since April 2011. Mr. Burish is a shareholder of the law firm of Hurley, Burish & Stanton, Madison, WI, which he helped start in 1983. He is the founder and CEO of Our House Senior Living, LLC, Milestone Senior Living, LLC and Milestone Management Services, LLC which he started in 1997. Mr. Burish received his BA degree in communications from Marquette University in 1975 and his JD degree from the University of Wisconsin in 1978.

**The members of the Board of Directors unanimously recommend a vote FOR the election of Mr. Burish as Class II Director.**



## DIRECTORS CONTINUING IN OFFICE

### **Frederick H. Kopko, Jr.**

**Term Expires in 2016  
(Class III Director)**

Frederick H. Kopko, age 59, served as Sonic Foundry's Secretary from April 1997 to February 2001 and has been a Director since December 1995. Mr. Kopko is a partner of the law firm of McBreen & Kopko, Chicago, Illinois, and has been a partner of that firm since January 1990. Mr. Kopko practices in the area of corporate law. He is the Managing Director, Neltjeberg Bay Enterprises LLC, a merchant banking and business consulting firm and has been a Director of Mercury Air Group, Inc. since 1992. Mr. Kopko received a B.A. degree in Economics from the University of Connecticut, a J.D. degree from the University of Notre Dame Law School and an M.B.A. degree from the University of Chicago.

### **Brian T. Wiegand**

**Term Expires in 2017  
(Class IV Director)**

Mr. Wiegand, age 46, has been a director of the Company since July 2012, and is a serial entrepreneur who successfully founded and sold several internet-based companies. He is currently the founder and CEO of Hopster, a company that links digital marketing efforts with real-world shopping behavior by rewarding consumer purchase loyalty, engagement and advocacy. Hopster announced in October 2014 that it was acquired by Inmar, Incorporated. Mr. Wiegand co-founded and served as executive chair of the board of Alice.com, an online retail platform that connects manufacturers and consumers in the consumer packaged goods market. Alice.com filed for receivership in August 2013. Mr. Wiegand also co-founded Jellyfish.com, a shopping search engine, in June of 2006. He served as CEO until October 2007 when the company was sold to Microsoft. Mr. Wiegand continued with Microsoft as the General Manager of Social Commerce until May 2008. He also co-founded NameProtect, a trademark research and digital brand protection services company in August 1997 which was sold to Corporation Services Company in March 2007. In addition, Mr. Wiegand founded BizFilings in 1996, the Internet's leading incorporation Services Company. He served as the president and CEO until 2002 when the company was acquired by Wolters Kluwer. Mr. Wiegand attended the University of Wisconsin – Madison.

### **Gary R. Weis**

**Term Expires in 2018  
(Class V Director)**

Mr. Weis, age 67, has been Chief Executive Officer since March 2011, Chief Technology Officer since September 2011 and a Director of Sonic since February 2004. Prior to joining Sonic, he served as President, Chief Executive Officer and a Director of Cometa Networks, a wireless broadband Internet access company from March 2003 to April 2004. From May 1999 to February 2003 he was Senior Vice President of Global Services at AT&T where he was responsible for one of the world's largest data and IP networks, serving more than 30,000 businesses and providing Internet access to more than one million individuals worldwide. While at AT&T, Mr. Weis also was CEO of Concert, a joint venture between AT&T and British Telecom. Previously, from January 1995 to May 1999 he was General Manager of IBM Global Services, Network Services. Mr. Weis served as a Director from March 2001 to February 2003 of AT&T Latin America, a facilities-based provider of telecom services in Brazil, Argentina, Chile, Peru and Columbia. Mr. Weis earned BS and MS degrees in Applied Mathematics and Computer Science at the University of Illinois, Chicago.

### **David C. Kleinman**

**Term Expires in 2019  
(Class I Director)**

Mr. Kleinman, age 79, has been a Director of Sonic since December 1997 and has taught at the Chicago Booth School of Business at the University of Chicago since 1971, where he has been Adjunct Professor of Strategic Management. Mr. Kleinman was a Director (trustee) of the Columbia Acorn Trust, and its predecessors from 1972 to December 2010 (where he was a member of the Committee on Investment Performance and past chair, a member and past chair of the Audit Committee and a member of the Compliance Committee); a Director (trustee) of the Wanger Advisors Trust

from 2005 to December 2010; a Director and non-executive chair of the Board from 1984 to 2014 and Chair Emeritus since 2014 of North Lime Holdings and its wholly owned subsidiary, Irex Corporation, a contractor and distributor of insulation materials; and a Director since 1993 of Plymouth Tube Company, a manufacturer of metal tubing and metal extrusions (where he serves on the Audit Committee). From 1999 to 2006, he was a member of the Advisory Board of DSC Logistics, a logistics management and warehousing firm. From May 1997 to February 2004, Mr. Kleinman served as a Director of AT&T Latin America and predecessor companies, a facilities-based provider of telecom services in Brazil, Argentina, Chile, Peru and Columbia (where he was chair of the Audit Committee and a member of the Compensation Committee). From 1994 to 2005, he was a director of Wisconsin Paper and Products Company, a jobber of paper and paper products. From 1964 to 1971, Mr. Kleinman was a member of the finance staff of the Ford Motor Company. Mr. Kleinman received a BS degree in Mathematical Statistics and a PHD in Business from the University of Chicago.

**Paul S. Peercy**

**Term Expires in 2019  
(Class I Director)**

Mr. Peercy, age 74, has been a Director of Sonic since February 2004. Mr. Peercy served as dean of the University of Wisconsin-Madison College of Engineering from September 1999 until April 2013. Since 2001 Mr. Peercy has been a member of the National Academy of Engineering. In 2000, then-Wisconsin Governor Tommy Thompson named Mr. Peercy to the Wisconsin Technology and Entrepreneurship Council. From August 1995 to September 1999, Mr. Peercy served as president of SEMI/SEMATECH, an Austin, Texas-based non-profit consortium of more than 160 of the nation's suppliers to the semiconductor industry. Prior to that position he was director of Microelectronics and Photonics at Sandia National Laboratories in Albuquerque, New Mexico. He is the author or co-author of more than 175 technical papers and the recipient of two patents. Mr. Peercy is a Director and member of the audit committee of Bemis Company, Inc, a manufacturer of flexible packaging and pressure sensitive materials. Mr. Peercy received a BA degree in Physics from Berea College and MS and PhD degrees in Physics from the University of Wisconsin - Madison.

When considering whether the Board of Directors and nominees thereto have the experience, qualifications, attributes and skills, taken as a whole, to enable the Board of Directors to satisfy its oversight responsibilities effectively in light of our business and structure, the Board of Directors focused primarily on the information discussed in each of the Board members' biographical information set forth above. Each of the Company's directors possess high ethical standards, act with integrity and exercise careful, mature judgment. Each is committed to employing his skills and abilities to aid the long-term interests of the stakeholders of the Company. In addition, each of our directors has exhibited judgment and skill, and has either been actively involved with the Company for a considerable period of time or has experience with other organizations of comparable or greater size. In particular, Mr. Kopko has had extensive experience with companies comparable in size to Sonic Foundry, including serving as a director of Mercury Air Group, Inc. and fills a valuable need with experience in securities and other business law. Mr. Weis has had experience in both developing and established companies, having served as a CEO and Director of Cometa Networks and in several positions at AT&T and IBM, including Senior Vice President of Global Services. While at AT&T, Mr. Weis also was CEO of Concert, a joint venture between AT&T and British Telecom. Mr. Weis has served as CEO of the Company since March 2011. Mr. Kleinman has significant experience serving on boards of directors of various companies and has significant experience in finance and strategic management through his employment with the Chicago Booth School of Business at the University of Chicago where he also obtained valuable market insight to the Company's largest customer base. Mr. Peercy shares that same market expertise through his service at the University of Wisconsin in his role as Dean of the engineering school and also has significant business and technical experience obtained at positions including his role as director of Microelectronics and Photonics at Sandia National Laboratories and through his role as president of SEMI/SEMATECH. Mr. Burish brings additional valuable legal experience to the Board as well as experience obtained through founding multiple companies. Mr. Wiegand has significant experience in founding and operating technology companies and building brand awareness with both businesses and consumers.

## **CORPORATE GOVERNANCE**

### **Director Independence**

Through its listing requirements for companies with securities listed on the NASDAQ Capital Market, the NASDAQ Stock Market (“NASDAQ”) requires that a majority of the members of our Board be independent, as defined under NASDAQ’s rules. The NASDAQ rules have both objective tests and a subjective test for determining who is an “independent director.” The objective tests state, for example, that a director is not considered independent if he or she is an employee of the Company or has engaged in various types of business dealings with the Company. The subjective test states that an independent director must be a person who lacks a relationship that in the opinion of the Board would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The Board has made a subjective determination as to each independent director that no relationship exists that, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. In making these determinations, the Board reviews information provided by the directors in an annual questionnaire with regard to each director’s business and personal activities as they relate to the Company. Based on this review and consistent with NASDAQ’s independence criteria, the Board has affirmatively determined that Mark D. Burish, David C. Kleinman, Paul S. Peercy and Brian T. Wiegand are independent.

### **Related Person Transaction**

The Board has adopted a Related Person Transaction Policy (the “Policy”), which is a written policy governing the review and approval or ratification of Related Person Transactions, as defined in SEC rules.

Under the Policy, each of our directors and executive officers must notify the Chairman of the Audit Committee in writing of any new potential Related Person Transaction involving such person or an immediate family member. The Audit Committee will review the relevant facts and circumstances and will approve or ratify the transaction only if it determines that the transaction is not inconsistent with, the best interests of the Company. The Related Party Transaction must then be approved by the independent directors. In determining whether to approve or ratify a Related Person Transaction, the Audit Committee and the independent directors may consider, among other things, the benefits to the Company; the impact on the director’s independence (if the Related Person is a director or an immediate family member); the availability of other sources for comparable products or services; the terms of the transaction; and the terms available to unrelated third parties or to employees generally. There were no new Related Person Transactions in the fiscal year ended September 30, 2014 (“Fiscal 2014”).

### **Board Leadership Structure and Role in Risk Oversight**

In fiscal 2011 the Company separated the positions of Chairman of the Board and Chief Executive Officer. Mark D. Burish serves as Non-Executive Chairman of the Board and Gary R. Weis serves as our Chief Executive Officer and Chief Technical Officer. The Company believes that having separate positions provides an appropriate leadership structure.

Our business and affairs are managed under the direction of our board, which is the Company’s ultimate decision-making body, except with respect to those matters reserved to our stockholders. Our Board’s key mission is to maximize long-term stockholder value. Our Board establishes our overall corporate policies, selects and evaluates our executive management team (which is charged with the conduct of our business), and acts as an advisor and counselor to executive management. Our board also oversees our business strategy and planning, as well as the performance of management in executing its business strategy and assessing and managing risks.

### **What is the Board’s role in risk oversight?**

The board takes an active role in monitoring and assessing the Company’s risks, which include risks associated with

operations, credit, financing and capital investments. Management is responsible for the Company's day-to-day risk management activities and our board's role is to engage in informed risk oversight. Management, through its disclosure committee, compiles an annual ranking of risks to which the Company could be subjected and reviews the results of this risk assessment with the audit committee. Any significant risks are then reviewed by the board and assigned for oversight. In fulfilling this oversight role, our board focuses on understanding the nature of our enterprise risks, including our operations and strategic direction, as well as the adequacy of our risk management process and overall risk management system. There are a number of ways our board performs this function, including the following:

- at its regularly scheduled meetings, the board receives management updates on our business operations, financial results and strategy and discusses risks related to the business;
- the audit committee assists the board in its oversight of risk management by discussing with management, particularly, the Chief Financial Officer, our guidelines and policies regarding financial and enterprise risk management and risk appetite, including major risk exposures, and the steps management has taken to monitor and control such exposures; and
- through management updates and committee reports, the board monitors our risk management activities, including the annual risk assessment process, risks relating to our compensation programs, and financial and operational risks being managed by the Company.

The board of directors also has oversight responsibility for risks and exposures related to employee compensation programs and management succession planning, and assesses whether the organization's compensation practices encourage risk taking that would have a material adverse effect on the Company. The compensation committee periodically reviews the structure and elements of our compensation programs and its policies and practices that manage or mitigate such risk, including the balance of short-term and long-term incentives, use of multiple performance measures, and a multi-year vesting schedule for long-term incentives. Based on these reviews, the committee believes our compensation programs do not encourage excessive risk taking.

### **Board Structure and Meetings**

The Board met seven times during Fiscal 2014. The Board also acted by written consent from time to time. All directors attended at least 75% of the total number of Board meetings and committee meetings on which they serve (during the period in which each director served). In addition, NASDAQ marketplace rules contemplate that the independent members of our Board will meet during the year in separate closed meetings referred to as "executive sessions" without any employee director or executive officer present. Executive sessions were usually held after regularly scheduled Board meetings during Fiscal 2014. Also, disinterested members of the Board of Directors met three times in Fiscal 2014 to discuss and approve an investment in equity securities of the Company by the Chairman of the Board of Directors of the Company and by a 5% shareholder of the Company. The transaction closed in December 2014. See "Certain Transactions".

The Board of Directors has five standing committees, the Audit Committee, the Executive Compensation Committee, the New Markets Committee, the Governance Committee and the Nominations Committee.

Sonic has a standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Members of the Audit Committee are Messrs. Kleinman (chair), Burish and until his death in August 2014, Janowiak. Upon the death of Mr. Janowiak, Mr. Peercy was appointed to the Audit Committee. Sonic's Board of Directors has determined that all members of Sonic's Audit Committee are "independent" as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act and as defined under Nasdaq listing standards. The Audit Committee provides assistance to the Board in fulfilling its oversight responsibility including: (i) internal and external financial reporting, (ii) risks and controls related to financial reporting, and (iii) the internal and external audit process. The Audit Committee is also responsible for recommending to the Board the selection of our independent public accountants and for reviewing all related party transactions. The Audit

Committee met six times in Fiscal 2014. A copy of the charter of the Audit Committee is available on Sonic's website.

Sonic's Board of Directors has determined that, due to his affiliation with the Chicago Booth School of Business at the University of Chicago, and due to his current and past service as a director on numerous company boards, and membership on numerous audit committees, including past or present chair, along with his other academic and business credentials, Mr. Kleinman has the requisite experience and applicable background to meet Nasdaq standards requiring financial sophistication of at least one member of the audit committee. Sonic's Board of Directors has also determined that neither Mr. Kleinman nor any other member of the Audit Committee is an audit committee financial expert as defined by applicable SEC regulations

The Compensation Committee consists of Messrs. Kleinman (chair), Burish and until his death in August 2014, Janowiak. Upon the death of Mr. Janowiak, Mr. Peercy was appointed to the Compensation Committee. The Board of Directors has determined that all of the members of the Compensation Committee are "independent" as defined under Nasdaq listing standards. The Compensation Committee makes recommendations to the Board with respect to salaries of employees, the amount and allocation of any incentive bonuses among the employees, and the amount and terms of stock options to be granted to executive officers. The Compensation Committee met twice in Fiscal 2014. A copy of the charter of the Compensation Committee is available on Sonic's website.

The New Markets Committee consists of Messrs. Peercy (chair) and Kleinman. The New Markets Committee was established on January 24, 2013 to assist management in developing new market entry plans, providing access to contacts that may facilitate entry, assessing risk and monitoring outcomes.

The Governance Committee consists of Messrs. Burish (chair), Kopko and Peercy. The Governance Committee was established on January 24, 2013 to consider board terms and other governance issues related to enhancing shareholder value.

The Nominations Committee consists of Messrs. Peercy (chair), Wiegand and Kleinman. The Board of Directors has determined that all of the members of the Nominations Committee are "independent" as defined under Nasdaq listing standards. The purpose of the Nominations Committee is to evaluate and recommend candidates for election as directors, make recommendations concerning the size and composition of the Board of Directors, develop specific criteria for director independence, and assess the effectiveness of the Board of Directors. Our Board of Directors has adopted a charter for the Nominations Committee, which is available on Sonic's website. The Nominations Committee will review all candidates in the same manner regardless of the source of the recommendation. In recommending candidates for election to the Board of Directors, the Nominations Committee reviews each candidate's qualifications, including whether a candidate possesses any of the specific qualities and skills desirable in certain members of the Board of Directors. Evaluations of candidates generally involve a review of background materials, internal discussions and interviews with selected candidates as appropriate. Generally the Nominations Committee will consider various criteria in considering whether to make a recommendation. These criteria include expectations that directors have substantial accomplishments in their professional backgrounds and are able to make independent, analytical inquiries and exhibit practical wisdom and mature judgment. Director candidates should possess the highest personal and professional ethics, integrity and values, be committed to promoting the long-term interest of our stockholders and be able and willing to devote the necessary time to carrying out their duties and responsibilities as members of the Board. While the Board of Directors has not adopted a policy regarding diversity, we also believe our directors should come from diverse backgrounds and experience bases in order to promote the representation of diverse views on the Board of Directors. Stockholder recommendations of candidates for Board membership will be considered when submitted to Corporate Secretary, Sonic Foundry, Inc., 222 W. Washington Ave., Madison, WI 53703. When submitting candidates for nomination to be elected at Sonic's annual meeting of stockholders, stockholders must also follow the notice procedures and provide the information required by Sonic's bylaws.

In particular, for a stockholder to nominate a candidate for election at the 2016 Annual Meeting of Stockholders, the nomination must be delivered or mailed to and received by Sonic's Secretary between November 5, 2015 and December 5, 2015 (or, if the 2016 annual meeting is advanced by more than 30 days or delayed by more than 60 days from March 5, 2016, not earlier than the close of business on the 120th day prior to such annual meeting and not later than the close of business on the later of the 90th day prior to such annual meeting or the tenth calendar day following

the date on which public announcement of the date of the annual meeting is first made). The nomination must include the same information as is specified in Sonic's bylaws for stockholder nominees to be considered at an annual meeting, including the following:

- The stockholder's name and address and the beneficial owner, if any, on whose behalf the nomination is proposed;
- The stockholder's reason for making the nomination at the annual meeting, and the signed consent of the nominee to serve if elected;
- The number of shares owned by, and any material interest of, the record owner and the beneficial owner, if any, on whose behalf the record owner is proposing the nominee;
- A description of any arrangements or understandings between the stockholder, the nominee and any other person regarding the nomination; and
- Information regarding the nominee that would be required to be included in Sonic's proxy statement by the rules of the Securities and Exchange Commission, including the nominee's age, business experience for the past five years and any other directorships held by the nominee.

### **DIRECTORS COMPENSATION**

Our directors who are not also our full-time employees, receive an annual retainer of \$20,000 in addition to a fee of \$1,500 for attendance at each meeting of the Board of Directors and \$1,000 per committee meeting attended. In addition, Mr. Kleinman receives an Audit Committee annual retainer of \$8,000 and a Compensation Committee annual retainer of \$3,000 for his services as chairman of each committee and Mr. Burish receives an annual retainer of \$35,000 as compensation for his services as Chairman of the Board of Directors. In March 2013 Mr. Percy received an annual retainer of \$10,000 for his services as chairman of the New Markets Committee and Mr. Kleinman received an annual retainer of \$3,000 for his services as a member of the New Markets Committee. The Board of Directors discontinued the retainer for directors serving on the New Markets Committee in fiscal 2014. The cash compensation paid to the six non-employee directors combined in Fiscal 2014 was \$249,500. When traveling from out-of-town, the members of the Board of Directors are also eligible for reimbursement for their travel expenses incurred in connection with attendance at Board meetings and Board Committee meetings. Directors who are also employees do not receive any compensation for their participation in Board or Board Committee meetings.

Pursuant to the 2008 Sonic Foundry Non-Employee Amended Directors Stock Option Plan (the "Directors Plan") we grant to each non-employee director who is reelected or who continues as a member of the Board of Directors at each annual stockholders meeting a stock option to purchase 2,000 shares of Common Stock. Further, the chair of our Audit Committee receives an additional stock option grant to purchase 500 shares of Common Stock per year pursuant to Sonic's Non-Employee Amended Directors Stock Option Plan.

The exercise price of each stock option granted was equal to the market price of Common Stock on the date the stock option was granted. Stock options issued under the Directors Plan vest fully on the first anniversary of the date of grant and expire after ten years from date of grant. An aggregate of 100,000 shares are reserved for issuance under the Directors Plan.

If any change is made in the stock subject to the Directors Plan, or subject to any option granted thereunder, the Directors Plan and options outstanding thereunder will be appropriately adjusted as to the type(s), number of securities and price per share of stock subject to such outstanding options.

The options and warrants set forth above have an exercise price equal to the fair market value of the underlying common stock on the date of grant. The term of all such options is ten years.

The following table summarizes cash and equity compensation provided our non-employee directors during the fiscal year ended September 30, 2014 (including Michael Janowiak, who died in August 2014).

Name (a)	Fees Earned Or Paid In Cash \$(1) (b)	Stock Awards \$( (c)	Option Awards \$(2) (d)	Non-Equity Incentive Plan Compen- sation \$( (e)	Change in Pension Value and Non-qualified Deferred Compen- sation Earnings \$( (f)	All Other Compensation \$( (g)	Total \$( (h)
Mark D. Burish	73,500	—	4,780	—	—	—	78,280
Michael H. Janowiak	35,000	—	4,780	—	—	—	39,780
David C. Kleinman	49,500	—	5,975	—	—	—	55,475
Frederick H. Kopko	30,500	—	4,780	—	—	—	35,280
Paul S. Peercy	30,500	—	4,780	—	—	—	35,280
Brian T. Wiegand	30,500	—	4,780	—	—	—	35,280

- (1) The amount reported in column (b) is the total of retainer fees and meeting attendance fees.
- (2) The amount reported in column (d) is the aggregate grant date fair value of options granted during the fiscal year ended September 30, 2014 in accordance with FASB ASC Topic 718. Each director, received an option award of 2,000 shares on March 6, 2014 at an exercise price of \$10.07 with a grant date fair value of \$4,780. In addition, Mr. Kleinman received a grant of 500 shares on March 6, 2014 at an exercise price of \$10.07 with a grant date fair value of \$1,195 in connection with his position as chair of the Audit Committee.

### EXECUTIVE OFFICERS OF SONIC

Our executive officers, who are appointed by the Board of Directors, hold office for one-year terms or until their respective successors have been duly elected and have qualified. There are no family relationships between any of the executive officers of Sonic.

**Gary R. Weis** serves as both our Chief Executive and Chief Technology Officer. (See " Directors Continuing in Office ".)

**Kenneth A. Minor**, age 52, has been our Chief Financial Officer since June 1997, Assistant Secretary from December 1997 to February 2001 and Secretary since February 2001. From September 1993 to April 1997, Mr. Minor was employed as Vice President and Treasurer for Fruehauf Trailer Corporation, a manufacturer and global distributor of truck trailers and related aftermarket parts and service where he was responsible for financial, treasury and investor relations functions. Prior to 1993, Mr. Minor served in various senior accounting and financial positions for public and private corporations as well as the international accounting firm of Deloitte Haskins and Sells. Mr. Minor is a certified public accountant and has a B.B.A. degree in accounting from Western Michigan University.

**Robert M. Lipps**, age 43, has been Executive Vice President of Sales since April 2008, joining Sonic Foundry in April 2006 as Vice President of International Sales and assuming expanded responsibility for U.S. central sales in 2007. Mr. Lipps leads the company's global sales organization including oversight of domestic, international and channel sales. He holds 15 years of sales leadership, business development and emerging market entry expertise in the technology and manufacturing sectors, including sales and channel management. From January 2004 to March 2006 he served as General Manager of Natural Log Homes LLC, a New Zealand based manufacturer of log homes. From July 1999 to Dec 2002 he served as Latin America Regional Manager of Adaytum, a software publisher of planning and performance management solutions, (acquired by Cognos Software, an IBM Company, in January 2003) and from May 1996 to July 1999 he served as International Sales Manager for Persoft, a software publisher of host access and

mainframe connectivity solutions (acquired by Esker software in 1998). Mr. Lipps has a B.S. degree in Marketing from the University of Wisconsin at La Crosse.

## **SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table shows information known to us about the beneficial ownership of our Common Stock as of January 9, 2015, by each stockholder known by us to own beneficially more than 5% of our Common Stock, each of our executive officers named in the Summary Compensation Table (“Named Executive Officers”), each of our directors, and all of our directors and executive officers as a group. Unless otherwise noted, the mailing address for these stockholders is 222 West Washington Avenue, Madison, Wisconsin 53703.

Beneficial ownership is determined in accordance with the rules of the SEC, and includes voting or investment power with respect to shares. Shares of common stock issuable upon the exercise of stock options or warrants exercisable within 60 days after January 9, 2015, which we refer to as Presently Exercisable Options, are deemed outstanding for computing the percentage ownership of the person holding the options but are not deemed outstanding for computing the percentage ownership of any other person. Unless otherwise indicated below, to our knowledge, all persons named in the table have sole voting and investment power with respect to their shares of common stock, except to the extent authority is shared by spouses under applicable law. The inclusion of any shares in this table does not constitute an admission of beneficial ownership for the person named below.



Name of Beneficial Owner(1)	Number of Shares of Class Beneficially Owned	Percent of Class(2)
<b>Common Stock</b>		
Wealth Trust Axiom LLC (3) 4 Radnor Corp Center, suite 520 Radnor PA 19087	440,408	10.1%
Andrew D. Burish(4) 8020 Excelsior Drive Madison, WI, 53717	397,794	9.1
Mark D. Burish(5) 33 East Main St. Madison, WI 53703	357,836	8.1
Gary R. Weis(6)	200,040	4.5
Kenneth A. Minor(7)	124,710	2.8
Robert M. Lipps(8)	110,866	2.5
Frederick H. Kopko, Jr.(9) 29 South LaSalle Street Chicago, IL 60603	46,627	1.1
David C. Kleinman(10) 1101 East 58th Street Chicago, IL 60637	38,374	*
Paul S. Peercy(11) 1415 Engineering Dr Madison, WI 53706	22,414	*
Brian T. Wiegand (12) 8215 Greenway Blvd., Suite 340 Middleton, WI 53562	20,374	*
All current Executive Officers and Directors as a Group (8 persons)(13)	921,261	19.2%

\* less than 1%

- (1) Sonic believes that the persons named in the table above, based upon information furnished by such persons, except as set forth in notes (3) and (4) where such information is based on a Schedule 13G, have, except as set forth in note (3), sole voting and dispositive power with respect to the number of shares indicated as beneficially owned by them.
- (2) Applicable percentages are based on 4,347,308 shares outstanding, adjusted as required by rules promulgated by the Securities and Exchange Commission.
- (3) Information is based on Schedule 13G filed on February 10, 2014 by Albert C. Matt, President of Wealth Trust Axiom LLC. Based on such information, Wealth Trust Axiom LLC has sole dispositive power but not sole voting power with respect to such shares.
- (4) Includes 38,897 shares and 38,897 shares subject to Presently Exercisable Common Stock Warrants purchased directly from the Company on December 22, 2014. Information is based on Schedule 13G filed on February 7,

2014. Also includes 38,897 shares and warrants to purchase an additional 38,897 shares purchased directly from the Company on December 22, 2014.

- (5) Includes 35,905 shares and 35,908 shares subject to presently Exercisable Common Stock Warrants purchased directly from the Company on December 22, 2014. Also includes 10,000 shares subject to Presently Exercisable Common Stock Options.
- (6) Includes 138,166 shares subject to Presently Exercisable Options.
- (7) Includes 97,561 shares subject to Presently Exercisable Options.
- (8) Includes 108,811 shares subject to Presently Exercisable Options.
- (9) Includes 18,000 shares subject to Presently Exercisable Options.
- (10) Includes 25,500 shares subject to Presently Exercisable Options.
- (11) Includes 20,000 shares subject to Presently Exercisable Options.
- (12) Includes 6,000 shares subject to Presently Exercisable Options.
- (13) Includes an aggregate of 459,943 Presently Exercisable Options.

## **Compensation Discussion and Analysis**

### ***Introduction***

This Compensation Discussion and Analysis describes our compensation strategy, policies, programs and practices for the executive officers identified in the Summary Compensation Table. Throughout this proxy statement, we refer to these individuals, who serve as our Chief Executive Officer, Chief Financial Officer and Executive Vice President of Sales as the “executive officers.”

The Executive Compensation Committee (“Committee”) establishes and oversees our compensation and employee benefits programs and approves the elements of total compensation for the executive officers. The day-to-day design and administration of our retirement and employee benefit programs available to our employees are handled by our Human Resources and Finance Department employees. The Committee is responsible for reviewing these programs with management and approving fundamental changes to them.

### ***Overview and Objectives of our Executive Compensation Program***

The compensation program for our executive officers is designed to attract, motivate, reward and retain highly qualified individuals who can contribute to Sonic’s growth with the ultimate objective of increasing stockholder value. Our compensation program consists of several forms of compensation: base salary, annual bonus, long-term incentives and limited perquisites and benefits.

Base salary and annual bonus are cash-based while long-term incentives consist of stock option awards. The Committee does not have a specific allocation goal between cash and equity-based compensation or between annual and long-term incentive compensation. Instead, the Committee relies on the process described in this discussion and analysis in its determination of compensation levels and allocations for each executive officer.

The Committee established performance metrics for each of its Named Executive Officers in fiscal 2014 designed to match Company performance to the amount of incentive compensation paid to such officers following completion of the fiscal year.

The recommendations of the Chief Executive Officer play a significant role in the compensation-setting process. The Chief Executive Officer provides the Committee with an annual overall assessment of Sonic’s achievements and performance, his evaluation of individual performance and his recommendations for annual compensation and long-term incentive awards. The Committee has discretion to accept, reject or modify the Chief Executive Officer’s recommendations.

The Committee determines the compensation for each executive officer in an executive session.

### *Market Competitiveness*

The Committee's target is for total cash compensation to average between the 50th and 75th percentile of published compensation data derived from two sources: (i) a peer group of companies that are in our industry, competitors for key talent, or with similar financial characteristics; and (ii) published market survey data for companies within our revenue range. The peer group data was obtained from the most recently filed proxy statement of 14 publicly-traded technology companies with annual revenues ranging from approximately \$25 million to just under \$100 million; market capitalization of \$25 million to approximately \$100 million and approximately 300 employees or less. The following companies comprised the peer group for the study: ARI Network Services Inc., Asure Software Inc., Autobytel Inc., Bsquare Corporation, Envivio Inc., FalconStor Software Inc., GlobalSCAPE Inc., Glowpoint Inc., GSE Systems Inc., Inuvo Inc., MAM Software Group, Inc., Smith Micro Software Inc., TheStreet Inc. and ChyronHego Corporation. Given competitive recruiting pressures, the Committee retains its discretion to deviate from this target under appropriate circumstances. The Committee periodically receives updates of the published compensation data.

### *Pay for Performance*

The Committee believes that both long and short term compensation of executive officers should correlate to Sonic's overall financial performance. Incentive payouts will be larger with strong performance and smaller if Sonic's financial results decline. From time to time, extraordinary Board-approved initiatives in a fiscal year, such as a restructuring, acquisition, or divestiture, are considered by the Committee in its overall evaluation of Sonic's performance.

### *Competitive Benchmarking/Peer Group Analysis*

The Committee reviewed market data from Towers Watson Data Services dated April 1, 2010 in various size and industry stratifications similar to that of Sonic.

The second source of compensation data came from a peer group of fourteen public companies that we consider similar to our market for sales, or for key talent, or with similar financial or other characteristics such as number of employees. The companies in the peer group are described above.

### ***Components of Executive Compensation***

#### *Base Salary*

The Committee seeks to pay the executive officers a competitive base salary in recognition of their job responsibilities for a publicly held company. As noted above, the target compensation range for an executive's total cash compensation (salary and bonus) is between the 50th and 75th percentile of the market data reviewed by the Committee.

As part of determining annual increases, the Committee also considers the Chief Executive Officer's recommendation regarding individual performance as well as internal equitable considerations.

In evaluating individual performance, the Committee considers initiative, leadership, tenure, experience, skill set for the particular position, knowledge of industry and business, and execution of strategy in placing the individual within the range outlined.

The Committee considered base wage changes for Messrs. Weis, Minor and Lipps at a meeting of the Committee held on November 5, 2014. Accordingly, base compensation for Mr. Weis was increased from \$457,320 to \$475,615, base pay for Mr. Minor was increased from \$281,910 to \$293,190 and base compensation for Mr. Lipps

was increased from \$226,669 to \$235,739. After its review of all sources of market data as described above, the Committee believes that the base salaries and the bonuses described are within its targeted range for total cash compensation.

#### *Annual Performance-Based Variable Compensation*

The performance-based variable compensation reported for each executive officer represents compensation that was earned based on fiscal 2014 performance. The following describes the methodologies used by the Compensation Committee to determine the final annual performance-based variable compensation earned by each executive officer:

*Selection of Performance Metrics.* For fiscal 2014, the Compensation Committee designed a short-term incentive program (“STIP”) driven by four performance measures that it determined were appropriate to drive desired business behavior for the Company and would correlate positively with total shareholder return. These measures were the Company’s results with respect to (1) customer billings, (2) net income, (3) customer satisfaction, and (4) the officer’s achievement of certain individual goals. Messrs. Weis, Minor, Lipps and two Non-Executive officers were included in the plan. Mr. Lipps’ short term incentive plan included a separate component based solely on the level of customer billings achieved.

*Establishment of Incentive Goals and Payout Approach.* The Compensation Committee designed the relationship between pay and performance to ensure that desired performance would be rewarded with material payouts. Similarly, performance that did not meet the goals would reduce the performance-based variable compensation payout to as low as zero. In setting the performance levels, the Compensation Committee strived to establish challenging but achievable goals. The factors considered by the Compensation Committee in assessing the challenge inherent in the goals included:

Management’s internal operating plan; and

Customer satisfaction.

*Payout Based on Performance Against Goals.* For fiscal 2014 the Company’s performance, as evaluated by the Compensation Committee, lead to the determination that 55% of the STIP performance metrics were achieved and therefore 55% of the target bonus payouts were made under the STIP compensation plan. The STIP earned by Messrs. Weis, Minor and Lipps were \$125,763, \$54,268 and \$37,400, respectively. Total billings – based incentives paid to Mr. Lipps during fiscal 2014 was \$75,855. Additionally the Compensation Committee approved incentive awards for each of the Named Executives to negotiate and execute a definitive stock purchase agreement with Mediasite KK in fiscal 2013. Upon execution of the Stock Purchase Agreement with Mediasite KK in December 2013, the Named Executives earned the award which was paid in January 2014. The award earned by Messrs. Weis, Minor and Lipps were \$150,000, \$75,000 and \$40,000, respectively.

#### *Stock Options*

The Committee has a long-standing practice of providing long-term incentive compensation grants to the executive officers. The Committee believes that such grants, in the form of stock options, help align our executive officers’ interests with those of Sonic’s stockholders. All stock options have been granted under our 1995 Stock Option Plan, the 1999 Non-Qualified Plan or the 2009 Stock Incentive Plan (“Employee Plans”). All but the 2009 Stock Incentive Plan are now terminated.

The Committee reviews option grant recommendations by the Chief Executive Officer for each executive officer, but retains full discretion to accept, reject or revise each recommendation. The Committee’s policy is to grant options on the date it approves them or such other future date as the Committee may agree at the time of approval. The exercise price is determined in accordance with the terms of the Employee Plan and cannot be less than the Fair

Market Value, as defined in the Plan, of Sonic's common stock. The Committee typically grants options once a year, but may grant options to newly hired executives at other times.

In making its determinations, the Committee considers the number of options or shares owned by the executive officers.

On November 5, 2014 the Committee awarded Messrs. Weis, Minor and Lipps option grants to purchase 62,264, 34,245 and 34,245 shares of common stock, respectively, effective November 10, 2014 with the strike price equal to the closing price of Sonic's stock on that date, which was \$9.36. Each grant will vest one third each on the first, second and third anniversaries of the grant.

#### *Health and Welfare Benefits*

Our officers are covered under the same health and welfare plans, including our 401(k) plan, as salaried employees.

#### *Employment Agreements*

We entered into employment agreements with Kenneth A. Minor in October 2007 and Robert M. Lipps in August 2008. Effective March 21, 2014 the Company entered into Amended and Restated Employment Agreements with Messrs. Minor and Lipps.

The salaries of each of Messrs. Minor and Lipps are subject to increase each year at the discretion of the Board of Directors. Messrs. Minor and Lipps are also entitled to incidental benefits of employment under the agreements. Each of the employment agreements provides that a cash severance payment be made upon termination, other than for cause, or upon death or disability. In each case, such cash severance is equal to the highest cash compensation paid in any of the last three fiscal years immediately prior to termination. In addition, Messrs. Minor and Lipps will receive immediate vesting of all previously unvested common stock and stock options and have the right to voluntarily terminate their employment, and receive the same severance arrangement detailed above following (i) any "person" becoming a "beneficial" owner of stock of Sonic Foundry representing 50% or more of the total voting power of Sonic Foundry's then outstanding stock; or, (ii) Sonic Foundry is acquired by another entity through the purchase of substantially all of its assets or securities; or (iii) Sonic Foundry is merged with another entity, consolidated with another entity or reorganized in a manner in which any "person" is or becomes a "beneficial" owner of stock of the surviving entity representing 50% or more of the total voting power of the surviving entity's then outstanding stock; and, within two years and ninety days of any such event, Messrs. Minor or Lipps, as the case may be, is demoted without cause or his title, authority, status or responsibilities are substantially altered, their salary is reduced or the principal office is more than 50 miles outside the Madison metropolitan area. Pursuant to the employment agreements, each of Messrs. Minor and Lipps has agreed not to disclose our confidential information and not to compete against us during the term of his employment agreement and for a period of one year thereafter. Such non-compete clauses may not be enforceable, or may only be partially enforceable, in state courts of relevant jurisdictions.

Effective September 30, 2011, the Company entered into an amended and restated employment agreement with Mr. Weis. Pursuant to the terms of the amended and restated employment agreement, Mr. Weis will receive an annual base salary subject to increase at the discretion of the Board. Mr. Weis may also receive a performance bonus at the discretion of the Board. Mr. Weis in addition will assume duties as are customarily performed by a Chief Technology Officer.

The amended and restated employment agreement will continue in effect until terminated as set forth therein. In the event Mr. Weis's employment is terminated without cause, as defined in the amended and restated employment agreement, or in the event his employment is constructively terminated, Mr. Weis shall be entitled to receive, in equal bi-weekly installments over a one-year period, compensation equal to one and five hundredths (1.05) multiplied by the highest cash compensation paid to Mr. Weis in any of the last three years immediately prior to his termination. In the event of a Change of Control, as defined in the amended and restated employment

agreement, Mr. Weis is entitled to terminate the agreement within one year following such Change of Control, in which event he shall be entitled to receive, in a lump sum payable within thirty days of such termination, compensation equal to two and one-tenth (2.1) multiplied by the highest cash compensation paid to Mr. Weis in any of the last three fiscal years immediately prior to his termination. In any of the above events, (i) all of Mr. Weis's unvested stock options and stock grants shall vest immediately upon termination, and (ii) Mr. Weis shall receive health insurance continuation as required by COBRA, salary accrued to the date of termination, and any accrued vacation pay. Mr. Weis has further agreed not to disclose the Company's proprietary information, and, until one year following the termination of his employment agreement, not to compete with the Company or solicit the Company's employees. Such non-compete clause may not be enforceable, or may be only partially enforceable, in state courts of relevant jurisdiction.

For illustrative purposes, if Sonic terminated the employment of Mr. Weis (not for cause) on September 30, 2014, Sonic would be obligated to pay \$764,891, representing 1.05 times the cash compensation paid Mr. Weis during fiscal 2014 and \$1,529,783 if Mr. Weis elected to terminate his employment on September 30, 2014, following a change of control as defined in the employment agreement. If Sonic terminated Messrs. Minor and Lipps on September 30, 2014, (not for cause), or if Messrs. Minor and Lipps elected to terminate their employment following a demotion or alteration of duties on September 30, 2014, and a change of control as defined in the employment agreements had occurred, Sonic would be obligated to pay \$410,145 and \$378,339, respectively. In addition, any non-vested rights of Messrs. Weis, Minor and Lipps under the Employee Plans, would vest as of the date of employment termination. The value of accelerated vesting of the options under these circumstances would be \$155,000 for Mr. Weis and \$96,000 for both Messrs. Minor and Lipps.

#### *Personal Benefits*

Our executives receive a limited number of personal benefits certain of which are considered taxable income to them and which are described in the footnotes to the section of this Proxy Statement entitled "Summary Compensation Table".

#### *Internal Revenue Code Section 162(m)*

Internal Revenue Code Section 162(m) limits the ability of a public company to deduct compensation in excess of \$1 million paid annually to each of the Chief Executive Officer and each of the other executive officers named in the Summary Compensation Table. There are exemptions from this limit, including compensation that is based on the attainment of performance goals that are established by the Committee and approved by the Company stockholders. No executive officer was affected by this limitation in fiscal 2014.

### **COMPENSATION COMMITTEE REPORT**

The Compensation Committee of Sonic has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in the Proxy Statement.

#### COMPENSATION COMMITTEE

David C. Kleinman, Chair  
Mark D. Burish  
Paul S. Peercy

## Summary Compensation

The following table sets forth the compensation of our principal executive officer, our principal financial officer and our other two executive officers for the fiscal year ended September 30, 2014.

Name and Principal Position (a)	Year (b)	Salary (\$) (c)	Bonus (\$) (d)	Stock Awards (\$) (e)	Option Awards (\$)(1) (f)	Non-Equity Incentive Plan Compensation (\$)(2) (g)	Change in Pension Value and Non-qualified	All Other Compensation (\$)(3) (i)	Total (\$) (j)
							Deferred Compensation Earnings (\$) (h)		
Gary R. Weis Chief Executive and Chief Technology Officer	2014	452,705	—	—	202,358	275,763	—	10,400	941,226
	2013	395,865	—	—	198,560	79,461	—	13,214	687,100
	2012	378,400	—	—	—	75,680	—	6,986	461,066
Kenneth A. Minor Chief Financial Officer and Secretary	2014	280,877	—	—	111,296	129,268	—	17,774	539,215
	2013	267,502	—	—	108,800	37,588	—	16,718	430,608
	2012	255,123	—	—	103,400	50,784	—	16,809	426,116
Robert M. Lipps Executive Vice President - Sales	2014	225,084	—	—	111,296	153,255	—	10,988	500,623
	2013	205,308	—	—	108,800	102,501	—	9,900	426,509
	2012	195,811	—	—	103,400	109,911	—	8,787	417,909

- (1) The option awards in column (f) represent the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 for stock options granted during the fiscal year. The assumptions and methodology used in calculating the compensation expense of the option awards are provided in Sonic's Form 10-K. See Note 1, "Accounting for Stock Based Compensation" in the Notes to the Consolidated Financial Statements in Sonic's Form 10-K. The amounts in this column represent value attributed to the awards at the date of grant and not necessarily the actual value that will be realized by the executive. There can be no assurance that the options will ever be exercised (in which case no value will be realized by the executive) or that the value on exercise will equal the ASC Topic 718 value.
- (2) The amounts in column (g) represent cash bonuses which were awarded for performance during the prior fiscal year based on a pre-established formula.
- (3) The amount shown under column (i) for the fiscal year 2014 includes Sonic's matching contribution under our 401(k) plan of \$10,400, \$10,624 and \$10,988 for Messrs Weis, Minor and Lipps. Mr. Minor receives \$650 per month as a car allowance of which the taxable personal portions were \$7,150. Mr. Lipps receives a car allowance of \$700 per month of which there was no taxable personal portion. Mr. Weis received car and housing allowances totaling \$2,500 per month, of which there was no taxable personal portion.

### Grants of Plan-Based Awards

The following table shows the plan-based awards granted to the Named Executive Officers during fiscal 2014.

Name (a)	Grant Date (b)	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All other stock awards: Number of Shares of stock or units (i)	All other option awards: Number of Securities Underlying Options (j)	Exercise or base price of option awards (\$/Sh) (k)	Grant Date fair Value of Stock and option awards (\$) (2) (l)
		Threshold (\$) (c)	Target (\$) (d)	Maximum (\$) (e)	Threshold (\$) (f)	Target (\$) (g)	Maximum (\$) (h)				
Gary R. Weis	10/28/13	—	—	—	—	—	—	—	61,500	9.45	198,560
Kenneth A. Minor	10/28/13	—	—	—	—	—	—	—	33,825	9.45	108,800
Robert M. Lipps	10/28/13	—	—	—	—	—	—	—	33,825	9.45	108,800

- (1) Sonic grants employee stock options with exercise prices equal to the closing stock price on the date of grant.
- (2) The amount reported in column (l) represents the grant date fair value of the award following the required FASB ASC Topic 718 compensation methodology. Grant date fair value is calculated using the Lattice method. See Note 1, "Accounting for Stock Based Compensation" in the Notes to the Consolidated Financial Statements in Sonic's Form 10-K for the fiscal year ended September 30, 2014 for an explanation of the methodology and assumptions used in FASB ASC Topic 718 valuation. With respect to the option grants, there can be no assurance that the options will ever be exercised (in which case no value will be realized by the executive) or that the value on exercise will equal the FASB ASC Topic 718 value.

Sonic grants options to its executive officers under our employee stock option plans. As of September 30, 2014, options to purchase a total of 1,240,941 shares were outstanding under the plans, and options to purchase 873,266 shares remained available for grant thereunder.



## Outstanding Equity Awards at Fiscal Year-End

The following table shows information concerning outstanding equity awards as of September 30, 2014 held by the Named Executive Officers.

Name	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#) (d)	Option Exercise Price (\$) (e)	Option Expiration Date (f)	Number of Shares or Units of Stock That Have Not Vested (g)	Market Value of Shares or Units of Stock That Have Not Vested (h)	Equity Incentive Plan Awards: Number of Shares, Units or Other Rights That Have Not Vested (i)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (j)
Gary R. Weis	2,000	0	None	12.30	5/15/2015				
	2,000	0		17.40	3/15/2016				
	2,000	0		37.60	3/15/2017				
	2,000	0		8.00	3/6/2018				
	5,000	0		5.00	11/3/2018				
	2,000	0		5.50	3/5/2019				
	2,000	0		6.90	3/4/2020				
	2,000	0		14.83	3/3/2021				
	33,333	16,667		8.68	9/30/2021				
	24,334	48,666		7.80	10/17/2022				
0	61,500		9.45	10/28/2023					
Kenneth A. Minor	5,000	0	None	14.50	11/26/2014				
	12,000	0		15.50	12/04/2017				
	6,000	0		5.26	12/2/2019				
	14,120	0		15.21	11/24/2020				
	18,333	9,167		9.46	10/24/2021				
	13,333	26,667		7.80	10/17/2022				
	0	33,825		9.45	10/28/2023				
Robert M. Lipps	2,500	0	None	22.60	04/10/2016				
	750	0		37.10	12/07/2016				
	1,500	0		15.50	12/04/2017				
	2,500	0		7.50	03/10/2018				
	10,000	0		7.80	04/16/2018				
	6,000	0		5.30	11/10/2018				
	6,000	0		5.26	12/2/2019				
	14,120	0		15.21	11/24/2020				
	18,333	9,167		9.46	10/24/2021				
	13,333	26,667		7.80	10/17/2022				
	0	33,825		9.45	10/28/2023				

(1) All options were granted under either our stockholder approved Employee Stock Option Plans or the Non-Qualified Stock Option Plan. All unexercisable options listed in the table become exercisable over a three-year period in equal annual installments beginning one year from the date of grant.

### Option Exercises and Stock Vested

The following table shows information concerning option exercises in fiscal 2014 by the Named Executive Officers.

	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
None				

### 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)	1,169,883	\$ 10.10	873,266
Equity compensation plans not approved by security holders (2)	71,058	12.65	—
<b>Total</b>	<b>1,240,941</b>	<b>\$ 10.24</b>	<b>873,266</b>

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

### Compensation Committee Interlocks and Insider Participation

The members of the Executive Compensation Committee of Sonic's Board of Directors for fiscal 2014 were those named in the Executive Compensation Committee Report. No member of the Committee was at any time during fiscal 2014 or at any other time an officer or employee of Sonic Foundry, Inc.

No executive officer of Sonic Foundry, Inc. has served on the board of directors or compensation committee of any other entity that has or has had one or more executive officers serving as a member of the Board of Directors of Sonic Foundry.

## **PROPOSAL TWO: RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS**

The Board of Directors, upon the recommendation of the Audit Committee, has appointed the firm of Baker Tilly Virchow Krause LLP (“BT”) as independent auditors to audit our financial statements for the year ending September 30, 2015, and has further directed that management submit the selection of independent public accountants for ratification by the stockholders at the annual meeting. Representatives of BT are expected to be present at the annual meeting to respond to stockholders' questions and to have the opportunity to make any statements they consider appropriate.

Stockholder ratification of the selection of BT as our independent auditors is not required by our Bylaws or otherwise. However, the Board is submitting the selection of BT to the stockholders for ratification as a matter of good corporate practice. If the stockholders fail to ratify the selection, the Board and the Audit Committee will reconsider whether or not to retain that firm. Even if the selection is ratified, the Board and the Audit Committee in their discretion may direct the appointment of a different independent accounting firm at any time during the year if they determine that such a change would be in the best interests of Sonic and its stockholders.

The ratification of the appointment of BT as independent public accountants requires the approval of a majority of the votes cast at the Annual Meeting.

### **Recommendation of Board of Directors**

**The Board of Directors unanimously recommends a vote FOR proposal 2 ratifying the appointment of BT as independent auditors for Sonic Foundry.**

### **Relations with Independent Auditors**

On June 11, 2014, the Company, upon the recommendation of its audit committee, dismissed Grant Thornton LLP (“GT”) and appointed Baker Tilly Virchow Krause, LLP (“BT”) as its independent auditor for the fiscal year that commenced October 1, 2013.

During the years ended September 30, 2012 and 2013 and through June 11, 2014, neither the Company nor its audit committee consulted BT with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements, as defined in Item 304(a)(2)(i) of Regulation S-K, for which was concluded an important factor considered by the Company in reaching a decision as to the accounting, auditing or financial reporting issue. Likewise, neither the Company nor the audit committee consulted BT regarding any matter that was the subject of a disagreement or a reportable event, as defined in Item 304(a)(2)(ii) of Regulation S-K.

As stated in Proposal 2, the Board has selected BT to serve as our independent auditors for the fiscal year ending September 30, 2015.

Audit services performed by BT and GT for Fiscal 2014 and 2013 consisted of the examination of our financial statements, review of fiscal quarter results, and services related to filings with the Securities and Exchange Commission (SEC). We also retained GT to perform certain audit related services associated with the audit of our benefit plan, and tax preparation and consultative services associated with the preparation of Federal and State tax returns. All fees paid to BT and GT were reviewed, considered for independence and upon determination that such payments were compatible with maintaining such auditors' independence, approved by Sonic's audit committee prior to performance.

### **Fiscal Years 2014 and 2013 Audit Firm Fee Summary**

During fiscal years 2014 and 2013, we retained BT and GT to provide services in the following categories and amounts:

	Years Ended September 30,	
	2014	2013
<b><u>Grant Thornton LLP</u></b>		
Audit Fees	\$140,346	\$177,780
Audit Related	12,328	11,950
Tax Fees	33,500	26,940
<b><u>Baker Tilly Virchow Krause LLP</u></b>		
Audit Fees	\$172,925	—
Tax Fees	3,500	9,262

All of the services described above were approved by Sonic's audit committee prior to performance. The Audit Committee may, in its discretion, delegate to one or more of its members the authority to pre-approve any audit or non-audit services to be performed by the independent auditors, provided that any such approvals are presented to the Audit Committee at its next scheduled meeting. The audit committee has determined that the payments made to its independent accountants for these services are compatible with maintaining such auditors' independence.

## REPORT OF THE AUDIT COMMITTEE <sup>1</sup>

The Audit Committee's role includes the oversight of our financial, accounting and reporting processes, our system of internal accounting and financial controls and our compliance with related legal and regulatory requirements, the appointment, engagement, termination and oversight of our independent auditors, including conducting a review of their independence, reviewing and approving the planned scope of our annual audit, overseeing the independent auditors' audit work, reviewing and pre-approving any audit and non-audit services that may be performed by them, reviewing with management and our independent auditors the adequacy of our internal financial controls, and reviewing our critical accounting policies and the application of accounting principles. The Audit Committee held six meetings during fiscal 2014.

Messrs. Kleinman, Burish and Peercy meet the rules of the SEC for audit committee membership and are "independent" as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act and under Nasdaq listing standards. A copy of the Audit Committee Charter is available on Sonic's website.

As set forth in the Audit Committee Charter, management of Sonic is responsible for the preparation, presentation and integrity of Sonic's financial statements and for the effectiveness of internal control over financial reporting. Management and the accounting department are responsible for maintaining Sonic's accounting and financial reporting principles and internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. The independent auditors are responsible for auditing Sonic's financial statements and expressing an opinion as to their conformity with generally accepted accounting principles.

We have reviewed and discussed with our independent auditors, BT, matters required to be discussed pursuant to Auditing Standard No. 16 (Communications with Audit Committees) as promulgated by the Public Company Accounting Oversight Board. We have received from the auditors a formal written statement describing the relationships between the auditor and Sonic that might bear on the auditor's independence consistent with applicable requirements of the Public Company Accounting Oversight Board. We have discussed with BT matters relating to its independence, including a review of both audit and non-audit fees, and considered the compatibility of non-audit services with the auditors' independence.

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<sup>1</sup> The material in this report is not "soliciting material", is not deemed filed with the SEC, and is not to be incorporated by reference in any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in such filing.

The members of the Audit Committee are not full-time employees of Sonic and are not performing the functions of auditors or accountants. As such, it is not the duty or responsibility of the Audit Committee or its members to conduct “field work” or other types of auditing or accounting reviews or procedures or to set auditor independence standards. Members of the Committee necessarily rely on the information provided to them by management and the independent accountants. Accordingly, the Audit Committee’s considerations and discussions referred to above do not assure that the audit of Sonic’s financial statements has been carried out in accordance with generally accepted auditing standards, that the financial statements are presented in accordance with generally accepted accounting principles or that Sonic’s auditors are in fact “independent”.

We have reviewed and discussed with management and BT the audited financial statements. We discussed with BT the overall scope and plans of their audit. We met with BT, with and without management present, to discuss results of their examination and the overall quality of Sonic’s financial reporting.

Based on the reviews and discussions referred to above and our review of Sonic’s audited financial statements for fiscal 2014, we recommended to the Board that the audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended September 30, 2014, for filing with the SEC.  
Respectfully submitted,

AUDIT COMMITTEE  
David C. Kleinman, Chair  
Mark D. Burish  
Paul S. Peercy

## CERTAIN TRANSACTIONS

Frederick H. Kopko, Jr., a director and stockholder of Sonic Foundry, is a partner in McBreen & Kopko. Pursuant to the 1997 Directors' Stock Option Plan, Mr. Kopko has been granted options to purchase 4,000 shares of Common Stock at exercise prices ranging from \$17.40 to \$37.60 and was granted options to purchase 14,000 shares of Common Stock at exercise prices ranging from \$5.50 to \$14.83 pursuant to the 2008 Non-Employee Directors Plan. During fiscal 2014, we paid the Chicago law firm of McBreen & Kopko certain compensation for legal services rendered subject to standard billing rates. On December 22, 2014, Sonic Foundry, Inc. issued 35,905 and 38,897 shares of common stock to Mark D. Burish and Andrew D. Burish, respectively. The shares were issued at a price of approximately \$8.36 per share, representing the twenty-day average closing price on the period ending December 18, 2014. On December 22, 2014, the closing price of the Company’s common stock was \$7.68 per share. The shares are restricted from any sale, distribution or pledge of any kind for a two year period ending December 22, 2016. Messrs. Mark and Andrew Burish also received warrants to purchase 35,905 and 38,897 shares of common stock at an exercise price of \$14.00 per share, respectively, which expire on December 22, 2019. This transaction was approved by a committee of disinterested directors of the Company.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires Sonic's officers and directors, and persons who own more than ten percent of the Common Stock, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Based solely upon a review of Forms 3 and Forms 4 furnished to us pursuant to Rule 16a-3 under the Exchange Act during our most recent fiscal year, to Sonic Foundry's knowledge, all reporting persons complied with all applicable filing requirements of Section 16(a) of the Securities Exchange Act of 1934, as amended, with the exception of Mr. Mark Burish, who inadvertently filed a Form 4 on February 24, 2014 which was due February 21, 2014.

## **Code of Ethics**

Sonic has adopted a Code of Ethics (as defined in Item 406 of Regulation S-K) that applies to its principal executive, financial and accounting officers. Sonic Foundry will provide a copy of its code of ethics, without charge, to any investor who requests it. Requests should be addressed in writing to Mr. Kenneth Minor, Corporate Secretary, 222 West Washington Ave, Madison, WI 53703.

## **COMMUNICATIONS WITH THE BOARD OF DIRECTORS**

Any stockholder who desires to contact our Board or specific members of our Board may do so electronically by sending an email to the following address: *directors@sonicfoundry.com*. Alternatively, a stockholder can contact our Board or specific members of our Board by writing to: Secretary, Sonic Foundry Incorporated, 222 West Washington Avenue, Madison, WI 53703.

Each communication received by the Secretary will be promptly forwarded to the specified party following normal business procedures. The communication will not be opened but rather will be delivered unopened to the intended recipient. In the case of communications to the Board or any group or committee of Directors, the Secretary will open the communication and will make sufficient copies of the contents to send to each Director who is a member of the group or committee to which the envelope is addressed.

## **STOCKHOLDER PROPOSALS FOR 2016 ANNUAL MEETING OF STOCKHOLDERS**

### *Requirements for Stockholder Proposals to be Considered for Inclusion in Sonic's Proxy Materials.*

Stockholders of Sonic may submit proposals on matters appropriate for stockholder action at meetings of Sonic's stockholders in accordance with Rule 14a-8 promulgated under the Securities Exchange Act of 1934. For such proposals to be included in Sonic's proxy materials relating to its 2016 Annual Meeting of Stockholders, all applicable requirements of Rule 14a-8 must be satisfied and such proposals must be received by Sonic no later than the anniversary date of 120 days prior to the date of this proxy statement (September 29, 2015). Such proposals should be delivered to Corporate Secretary, Sonic Foundry, Inc., 222 West Washington Avenue, Madison, Wisconsin 53703.

### *Requirements for Stockholders Proposals to be Brought Before the Annual Meeting.*

Sonic's bylaws provide that, except in the case of proposals made in accordance with Rule 14a-8, for stockholder nominations to the Board of Directors or other proposals to be considered at an annual meeting of stockholders, the stockholder must have given timely notice thereof in writing to the Secretary not less than ninety nor more than one hundred twenty calendar days prior to the anniversary of the date on which Sonic held its immediately preceding annual meeting of stockholders. To be timely for the 2016 Annual Meeting of Stockholders, a stockholder's notice must be delivered or mailed to and received by Sonic's Secretary at the principal executive offices of Sonic between November 5, 2015 and December 5, 2015. However, in the event that the annual meeting is advanced by more than 30 days or delayed by more than 60 days from March 5, 2016, to be timely, notice by the stockholders must be so received not earlier than the close of business on the 120th day prior to such annual meeting and not later than the close of business on the later of the 90th day prior to such annual meeting or the tenth calendar day following the date on which public announcement of the date of the annual meeting is first made. In no event will the public announcement of an adjournment of an annual meeting of stockholders commence a new time period for the giving of a stockholder's notice as provided above. A stockholder's notice to Sonic's Secretary must set forth the information required by Sonic's bylaws with respect to each matter the stockholder proposes to bring before the annual meeting.

In addition, the proxy solicited by the Board of Directors for the 2016 Annual Meeting of Stockholders will confer discretionary authority to vote on (i) any proposal presented by a stockholder at that meeting for which Sonic has not been provided with notice on or prior to the anniversary date of 45 days prior to the date of this proxy statement (December 13, 2015) and (ii) any other proposal, if the 2016 proxy statement briefly describes the matter and how

management's proxy holders intend to vote on it, and if the stockholder does not comply with the requirements of Rule 14a-4(c)(2) under the Securities Exchange Act of 1934. Notwithstanding the above, all stockholder proposals must comply with the provisions of Sonic's bylaws.

### OTHER MATTERS

The Board of Directors has at this time no knowledge of any matters to be brought before this year's Annual Meeting other than those referred to above. However, if any other matters properly come before this year's Annual Meeting, it is the intention of the persons named in the proxy to vote such proxy in accordance with their judgment on such matters.

### GENERAL

A copy of our Annual Report to Stockholders for the fiscal year ended September 30, 2014 is being mailed, together with this Proxy Statement, to each stockholder. Additional copies of such Annual Report and of the Notice of Annual Meeting, this Proxy Statement and the accompanying proxy may be obtained from us. We will, upon request, reimburse brokers, banks and other nominees, for costs incurred by them in forwarding proxy material and the Annual Report to beneficial owners of Common Stock. In addition, directors, officers and regular employees of Sonic and its subsidiaries, at no additional compensation, may solicit proxies by telephone, telegram or in person. All expenses in connection with soliciting management proxies for this year's Annual Meeting, including the cost of preparing, assembling and mailing the Notice of Annual Meeting, this Proxy Statement and the accompanying proxy are to be paid by Sonic.

**Sonic will provide without charge (except for exhibits) to any record or beneficial owner of its securities, on written request, a copy of Sonic's Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended September 30, 2014, including the financial statements and schedules thereto. Exhibits to said report, and exhibits to this proxy statement, will be provided upon payment of fees limited to Sonic's reasonable expenses in furnishing such exhibits. Written requests should be directed to Investor Relations, 222 West Washington Avenue, Madison, Wisconsin 53703. We also make available, free of charge, at the "Investor Information" section of our website, our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, our proxy statement, amendments and exhibits to such reports as soon as practicable after the filing of such reports, exhibits and proxy statements with the Securities and Exchange Commission.**

In order to assure the presence of the necessary quorum at this year's Annual Meeting, and to save Sonic the expense of further mailings, please date, sign and mail the enclosed proxy promptly in the envelope provided. No postage is required if mailed within the United States. The signing of a proxy will not prevent a stockholder of record from voting in person at the meeting.

By Order of the Board of Directors,



Kenneth A. Minor, Secretary

January 27, 2015

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

**FORM 10-K**

(Mark One)

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

For the fiscal period ended September 30, 2014

**OR**

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

Commission File Number

000-30407

**SONIC FOUNDRY, INC.**  
(Exact name of registrant as specified in its charter)

**MARYLAND**  
(State or other jurisdiction of incorporation or organization)

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

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

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

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

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

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

Yes  No

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

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Yes  No

The aggregate market value of the registrant's common stock held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the Registrant's most recently completed second fiscal quarter was approximately \$40,992,000.

The number of shares outstanding of the registrant's common equity was 4,263,754 as of December 5, 2014.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2014 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, 2015.

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**Sonic Foundry, Inc.**  
**Annual Report on Form 10-K**  
**For the Year Ended September 30, 2014**

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

**PART I**

**ITEM 1. BUSINESS**

**Who We Are**

Sonic Foundry (NASDAQ: SOFO) is the trusted market leader for video capture, management and webcasting solutions in education, business and government. The patented Mediasite Enterprise Video Platform transforms communications, training, education and events. The company empowers organizations to reach everyone through the power of video to accelerate knowledge-sharing, preserve valuable content, build stronger teams and get results.

Today, over 3,000 customers in over 60 countries use Mediasite to capture, stream and manage a vast number of video hours with millions of viewers around the world. According to usage statistics among our education customers, a student starts watching Mediasite every second, adding up to over 30 million views annually.

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

**Challenges We Address**

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

- Ensuring learners’ academic and professional success
- Connecting with a geographically-dispersed audience
- Improving productivity and overall organizational knowledge
- Reducing logistical and financial impacts
- Avoiding cumbersome and restrictive technologies

**Sonic Foundry, Inc.**  
**Annual Report on Form 10-K**  
**For the Year Ended September 30, 2014**

**Sonic Foundry Solutions**

Sonic Foundry is changing the way organizations share and use information with these solutions:

**Mediasite Enterprise Video Platform**

Mediasite Enterprise Video Platform is the trusted cornerstone to enterprise and campus video content management strategies. It's a powerful and flexible system to deliver rich interactive video – live and on-demand – to any user on any screen. Video content can be created anywhere – training rooms, classrooms, videoconferences, desktops and mobile devices, studios and live events. Regardless of the source, Mediasite Enterprise Video Platform ensures all content has a secure, central home. We understand the incredible value and power of quickly publishing, easily retrieving and ultimately measuring the impact of video content.

- **Publish:** Distribute and archive content where and when users most need it
- **Organize:** Archive and index content in video portals or channels so busy learners can quickly find what they need
- **Search:** Pinpoint important information in just seconds with advanced indexing and automated metadata creation
- **Analyze:** Monitor who is watching what and when in order to measure learning outcomes or program effectiveness
- **Edit:** Put the finishing touches on recorded content and easily repurpose video
- **Secure:** Guarantee only authorized users access content with role-based directory integration

**Mediasite Cloud**

Mediasite Cloud provides a reliable, worry-free option for video streaming and content management projects of any size. Customers conveniently host and manage all of their content with our SaaS-based Mediasite Cloud or use as needed for important and large events to divert heavy viewing traffic from their on-premises Mediasite Platform. Our co-located and high availability Mediasite Cloud data center and experienced team are in place to successfully manage our customer's video streaming needs. Clients increasingly trust Mediasite Cloud and Sonic Foundry to provide a secure, fault-tolerant environment for their valuable content.

**Mediasite Capture Solutions**

Valuable knowledge and expertise is shared every minute, but what's the best way to capture that knowledge before it evaporates into thin air? Mediasite provides flexible options to record and upload any content from anywhere.

- **My Mediasite:** My Mediasite empowers faculty, trainers, staff and students to create and share video, training modules, lectures or assignments wherever they are. It's a friendly launch pad for users to record, upload, manage and publish their own video content from their laptop, computer, or mobile device.
- **Mediasite RL Recorders:** In lecture halls, training rooms, board rooms and auditoriums, Mediasite RL Recorder's automated and schedule-driven content capture speeds user adoption, cuts publishing delays and minimizes support requirements for high volume live and on-demand streaming.
- **Mediasite MultiView Recorders:** For sophisticated training scenarios, simulations or complex procedures, Mediasite MultiView Recorders uniquely capture and simul-stream multi-video content from up to four content sources.
- **Mediasite ML Recorders:** Designed for on-the-go webcasting, hybrid events, guest speakers and conferences, Mediasite ML's lightweight, portable design moves easily from location to location and can be set up and ready to record in only a few minutes.

**Sonic Foundry, Inc.**  
**Annual Report on Form 10-K**  
**For the Year Ended September 30, 2014**

**Mediasite Events**

Mediasite Events is a leading global provider of live and on-demand webcasting for hybrid events and high-profile meetings, supplying turnkey streaming solutions for close to 700 events each year. The group works with Fortune 500 corporations, universities, associations, sporting events and charitable organizations to produce successful, high-quality online experiences that score rave reviews and achieve event goals. With Mediasite Events, customers:

- Expand their audience by reaching those that cannot attend in person
- Generate additional revenue streams to maximize event ROI
- Engage remote audiences and differentiate themselves from competing events
- Bolster training and communication effectiveness with interactive video
- Build stronger teams and deepen morale
- Save travel time and money
- Improve retention and learning outcomes

**Mediasite Services**

Organizations maximize their return on video with these additional Mediasite Services:

- Advanced Integration Services: The value of Mediasite Enterprise Video Platform is further enhanced when customers' video assets and streaming workflows seamlessly integrate with the systems that drive their online learning, training or communication strategies. Mediasite Advanced Integration Services provides the resources and expertise to incorporate Mediasite video creation, management and delivery processes into existing or planned application platforms, infrastructures and workflows. Leveraging Mediasite's open architecture and application programming interfaces (APIs), Sonic Foundry developers collaborate with customers to scope, design and implement a Mediasite solution tailored to their unique requirements.
- Installation Services: Sonic Foundry provides on-site consulting and installation services to help customers optimize deployments and efficiently integrate Mediasite within existing AV and IT infrastructures, processes and workflows.
- Training Services: Expert Sonic Foundry trainers provide the necessary knowledge transfer so organizations feel confident in using, managing and leveraging Mediasite's capabilities. On-site training is customized to specific requirements and skill levels, while online training provides convenient anytime access to a web-based catalog of training modules.

**Mediasite Customer Assurance**

Sonic Foundry's annually renewable maintenance and support plans provide customers access to technical expertise and Mediasite software updates. With a Mediasite Customer Assurance contract, customers are entitled to:

- Software upgrades and updates for Mediasite Enterprise Video Platform and Mediasite Capture Solutions
- Unlimited technical support assistance
- Mediasite Recorder hardware warranty extension
- Advanced Mediasite Recorder replacement
- Authorized access to the Mediasite Customer Assurance Portal where they can access software downloads, documentation, the Mediasite Knowledge Base, video tutorials and technical resources at any time.

Nearly all of our customers purchase a Customer Assurance plan when they purchase Mediasite Enterprise Video Platform or Mediasite Capture Solutions.

**What Sets Mediasite Apart?**

For enterprises to maximize their return on video, it takes more than capturing, storing and streaming content. The true impact and power of video is realized when content is *transformed* into highly interactive learning experiences rich with searchable metadata and detailed viewing statistics. The Mediasite advantage comes from:

- **Interactive, consistent playback experiences across devices** – By engaging the viewer's auditory, visual and kinesthetic senses, Mediasite increases content comprehension and retention. Unconstrained by viewing device or traditional webcast layouts, Mediasite involves the viewer in their online video experience with polls, bookmarks, sharing, ask-a-question, resource links and more. Plus, Mediasite's consistent playback experience across all devices significantly reduces learning curves and accelerates adoption and content mastery.
- **Auto-indexing and powerful video search** – We understand the need to bring order to growing video libraries so content can be found, used and re-purposed. Mediasite's unique auto-scan and index capabilities for slides,

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tags and audio transcripts, make all video discoverable – saving users immeasurable time with Mediasite’s TotalSearch engine.

- **Analytics** – Measuring the impact and value of video initiatives is critical to their ongoing success. With Mediasite, powerful analytics tools show exactly who is watching what content when and provide the deep insight needed to:
  - Analyze patterns in viewing frequency and behavior
  - Correlate these trends to learning outcomes, individual performance and overall program effectiveness
  - Measure return on investment
  - Make informed decisions about e-learning programs
  - Plan effectively for future needs and system expansion

Mediasite uniquely sets itself apart as a complete platform that addresses all phases of the video lifecycle – from content creation to delivery to retention and management. Unlike many competing platforms that focus only on a subset of capabilities to support that lifecycle, customers can leverage Mediasite as a total solution for all enterprise video needs. Plus, Mediasite’s comprehensive portfolio of video creation solutions and deployment options provides customers the flexibility and scalability they need to develop a comprehensive enterprise video strategy.

Sonic Foundry and the growing Mediasite Community provide a reliable, collaborative support network for all Mediasite customers. Our worldwide network of field-based system engineers and responsive customer care ensure that customers have readily available resources committed to their success. Plus, with over 1,800 active customer members, the Mediasite Community is one of the most vibrant and growing user communities for video, webcasting, lecture capture and e-learning. Members share ideas and get feedback year-round from community experts through a private online portal, live quarterly webcasts and unrivaled networking and learning opportunities at Unleash, the annual Mediasite User Conference, and other regional customer events.

**Sonic Foundry Solutions in Higher Education:**

Among post-secondary institutions, Mediasite is used for all academic and campus environments, including:

- Lecture capture
- Flipped classroom instruction: students view lectures from home and use classroom time for discussion
- Distance learning
- Continuing education
- Campus YouTube
- Special events: commencement, guest speakers, sporting events, etc.
- Faculty training and development
- Student video
- Recruitment and admissions
- University business: leadership meetings, alumni relations, outreach

Through interviews, many higher education institutions report that Mediasite:

- Improves student learning outcomes
- Keeps their institution competitive by supporting higher enrollment and/or tuition without new classrooms
- Empowers faculty with technology supporting new teaching pedagogies both in the classroom and online
- Boosts campus outreach, recruitment efforts and awareness of campus events
- Helps campuses manage, secure and search all campus video



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Recent trends in video drive more departments to adopt online education. Some examples include blended or hybrid courses, fully online distance learning programs, dual enrollment programs and flipped classrooms. Historically, graduate programs and STEM (science, technology, engineering and math)-oriented degree programs in schools of medicine, nursing, engineering or business have comprised the majority of our academic customer base. We are now experiencing heightened market demand for academic video within undergraduate and community college programs as well.

According to the Center for Digital Education report, *The Upside of Upside Down: Faculty Perspectives on the Flipped Classroom, 2013*, there's growing faculty and student demand for this technology-driven pedagogy relying on video. In fact, more than two-thirds of faculty – 70 percent – are already using or are planning to employ the model by the end of 2014. The top factors driving U.S. colleges to embrace flipped classrooms include: the ability to provide a better learning experience for students, greater availability of technologies that support the model, and positive results from initial trials. As the first comprehensive national faculty survey on this technology-driven approach, the study also reveals that among those employing it already, 57 percent of faculty agree that their flipped classroom is “extremely successful” or “successful”, citing key student benefits of “improved mastery of information” and “improved retention of information”, at 81 percent and 80 percent of responses respectively.

According to the Babson Survey Research Group and Sloan Consortium report, *Grade Change: Tracking Online Education in the United States* over 7.1 million students were taking at least one online course during the fall 2012 term, an increase of 411,000 students over the previous year. That number represents 33% of all higher education students. The proportion of chief academic leaders that say online learning is critical to their long-term strategy is now at 66%. Community colleges, specifically, have significantly increased their number of blended or hybrid and web-enhanced courses. The Instructional Technology Council's “2013 Distance Education Survey Results: *Trends in eLearning: Tracking the Impact of eLearning at Community Colleges* (April 2014)” reports that “a robust, steady increase in the popularity for online learning continues.” The report states that students have “voted with their feet, by enrolling in distance education courses when they are available.” From fall 2012 to fall 2013, ITC's survey participants reported 5.2 percent growth in student enrollment in their online programs.

Analysts predict the lecture capture market will more than triple over the next six years. Frost & Sullivan analysts estimate lecture capture revenues will reach over \$175.8 million by 2016, exhibiting a nearly 20.7 percent compound annual growth rate (CAGR) for the six-year period (*Global Enterprise Video Webcasting and Lecture Capture Solutions Markets* report, 2013).

All of these findings point to growth of academic video on college and university campuses. A recent whitepaper by University Business, *Academic Video at a Tipping Point: Preparing Your Campus for the Future*, spells out how advances in technology, the rise of course capture platforms and expectations among faculty and students, have all pushed academic video to reach a tipping point. The whitepaper can be downloaded at [www.sonicfoundry.com/UBwhitepaper](http://www.sonicfoundry.com/UBwhitepaper).

To remain relevant, colleges and universities are striving to differentiate themselves through technical leadership as a means to attract these tech-savvy students, while balancing their campus technology improvements with systems that faculty will embrace and adopt. As a result, the education market is restructuring and increasing investments around online learning.

The visible integration of video-based learning content into core university applications like learning management systems (LMSes) and the success of bundled online learning technology solutions are two healthy indicators for the widespread adoption of campus video. LMSes like Canvas by Instructure, Brightspace™/Desire2Learn®, Blackboard®, Moodle and Sakai are ubiquitous in the education enterprise. As the foundation for e-learning, these systems are rapidly evolving to be students' single-source portal for all course-related materials including recorded lecture and assignment videos. Mediasite's packaged LMS integrations and support for the Learning Tools Interoperability (LTI) standard, address the need to make learning content accessible to students when and where they need it. Similarly, video content management platforms are emerging as repositories for campus' media-centric content. These platforms provide additional opportunities through which to make Mediasite content accessible to faculty, staff and students.

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**Sonic Foundry Solutions in the Enterprise:**

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

In corporate enterprises it is used for:

- Executive communications: state of the enterprise speeches, town hall meetings
- Workforce development: training, HR briefings, policy documentation, secure corporate YouTube
- Sales, marketing and customer support
- Investor relations: earnings calls, analyst briefings, annual reports
- Conferences and events: user group, sales and annual meetings

In health-related enterprises it is used for:

- Education and conferences: continuing medical education, grand rounds, seminars
- On-demand medical information
- Caregiver training
- Emergency response coordination and public health announcements
- Research and collaboration

In government agencies it is used for:

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

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

- Expands training and communications opportunities
- Cuts travel and meeting expenses
- Boosts efficiency by allowing participants to watch when it's convenient to avoid interruptions and increase retention
- Helps build stronger teams through direct management/employee communications

Executives, event planners and line of business managers for human resources/talent development, sales, marketing, and customer service are pushing for more video in their organizations to improve communication, collaboration and results.

In its 2013 report, *Global Enterprise Video Webcasting and Lecture Capture Solutions Markets*, industry analyst Frost & Sullivan cites rapid growth of the worldwide enterprise video webcasting market, anticipating the market to grow at a compound annual growth rate of 27.2 percent from 2011-2016.

Aragon Research reports that rich media assets that are produced in marketing webinars, webcasts, training, sales communications and other interactions are growing at explosive rates. In its March 2014 research note, *Manage Interactive Content with Video Content Management*, the firm predicts that “by 2016, interactive presentations and video documents will be accepted formats for basic knowledge transfer,” and “by year-end 2018, video documents will replace text documents as the leading form of digital content.”

**Future Direction**

Video management, webcasting and lecture capture are becoming an everyday part of the way people work and learn. We strive to shorten the time it takes to not only capture and distribute information but to also transform video into more interactive, discoverable content with rich management, search and analytics capabilities. As a company, we are helping create and manage the video libraries of tomorrow. Our ongoing innovations center on supporting this vision by:

- Advancing enterprise video content management to accommodate organizations' existing digital video assets, content generated from third-party video sources and the corresponding metadata associated with those video assets.
- Introducing new applications to easily publish, search and retrieve videos from a video library as well as expanding and automating Mediasite's powerful multi-modal search capabilities.

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- Offering the industry’s widest variety of content capture solutions capable of scaling economically across entire organizations and allowing anyone, on any device, to capture and share their knowledge or expertise.
- Delivering content capture solutions that test the limits of recording, synchronizing and playing back multiple high definition video sources.
- Supporting consistent, interactive content playback experiences across all viewing devices.
- Deepening integration with core enterprise platforms including learning and course management systems (LMS/CMS), content management systems, enterprise collaboration platforms and student information systems (SIS).
- Introducing market-driven innovations to our Mediasite Cloud offering.

**Segment Information**

We have determined that in accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 280-10, *Segment Reporting*, we operate in three operating segments, however these segments meet the criteria for aggregation for reporting purposes as one reporting segment as of September 30, 2014. Prior to the acquisitions in the year ended September 30, 2014, we reported in one operating segment. Therefore, such information is not presented.

Our services are typically billed and collected in advance of providing the service which requires minimal cost to perform in the future. Billings, which are a non-GAAP measure, are a better indicator of customer activity and cash flow than revenue is, in management’s opinion, and is therefore used by management as a key operational indicator. Billings is computed by combining revenue with the change in unearned revenue. Total billings for Mediasite product and support outside the United States totaled 37 percent and 29 percent in fiscal 2014 and 2013, respectively.

Our largest individual customers are typically value added resellers (“VARs”) and distributors since the majority of our end users require additional complementary products and services which we do not provide. Accordingly, in fiscal 2014 and 2013 one master distributor, Synnex Corporation (“Synnex”), contributed 15 percent and 20 percent, respectively, of total world-wide billings. A second master distributor, Starin Marketing, Inc. (“Starin”), contributed 15 percent and 22 percent of total world-wide billings in fiscal 2014 and 2013, respectively. As master distributors, Synnex and Starin fulfill transactions to VARs, end users and other distributors. No other customer represented over 10 percent of billings in 2014 or 2013.

**Sales**

We sell and market our offerings through a sales force that manages a channel of value-added resellers, system integrators, consultants and distributors. These third party representatives specialize in understanding both audio/video systems and IT networking. In fiscal 2014, we utilized two master distributors in the U.S. and approximately 200 resellers, and sold our products to over 1,300 total end users. Our focus has been primarily in the United States and primarily to customers we have identified as having the greatest potential for high use; that is, organizations with presenters, trainers, lecturers, marketers, event planners and leaders who have a routine need to communicate to many people in higher education, government, health and certain corporate markets. Despite our historical attention on the United States market, reseller, customer interest and sales outside the United States has grown and accordingly, we made two international acquisitions in fiscal 2014 in the Netherlands and Japan, significantly increasing our international headcount in sales, operations, technical and administrative positions to 55. To date, we have sold our products to customers in over 60 countries outside the United States. Total non-GAAP billings for Mediasite product and support outside the United States totaled 37 percent and 29 percent in fiscal 2014 and 2013, respectively.

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

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

With Mediasite Events, we continue to see growing demand for conference webcasting and hybrid events (conferences which combine both face-to-face meeting and viewing over the web). These event-based communication, education and training applications, combined with outsourced webcasting services, are expected to drive the company's corporate sales activities going forward.

**Repeat orders:** Many customers initially purchase a small number of Mediasite Recorders to test or pilot in a department, school or business unit. A successful pilot project and the associated increase in webcasting demand from other departments or schools leads to follow up, multiple Recorder orders as well as increased Mediasite Server capacity. In fiscal 2014, 77 percent of billings were to preexisting customers compared to 81 percent of billings in fiscal 2013.

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

### **Marketing**

Marketing efforts span the spectrum of thought leadership and best practices webinars, tradeshow, product demonstrations, websites, public relations, social media, direct mail, e-mail campaigns, newsletters, print and online advertising, sponsorships, Mediasite Community-building, annual user conference, brochures, white papers and analyst relations. We often publish 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 platform and Mediasite Events. We have a large, growing database of potential customers in the education, corporate and government marketplaces and regularly execute demand generation activities to target specific verticals that have a direct and demonstrated need for our offerings.

### **Operations**

We contract with a third party to build the hardware for our Mediasite Recorders and purchase quantities sufficient to fill specific customer orders, including purchases of inventory by resellers. Quantities are maintained in inventory by the third party 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 Mediasite Customer Assurance support and maintenance plan. We believe there are alternative sources of manufacturing for our recorders and believe there are numerous additional sources and alternatives to the existing production process. We have experienced delays in production of our products and component parts used in our products in the past and expect to continue to maintain excess quantities of inventory in the future to mitigate the risk of such delays. To date, we have not experienced any material returns due to product defects.

## **OTHER INFORMATION**

### **Competition**

Various vendors provide lecture capture, enterprise webcasting or video content management capabilities, but few offer an end-to-end solution that addresses all phases of the video content lifecycle (capture, delivery, transformation and management) in a single platform like Mediasite.

**Lecture capture solutions** designed specifically for higher education differ in their technology approach.

- Appliance- or room-based lecture capture provides a fully integrated system with complete recording automation for live or on-demand content. The automated, pre-scheduled workflow results in the greatest faculty and staff adoption and largest volumes of recorded content in the shortest amount of time.

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- Software-based lecture capture that resides on a podium or computer in the classroom also captures and publishes rich media content, but relies on campus- or user-supplied hardware.
- Desktop capture tools reside on individual users' laptops or computers allowing them to record user-generated content.

Few lecture capture vendors, offer a mix of all lecture capture approaches to best suit customers' needs. Most vendors, including Crestron, Panopto and Tegrity, support only one approach to lecture capture. Likewise, a very small number of vendors provide an integrated platform like Mediasite to archive and manage video and rich media recorded with their solution. Most rely on a third-party platform, typically the institution's learning or course management system, to publish, search and secure content.

**Enterprise video management solutions** (e.g. Kaltura, Qumu) serve as centralized media repositories that facilitate the delivery, publishing and management of on-demand video. Unlike Mediasite, most platforms do not include a video capture, webcasting or live streaming component, but instead ingest or import video-based content captured by other third-party devices or solutions. Also, most other platforms focus on ingesting video-only content rather than rich video which combines multiple synchronous video and/or slide streams into an interactive media experience.

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

Solutions that are designed primarily to address other online communication needs sometimes compete with Mediasite. Typically, these solutions are complementary to and integrated with the Mediasite solution:

- **Web and video conferencing** (e.g. Adobe, Cisco TANDBERG, Cisco WebEx, Citrix, and Polycom). These solutions are designed primarily for synchronous, collaborative communication versus one-to-many communications like Mediasite. Many organizations acknowledge that they need both conferencing and webcasting technologies to appropriately address their different communication requirements. Since most conferencing platforms lack sophisticated content management capabilities, customers use Mediasite Enterprise Video Management Platform to ingest conference content for centralized management and the added benefits of interactive playback, searchability, analytics and security.
- **Authoring tools** (e.g. TechSmith). Unlike webcasting, web conferencing or video conferencing, which capture and stream content as it occurs in real-time, these tools are used to produce and edit on-demand video or screencast content. The authoring process can require a significant amount of production and user expertise. Mediasite ingests content produced by popular authoring tools like TechSmith's Camtasia— allowing the content to be delivered, managed and secured.
- **Virtual event platforms** (e.g. INXPO, ON24). These companies offer cloud-based virtual meeting environments for online conferences, tradeshows and meetings. The platforms often include the ability to embed or link to streaming video or webcasts within the interactive environment. In some instances, Mediasite content is integrated into these virtual meeting environments and streamed live or on-demand.

### **Intellectual Property**

The status of United States patent protection in the Internet industry is not well defined and will evolve as the U.S. Patent and Trademark Office grants additional patents. Currently four U.S. patents have been issued to us and we may seek additional patents in the future. We do not know if 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 our patents which have been issued 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. Any future, patent applications may not result in the issuance of valid patents.

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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 four 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 or may be required to defend against alleged infringement claims filed against our customers due to indemnification agreements. We may be unaware of filed patent applications which have not yet been made public and which relate to our services.

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

### **Research and Development**

We believe that our future success will depend in part on our ability to continue to develop new business, and to enhance our existing business. Accordingly, we invest a significant amount of our resources in research and development activities. During each of the fiscal years ended September 30, 2014 and 2013, we spent \$5.6 million and \$4.3 million, respectively, on internal research and development activities in our business. These amounts represent 16% and 15%, respectively, of total revenue in each of those years. The increase reflects our decision to accelerate development on identified new products as well as enhancements to existing products.

### **Global Expansion**

We completed the acquisitions of MediaMission in the Netherlands and Mediasite KK in Japan in fiscal 2014. With these acquisitions, we expect to significantly expand our global market reach in the Asia-Pacific Region and Europe, and accelerate our commitment to enterprise video communication world-wide.

### **Employees**

At September 30, 2014 and 2013, we had 183 and 116 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.

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**ITEM 1A. RISK FACTORS**

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

***Economic conditions could materially adversely affect the Company.***

With the continued global economic pressure experienced in fiscal 2014, there is a continuing risk of further weakening in conditions, particularly with those customers that rely on local, state or Federal government funding. Japan experienced a decline in its gross domestic growth rate in fiscal 2014 as well as delays in certain government programs, both of which had a negative impact on our recently acquired operation in Japan. Any continuing unfavorable economic conditions could continue to negatively affect, our business, operating results or financial condition, which could in turn affect our stock price. Weak economic conditions and the resulting impact on the availability of public funds along with the possibility of state and local budget cuts and reduced university enrollment could lead to a reduction in demand for our products and services. In addition, a prolonged economic downturn could cause insolvency of key suppliers resulting in product delays, inability of customers to obtain credit to finance purchases of the Company's products and inability or delay of our channel partners and other customers to pay accounts receivable owed to us.

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

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

***We may need to raise additional capital.***

At September 30, 2014 we had cash of \$4.3 million and availability under our line of credit facility with Silicon Valley Bank of \$3.0 million. At September 30, 2014, of the \$4.3 million aggregate cash and cash equivalents held by the Company, the amount of cash and cash equivalents held by our foreign subsidiaries was \$2.9 million. The Company has historically financed its operations primarily through cash from sales of equity securities, and to a limited extent, cash from operations and through bank credit facilities. The Company has a history of operating losses and used cash in operations in certain periods, including in fiscal 2014. While the Company expects to increase revenue in fiscal 2015 and manage expense growth to a level less than anticipated growth in revenues, we cannot ensure that revenue will grow as anticipated and, if revenue is determined to be growing at a rate less than anticipated, it may be too late to reduce expenses for fiscal 2015. The Company's recent international acquisitions included notes payable to the sellers as a component of consideration. Those notes require payments in fiscal 2015 of approximately \$2.1 million and the operations could require additional capital resources to fund operations or equipment purchases. If the funds held by our foreign subsidiaries are needed for our operations in the United States, the repatriation of some of these funds to the United States could require payment of additional U.S. taxes.

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

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. The Company believes its cash position and available credit is adequate to accomplish its business plan through at least the next twelve months.

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

Our investments in growing revenues have generated losses in most years. Despite our plans to grow revenue to a greater extent than expenses in fiscal 2015 and beyond, we may not realize sufficient revenues to reach or sustain profitability on a quarterly or annual basis. For the year ended September 30, 2014, we had a gross margin of \$25.6 million on revenue of \$35.8 million with which to cover selling, marketing, product development and general and administrative costs. Our selling, marketing, product development and general and administrative 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. Operating costs in fiscal 2014 also included significant costs of closing two acquisitions and defending and settling a patent infringement lawsuit. Fluctuations in profitability or failure to maintain profitability have and will likely impact the price of our stock in the future.

***Multiple unit deals are needed for continued success.***

We need to sell multiple units to educational, corporate and government institutions in order to sell most efficiently and remain profitable. In fiscal 2014 and fiscal 2013, 77% and 81% of revenue was generated by sales to existing customers, respectively. In particular, sales of multiple units to corporate customers have lagged behind results achieved in the higher education market; consequently, we have allocated more resources to the higher education market. While we have addressed a strategy to leverage existing customers and close multiple unit transactions, a customer may choose not to make expected purchases of our products. The failure of our customers to make expected purchases will harm our business.

***Manufacturing disruption or capacity constraints would harm our business.***

We subcontract the manufacture of our recorders to one third-party contract manufacturer. Although we believe there are multiple sources of supply from other contract manufacturers as well as multiple suppliers of component parts required by our contract manufacturer, a disruption of supply of component parts or completed products, even if short term, would have a material negative impact on our revenues. Many component parts currently have long delivery lead times or cease production of certain components with limited notice in which to evaluate or obtain alternate supply, requiring conservative estimation of production requirements. Lengthening lead times, product design changes and other third party manufacturing disruptions have caused delays in delivery. In order to compensate for supply delays, we have sourced components from off-shore sources, used cross component parts, paid significantly higher prices or extra fees to expedite delivery for short supply components, and currently hold substantially larger quantities of inventory than in the past. Many of these strategies have increased our costs or require substantial resources to maintain and may not be sufficient to ensure against a product shortage. We depend on our subcontract manufacturer to produce our products efficiently while maintaining high levels of quality. Any manufacturing or component defects, delay in production or changes in product features will likely cause customer dissatisfaction and may harm our reputation. Moreover, any incapacitation of the manufacturing site due to destruction, natural disaster or similar events could result in a loss of product inventory. As a result of any of the



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foregoing, we may not be able to meet demand for our products, which could negatively affect revenues in the quarter of the disruption or longer depending upon the magnitude of the event, and could harm our reputation.

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

Most of our customers and potential customers are public colleges, universities, schools and other education providers who depend substantially on government funding. Accordingly, any general decrease, delay or change in federal, state or local funding for colleges, universities, schools and other education providers could cause our current and potential customers to reduce or delay their purchases of our products and services, or to decide not to renew service contracts, either of which could cause us to lose revenues. In addition, a specific reduction in governmental funding support for products such as ours would also cause us to lose revenues. Unfavorable economic conditions may result in further budget cuts and lead to lower overall spending, including information technology spending, by our current and potential clients, which may cause our revenues to decrease.

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

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

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

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

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

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

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

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

Our largest potential sources of revenue are educational institutions, large corporations and government entities that often require long testing and approval processes before making a decision to purchase our products, particularly when evaluating our products for inclusion in new buildings under construction, high dollar transactions or competitive bids.

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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. In addition, educational institutions that started with small pilots are committing to more complex installations. Further, our educational market is expanding to include undergraduate classrooms, which, due to the increased size of these types of transactions, typically require a longer sales cycle. Also, our enterprise accounts are less motivated by seasonal sales and promotions, and therefore are frequently difficult to finalize. As a result of these factors, our sales and deployment cycles are unpredictable. Our sales and deployment cycles are also subject to delays as a result of customer-specific factors over which we have little or no control, including budgetary constraints and internal approval procedures, particularly with customers or potential customers that rely on government funding.

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

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

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

Revenue for any particular quarter is extremely difficult to predict with any degree of certainty. We typically ship products within a short time after we receive an order and therefore, we 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 and inventory levels are based largely on these estimates. In addition, our event business is particularly unpredictable and subject to variation due to the short time-frame between when we learn of an opportunity and when the event occurs. Further, the majority of our product orders are received in the last month of a quarter; thus, the unpredictability of the receipt of these orders could negatively impact our future results. We historically have received all or nearly all our channel partner orders in the last month of a quarter and often in the last few days of the quarter. Accordingly, any significant shortfall in demand for our products or services in relation to our expectations, even if the result was a short term delay in orders, would have an adverse impact on our operating results.

We have experienced growing demand for our hosting and event services as well as a growing preference from our customers in purchasing our software as a service (SaaS). As a result, we expect that service billings as a percentage of total billings will continue to grow which we believe will ultimately lead to more recurring revenue. We subcontract for some services required by our events customers, such as onsite management labor and closed captioning. We typically charge for such services at a lower margin than other services. The percentage of billings represented by services, provided either directly or indirectly, is also likely to fluctuate from quarter to quarter due to seasonality of event services and other factors. Since content hosting and support services are typically billed in advance of providing the service, revenue is initially deferred, leading to reduced current period revenue with a corresponding negative impact to profits or losses in periods of significant increase in the percentage of our billings for deferred services.

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***The market price of our common stock may be subject to volatility***

The trading prices of the securities of technology companies have been highly volatile. Factors affecting the market price of our common stock include:

- Variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;
- Our announcement of actual results for a fiscal period that are higher or lower than expected results or our announcement of revenue or earnings guidance that is higher or lower than expected, including as a result of difficulty forecasting seasonal variations in our financial condition and operating results;
- Changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;
- Announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;
- Announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;
- Announcements of customer additions and customer cancellations or delays in customer purchases;
- Recruitment or departure of key personnel;
- Disruptions in our service due to computer hardware, software, network or data center problems;
- The economy as a whole, market conditions in our industry and the industries of our customers;
- The issuance of shares of common stock by us, whether in connection with an acquisition or a capital raising transaction;
- Issuance of debt or other convertible securities; and
- Any other factors discussed herein.

In addition, if the market for technology stocks or the stock market in general experiences uneven investor confidence, the market price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The market price of our common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not directly affect us.

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

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

We provide two of our distributors with stock balancing return rights, which generally permit our distributors to return products, subject to ordering an equal dollar amount of alternate products. We also provide price protection rights to these two distributors. Price protection rights require that we grant retroactive price adjustments for

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inventories of our products held by distributors if we lower our prices for those products within a specified time period. To cover our exposure to these product returns and price adjustments, we establish reserves based on our evaluation of historical product trends and current marketing plans. However, we cannot be assured that our reserves will be sufficient to cover our future product returns and price adjustments. If we inadequately forecast reserves, we would not be able to recognize revenue until these two distributors sell the inventory to the final end user which would have a material adverse effect on revenues in the period covered by that change.

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

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

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

A significant portion of our sales are fulfilled by VARs, regional distributors or master distributors. As an example, 30% of our billings in 2014 were to Synnex Corporation and Starin Marketing Inc., two master distributors who fulfill demand from other distributors, VARs or end-users. While our VARs typically maintain payment terms consistent with other end-users, our master distributors have longer payment terms and a delay in payment may occur as a result of a number of factors including changes in demand, general economic factors, financial performance, inventory levels or disputes over payments. Any delay from Synnex, Starin, or other large distributors or VARs, could have a material impact on the collections of our receivables during a particular quarter.

We offer credit terms to some of our international customers; however, payments tend to go beyond terms in certain countries and advances allowable on accounts receivable from international customers under our revolving line of credit are calculated using a lower advance rate than domestic receivables and are limited to \$500 thousand. Therefore, as Europe, Asia and other international regions grow, accounts receivable balances will likely increase as compared to previous years and our ability to finance the increase will be limited.

***Supporting our existing and growing customer base and implementing large customer deployments could strain our personnel resources and infrastructure, and if we are unable to scale our operations and increase productivity, customer satisfaction and our business will be harmed.***

Frequent enhancements to our software puts pressure on our customers to install, maintain and train their personnel on its use. Further, frequent releases of the software can lead to less product stability. As a result, our customer care and engineering resources have come under, and are expected in the future to come under significant pressure in providing the high-quality of technical support our customers expect during periods of high demand. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services. Increased customer demand for these services, without corresponding revenues, could increase costs and adversely affect our operating results. In addition, our sales process is highly dependent on our applications and business reputation and on positive recommendations from our existing customers. Any failure to maintain high-quality technical support, or a market perception that we do not maintain high-quality support, could adversely affect our reputation, our ability to sell our products and services to existing and prospective customers, and our business, operating results and financial position.

As we target more of our sales efforts at larger initial transactions, we face increasingly complex deployments requiring substantial technical and management resources, including in some cases significant product customization and integration with other applications or hardware. Customers making large expenditures for our products and services typically have higher expectations of product and service operability and response time if issues arise. Some

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of these customers have asked us to host their content and have significant amounts of legacy content to transfer to our datacenter. Such increased activity and storage demand on our data centers put additional strain on our personnel and hosting infrastructure. High demand on technical and management resources to manage large transactions distract personnel from existing customers, development of new products and other important activities which could lead to potential customer dissatisfaction, product development delays or other issues associated with the distraction.

If a customer is not satisfied with the quality of work performed by us or a third party or with the type of services or solutions delivered, then we could incur additional costs to address the situation, the profitability of that work might be impaired, and the customer's dissatisfaction with our services could damage our ability to obtain additional work from that customer. In addition, negative publicity related to our customer relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new business with current and prospective customers.

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

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

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

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

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

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

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

***There is a great deal of competition in the market for our products, which could lower the demand for our products and have a negative impact on our operations.***

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The market for our products and services is intensely competitive, dynamic and subject to rapid technological change. The intensity of the competition and the pace of change are expected to increase in the future. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business. Competitors vary in size and in the scope and breadth of the products and services offered, many of which have greater financial resources, greater name recognition, more employees and greater financial, technical, marketing, public relations and distribution resources than we have. In addition, new competitors with greater financial resources may arise through partnerships, distribution agreements, mergers, acquisitions or other types of transactions at any time. In particular, large companies have begun to make investments in and/or partner with smaller companies to enter the lecture capture and video management markets.

Various vendors provide lecture capture, enterprise webcasting or video content management capabilities, but few offer an end-to-end solution that addresses all phases of the video content lifecycle (capture, delivery, transformation and management) in a single platform like Mediasite.

**Lecture capture solutions** designed specifically for higher education differ in their technology approach.

- Appliance- or room-based lecture capture provides a fully integrated system with complete recording automation for live or on-demand content. The automated, pre-scheduled workflow results in the greatest faculty and staff adoption and largest volumes of recorded content in the shortest amount of time.
- Software-based lecture capture that resides on a podium or computer in the classroom also captures and publishes rich media content, but relies on campus- or user-supplied hardware.
- Desktop capture tools reside on individual users' laptops or computers allowing them to record user-generated content.

Few lecture capture vendors, offer a mix of all lecture capture approaches to best suit customers' needs. Most vendors, including Crestron, Panopto and Tegrity, support only one approach to lecture capture. Likewise, a very small number of vendors provide an integrated platform like Mediasite to archive and manage video and rich media recorded with their solution. Most rely on a third-party platform, typically the institution's learning or course management system, to publish, search and secure content.

**Enterprise video management solutions** (e.g. Kaltura, Qumu) serve as centralized media repositories that facilitate the delivery, publishing and management of on-demand video. Unlike Mediasite, most platforms do not include a highly automated video capture solution, webcasting or live streaming component, but instead ingest or import video-based content captured by other third-party devices or solutions. Also, most other platforms focus on ingesting video-only content rather than rich video which combines multiple synchronous video and/or slide streams into an interactive media experience.

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

Solutions that are designed primarily to address other online communication needs sometimes compete with Mediasite. Typically, these solutions are complementary to and integrated with the Mediasite solution:

- **Web and video conferencing** (e.g. Adobe, Cisco TANDBERG, Cisco WebEx, Citrix, and Polycom). These solutions are designed primarily for synchronous, collaborative communication versus one-to-many communications like Mediasite. Many organizations acknowledge that they need both conferencing and webcasting technologies to appropriately address their different communication requirements. Since most conferencing platforms lack sophisticated content management capabilities, customers use Mediasite Enterprise Video Management Platform to ingest conference content for centralized management and the added benefits of interactive playback, searchability, analytics and security.
- **Authoring tools** (e.g. TechSmith). Unlike webcasting, web conferencing or video conferencing, which capture and stream content as it occurs in real-time, these tools are used to produce and edit on-demand video or screencast content. The authoring process can require a significant amount of production and user expertise. Mediasite is

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ingests content produced by popular authoring tools like TechSmith's Camtasia— allowing the content to be delivered, managed and secured.

- **Virtual event platforms** (e.g. INXPO, ON24). These companies offer cloud-based virtual meeting environments for online conferences, tradeshows and meetings. The platforms often include the ability to embed or link to streaming video or webcasts within the interactive environment. In some instances, Mediasite content is integrated into these virtual meeting environments and streamed live or on-demand.

The competitive environment may require us to make changes in our products, pricing, licensing, services, or marketing to maintain and extend our current technology. Price concessions or the emergence of other pricing, licensing, and distribution strategies or technology solutions of competitors may reduce our revenue, margins or market share. Other changes we have to make in response to competition could cause us to expend significant financial and other resources, disrupt our operations, strain relationships with partners, release products and enhancements before they are thoroughly tested or result in customer dissatisfaction, any of which could harm our operating results and stock price.

***Our business is susceptible to risks associated with international operations.***

International product and service billings ranged from 27% to 37% of our total billings in each of the past two years and are expected to continue to account for a significant portion of our business in the future, particularly as a result of acquisitions made in fiscal 2014 in the Netherlands and Japan. International sales are subject to a variety of risks, including:

- Difficulties in establishing and managing international subsidiaries, distribution channels and operations;
- Difficulties in selling, servicing and supporting overseas products, translating products into foreign languages and compliance with local hardware requirements;
- Challenges related to language or cultural differences
- The uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property or requirements for product certification or other restrictions;
- Multiple and possibly overlapping tax structures;
- Currency and exchange rate fluctuations;
- Difficulties in collecting accounts receivable in foreign countries, including complexities in documenting letters of credit; and
- Economic or political changes in international markets.
- Difficulty in complying with international employment related requirements

***We may need to make acquisitions or form strategic alliances or partnerships in order to remain competitive in our market, and recent acquisitions, strategic alliances or partnerships, including the acquisition of Mediasite KK and MediaMission, could be difficult to integrate, disrupt our business and dilute stockholder value.***

We completed the acquisitions of Mediasite KK in Japan and MediaMission in the Netherlands in fiscal 2014. As a result of these acquisitions, we are integrating products, services, dispersed operations, management systems and very different cultures. In the future, we may acquire or form strategic alliances or partnerships with other businesses in order to remain competitive or to acquire new technologies. Acquisitions and investments involve numerous risks, including:

- The potential failure to achieve the expected benefits of the combination or acquisition;
- Difficulties in and the cost of integrating operations, technologies, services and personnel;
- Diversion of financial and managerial resources from existing operations;
- Risk of entering new markets in which we have little or no experience or where competitors may have stronger market positions;
- Potential write-offs of acquired assets or investments, and potential financial and credit risks associated with acquired customers;
- Potential loss of key employees;
- Inability to generate sufficient revenue to offset acquisition or investment costs;

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- The inability to maintain relationships with customers and partners of the acquired business;
- The difficulty of transitioning the acquired technology onto our existing platforms and maintaining the security standards consistent with our other services for such technology;
- Potential unknown liabilities associated with the acquired businesses;
- Unanticipated expenses related to acquired technology and its integration into existing technology;
- Negative impact to our results of operations because of the depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation, and the loss of acquired deferred revenue and unbilled deferred revenue;
- Delays in customer purchases due to uncertainty related to any acquisition;
- The need to implement controls, procedures and policies at the acquired company;
- Challenges caused by distance, language and cultural differences;
- In the case of foreign acquisitions, the challenges associated with integrating operations across different cultures and languages and currency, technological, employee and other regulatory risks and uncertainties in the economic, social and political conditions associated with specific countries; and
- The tax effects of any such acquisitions.

Our failure to successfully manage the acquisitions of Mediasite KK and MediaMission, or other future acquisitions, strategic alliances or partnerships could seriously harm our operating results. In addition, our stockholders would be diluted if we finance the future acquisitions, strategic alliances or partnerships by incurring convertible debt or issuing equity securities.

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

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

We use open source software in our application suite. Although we monitor our use of open source software closely, the terms of many open source licenses have not been interpreted by United States courts, and there is risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to re-engineer our technology or to discontinue offering all or a portion of our products in the event re-engineering cannot be accomplished on a timely basis, any of which could adversely affect our business, operating results and financial condition.

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

Our customers may use our products and services to share confidential and sensitive information, the security of which is critical to their business. Third parties may attempt to breach our security for customer hosted content or the networks of our customers. Malicious third-parties may also conduct attacks designed to temporarily deny customers access to our services. Customers may take inadequate security precautions with their sensitive information and may inadvertently make that information public. We may be liable to our customers or subject to



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finer for a 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.

***Privacy concerns and laws, evolving regulation of cloud computing, cross-border data transfer restrictions and other domestic or foreign regulations may limit the use and adoption of our solutions and adversely affect our business.***

Regulation related to the provision of services on the Internet is increasing, as federal, state and foreign governments continue to adopt new laws and regulations addressing data privacy and the collection, processing, storage and use of personal information, including health data. In some cases foreign data privacy laws and regulations, such as the European Union's Data Protection Directive, and the country-specific regulations that implement that directive, also govern the processing of personal information. Further, laws are increasingly aimed at the use of personal information for marketing purposes, such as the European Union's e-Privacy Directive, and the country-specific regulations that implement that directive. Such laws and regulations are subject to differing interpretations and may be inconsistent among jurisdictions. These and other requirements could reduce demand for our solutions or restrict our ability to store and process data or, in some cases, impact our ability to offer our services and solutions in certain locations.

In addition to government activity, privacy advocacy and other industry groups have established or may establish new self-regulatory standards that may place additional burdens on us. Our customers expect us to meet voluntary certification or other standards established by third parties, such as the U.S.-EU Safe Harbor Framework. If we are unable to maintain these certifications or meet these standards, it could adversely affect our ability to provide our solutions to certain customers and could harm our business.

Our customers and potential customers do business in a variety of industries, including financial services, the public sector, healthcare and telecommunications. Regulators in certain industries have adopted and may in the future adopt regulations or interpretive positions regarding the use of cloud computing and other outsourced services. The costs of compliance with, and other burdens imposed by, industry-specific laws, regulations and interpretive positions may limit customers' use and adoption of our services and reduce overall demand for our services.

The costs of compliance with and other burdens imposed by laws, regulations and standards may limit the use and adoption of our service and reduce overall demand for it, or lead to significant fines, penalties or liabilities for any noncompliance.

Furthermore, concerns regarding data privacy may cause our customers' customers to resist providing the data necessary to allow our customers to use our service effectively. Even the perception that the privacy of personal information is not satisfactorily protected or does not meet regulatory requirements could inhibit sales of our products or services, and could limit adoption of our cloud-based solutions.

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

Unanticipated problems affecting our network systems could cause interruptions or delays in the delivery of the hosting services we provide to some of our clients. We are not equipped to provide full disaster recovery to all of our hosted clients. If there are operational failures in our network infrastructure that cause interruptions, slower response times, loss of data or extended loss of service for our remotely hosted clients, we may be required to issue credits or pay penalties, current clients may terminate their contracts or elect not to renew them and we may lose sales to potential clients. We have recently acquired additional hardware and systems, expect to make more significant investments in hardware (primarily for storage) and outsourced most aspects of our network infrastructure to two providers. As a result, we are reliant on third parties for network availability so outages may be outside our control and we may need to acquire additional hardware in order to provide an appropriate level of redundancy required by our customers.

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***We license technology from third parties. If we are unable to maintain these licenses, our operations and financial condition may be negatively impacted.***

We license technology from third parties. The loss of, our inability to maintain, or changes in material terms of these licenses could result in increased cost or delayed sales of our software and services, or may cause us to remove features from our products or services. We anticipate that we will continue to license technology from third parties in the future. This technology may not continue to be available on commercially reasonable terms, if at all. Although we do not believe that we are substantially dependent on any individual licensed technology, some of the component technologies that we license from third parties could be difficult for us to replace. The impairment of these third-party relationships, especially if this impairment were to occur in unison, could result in delays in the delivery of our software and services until equivalent technology, if available, is identified, licensed and integrated. This delay could adversely affect our operating results and financial condition.

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

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

- Damage our reputation
- Cause our customers to initiate product liability suits against us
- Increase our product development resources
- Cause customers to cancel orders, ask for partial refunds or potential customers to purchase competitive products or services
- Delay release or market acceptance of our products, or otherwise adversely impact our relationships with our customers
- Cause us to allocate valuable engineering resources to fix our existing products, which may cause us to allocate fewer resources toward developing new products, or toward adding features to our existing products

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

We need to provide value-added services in order to avoid being viewed as a commodity supplier. This entails building long-term customer relationships and developing features that will distinguish our products. Our technology is complex and is often confused with other products and technologies in the market place, including video conferencing, streaming and collaboration.

We have developed lower cost hardware and desktop software products to better address that market segment. Both products have more limited features compared to our existing products. While we believe we can preserve the market for our full-featured products, release of lower cost products could reduce demand for products sold at higher prices.

If we fail to build long-term customer relationships and develop features that distinguish our products in the market place, our margins will shrink and our stock may become less valuable to investors.

***Our success depends upon the proprietary aspects of our technology.***

Our success and ability to compete depend to a significant degree upon the protection of our proprietary technology. We currently have four U.S. patents that have been issued to us. We may seek additional patents in the future. However, it is possible that:

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

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- Any issued patent could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in those patents
- Current and future competitors may independently develop similar technology, duplicate our services or design around any of our patents
- Effective patent protection, including effective legal-enforcement mechanisms against those who violate our patent-related assets, may not be available in every country in which we do or plan to do business
- We may not have the resources to enforce our patents or may determine the potential benefits are not worth the cost and risk of ultimately being unsuccessful

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

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

- Third parties may infringe or misappropriate our copyrights, trademarks and similar proprietary rights
- Laws and contractual restrictions may not be sufficient to prevent misappropriation of our technology or to deter others from developing similar technologies
- Effective trademark, copyright and trade secret protection, including effective legal-enforcement mechanisms against those who violate our trademark, copyright or trade secret assets, may be unavailable or limited in foreign countries
- Contractual agreements may not provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information
- Other companies may claim common law trademark rights based upon state or foreign laws that precede the federal registration of our marks
- Policing unauthorized use of our services and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the extent of any unauthorized use

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

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

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

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

Our future success depends upon the continued service of our key management, technical, sales and other critical personnel, particularly our Chief Executive Officer. Most of our officers and other key personnel are employees-at-will, and we cannot assure that we will be able to retain them. Key personnel have left our company in the past, sometimes to accept employment with companies that sell similar products or services to existing or potential customers of ours. There will likely be additional departures of key personnel from time to time in the future and such departures could result in additional competition, loss of customers or confusion in the marketplace. As we seek to replace such departures, or expand our business, the hiring of qualified sales, technical and support personnel has been difficult due to the limited number of qualified professionals. The loss of any key employee could result in

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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 addition, we do not have life insurance policies on any of our key employees. If we lose the services of any of our key employees, the integration of replacement personnel could be time consuming, may cause disruptions to our operations and may be unsuccessful.

***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.

***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, 2014, we had no outstanding warrants and 1.2 million of outstanding stock options granted under our stock option plans, 700 thousand of which are immediately exercisable.

To the extent that these stock options 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 even the potential of their exercise may have an adverse effect on the trading price of our common stock. The holders of our options 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 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 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.

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

The use of our net operating loss carryforwards may have limitations resulting from certain future ownership changes, time limitations or other factors under the Internal Revenue Code and other taxing authorities.

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

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

As a publicly traded company we are subject to significant regulations, including the Sarbanes-Oxley Act of 2002. While we have developed and instituted a corporate compliance program based on what we believe are the current

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best practices and continue to update the program in response to newly implemented regulatory requirements and guidance, we cannot assure that we are or will be in compliance with all potentially applicable regulations. Although our non-affiliate market capitalization was less than \$75 million at March 31, 2014 and we were therefore not required to have an auditor attestation on our internal controls over financial reporting for fiscal 2014, SEC rules may in the future require us to have such an attestation if our non-affiliate market capitalization exceeds a certain threshold. We have found a material weakness in our internal control over financial reporting in the past and cannot assure that in the future our management or our auditors, will not find additional material weaknesses in connection with our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act. We also cannot assure that we could correct all such weaknesses to allow our management to attest that we have maintained effective internal controls 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, the disclosure of any material weakness in our internal control over financial reporting could have a negative impact on our stock price.

***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 26,000 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 December 31, 2018.

Our operations in Japan are managed in Tokyo Japan in a leased facility of approximately 7,705 square feet with a term expiring on August 31, 2015. The facility includes sales, technical and administrative functions. The rent for the remainder of the lease period is approximately \$38 thousand per month.

Our European operations are managed in Utrecht Netherlands in a leased facility of approximately 3,886 square feet with a term expiring on January 31, 2019. The facility includes sales, technical and administrative functions. The rent for the remained of the lease period is approximately \$5 thousand per month.

**ITEM 3. LEGAL PROCEEDINGS**

On October 26, 2012, a complaint was filed by Astute Technology, LLC (“Astute”) against one of our customers in the United States District Court for the Eastern District of Texas (Case No. 2:012-cv-689). The complaint alleged patent infringement. Because we agreed to indemnify our customers from costs and damages in connection with infringement, we defended the complaint.

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

In June 2014, the Company entered into an agreement with Astute which resolved the matters referenced above. The key terms of the agreement were: 1) grant non-revocable license of Astute patents to the Company; 2) grant a fully paid, non-refundable license of certain Sonic Foundry patents to Astute; 3) Both Astute and our customer agree to identify three meetings they currently capture that the other party will not seek or respond to any request for proposal; and 4) payment of \$1.35 million to Astute. The payment will be made in three equal amounts with the first paid in June 2014, the second paid in October 2014 and the final payment due March 2015. The Company is contributing \$1.1 million toward the amount payable to Astute. \$428 thousand has been determined to relate to prior use and was recorded as a charge to income and the remaining \$672 thousand was recorded as a product right asset, which is being amortized, straight line, over the remaining life of the patents, through 2020. Future amounts due to Astute were accrued for as of the time of settlement.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable

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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." Effective September 16, 2009, we transferred the listing of our common stock to the NASDAQ Capital Market. The following table sets forth, for the periods indicated, the high and low sale prices per share of our common stock as reported on the NASDAQ Global or Capital Markets.

	<u>High</u>	<u>Low</u>
<b>Year Ended September 30, 2015:</b>		
First Quarter (through December 5, 2014)	\$ 9.98	\$ 8.04
<b>Year Ended September 30, 2014:</b>		
First Quarter	11.00	8.50
Second Quarter	10.99	9.25
Third Quarter	12.70	10.00
Fourth Quarter	11.60	9.14
<b>Year Ended September 30, 2013:</b>		
First Quarter	8.18	5.67
Second Quarter	7.02	5.80
Third Quarter	11.43	6.24
Fourth Quarter	10.80	8.05

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

At December 5, 2014 there were 269 common stockholders of record and approximately 4,800 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)	1,169,883	\$ 10.10	873,266
Equity compensation plans not approved by security holders (2)	71,058	12.65	-
<b>Total</b>	<b>1,240,941</b>	<b>\$ 10.24</b>	<b>873,266</b>

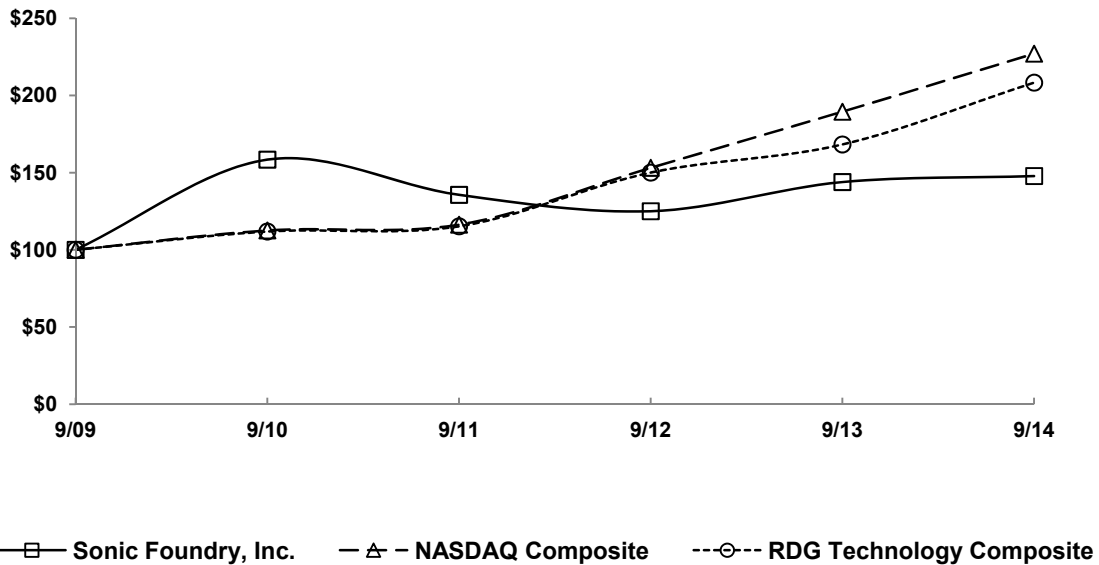
- (1) Consists of the 2009 Stock Incentive Plan, Employee Incentive Stock Option Plan and the Directors Stock Option Plans. For further information regarding these plans, reference is made to Note 5 of the financial statements.
- (2) Consists of the Non-Qualified Stock Option Plan. For further information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

The graph below compares the cumulative total stockholder return on our common stock from September 30, 2009 through and including September 30, 2014 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, 2009 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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**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
Among Sonic Foundry, Inc., the NASDAQ Composite Index, and the RDG Technology Composite Index



\*\$100 invested on 9/30/09 in stock or index, including reinvestment of dividends.  
Fiscal year ending September 30.

**(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).

	<b>Years Ended September 30,</b>				
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Statement of Operations Data:</b>					
Revenue	\$ 35,830	\$ 27,756	\$ 26,090	\$ 25,222	\$ 20,476
Cost of revenue	10,275	7,696	7,246	7,311	5,065
Gross margin	25,555	20,060	18,844	17,911	15,411
Operating expenses	28,637	20,698	18,735	17,633	15,138
Income (loss) from operations	(3,082)	(638)	109	278	273
Gain on investment in Mediasite KK	1,390	-	-	-	-
Equity in earnings from investment in Mediasite KK	38	209	420	-	-
Other income (expense), net	173	(123)	(132)	(310)	(170)
Interest expense, net	(231)	-	-	-	-
Provision for income taxes	(1,104)	(240)	(240)	(211)	(225)
Net income (loss)	\$ (2,816)	\$ (792)	\$ 157	\$ (243)	\$ (122)
Basic net income (loss) per common share	\$ (0.67)	\$ (0.20)	\$ 0.04	\$ (0.06)	\$ (0.03)
Diluted net income (loss) per common share	\$ (0.67)	\$ (0.20)	\$ 0.04	\$ (0.06)	\$ (0.03)
Weighted average common shares: - Basic	4,174,191	3,932,692	3,857,161	3,748,840	3,617,423
- Diluted	4,174,191	3,932,692	3,907,888	3,748,840	3,617,423
<b>Balance Sheet Data at September 30:</b>					
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Cash and cash equivalents	\$ 4,344	\$ 3,482	\$ 4,478	\$ 5,515	\$ 3,358
Working capital	18	2,575	3,332	3,083	1,442
Total assets	34,623	24,333	22,821	21,840	18,267
Long-term liabilities	7,268	3,585	3,748	3,072	3,202
Stockholders' equity	11,315	10,704	10,539	9,261	7,137

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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 video content management and distribution for education, business and government. Using the Mediasite webcasting platform and webcast services of the Company's events team, the Company empowers our customers to advance how they share knowledge online, using video webcasts to bridge time and distance, enhance learning outcomes and improve performance.

**Recent Accounting Pronouncements**

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)”. The guidance substantially converges final standards on revenue recognition between the FASB and the International Accounting Standards Board providing a framework on addressing revenue recognition issues and, upon its effective date, replaces almost all existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles. The guidance is effective for annual reporting periods beginning after December 15, 2016. We are currently evaluating the impact of adopting ASU 2014-09 to determine the impact, if any, it may have on our financial statements.

In June 2014, the FASB issued Accounting Standards Update No. 2014-12, "Compensation - Stock Compensation" ("ASU 2014-12"). ASU 2014-12 is intended to resolve diverse accounting treatment for share based awards in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. The standard is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015 and may be applied prospectively or retrospectively. We are currently evaluating the impact of adopting ASU 2014-12 to determine the impact, if any, it may have on our financial statements.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40), Disclosure of Uncertainties about an Entities Ability to Continue as a Going Concern (ASU 2014-15). The guidance in ASU 2014-15 sets forth management's responsibility to evaluate whether there is

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substantial doubt about an entity's ability to continue as a going concern as well as required disclosures. ASU 2014-15 indicates that, when preparing financial statements for interim and annual financial statements, management should evaluate whether conditions or events, in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern for one year from the date the financial statements are issued or are available to be issued. This evaluation should include consideration of conditions and events that are either known or are reasonably knowable at the date the financial statements are issued or are available to be issued, as well as whether it is probable that management's plans to address the substantial doubt will be implemented and, if so, whether it is probable that the plans will alleviate the substantial doubt. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods and annual periods thereafter. Early application is permitted. We are currently evaluating the impact of adopting ASU 2014-15 to determine the impact, if any, it may have on our financial statements.

Accounting standards that have been issued but are not yet effective by the FASB or other standards-setting bodies that do not require adoption until a future date, which are not discussed above, are not expected to have a material impact on the Company's financial statements upon adoption.

### **Critical Accounting Policies**

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

- Revenue recognition, allowance for doubtful accounts and reserves;
- Impairment of long-lived assets;
- Valuation allowance for net deferred tax assets;
- Accounting for stock-based compensation;
- Capitalized software development costs; and
- Valuation of assets and liabilities in business combinations

#### *Revenue Recognition, Allowance for Doubtful Accounts and Reserves*

##### General

Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured. Revenue is deferred when undelivered products or services are essential to the functionality of delivered products, customer acceptance is uncertain, significant obligations remain, or the fair value of undelivered elements is unknown. Typically, 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 or upon customer acceptance if non-delivered products or services are essential to the functionality of delivered products. Under the terms and conditions of the sale, this occurs at the time of shipment to the customer. Product revenue currently represents sales of our Mediasite recorders and Mediasite related products such as our server software and other software licenses. If a license is time-based, the revenue is recognized over the term of the license agreement.

##### Services

The Company sells support and content hosting contracts to its customers, typically one year in length, and records the related revenue ratably over the contractual period. Our support contracts cover phone and electronic technical support availability over and above the level provided by our distribution partners, software upgrades on a when and if available basis, advance hardware replacement and an extension of the standard hardware warranty from 90 days to one year. The manufacturers we contract with to build the units provide a limited one-year warranty on the

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hardware. We also sell installation, training, event webcasting, and customer content hosting services. Revenue for those services is recognized when performed in the case of installation, training and event webcasting services. Occasionally, the Company will sell customization services to enhance the server software. Revenue from those services is recognized when performed, if perfunctory, or under contract accounting. 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.

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.

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

Management has established VSOE for hosting services. Billings for hosting are spread ratably over the term of the hosting agreement, with the typical hosting agreement having a term of 12 months, with renewal on an annual basis. The Company sells most hosting contracts without the inclusion of products. When the hosting arrangement is sold

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in conjunction with product, the product revenue is recognized immediately while the remaining hosting revenue is spread ratably over the term of the hosting agreement. The selling price is allocated between these elements using the relative selling price method. The Company uses ESP for development of the selling price for hardware products with embedded software.

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

#### Reserves

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

#### Credit Evaluation and Allowance for Doubtful Accounts

We assess the realization of our receivables by performing ongoing credit evaluations of our customers' financial condition. Through these evaluations, we may become aware of a situation where a customer may not be able to meet its financial obligations due to deterioration of its financial viability, credit ratings or bankruptcy. Our reserve requirements are based on the best facts available to us and are reevaluated and adjusted as additional information is received. Our reserves are also based on amounts determined by using percentages applied to certain aged receivable categories. These percentages are determined by a variety of factors including, but not limited to, current economic trends, historical payment and bad debt write-off experience. Allowance for doubtful accounts for accounts receivable was \$150,000 at September 30, 2014 and \$90,000 at September 30, 2013.

#### *Impairment of long-lived assets*

Goodwill that have indefinite useful lives are recorded at cost and are not amortized but, instead, tested at least annually for impairment. We assess the impairment of goodwill on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value. If a qualitative assessment is used and the Company determines that the fair value of goodwill is more likely than not (i.e., a likelihood of more than 50%) less than its carrying amount, a quantitative impairment test will be performed. If goodwill is quantitatively assessed for impairment, a two-step approach is applied. First, the Company compares the estimated fair value of the goodwill to its carrying value. The second step, if necessary, measures the amount of impairment, if any, by comparing the implied fair value of goodwill to its carrying value.

In fiscal 2014 and 2013, we performed the two-step goodwill test and determined that the fair value of goodwill is more than the carrying value. For purposes of the fiscal 2014 test, goodwill balances are evaluated within three separate reporting units. For purposes of the fiscal 2013 test, goodwill was considered to be in one reporting unit. The Company has recognized no impairment charges as of September 30, 2014 and September 30, 2013.

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

Long-lived assets and intangible assets other than goodwill are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. For the years ended September 30, 2014 and 2013, no events or changes in circumstances occurred that required this analysis.

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*Valuation allowance for net deferred tax assets*

Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. We do not provide for U.S. income taxes on the undistributed earnings of our foreign subsidiaries, which we consider to be permanently invested outside of the U.S.

We make judgments regarding the realizability of our deferred tax assets. The balance sheet carrying value of our net deferred tax assets is based on whether we believe that it is more likely than not that we will generate sufficient future taxable income to realize these deferred tax assets after consideration of all available evidence. We regularly review our deferred tax assets for recoverability considering historical profitability, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weight given to the positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. As such, it is generally difficult for positive evidence regarding projected future taxable income exclusive of reversing taxable temporary differences to outweigh objective negative evidence of recent financial reporting losses. Generally, cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome in determining that a valuation allowance is not needed.

As of September 30, 2014 and 2013, valuation allowances have been established for all U.S. and for certain foreign deferred tax assets which we believe do not meet the “more likely than not” criteria for recognition. If we are subsequently able to utilize all or a portion of the deferred tax assets for which a valuation allowance has been established, then we may be required to recognize these deferred tax assets through the reduction of the valuation allowance which could result in a material benefit to our results of operations in the period in which the benefit is determined.

*Accounting for stock-based compensation*

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

*Capitalized Software Development Costs*

Software development costs incurred in conjunction with product development are charged to research and development expense until technological feasibility is established. Thereafter, until the product is released for sale, software development costs are capitalized and reported at the net realizable value of the related product. Typically the period between achieving technological feasibility of the Company’s products and the general availability of the products has been short. Consequently, software development costs qualifying for capitalization are typically immaterial and are generally expensed to research and development costs. During 2013, the Company’s My Mediasite product release required software capitalization since there was a longer period between technological feasibility and the general availability of the product. Upon product release, the amortization of software development costs is determined annually as the greater of the amount computed using the ratio of current gross revenues for the products to their total of current and anticipated future gross revenues or the straight-line method over the estimated economic life of the products, expected to be three years. Amortization expense of software development costs of \$252 thousand and \$75 thousand is included in Cost of Revenue – Product for the years ending September 30, 2014 and 2013, respectively. The amount of capitalized external and internal development costs was

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\$533 thousand for the year ended September 30, 2013.. There were no software development efforts that qualified for capitalization for the year ended September 30, 2014.

*Valuation of Assets and Liabilities in Business Combinations*

The assets acquired and the liabilities assumed in a business combination are measured at fair value. Fair value is based on the definition in ASC 820-10-20 as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. Variations of the cost, market and income approaches are used to measure the fair value of components of working capital (e.g. accounts receivable, inventory and accounts payable) and tangible assets, such as property plant and equipment. When measuring the fair value of acquired intangible assets, the income, market and cost approaches are generally considered. Financial assets and liabilities are valued based on a quoted price in an active market. In the absence of a quoted market price a valuation technique is used to determine fair value, such as a market approach or an income approach. Non-financial liabilities may be valued based on a transfer approach. These measures require significant judgment including estimates of expected cash flow, or discount rates among others.

**RESULTS OF OPERATIONS**

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

The acquisition of MediaMission Holding B.V. was completed on December 16, 2013. The acquisition of Mediasite KK was completed on January 14, 2014. The results of these subsidiaries from the dates of acquisition through September 30, 2014 are included in the discussion below.

**Revenue**

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

Revenue in fiscal 2014 totaled \$35.8 million, compared to \$27.8 million in fiscal 2013, an increase of 29%. Revenue consisted of the following:

- Product revenue from the sale of Mediasite recorder units and server software increased from \$13.6 million in fiscal 2013 to \$16.8 million in fiscal 2014. The average sales price per unit was impacted by an increase in the rack to mobile ratio for recorders and a large discounted deal to one international customer during the year. This was partially offset by recorders sold by Mediasite KK and MediaMission which maintain a higher average selling price. The product revenue growth is primarily related to an increase in the number of units sold, including over 240 units to one large international customer.

	<u>2014</u>	<u>2013</u>
Units sold	1,812	1,458
Rack to mobile ratio	3.5 to 1	2.0 to 1
Average sales price, excluding support (000's)	\$8.9	\$9.2
Refresh Units	453	573

- Services revenue represents the portion of fees charged for Mediasite customer support contracts amortized over the length of the contract, typically 12 months, as well as training, installation, event and content hosting services. Services revenue increased from \$13.9 million in fiscal 2013 to \$18.6 million in fiscal 2014 due primarily to an increase in hosting and support contracts on Mediasite recorder units. At September 30, 2014 \$10.0 million of revenue was deferred, of which we expect to recognize \$9.1 million in the next twelve months, including approximately \$3.8 million in the quarter ending December 31, 2014. At September 30, 2013, \$7.1 million of revenue was deferred.



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

### **Gross Margin**

Total gross margin in fiscal 2014 was \$25.6 million or 71% compared to \$20.1 million or 72% in fiscal 2013. Gross margin percentage remained approximately the same compared to prior year and the dollar increase is due to a higher volume of products and services sold. The significant components of cost of revenue include:

- Material and freight costs for the Mediasite recorders. Costs for fiscal 2014 Mediasite recorder hardware and other costs totaled \$5.4 million compared to \$5.0 million in fiscal 2013. Freight costs were \$286 thousand and labor and allocated costs were \$1.2 million in fiscal 2014 compared to \$336 thousand and \$939 thousand, respectively, in fiscal 2013. The remaining \$468 thousand in fiscal 2014 relate to material and freight costs for MediaMission and MSKK.
- Services costs. Staff wages and other costs allocated to cost of service revenues were \$1.7 million in fiscal 2014 compared to \$1.5 million fiscal 2013, resulting in gross margin on services of 84% in fiscal 2014 and 89% in fiscal 2013. The remaining \$1.2 million in fiscal 2014 relate to costs of providing content hosting, events and technical support services at MediaMission and MSKK.

The Company expects the gross margin percentage to remain consistent or slightly increase in fiscal 2015 as total revenue increases.

### **Operating Expenses**

#### **Selling and Marketing Expenses**

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

Selling and marketing expense increased \$3.5 million, or 27%, from \$13.1 million in fiscal 2013 to \$16.6 million in fiscal 2014. Increases in the major categories include:

- Salaries, incentive compensation, and benefits increased \$475 thousand over the prior year due to higher staff levels in fiscal 2014 compared to fiscal 2013.
- Costs allocated from General and Administrative increased by \$662 thousand as a result of higher stock compensation, bonus and depreciation expense.
- Selling and marketing expenses for MediaMission and MSKK accounted for \$290 thousand and \$2.1 million, respectively in fiscal 2014.

At September 30, 2014 we had 127 employees in Selling and Marketing, an increase from 75 employees at September 30, 2013. Of the 127 employees in Selling and Marketing at September 30, 2014, 43 are employed by our newly acquired foreign subsidiaries. We anticipate minimal growth in Selling and Marketing headcount in fiscal 2015.

#### **General and Administrative Expenses**

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

G&A expenses increased \$2.3 million or 68% from \$3.3 million in fiscal 2013 to \$5.6 million in fiscal 2014.

- Increase in compensation and benefits of \$178 thousand due to a higher staff levels in fiscal 2014 compared to fiscal 2013.

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- Professional services increase of \$955 thousand, primarily due to legal costs associated with litigation with Astute Technology that was settled in June 2014.
- G&A expenses for MediaMission and MSKK accounted for \$246 thousand and \$785 thousand, respectively.

At September 30, 2014 we had 17 full-time employees in G&A, an increase from 7 full-time employees at September 30, 2013. Of the 17 employees in G&A at September 30, 2014, 8 are employed by our newly acquired foreign subsidiaries. We do not anticipate growth in G&A headcount in fiscal 2015.

### **Product Development Expenses**

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

R&D expenses increased \$1.3 million, or 30%, from \$4.3 million in fiscal 2013 to \$5.5 million in fiscal 2014. Some significant differences include:

- Increase in compensation and benefits of \$616 thousand. A slightly higher headcount and typical annual base wage increases accounts for \$347 thousand of this increase and the remaining \$269 thousand relates to the capitalization of software development internal labor in YTD-2013.
- Professional services increase of \$168 thousand, mainly due to the use of outsourced development.
- Costs allocated from General and Administrative increased by \$149 thousand as a result of higher stock compensation, bonus and depreciation expense.
- Product development expenses for MediaMission and MSKK accounted for \$262 thousand and \$75 thousand, respectively.

At September 30, 2014 we had 39 full-time employees in Product Development compared to 36 employees at September 30, 2013. Of the 39 employees in Product Development at September 30, 2014, 4 are employed by our newly acquired foreign subsidiaries. There were no software development efforts in fiscal 2014 that qualified for capitalization. Fiscal 2013 software development efforts of \$533 thousand qualified for capitalization.

### **Acquisition Costs**

During fiscal 2014, the Company incurred acquisition costs related to acquiring MediaMission B.V. in the Netherlands and Mediasite KK in Japan. These costs consisted of professional services incurred and incentive compensation earned totaling \$490 thousand. There were no additional acquisition costs in the remainder of fiscal 2014. We do not anticipate incurring additional costs related to the acquisition of these two companies.

### **Patent Settlement**

During the third quarter of fiscal 2014, the Company completed a patent settlement agreement related to a dispute with Astute Technology in which the Company agreed to pay \$1.1 million over a ten month period ending March 2015 for a license to use certain patents. The Company determined that \$428 thousand of the license relates to prior use and accordingly was recorded as a charge to income. The remaining \$672 thousand was recorded as an asset, which is being amortized over the remaining life of the patents, through 2020. Future amounts due to Astute were accrued for as of the time of settlement.

### **Other Income and Expense, Net**

The Company's investment in Mediasite KK was accounted for under the equity method of accounting using a one quarter timing lag through December 31, 2013. On January 14, 2014, the Company's ownership percentage increased from approximately 26% of their common stock to 100%. In connection with the acquisition, the one quarter lag in reporting their results was eliminated. Obtaining control of Mediasite KK also required a "step-up" in the recorded value of the Company's previously owned interest in Mediasite KK to fair value. The gain amounted to approximately \$1.4 million. The Company recorded equity in earnings of \$38 thousand and \$209 thousand for the years ended September 30, 2014 and September 30, 2013, respectively.

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Other expense primarily consists of interest costs related to outstanding debt. Interest expense of \$231 thousand was recognized in fiscal 2014 compared to \$92 thousand in fiscal 2013. The increase is primarily due to additional borrowings with Silicon Valley Bank and the addition of the subordinated note payables related to the acquisitions. Other income is primarily interest income from overnight investment vehicles. In fiscal 2014, a foreign currency gain of \$163 thousand was also realized related to re-measurement of the subordinated notes payable related to the Company's foreign subsidiaries.

#### **Provisions Related to Income Taxes**

The Company incurred an \$901 thousand tax expense related to the "step-up" in the value of its previously recorded interest in MSKK. This amount consisted of \$542 thousand directly attributed to the "step-up" gain and \$359 thousand related to a change in the valuation allowance for the pre-acquisition investment in MSKK.

The Company records a non-cash deferred tax liability related to goodwill acquired in 2001. The related income tax benefit was \$240 thousand for both fiscal 2014 and fiscal 2013.

#### **LIQUIDITY AND CAPITAL RESOURCES**

On September 30, 2014 and 2013, we had cash and cash equivalents of \$4.3 million and \$3.5 million, respectively. Of the \$4.3 million aggregate cash and cash equivalents held by the Company, the amount of cash and cash equivalents held by our foreign subsidiaries was \$2.9 million. Presently, it is our intention not to repatriate cash in foreign jurisdictions, as these funds will be used to support ongoing foreign operations and debt service payments resulting from our recent foreign business acquisitions.

Cash used in operating activities totaled \$87 thousand in fiscal 2014 and cash provided by operating activities totaled \$1.0 million in fiscal 2013, a decrease of \$1.1 million. Cash used in operating activities increased partly due to negative impacts of working capital and other changes including a net loss of \$2.8 million, \$1.4 million of gain or equity in earnings from investment in Mediasite KK, a \$587 thousand increase in accounts receivable, a \$547 thousand increase in prepaid expenses and other assets and a \$809 thousand decrease in accounts payable and accrued liabilities. Cash used in fiscal 2014 was partially offset by the positive effects of a \$2.3 million increase in unearned revenue, \$919 thousand of stock based compensation, \$1.3 million of depreciation expense, \$1.1 million of deferred taxes, and a \$259 thousand decrease in inventory. Cash provided in fiscal 2013 was impacted by working capital and other changes including the positive effects of a \$1.5 million increase in unearned revenue, \$656 thousand of stock based compensation, \$1.1 million of depreciation expense, \$240 thousand of deferred taxes, and a \$176 thousand increase in accounts payable, accrued liabilities and other long-term liabilities. These were partially offset by the negative effects of \$394 thousand increase in inventory, a \$1.3 million increase in accounts receivable, \$209 thousand of equity in earnings from investment in Mediasite KK and a \$792 thousand net loss.

Cash provided by investing activities totaled \$300 thousand in fiscal 2014 compared to cash used in investing activities of \$1.7 million in fiscal 2013. In fiscal year 2014, \$1.3 million was provided by the acquisition of MSKK which was partially offset by cash used for the acquisition of MediaMission of \$119 thousand. The remainder was due to purchases of property and equipment. In fiscal year 2013, \$533 thousand was used in capitalization of software development costs. The remainder was due to purchases of property and equipment.

Cash provided by financing activities in fiscal 2014 totaled \$861 thousand compared to \$314 thousand used in fiscal 2013. Cash provided in fiscal 2014 was due primarily to \$2.0 million of cash provided by proceeds from notes payable and \$286 thousand in proceeds from exercise of stock options. This was partially offset by \$1.4 million of cash used for payments of notes payable and capital leases. Cash used in fiscal 2013 was due primarily to \$839 thousand of cash used for payments on notes payable and capital leases. This was partially offset by \$523 thousand of proceeds from exercise of common stock options and issuance of common stock.

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The Company believes its cash position is adequate to accomplish its business plan through at least the next twelve months. We will likely evaluate operating or capital lease opportunities to finance equipment purchases in the future and anticipate utilizing the Company's revolving line of credit to support working capital needs. In November 2014 we entered into subscription agreements with two existing shareholders totaling \$500 thousand for shares of common stock at an average market price determined at close. We may seek additional equity financing, or issue additional shares previously registered in our available shelf registration, although we currently have no plans to do so.

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

On May 31, 2013, the Company entered into a First Amendment to the Second Amended and Restated Loan and Security Agreement (the "First Amendment") with Silicon Valley Bank. Under the First Amendment: (i) the Revolving Loan Maturity Date (as defined) was extended from October 1, 2013 to October 1, 2015, (ii) the interest rate on the revolving line of credit was decreased so that interest will accrue at the per annum rate of three quarters of one percent (0.75 %) above the Prime Rate (as defined), provided that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) of greater than 2.0 to 1.0, or one-and-one quarter percent (1.25%) above the Prime Rate, if Sonic Foundry does not maintain an Adjusted Quick Ratio of greater than 2.0 to 1.0, (iii) the interest rate on the Unused Revolving Loan Facility Fee (as defined) was decreased to seventeen and one-half hundredths of one percent (0.175%).

On January 10, 2014, the Company entered into a Second Amendment to Second Amended and Restated Loan and Security Agreement (the "Second Amendment") with Silicon Valley Bank. Under the Second Amendment upon funding: (i) the balance of the term loan payable to Silicon Valley Bank of approximately \$544,000 was repaid and replaced by a new term loan of \$2,500,000 to be repaid in 36 equal monthly principal payments, (ii) the interest rate was decreased so that interest accrues at the Prime Rate (as defined) plus two and one quarter percent (which equated to an interest rate of 5.5%) from the Prime Rate plus three and one quarter percent (which equated to an interest rate of 6.5%) payable on the previous loan from Silicon Valley Bank, (iii) the covenant that requires the Minimum Adjusted Quick ratio be at or greater than 1.75:1.0 was reduced to 1.5:1.0, (iv) the Debt Service Coverage ratio was changed to a quarterly test rather than monthly, (v) the approval to repurchase up to \$1,000,000 of outstanding shares of common stock was eliminated, (vi) the purchase of all the outstanding stock in MediaMission Holding B.V., the owner of 100% of the stock of MediaMission B.V. and the purchase of all outstanding stock in Mediasite KK was approved, and (vii) a maximum limit of bank indebtedness of Mediasite KK of \$500,000 was provided for. The funding occurred contemporaneously with the closing of the Company's purchase of the outstanding common stock of Mediasite KK on January 17, 2014 which was effective January 14, 2014.

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On March 24, 2014 the Companies entered into a Third Amendment to the Second Amended Agreement (“Third Amendment”) which 1) reduced the minimum required Adjusted Quick Ratio for each of the months ended February 28, 2014, April 30, 2014, May 31, 2014, July 31, 2014, August 31, 2014, October 31, 2014 and November 30, 2014 from 1.50:1.00 to 1.25:1.00; and 2) waived compliance with the maximum subsidiary indebtedness requirement for the period up to the date preceding the Third Amendment, as amended.

At September 30, 2014, a balance of \$1.9 million was outstanding on the term loans with Silicon Valley Bank, with an effective interest rate of six-and-one half percent (6.5%), and no balance was outstanding on the revolving line of credit. At September 30, 2013, a balance of \$767 thousand was outstanding on the term loans with Silicon Valley Bank and no balance was outstanding on the revolving line of credit. At September 30, 2014, there was \$3.0 million available under this credit facility for advances. At September 30, 2014 the Company was in compliance with all covenants in the Second Amended Agreement, as amended.

At September 30, 2014, a balance of \$170 thousand was outstanding on the notes payable with Mitsui Sumitomo Bank, with an annual interest rate of approximately one-and-one half percent (1.575%) related to Mediasite K.K.

At September 30, 2014, a balance of \$628 thousand was outstanding on the subordinated note payable related to the acquisition of MediaMission, with an annual interest rate of six-and-one half percent (6.5%).

At September 30, 2014, a balance of \$1.8 million was outstanding on the subordinated payable related to the acquisition of Mediasite KK with an annual interest rate of five percent (5%).

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. At September 30, 2014, the Company has an obligation to purchase \$1.8 million of Mediasite product, which is not recorded on the Company's Consolidated Balance Sheet.

**Contractual Obligations**

The following summarizes our contractual obligations at September 30, 2014 and the effect those obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	<b>Total</b>	<b>Less than 1 Year</b>	<b>Years 2-3</b>	<b>Years 4-5</b>	<b>Over 5 years</b>
<b>Contractual Obligations:</b>					
Product purchase commitments	\$ 1,808	\$ 1,808	\$ —	\$ —	\$ —
Operating lease obligations	3,466	1,104	1,432	930	—
Capital lease obligations (a)	398	221	173	4	—
Notes payable (a)	2,259	1,074	1,185	—	—
Subordinated notes payable (a)	2,578	2,234	344	—	—

(a) Includes fixed and determinable interest payments

**Sonic Foundry, Inc.**  
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**For the Year Ended September 30, 2014**

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Derivative Financial Instruments**

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

**Interest Rate Risk**

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

At September 30, 2014, \$1.9 million of the Company's \$4.5 million in outstanding debt is variable rate. We do not expect that an increase in the level of interest rates would have a material impact on our Consolidated Financial Statements. We monitor our positions with, and the credit quality of, the financial institutions that are party to any of our financial transactions.

**Foreign Currency Exchange Rate Risk**

The functional currency of our foreign subsidiaries in the Netherlands is the Euro and in Japan is the Japanese Yen. They are subject to foreign currency exchange rate risk. Any increase or decrease in the exchange rate of the U.S. Dollar compared to the Euro or Japanese Yen will impact our future operating results and financial position.

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**ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Report of Independent Registered Public Accounting Firm**

To the Shareholders, Audit Committee and Board of Directors  
Sonic Foundry, Inc. and Subsidiaries  
Madison, WI

We have audited the accompanying consolidated balance sheet of Sonic Foundry, Inc. and Subsidiaries (the "Company") as of September 30, 2014, and the related consolidated statements of operations comprehensive loss, stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sonic Foundry, Inc. and Subsidiaries as of September 30, 2014 and the results of their operations and cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Baker Tilly Virchow Krause, LLP

Madison, Wisconsin  
December 17, 2014

**Sonic Foundry, Inc.**  
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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders  
Sonic Foundry, Inc.

We have audited the accompanying consolidated balance sheet of Sonic Foundry, Inc. and subsidiary (a Maryland corporation) (the “Company”) as of September 30, 2013, and the related consolidated statement of operations, comprehensive loss, stockholders’ equity, and cash flows for the year ended September 30, 2013. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sonic Foundry, Inc. and subsidiary as of September 30, 2013, and the results of their operations and their cash flows for the year ended September 30, 2013 in conformity with accounting principles generally accepted in the United States of America.

**/s/ GRANT THORNTON LLP**

Milwaukee, Wisconsin  
December 26, 2013



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

	<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,344	\$ 3,482
Accounts receivable, net of allowances of \$150 and \$90	8,449	6,885
Inventories	1,721	1,447
Prepaid expenses and other current assets	1,544	805
Total current assets	16,058	12,619
Property and equipment:		
Leasehold improvements	911	852
Computer equipment	5,440	5,296
Furniture and fixtures	720	581
Total property and equipment	7,071	6,729
Less accumulated depreciation and amortization	3,675	3,449
Net property and equipment	3,396	3,280
Other assets:		
Goodwill	11,185	7,576
Investment in Mediasite KK	-	385
Customer relationships, net of amortization of \$191 and \$0	2,471	-
Software development costs, net of amortization of \$252 and \$75	281	458
Product rights, net of amortization of \$41 and \$0	631	-
Other intangibles, net of amortization of \$162 and \$135	37	15
Other long-term assets	564	-
<b>Total assets</b>	<b>\$ 34,623</b>	<b>\$ 24,333</b>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Revolving line of credit	\$ -	\$ -
Accounts payable	1,183	1,513
Accrued liabilities	2,512	1,204
Unearned revenue	9,079	6,470
Current portion of capital lease obligations	196	223
Current portion of notes payable	974	634
Current portion of subordinated notes payable	2,096	-
Total current liabilities	16,040	10,044
Long-term portion of unearned revenue	929	648
Long-term portion of capital lease obligations	173	149
Long-term portion of notes payable	1,139	133
Long-term portion of subordinated notes payable	314	-
Other liabilities	401	445
Deferred tax liability	4,312	2,210
Total liabilities	23,308	13,629
Commitments and contingencies		
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; 4,276,470 and 3,999,634 shares issued and 4,263,754 and 3,986,918 shares outstanding	43	40
Additional paid-in capital	194,260	190,653
Accumulated deficit	(182,372)	(179,556)
Accumulated other comprehensive loss	(421)	(238)
Receivable for common stock issued	(26)	(26)

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

Treasury stock, at cost, 12,716 shares	<u>(169)</u>	<u>(169)</u>
Total stockholders' equity	<u>11,315</u>	<u>10,704</u>
<b>Total liabilities and stockholders' equity</b>	<b><u>\$ 34,623</u></b>	<b><u>\$ 24,333</u></b>
<b>See accompanying notes</b>		

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

	<b>Years Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Revenue:</b>		
Product	\$ 16,773	\$ 13,588
Services	18,649	13,933
Other	408	235
Total revenue	35,830	27,756
<b>Cost of revenue:</b>		
Product	7,350	6,215
Services	2,925	1,481
Total cost of revenue	10,275	7,696
<b>Gross margin</b>	25,555	20,060
<b>Operating expenses:</b>		
Selling and marketing	16,551	13,079
General and administrative	5,623	3,343
Product development	5,545	4,276
Patent settlement	428	—
Acquisition costs	490	—
Total operating expenses	28,637	20,698
<b>Loss from operations</b>	(3,082)	(638)
<b>Non-operating income (expenses):</b>		
Gain on investment in Mediasite KK	1,390	—
Equity in earnings from investment in Mediasite KK	38	209
Interest expense, net	(231)	(92)
Other income (expense), net	173	(31)
Total non-operating income (expenses)	1,370	86
Income (loss) before income taxes	(1,712)	(552)
Provision for income taxes	(1,104)	(240)
<b>Net loss</b>	\$ (2,816)	\$ (792)
<b>Loss per common share:</b>		
Basic net loss per common share	\$ (0.67)	\$ (0.20)
Diluted net loss per common share	\$ (0.67)	\$ (0.20)
Weighted average common shares – Basic	4,174,191	3,932,692
– Diluted	4,174,191	3,932,692
<b>See accompanying notes</b>		

**Sonic Foundry, Inc.**  
**Consolidated Statements of Comprehensive Loss**  
**For the Year Ended September 30, 2014 and 2013**  
**(in thousands)**

	<b>Years Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
Net loss	\$ (2,816)	\$ (792)
Other comprehensive loss, net of taxes:		
Foreign currency translation adjustment	(183)	(238)
Total other comprehensive loss	(183)	(238)
<b>Comprehensive loss</b>	<b>\$ (2,999)</b>	<b>\$ (1,030)</b>

**See accompanying notes**

**Sonic Foundry, Inc.**  
**Consolidated Statements of Stockholders' Equity**  
(in thousands except for share and per share data)

	<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Accumulated deficit</u>	<u>Accumulated other comprehensive loss</u>	<u>Receivable for common stock issued</u>	<u>Treasury stock</u>	<u>Total</u>
<b>Balance, September 30, 2012</b>	\$ 39	\$189,459	\$ (178,764)	\$ —	\$ (26)	\$ (169)	\$ 10,539
Stock compensation	—	656	—	—	—	—	656
Issuance of common stock	—	75	—	—	—	—	75
Exercise of common stock options	1	447	—	—	—	—	448
Foreign currency translation adjustment	—	—	—	(238)	—	—	(238)
Equity method investment ownership changes	—	16	—	—	—	—	16
Net loss	—	—	(792)	—	—	—	(792)
<b>Balance, September 30, 2013</b>	<u>\$ 40</u>	<u>\$190,653</u>	<u>\$ (179,556)</u>	<u>\$ (238)</u>	<u>\$ (26)</u>	<u>\$ (169)</u>	<u>\$ 10,704</u>
Stock compensation	—	921	—	—	—	—	921
Issuance of common stock	—	2,403	—	—	—	—	2,403
Exercise of common stock options	3	283	—	—	—	—	286
Foreign currency translation adjustment	—	—	—	(183)	—	—	(183)
Net loss	—	—	(2,816)	—	—	—	(2,816)
<b>Balance, September 30, 2014</b>	<u>\$ 43</u>	<u>\$194,260</u>	<u>\$ (182,372)</u>	<u>\$ (421)</u>	<u>\$ (26)</u>	<u>\$ (169)</u>	<u>\$ 11,315</u>

See accompanying notes

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

	<b>Years Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Operating activities</b>		
Net loss	\$ (2,816)	\$ (792)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Gain or equity in earnings from investment in Mediasite KK	(1,429)	(209)
Amortization of other intangibles	244	20
Amortization of software development costs	177	75
Amortization of product rights	41	
Depreciation and amortization of property and equipment	1,268	1,111
Provision for doubtful accounts	60	5
Deferred taxes	1,064	240
Stock-based compensation expense related to stock options	921	656
Remeasurement gain on subordinated debt	(157)	-
Changes in operating assets and liabilities:		
Accounts receivable	(597)	(1,312)
Inventories	259	(394)
Prepaid expenses and other assets	(547)	(48)
Accounts payable and accrued liabilities	(810)	263
Other long-term liabilities	(94)	(87)
Unearned revenue	2,329	1,485
Net cash (used in) provided by operating activities	(87)	1,013
<b>Investing activities</b>		
Capitalization of software development costs	-	(533)
Purchases of property and equipment	(862)	(1,162)
Cash received in Mediasite KK acquisition, net of cash paid	1,281	-
Cash paid for MediaMission acquisition, net of cash acquired	(119)	-
Net cash provided by (used in) investing activities	300	(1,695)
<b>Financing activities</b>		
Proceeds from notes payable	1,954	-
Payments on notes payable	(1,199)	(666)
Payment of debt issuance costs	(49)	-
Payments of loan fees	-	(20)
Proceeds from issuance of common stock	98	75
Proceeds from exercise of common options	286	448
Dividends from investment in Mediasite KK	-	22
Payments on capital lease obligations	(229)	(173)
Net cash provided by (used in) provided by financing activities	861	(314)
Changes in cash and cash equivalents due to changes in foreign currency exchange rates	(212)	-
Net increase (decrease) in cash and cash equivalents	862	(996)
Cash and cash equivalents at beginning of period	3,482	4,478
Cash and cash equivalents at end of period	\$ 4,344	\$ 3,482
<b>Supplemental cash flow information:</b>		
Interest paid	\$ 128	\$ 92
Taxes paid	171	-
<b>Non-cash transactions:</b>		
Property and equipment financed by accounts payable, accrued liabilities or capital lease	207	345
Acquired product rights	672	-
Subordinated notes payable issuance for purchase of MediaMission and MSKK	2,567	-
Common stock issued for purchase of MediaMission and MSKK	2,305	-
Comprehensive loss attributable to equity method investment in MSKK	-	238

**See accompanying notes**

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

***Business***

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

***Principles of Consolidation***

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

Prior to January 2014, the Company owned approximately 26% of Mediasite KK and accounted for its investment under the equity method of accounting. On January 14, 2014, the Company purchased the remaining 74% of Mediasite KK.

***Use of Estimates***

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

***Revenue Recognition***

**General**

Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured. Revenue is deferred when undelivered products or services are essential to the functionality of delivered products, customer acceptance is uncertain, significant obligations remain, or the fair value of undelivered elements is unknown. Typically, 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 or upon customer acceptance if non-delivered products or services are essential to the functionality of delivered products. Under the terms and conditions of the sale, this occurs at the time of shipment to the customer. Product revenue currently represents sales of our Mediasite recorder and Mediasite related products such as our server software and other software licenses. If a license is time-based, the revenue is recognized over the term of the license agreement.

**Services**

The Company sells support and content hosting contracts to 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

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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. Occasionally, the Company will sell customization services to enhance the server software. Revenue from those services is recognized when performed, if perfunctory, or under contract accounting. 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.

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, from 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 Accounting Standards Codification (ASC) Topic 605 and ASC Subtopic 985-605, the Company allocates the selling price using the relative selling price method whereas value is allocated using an ESP for software developed using a percent of list price approach. The other deliverables are valued using ESP or VSOE as previously discussed.

While the pricing model, currently in use, captures all critical variables, unforeseen changes due to external market forces may result in a revision of the inputs. These modifications may result in the consideration allocation differing from the one presently in use. Absent a significant change in the pricing inputs or the way in which the industry



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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***

As of September 30, 2014, of the \$4.3 million in cash and cash equivalents, \$1.4 million is deposited with two major U.S. 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. The remaining \$2.9 million of cash and cash equivalents is held by our foreign subsidiaries in financial institutions in Japan and the Netherlands and held in their local currency. The cash held in foreign financial institutions is not guaranteed.

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 \$150,000 at September 30, 2014 and \$90,000 at September 30, 2013.

We had billings for Mediasite product and support services as a percentage of total billings to one distributor of approximately 15% in 2014 and 20% in 2013 and to a second distributor of approximately 15% in 2014 and 22% in 2013. At September 30, 2014 and 2013, these two distributors represented 47% and 56% of total accounts receivable, respectively.

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Currently all of our product inventory purchases are from one third-party contract manufacturer. Although we believe there are multiple sources of supply from other contract manufacturers as well as multiple suppliers of component parts required by the contract manufacturers, a disruption of supply of component parts or completed products, even if short term, would have a material negative impact on our revenues. At September 30, 2014 and 2013, this supplier represented 27% and 34%, respectively, of total accounts payable. We also license technology from third parties that is embedded in our software. We believe there are alternative sources of similar licensed technology from other third parties that we could also embed in our software, although it could create potential programming related issues that might require engineering resources.

***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. As of September 30, 2014, of the \$4.3 million aggregate cash and cash equivalents held by the Company, the amount of cash and cash equivalents held by our foreign subsidiaries was \$2.9 million. If the funds held by our foreign subsidiaries were needed for our operations in the United States, the repatriation of some of these funds to the United States could require payment of additional U.S. taxes.

***Trade Accounts Receivable***

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

***Inventory Valuation***

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

Inventory consists of the following (in thousands):

	<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>
Raw materials and supplies	\$ 549	\$ 516
Finished goods	1,172	931
	\$ 1,721	\$ 1,447

***Capitalized Software Development Costs***

Software development costs incurred in conjunction with product development are charged to research and development expense until technological feasibility is established. Thereafter, until the product is released for sale, software development costs are capitalized and reported at the net realizable value of the related product. Typically the period between achieving technological feasibility of the Company's products and the general availability of the products has been short. Consequently, software development costs qualifying for capitalization are typically immaterial and are generally expensed to research and development costs. During 2013, the Company's My

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Mediasite product release required software capitalization since there was a longer period between technological feasibility and the general availability of the product. Upon product release, the amortization of software development costs is determined annually as the greater of the amount computed using the ratio of current gross revenues for the products to their total of current and anticipated future gross revenues or the straight-line method over the estimated economic life of the products, expected to be three years. Total amortization expense of software development costs of \$252 thousand and \$75 thousand is included in Cost of Revenue – Product for the twelve months ending September 30, 2014 and 2013, respectively. The amount of capitalized external and internal development costs was \$533 thousand for the year ended September 30, 2013.. There were no software development efforts that qualified for capitalization for the year ended September 30, 2014.

***Accounting for Stock-based Compensation***

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

***Valuation of Assets and Liabilities in Business Combinations***

The assets acquired and the liabilities assumed in a business combination shall be measured at fair value. Fair value is based on the definition in ASC 820-10-20 as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. Variations of the cost, market and income approaches are used to measure the fair value of components of working capital (e.g. accounts receivable, inventory and accounts payable) and tangible assets, such as property plant and equipment. When measuring the fair value of acquired intangible assets, the income, market and cost approaches are generally considered. Financial assets and liabilities are valued based on a quoted price in an active market. In the absence of a quoted market price a valuation technique is used to determine fair value, such as a market approach or an income approach. Non-financial liabilities may be valued based on a transfer approach. These measures require significant judgment including estimates of expected cash flow, or discount rates among others.

***Gain from investment in Mediasite KK***

The Company's investment in Mediasite KK was accounted for under the equity method of accounting using a one quarter timing lag through December 31, 2013. On January 14, 2014, the Company's ownership percentage increased from approximately 26% of their common stock to 100%. In connection with the acquisition, the one quarter lag in reporting their results was eliminated. The Company upon obtaining control of Mediasite KK recorded a "step-up" in the value of its previously owned interest in Mediasite KK to fair value. The gain amounted to approximately \$1.4 million and was partially offset by \$901 thousand of tax expense related to such investment. The Company recorded equity in earnings of \$38 thousand and \$209 thousand for the years ended September 30, 2014 and September 30, 2013, respectively. The recorded value of this investment is zero at September 30, 2014, due to elimination in the consolidated financial statements, and \$385 thousand at September 30, 2013. The Company also received \$22 thousand in dividends from Mediasite KK during the year ended September 30, 2013.

***Property and Equipment***

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

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	<u>Years</u>
Leasehold improvements	5 to 10 years
Computer equipment	3 to 5 years
Furniture and fixtures	5 to 7 years

***Impairment of Long-Lived Assets***

Goodwill that have indefinite useful lives are recorded at cost and are not amortized but, instead, tested at least annually for impairment. We assess the impairment of goodwill on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value. If a qualitative assessment is used and the Company determines that the fair value of goodwill is more likely than not (i.e., a likelihood of more than 50%) less than its carrying amount, a quantitative impairment test will be performed. If goodwill is quantitatively assessed for impairment, a two-step approach is applied. First, the Company compares the estimated fair value of the goodwill to its carrying value. The second step, if necessary, measures the amount of impairment, if any, by comparing the implied fair value of goodwill to its carrying value.

In fiscal 2014 and 2013, we performed the two-step goodwill test and determined that the fair value of goodwill is more than the carrying value. For purposes of the fiscal 2014 test, goodwill balances are evaluated within three separate reporting units. For purposes of the fiscal 2013 test, goodwill was considered to be in one reporting unit. The Company has recognized no impairment charges as of September 30, 2014 and September 30, 2013.

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

Long-lived assets and intangible assets other than goodwill are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. For the years ended September 30, 2014 and 2013, no events or changes in circumstances occurred that required this analysis.

***Comprehensive Loss***

Comprehensive loss includes disclosure of financial information that historically has not been recognized in the calculation of net income. Our comprehensive loss encompasses net loss and foreign currency translation adjustments. Assets and liabilities of international operations that have a functional currency that is not in U.S. dollars are translated into U.S. dollars at year-end exchange rates, and revenue and expense items are translated using weighted average exchange rates. Any adjustments arising on translation are included in shareholders' equity as an element of accumulated other comprehensive loss.

***Advertising Expense***

Advertising costs included in selling and marketing, are expensed when the advertising first takes place. Advertising expense was \$240 and \$238 thousand for years ended September 30, 2014 and 2013, respectively.

***Research and Development Costs***

Research and development costs are expensed in the period incurred, unless they meet the criteria for capitalized software development costs.

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***Income Taxes***

Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. We do not provide for U.S. income taxes on the undistributed earnings of our foreign subsidiaries, which we consider to be permanently invested outside of the U.S.

We make judgments regarding the realizability of our deferred tax assets. The balance sheet carrying value of our net deferred tax assets is based on whether we believe that it is more likely than not that we will generate sufficient future taxable income to realize these deferred tax assets after consideration of all available evidence. We regularly review our deferred tax assets for recoverability considering historical profitability, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weight given to the positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. As such, it is generally difficult for positive evidence regarding projected future taxable income exclusive of reversing taxable temporary differences to outweigh objective negative evidence of recent financial reporting losses. Generally, cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome in determining that a valuation allowance is not needed.

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

***Fair Value of Financial Instruments***

**Nonfinancial Assets Measured at Fair Value on a Nonrecurring Basis**

The Company's goodwill, intangible assets and other long-lived assets are nonfinancial assets that were acquired either as part of a business combination, individually or with a group of other assets. These nonfinancial assets were initially, and are currently, measured and recognized at amounts equal to the fair value determined as of the date of acquisition. Fair value measurements of reporting units are estimated using an income approach involving discounted or undiscounted cash flow models that contain certain Level 3 inputs requiring management judgment, including projections of economic conditions and customer demand, revenue and margins, changes in competition, operating costs, working capital requirements, and new product introductions. Fair value measurements of the reporting units associated with the Company's goodwill balances are estimated at least annually at the beginning of the fourth quarter of each fiscal year for purposes of impairment testing. Fair value measurements associated with the Company's intangible assets and other long-lived assets are estimated when events or changes in circumstances such as market value, asset utilization, physical change, legal factors, or other matters indicate that the carrying value may not be recoverable.

In determining the fair value of financial assets and liabilities, the Company currently utilizes market data or other assumptions that it believes market participants would use in pricing the asset or liability in the principal or most advantageous market, and adjusts for non-performance and/or other risk associated with the Company as well as counterparties, as appropriate. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

Level 1 Inputs: Unadjusted quoted prices which are available in active markets for identical assets or liabilities accessible to the Company at the measurement date.

Level 2 Inputs: Inputs other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

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Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

The hierarchy gives the highest priority to Level 1, as this level provides the most reliable measure of fair value, while giving the lowest priority to Level 3.

**Financial Instruments Not Measured at Fair Value**

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

***Legal Contingencies***

In June 2014 the Company entered into a settlement agreement with Astute Technology, LLC (“Astute”). The key terms of the agreement were: 1) grant non-revocable license of Astute patents to the Company; 2) grant a fully paid, non-refundable license of certain Sonic Foundry patents to Astute; 3) Both Astute and our customer agreed to identify three meetings they currently capture that the other party will not seek or respond to any request for proposal; and 4) payment of \$1.35 million to Astute. The payment will be made in three equal amounts with the first paid in June 2014, the second paid in October 2014 and the final payment due March 2015. The Company is contributing \$1.1 million toward the amount payable to Astute, with \$428 thousand relating to prior use and recorded as a charge to income. The remaining \$672 thousand was recorded as a product right asset, which is being amortized, straight line, over the remaining life of the patents, through 2020. Future amounts due to Astute were accrued for as of the time of settlement.

No legal contingencies were recorded for the year ended September 30, 2013. Except as reported above, no legal contingencies were recorded for the year ended September 30, 2014.

***Stock-Based Compensation***

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

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

	<b>Years Ending September 30,</b>	
	<b>2014</b>	<b>2013</b>
Expected life	4.8 – 5.1 years	4.7 – 4.8 years
Risk-free interest rate	0.60%-0.89%	0.35%-0.61%
Expected volatility	46.3%-47.2%	46.8%-49.3%
Expected forfeiture rate	10.5 %-12.2%	11.8%-13.0%
Expected exercise factor	1.39-1.45	1.36-1.37
Expected dividend yield	0%	0%

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***Per Share Computation***

Basic earnings (loss) per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares that may be repurchased, and excludes any dilutive effects of options and warrants. In periods where the Company reports net income, diluted net income per share is computed using common equivalent shares related to outstanding options and warrants to purchase common stock. The numerator for the calculation of basic and diluted earnings per share is net income (loss). The following table sets forth the computation of basic and diluted weighted average shares used in the earnings per share calculations:

	<b>Years Ending September 30,</b>	
	<b>2014</b>	<b>2013</b>
Denominator for basic earnings per share - weighted average common shares	4,174,191	3,932,692
Effect of dilutive options (treasury method)	—	—
Denominator for diluted earnings per share - adjusted weighted average common shares	4,174,191	3,932,692
Options outstanding during each year, but not included in the computation of diluted earnings per share because they are antidilutive	1,240,941	997,045

***Recent Accounting Pronouncements***

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)". The guidance substantially converges final standards on revenue recognition between the FASB and the International Accounting Standards Board providing a framework on addressing revenue recognition issues and, upon its effective date, replaces almost all existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles. The guidance is effective for annual reporting periods beginning after December 15, 2016. We are currently evaluating the impact of adopting ASU 2014-09 to determine the impact, if any, it may have on our financial statements.

In June 2014, the FASB issued Accounting Standards Update No. 2014-12, "Compensation - Stock Compensation" ("ASU 2014-12"). ASU 2014-12 is intended to resolve diverse accounting treatment for share based awards in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. The standard is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015 and may be applied prospectively or retrospectively. We are currently evaluating the impact of adopting ASU 2014-12 to determine the impact, if any, it may have on our financial statements.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40), Disclosure of Uncertainties about an Entities Ability to Continue as a Going Concern (ASU 2014-15). The guidance in ASU 2014-15 sets forth management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern as well as required disclosures. ASU 2014-15 indicates that, when preparing financial statements for interim and annual financial statements, management should evaluate whether conditions or events, in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern for one year from the date the financial statements are issued or are available to be issued. This evaluation should include consideration of conditions and events that are either known or are reasonably knowable at the date the financial statements are issued or are available to be issued, as well as whether it is probable that management's plans to address the substantial doubt will be implemented and, if so, whether it is probable that the plans will alleviate the substantial doubt. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods and

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annual periods thereafter. Early application is permitted. We are currently evaluating the impact of adopting ASU 2014-15 to determine the impact, if any, it may have on our financial statements.

Accounting standards that have been issued but are not yet effective by the FASB or other standards-setting bodies that do not require adoption until a future date, which are not discussed above, are not expected to have a material impact on the Company's financial statements upon adoption.

**2. Commitments**

The Company leases certain equipment under capital lease agreements expiring through January 2018. Such leases are included in fixed assets with a cost of \$893 thousand and accumulated depreciation of \$348 thousand at September 30, 2014. Minimum lease payments, including principal and interest, are summarized in the table below.

<u>Fiscal Year (in thousands)</u>	<u>Capital</u>
2015	\$ 221
2016	120
2017	53
2018	4
Total payments	<u>398</u>
Less interest	<u>(29)</u>
Total	<u>\$ 369</u>

The Company leases certain facilities and equipment under operating lease agreements expiring at various times through January 31, 2019. Total rent expense on all operating leases was approximately \$1 million and \$581 thousand for the years ended September 30, 2014 and 2013, respectively.

In November 2011, the Company occupied office space related to a lease agreement entered into on June 28, 2011. The lease term is from November 2011 through December 2018. The lease includes a tenant improvement allowance of \$613 thousand that was recorded as a leasehold improvement liability and is being amortized as a credit to rent expense on a straight-line basis over the lease term. At September 30, 2014, the unamortized balance was \$357 thousand.

The following is a schedule by year of future minimum lease payments under operating leases:

<u>Fiscal Year (in thousands)</u>	<u>Operating</u>
2015	\$ 1,104
2016	707
2017	725
2018	742
2019	188
Thereafter	-
Total	<u>\$ 3,466</u>

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. At September 30, 2014, the Company has an obligation to purchase \$1.8 million of Mediasite product, which is not recorded on the Company's Condensed Consolidated Balance Sheet.

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



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**3. Credit Arrangements**

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

On May 31, 2013, the Company entered into a First Amendment to the Second Amended and Restated Loan and Security Agreement (the “First Amendment”) with Silicon Valley Bank. Under the First Amendment: (i) the Revolving Loan Maturity Date (as defined) was extended from October 1, 2013 to October 1, 2015, (ii) the interest rate on the revolving line of credit was decreased so that interest will accrue at the per annum rate of three quarters of one percent (0.75 %) above the Prime Rate (as defined), provided that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) of greater than 2.0 to 1.0, or one-and-one quarter percent (1.25%) above the Prime Rate, if Sonic Foundry does not maintain an Adjusted Quick Ratio of greater than 2.0 to 1.0, (iii) the interest rate on the Unused Revolving Loan Facility Fee (as defined) was decreased to seventeen and one-half hundredths of one percent (0.175%).

On January 10, 2014, the Company entered into a Second Amendment to Second Amended and Restated Loan and Security Agreement (the “Second Amendment”) with Silicon Valley Bank. Under the Second Amendment upon funding: (i) the balance of the term loan payable to Silicon Valley Bank of approximately \$544,000 was repaid and replaced by a new term loan of \$2,500,000 to be repaid in 36 equal monthly principal payments, (ii) the interest rate was decreased so that interest accrues at the Prime Rate (as defined) plus two and one quarter percent (which equated to an interest rate of 5.5%) from the Prime Rate plus three and one quarter percent (which equated to an interest rate of 6.5%) payable on the previous loan from Silicon Valley Bank, (iii) the covenant that requires the Minimum Adjusted Quick ratio be at or greater than 1.75:1.0 was reduced to 1.5:1.0, (iv) the Debt Service Coverage ratio was changed to a quarterly test rather than monthly, (v) the approval to repurchase up to \$1,000,000 of outstanding shares of common stock was eliminated, (vi) the purchase of all the outstanding stock in MediaMission Holding B.V., the owner of 100% of the stock of MediaMission B.V. and the purchase of all outstanding stock in Mediasite KK was approved, and (vii) a maximum limit of bank indebtedness of Mediasite KK of \$500,000 was provided for. The funding occurred contemporaneously with the closing of the Company’s purchase of the outstanding common stock of Mediasite KK on January 17, 2014 which was effective January 14, 2014.

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On March 24, 2014 the Companies entered into a Third Amendment to the Second Amended Agreement which 1) reduced the minimum required Adjusted Quick Ratio for each of the months ended February 28, 2014, April 30, 2014, May 31, 2014, July 31, 2014, August 31, 2014, October 31, 2014 and November 30, 2014 from 1.50:1.00 to 1.25:1.00; and 2) waived compliance with the maximum subsidiary indebtedness requirement for the period up to the date preceding the Third Amendment.

At September 30, 2014, a balance of \$1.9 million was outstanding on the term loans with Silicon Valley Bank, with an effective interest rate of six-and-one half percent (6.5%), and no balance was outstanding on the revolving line of credit. At September 30, 2013, a balance of \$767 thousand was outstanding on the term loans with Silicon Valley Bank and no balance was outstanding on the revolving line of credit. At September 30, 2014, there was \$3.0 million available under this credit facility for advances. At September 30, 2014 the Company was in compliance with all covenants in the Second Amended Agreement, as amended.

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

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

At September 30, 2014, a balance of \$170 thousand was outstanding on the notes payable with Mitsui Sumitomo Bank, with an annual interest rate of approximately one-and-one half percent (1.575%) related to Mediasite K.K.

The annual principal payments on the notes payable are as follows:

**Fiscal Year (in thousands)**

2015	\$ 974
2016	861
2017	278
Total	<u>\$ 2,113</u>

At September 30, 2014, a balance of \$628 thousand was outstanding on the subordinated note payable related to the acquisition of MediaMission, with an annual interest rate of six-and-one half percent (6.5%).

At September 30, 2014, a balance of \$1.8 million was outstanding on the subordinated payable related to the acquisition of Mediasite KK with an annual interest rate of five percent (5%).

The annual principal payments on the subordinated notes are as follows:

**Fiscal Year (in thousands)**

2015	\$ 2,096
2016	314
Total	<u>\$ 2,410</u>

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**4. Accrued Liabilities**

Accrued liabilities consists of the following (in thousands):

	September 30,	
	2014	2013
Accrued compensation	\$ 1,173	\$ 882
Accrued expenses	903	286
Accrued interest & taxes	288	36
Other accrued liabilities	148	-
Total	\$ 2,512	\$ 1,204

The Company accrues expenses as they are incurred. Accrued compensation includes wages, vacation, commissions and bonuses. Accrued expenses is mainly related to stock compensation, professional fees and amounts owed to suppliers. Other accrued liabilities is made up of employee-related expenses, including \$98 thousand in dividends payable to the sellers and current employees of its wholly owned subsidiary, MediaMission B.V. These amounts were accrued prior to the Company's acquisition.

**5. Stock Options and Employee Stock Purchase Plan**

On March 5, 2009, Stockholders approved adoption of the 2009 Stock Incentive Plan (the "2009 Plan"). The 2009 Plan, beginning October 1, 2009, replaced two former employee stock option plans that terminated coincident with the effectiveness of the 2009 Plan. On March 7, 2012, Stockholders approved an amendment to increase the number of shares of common stock subject to this plan by 600,000 and to increase the number of shares for the directors' stock option plan by 50,000 shares. On March 6, 2014, Stockholders approved an amendment to increase the number of shares of common stock subject to the 2009 Plan by 800,000 to an aggregated total of 1,800,000 shares of common stock. The Company maintains a directors' stock option plan under which options may be issued to purchase up to an aggregate of 100,000 shares of common stock. Each non-employee director, who is re-elected or who continues as a member of the board of directors on each annual meeting date and on each subsequent meeting of Stockholders, will be granted options to purchase 2,000 shares of common stock under the directors' plan, or at other times or amounts at the discretion of the Board of Directors.

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

The Company has applied a graded (tranche-by-tranche) attribution method and expenses share-based compensation on an accelerated basis over the vesting period of the share award, net of estimated forfeitures.

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

	<b>Qualified Employee Stock Option Plans</b>	<b>Director Stock Option Plans</b>
Shares available for grant at September 30, 2012	601,926	44,500
Options granted	(297,600)	(12,500)
Options forfeited	53,279	-
Shares available for grant at September 30, 2013	357,605	32,000
Stockholder approval to increase shares	800,000	-
Options granted	(328,760)	(12,500)
Options forfeited	24,921	-
Shares available for grant at September 30, 2014	853,766	19,500

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

	<b>Years Ended September 30,</b>			
	<b>2014</b>		<b>2013</b>	
	<b>Options</b>	<b>Weighted Average Exercise Price</b>	<b>Options</b>	<b>Weighted Average Exercise Price</b>
Outstanding at beginning of year	997,045	\$ 10.54	846,280	\$ 11.28
Granted	341,260	10.11	310,100	7.60
Exercised	(38,143)	7.43	(75,532)	5.93
Forfeited	(59,221)	14.90	(83,803)	11.22
Outstanding at end of year	<u>1,240,941</u>	<u>\$ 10.31</u>	<u>997,045</u>	<u>\$ 10.54</u>
Exercisable at end of year	<u>700,922</u>		<u>566,440</u>	
Weighted average fair value of options granted during the year	<u>\$ 3.41</u>		<u>\$ 2.57</u>	

The options outstanding at September 30, 2014 have been segregated into four ranges for additional disclosure as follows:

	<b>Options Outstanding</b>			<b>Options Exercisable</b>	
	<b>Options Outstanding at September 30, 2014</b>	<b>Weighted Average Remaining Contractual Life</b>	<b>Weighted Average Exercise Price</b>	<b>Options Exercisable at September 30, 2014</b>	<b>Weighted Average Exercise Price</b>
<b>Exercise Prices</b>					
\$ 4.50 to \$9.90	767,015	7.3	\$ 8.04	411,548	\$ 7.64
10.00 to 14.83	343,303	7.1	11.65	158,751	12.93
15.00 to 19.00	95,865	4.0	15.78	95,865	15.78
21.40 to 46.90	34,758	2.0	30.47	34,758	30.47
	<u>1,240,941</u>			<u>700,922</u>	

At September 30, 2014, there was \$664 thousand of total unrecognized compensation cost related to non-vested stock-based compensation, including \$98 thousand of estimated forfeitures. The cost is expected to be recognized over a weighted-average life of 1.8 years.

A summary of the status of the Company's non-vested shares at September 30, 2014 and for the year then ended is presented below:

	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Non-vested shares at October 1, 2013	430,605	\$ 3.28
Granted	341,260	3.41
Vested	(217,703)	3.47
Forfeited	(14,643)	3.52
Non-vested shares at September 30, 2014	<u>539,519</u>	<u>\$ 3.29</u>

Stock-based compensation recorded in the year ended September 30, 2014 of \$921 thousand was allocated \$617 thousand to selling and marketing expenses, \$54 thousand to general and administrative expenses and \$250 thousand to product development expenses. Stock-based compensation recorded in the year ended September 30, 2013 of \$656 thousand was allocated \$429 thousand to selling and marketing expenses, \$40 thousand to general and

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administrative expenses and \$187 thousand to product development expenses. Cash received from exercises under all stock option plans and warrants for the years ended September 30, 2014 and 2013 was \$286 thousand and \$448 thousand, respectively. There were no tax benefits realized for tax deductions from option exercises for the years ended September 30, 2014 and 2013. The Company currently expects to satisfy stock-based awards with registered shares available to be issued.

The Company also has an Employee Stock Purchase Plan (Purchase Plan) under which an aggregate of 150,000 common shares may be issued. The Shareholders approved an amendment to increase the number of shares of common stock subject to the plan from 100,000 to 150,000 at the Company's annual meeting in March 2014. All employees who have completed 90 days of employment with the Company on the first day of each offering period and customarily work twenty hours per week or more are eligible to participate in the Purchase Plan. An employee who, after the grant of an option to purchase, would hold common stock and/or hold outstanding options to purchase stock possessing 5% or more of the total combined voting power or value of the Company will not be eligible to participate. Eligible employees may make contributions through payroll deductions of up to 10% of their compensation. No participant in the Purchase Plan is permitted to purchase common stock under the Purchase Plan if such option would permit his or her rights to purchase stock under the Purchase Plan to accrue at a rate that exceeds \$25,000 of the fair market value of such shares, or that exceeds 1,000 shares, for each calendar year. The Company makes a bi-annual offering to eligible employees of options to purchase shares of common stock under the Purchase Plan on the first trading day of January and July. Each offering period is for a period of six months from the date of the offering, and each eligible employee as of the date of offering is entitled to purchase shares of common stock at a purchase price equal to the lower of 85% of the fair market value of common stock on the first or last trading day of the offering period. A total of 14,346 shares are available to be issued under the plan. There were 11,863 and 15,062 shares purchased by employees during fiscal 2014 and 2013, respectively. The Company recorded stock compensation expense under this plan of \$21 and \$19 thousand during fiscal 2014 and 2013, respectively. Cash received from issuance of stock under this plan was \$98 and \$75 thousand during fiscal 2014 and 2013, respectively.

**6. Income Taxes**

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

	<u>Years Ended September 30,</u>	
	<u>2014</u>	<u>2013</u>
Current tax expense	\$ 40	\$ -
Deferred income tax expense	1,064	240
Provision for income taxes	<u>\$ 1,104</u>	<u>\$ 240</u>

The reconciliation of income tax expense (benefit) computed at the appropriate country specific rate to income tax expense (benefit) is as follows (in thousands):

	<u>Years Ended September 30,</u>	
	<u>2014</u>	<u>2013</u>
Income tax expense (benefit) at statutory rate	\$ (582)	\$ (188)
State income tax expense (benefit)	(53)	(11)
Foreign tax activity	40	-
R&D tax credit expiration	82	-
Permanent differences, net	212	111
Adjustment of temporary differences to income tax returns	121	(110)
Change in valuation allowance	1,284	438
Income tax expense	<u>\$ 1,104</u>	<u>\$ 240</u>

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

	<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>
Deferred tax assets:		
Net operating loss and other carryforwards	\$ 35,556	\$ 35,001
Common stock warrants	811	636
Allowance for doubtful accounts	59	35
Unearned revenue	319	-
Other	1	47
Total deferred tax assets	<u>36,746</u>	<u>35,719</u>
Deferred tax liabilities:		
Fixed assets	(129)	(129)
Other	(64)	(321)
Total deferred tax liabilities	<u>(193)</u>	<u>(450)</u>
Net deferred tax asset	36,553	35,269
Valuation allowance	(36,553)	(35,269)
Equity gains on investment in Mediasite KK	(916)	-
Customer relationships	(946)	-
Goodwill amortization	(2,450)	(2,210)
Deferred tax liability for goodwill and intangible assets amortization	<u>\$ (4,312)</u>	<u>\$ (2,210)</u>

At September 30, 2014, the Company had net operating loss carryforwards of approximately \$91 million for U.S. Federal and \$52 million for state tax purposes. For Federal tax purposes, the carryforwards expire in varying amounts between 2019 and 2034. For state tax purposes, the carryforwards expire in varying amounts between 2014 and 2033. Utilization of the Company's net operating loss may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization. In addition, the Company has research and development tax credit carryforwards of approximately \$418 thousand, which expire in varying amounts between 2019 and 2020.

Earnings of the Company's foreign subsidiaries are generally subject to U.S. taxation upon repatriation to the U.S. and the Company's tax provision reflects the related incremental U.S. tax except for certain foreign subsidiaries whose unremitted earnings are considered to be indefinitely reinvested. At September 30, 2014, unremitted earnings of foreign subsidiaries were deemed to be indefinitely reinvested. No deferred tax liability has been recognized with regard to the remittance of such earnings after MSKK and MediaMission BV acquisitions were completed during the year. Because of the availability of U.S. foreign tax credits, it is likely no U.S. tax would be due if such earnings were repatriated.

Beginning with an acquisition in fiscal year 2002, the Company has amortized Goodwill for tax purposes over a 15 year life. Goodwill is not amortized for book purposes. Tax amortization is not applicable to the goodwill from the foreign acquisitions that took place during fiscal 2014 since the foreign goodwill is non-deductible for US federal tax purposes.

The difference between the book and tax balance of certain of the company's goodwill creates a deferred tax liability and an annual tax expense. Because of the long term nature of the goodwill timing difference, tax planning strategies cannot be utilized with respect to the deferred tax liability. The Company's tax rate differs from the expected tax rate each reporting period as a result of the aforementioned items. The balance of the Deferred Tax Liability at September 30, 2014 was \$4.3 million and \$2.2 million at September 30, 2013. The Company recorded a

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deferred tax liability related to the Customer Relationship intangibles value acquired as part of the purchase of MediaMission BV and Mediasite KK. The Company also recorded tax expense related to the “step-up” gain on its original equity investment in Mediasite KK. The Company has some other temporary differences related to its Mediasite KK subsidiary.

In accordance with accounting guidance for uncertainty in income taxes, the Company has concluded that a reserve for income tax contingencies is not necessary. The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accruals for interest and penalties on the Company's Condensed Consolidated Balance Sheets at September 30, 2014 or September 30, 2013, and has not recognized any interest or penalties in the Condensed Consolidated Statements of Operations for either of the twelve month periods ended September 30, 2014 or 2013.

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

**7. Acquisition of MediaMission Holding B.V.**

On December 16, 2013, Sonic Foundry completed its acquisition of all of the outstanding stock of MediaMission Holding B.V., the owner of 100% of the outstanding stock in MediaMission B.V., (“MediaMission”) and MediaMission Hosting B.V. Sonic Foundry paid \$1.493 million for all the outstanding stock in MediaMission Holding B.V., comprised of \$458,000 cash, \$687,000 subordinated note payable over three years (interest rate of 6.5%) and \$348,000 in shares of Sonic Foundry stock. The stock portion of the purchase price consisted of 37,608 shares of Sonic Foundry common stock. In connection with the acquisition of MediaMission Holding B.V., the Company entered into employment agreements with the two managing principals of MediaMission. As a result of the acquisition, the Company is expected to further increase its presence in the European market. The goodwill of \$932 thousand arising from the acquisition consists largely of the synergies expected from combining the operations of the Company and MediaMission. None of the goodwill recognized is deductible for income tax purposes.

The Company recorded the acquired tangible and intangible assets and liabilities assumed based on their estimated fair values. The fair value of the customer relationships was estimated by applying the income approach. That measure is based on significant inputs that are not observable in the market, and therefore represents Level 3 inputs. Key assumptions include a discount rate of 28 percent, estimated effective tax rate of 20 percent, and estimated customer attrition rate of 15 percent. The Company believes that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed. The customer relationship intangible is amortized on a straight line basis over ten year years and amortization is categorized as a selling and marketing expense.

The following table summarizes the fair values of the assets acquired and liabilities assumed on the date of the acquisition (in thousands):

	<u>Fair Value</u>
Assets acquired:	
Cash	\$ 339
Other current assets	923
Property and equipment	49
Customer relationships	591
Goodwill	932
Total assets acquired	<u>2,834</u>
Liabilities assumed:	
Current liabilities	(1,111)
Deferred tax liability	(230)
Total liabilities assumed	<u>(1,341)</u>
Total purchase price	<u>\$ 1,493</u>

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MediaMission contributed revenue of \$1.0 million and a net loss of \$147 thousand for the period from the date of acquisition to September 30, 2014.

**8. Acquisition of MSKK**

On January 14, 2014, Sonic Foundry paid approximately \$5.7 million for the remaining stock in Mediasite KK, comprised of equal components of approximately \$1.9 million cash, subordinated note payable in one year (interest rate of 5%) and value in shares of Sonic Foundry. The stock portion of the purchase price consisted of 189,222 shares of Sonic Foundry common stock. Assets acquired include cash, accounts receivable, inventory, fixed assets and customer relationship and other intangibles and liabilities assumed include accounts payable, debt, taxes payable and unearned revenues. Prior to completion of this acquisition, the Company owned a minority interest of approximately 26% of Mediasite KK. In connection with the acquisition, the one quarter lag in reporting their results was eliminated. The Company determined that the acquisition was deemed to be a material business combination. During the second fiscal quarter of 2014, this initial investment was valued at the same amount as the value when control was achieved which resulted in a non-cash gain of approximately \$1.4 million. This amount was partially offset by a \$901 thousand tax expense associated with the gain. As a result of the acquisition, the Company is expected to further increase its presence in the Japanese and Asian market. The goodwill of \$2.9 million arising from the acquisition consists largely of the synergies expected from combining the operations of the Company and Mediasite KK. None of the goodwill recognized is deductible for income tax purposes.

The Company recorded the acquired tangible and intangible assets and liabilities assumed based on their estimated fair values. The fair value of the customer relationships was estimated by applying the income approach. That measure is based on significant inputs that are not observable in the market, and therefore represents Level 3 inputs. Key assumptions include a discount rate of 30 percent, estimated effective tax rate of 35.5 percent, and estimated customer attrition rate of 15 percent. The Company believes that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed. The customer relationship intangible is amortized on a straight line basis over ten year years and amortization is categorized as a selling and marketing expense.

The following table summarizes the fair values of the assets acquired and liabilities assumed on the date of the acquisition (in thousands):

	<u><b>Fair Value</b></u>
Assets acquired:	
Cash	\$ 3,163
Other current assets	1,792
Property and equipment	240
Customer relationships	2,071
Goodwill	2,906
Total assets acquired	<u>10,172</u>
Liabilities assumed:	
Current liabilities	(1,590)
Deferred tax liability	(808)
Total liabilities assumed	<u>(2,398)</u>
Less ownership basis of original 26% investment	<u>(2,053)</u>
Total purchase price for 74% remaining stock	<u>\$ 5,721</u>

Mediasite KK contributed revenue of \$4.3 million and net income of \$48 thousand for the period from the date of acquisition to September 30, 2014.



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**9. Pro Forma Financial Information (Unaudited)**

The following table represents the net loss (in thousands) for the Company on a pro forma basis, assuming the acquisitions of MediaMission and Mediasite KK had each occurred as of October 1, 2012. The table sets forth unaudited pro forma results for the twelve months ended September 30, 2013 and 2014, respectively and has been compiled from historical financial statements and other information, but is not necessarily indicative of the results that actually would have been achieved had the transaction occurred on the dates indicated or that may be achieved in the future.

	<u>Twelve Months Ended Sept 30,</u>	
	<u>2014</u>	<u>2013</u>
Revenue	\$37,575	\$35,369
Net income/(loss)	(2,694)	(750)
Basic income/(loss) per share	\$ (0.61)	\$ (0.18)

**10. Savings Plan**

The Company's defined contribution 401(k) savings plan covers substantially all employees meeting certain minimum eligibility requirements. Participating employees can elect to defer a portion of their compensation and contribute it to the plan on a pretax basis. The Company may also match certain amounts and/or provide additional discretionary contributions, as defined. The Company made matching contributions of \$375 and \$275 thousand during the years ended September 30, 2014 and 2013, respectively. The Company made no additional discretionary contributions during 2014 and 2013.

**11. Related-Party Transactions**

The Company incurred fees of \$236 and \$171 thousand during the years ended September 30, 2014 and 2013, respectively, to a law firm whose partner is a director and stockholder of the Company. The Company had accrued liabilities for unbilled services to the same law firm of \$15 and \$14 thousand at September 30, 2014 and 2013, respectively.

The Company recorded Mediasite product and customer support revenue of \$1.3 million during the year ended September 30, 2013, to Mediasite KK and Mediasite KK owed the Company \$280 thousand at September 30, 2013, respectively. Mediasite KK became a wholly owned subsidiary during fiscal 2014.

As of September 30, 2014 and 2013, the Company had a loan outstanding to an executive totaling \$26 thousand. The loan is collateralized by Company stock.

As of September 30, 2014, the Company had outstanding amounts due for management fees and dividends payable to the sellers of and current employees of its wholly-owned subsidiary, MediaMission B.V. totaling \$370 thousand.

**12. Goodwill and Other Intangible Assets**

Goodwill and intangible assets that have indefinite useful lives are recorded at cost and are not amortized but, instead, tested at least annually for impairment. The Company assesses the impairment of goodwill on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value.

The Company performs annual goodwill impairment test as of July 1, and tested goodwill recognized in connection with the acquisitions of Mediasite, MediaMission and Mediasite KK and determined it was not impaired. For purposes of the test, goodwill on the Company's books is evaluated within three separate reporting units.

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The changes in the carrying amount of goodwill for the year ended September 30, 2014 are as follows:

Balance as of September 30, 2013	\$ 7,576
Goodwill acquired during year:	
Mediasite KK	2,906
MediaMission	933
Foreign currency translation adjustment	(230)
Balance as of September 30, 2014	<u>\$ 11,185</u>

The following tables present details of the Company's total intangible assets at September 30, 2014 and 2013:

(in thousands)	Life (years)	Gross	Accumulated Amortization at September 30, 2014	Balance at September 30, 2014
Amortizable:				
Loan origination fees	3	\$ 199	\$ 162	\$ 37
Customer relationships	10	2,662	191	2,471
Software development costs	3	533	252	281
Product rights	6	672	41	631
		<u>4,066</u>	<u>646</u>	<u>3,420</u>
Non-amortizable goodwill		11,185	-	11,185
Total		<u>\$ 15,251</u>	<u>\$ 646</u>	<u>\$ 14,605</u>

(in thousands)	Life (years)	Gross	Accumulated Amortization at September 30, 2013	Balance at September 30, 2013
Amortizable:				
Loan origination fees	3	\$ 150	\$ 135	\$ 15
		<u>150</u>	<u>135</u>	<u>15</u>
Non-amortizable goodwill		7,576	-	7,576
Total		<u>\$ 7,726</u>	<u>\$ 135</u>	<u>\$ 7,591</u>

Estimated amortization expense for each of the five subsequent fiscal years is expected to be (in thousands):

<u>Fiscal Year (in thousands)</u>	
2015	\$ 597
2016	501
2017	390
2018	362
2019	302
Total	<u>\$ 2,152</u>

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**13. Segment Information**

The Company has determined that it operates in three operating segments, however these segments meet the criteria for aggregation for reporting purposes as one operating segment as of September 30, 2014. Prior to the acquisitions in the year ended September 30, 2014, we reported in one operating segment..

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

	<b>Years Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
United States	\$ 22,175	\$ 20,610
Europe and Middle East	6,446	3,621
Asia	5,813	1,772
Other	1,396	1,753
Total	<u>\$ 35,830</u>	<u>\$ 27,756</u>

**14. Customer Concentration**

In the fiscal year ended September 30, 2014 and 2013, two distributors represented 30% and 42% of total revenue. At September 30, 2014 and 2013, these two distributors represented 47% and 56% of total accounts receivable, respectively.

**15. Legal Proceedings**

From time to time, the Company is subject to legal proceedings or claims arising from its normal course of operations. The Company accrues for costs related to loss contingencies when such costs are probable and reasonably estimable. As of September 30, 2014, the Company is not aware of any material pending legal proceedings or threatened litigation that would have a material adverse effect on the Company's financial condition or results of operations, although no assurance can be given with respect to the ultimate outcome of pending actions.

On October 26, 2012, a complaint was filed by Astute Technology, LLC (“Astute”) against one of our customers in the United States District Court for the Eastern District of Texas (Case No. 2:012-cv-689). The complaint alleges patent infringement. Because we agreed to indemnify our customers from costs and damages in connection with infringement we defended the complaint.

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

In June, 2014 the Company entered into an agreement with Astute which resolved the matters referenced above. The key terms of the agreement are: 1) grant non-revocable license of Astute patents to the Company; 2) grant a fully paid, non-refundable license of certain Sonic patents to Astute; 3) Both Astute and our customer agree to identify three meetings they currently capture that the other party will not seek or respond to any request for proposal; and 4) payment of \$1.35 million to Astute. The payment will be made in three equal amounts with the first paid in June 2014, the second paid in October 2014 and the final payment due March 2015. The Company is contributing \$1.1 million toward the amount payable to Astute, with \$428 thousand relating to prior use and recorded as a charge to income. The remaining \$672 thousand was recorded as a product right asset, which is being amortized, straight line, over the remaining life of the patents, through 2020. Future amounts due to Astute were accrued for as of the time of settlement.

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**16. Quarterly Financial Data (unaudited)**

The following table sets forth selected quarterly financial information for the years ended September 30, 2014 and 2013. The operating results are not necessarily indicative of results for any future period.

(in thousands except per share data)	Quarterly Financial Data							
	<u>Q4-'14</u>	<u>Q3-'14</u>	<u>Q2-'14</u>	<u>Q1-'14</u>	<u>Q4-'13</u>	<u>Q3-'13</u>	<u>Q2-'13</u>	<u>Q1-'13</u>
Revenue	\$ 8,479	\$ 11,267	\$ 8,878	\$ 7,206	\$ 6,761	\$ 8,013	\$ 6,430	\$ 6,552
Gross margin	5,871	7,789	6,499	5,396	4,892	5,611	4,690	4,867
Income (loss) from operations	(1,357)	(77)	(1,022)	(626)	(582)	109	(34)	(131)
Equity in earnings from investment in Mediasite KK	-	-	15	23	30	11	90	78
Net income (loss)	(1,288)	33	(871)	(690)	(666)	40	(27)	(139)
Basic and diluted net income (loss) per share	\$(0.30)	\$ 0.01	\$(0.21)	\$(0.17)	\$(0.17)	\$ 0.01	\$(0.01)	\$(0.04)

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

Not applicable.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

Based on evaluations as of the end of the period covered by this report, our principal executive officer and principal financial officer, with the participation of our management team, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e), and 15d-15(e) under the Securities Exchange Act). Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that material information relating to the Company is accumulated and communicated to management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective as of September 30, 2014 solely as a result of three material weaknesses. These related weaknesses are discussed further in Management's Report on Internal Control over Financial Reporting below.

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

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

**Management's Report on Internal Control Over Financial Reporting**

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

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in the *1992 Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this evaluation, our principal executive officer and principal financial officer concluded that our internal controls over financial reporting were not effective as of September 30, 2014 due to three identified material weaknesses in internal control. The first material weakness is in internal control over the financial reporting and monitoring of Mediasite KK ("MSKK") which was identified in fiscal 2013 and continues to exist. Our internal controls related to the capture of MSKK's historical information, the accounting for our investment in MSKK based on that information and the review of such accounting did not operate effectively and were not sufficient to ensure that our accounting was in accordance with U.S. generally accepted accounting principles. The second material weakness relates to controls over the research and analysis of accounting for non-standard contract provisions. The company did not adequately assess some unique contract implications of one large contract with a customer during the second quarter of fiscal 2014. The third material weakness relates to controls over the preparation of consolidated financial information.

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In light of the material weakness described above, additional procedures were performed by our management to ensure that the condensed consolidated financial statements included in this report were prepared in accordance with U.S. generally accepted accounting principles.

**Changes in Internal Control Over Financial Reporting**

The Company is in the process of making changes to its internal control over financial reporting (as referred to in Paragraph 4(b) of the Certifications of the Company's principal executive officer and principal financial officer included as exhibits to this report) as it relates to the acquisitions that have materially affected, or are reasonably likely to affect the Company's internal control over financial reporting.

In the third and fourth quarters of fiscal 2014, we instituted certain controls and procedures to obtain the necessary information to properly consolidate the foreign operations and added additional resources to address any non-standard contract provisions. The controls and procedures allow the Company to obtain accurate financial information in a timely fashion which is in accordance with US generally accepted accounting principles. The third quarter of fiscal 2014 also represents the first full quarter of operations of the foreign subsidiaries as part of consolidated operations. Over time, we have continued to gain an understanding of the laws and customs which we were previously unfamiliar with, overcome certain challenges with language barriers and time zone differences, and implement controls surrounding the consolidation of these foreign operations with our domestic operations.

**Remediation**

The aforementioned internal controls over financial reporting of our foreign operations have provided a framework to remediate the material weakness surrounding our consolidation process. We are currently reviewing our processes and controls and deploying our additional accounting resources to design and implement effective controls over our consolidation process. Finally, we have utilized our additional resources to appropriately address any non-standard contract provisions during the quarter. There can be no assurances that we have fully remediated the weaknesses in the controls over the foreign operations. However, we feel that our remediation efforts to establish processes and controls as well as adding additional resources to our accounting team made significant improvements to our processes and controls in an effort to address each of the aforementioned material weaknesses.

**ITEM 9B. OTHER INFORMATION**

None.

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**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE**

The information required by Item 10 of Form 10-K with respect to directors and executive officers is incorporated herein by reference to the information contained in the section entitled “Proposal One: Election of Directors” and “Executive Officers of Sonic”, respectively, in the Company’s definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the Company’s 2013 Annual Meeting of Stockholders, which will be filed no later than January 28, 2015 (the “Proxy Statement”).

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

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

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

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

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**ITEM 11. EXECUTIVE COMPENSATION**

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

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

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

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

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

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by Item 14 of Form 10-K is incorporated herein by reference to the information contained in the section entitled “Ratification of Appointment of Independent Auditors – Fiscal 2013 and 2014 Audit Fee Summary” in the Proxy Statement.



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