

sonicfoundry®

2018 ANNUAL REPORT



POWERING  
A SMARTER,  
MORE  
CONNECTED  
WORLD

## Dear Fellow Shareholders,

This is my first annual letter to shareholders, and I've been looking forward to the opportunity to share my thoughts on Sonic Foundry – our challenges, opportunities and our plans to rebuild the business. Regaining and expanding the trust of our customers, our team and you, our shareholders is paramount. Though I have been in my position for a short time, I intend to prove to you that walking the walk and living up to expectations are core values for me, and I am excited for what lies ahead.

There is no doubt that we have a very solid foundation, and that begins in house. I spent a great deal of time in my first 60 days as CEO meeting with all employees to identify individual strengths and listen to their input. It was a very encouraging exercise, and I'm proud to say we have an incredibly resourceful, passionate and collaborative team in place. I'm honored to lead them going forward and am confident they'll get the job done.

Before I talk about where we're going, let's look at where we've been over the past year.

### **2018 in Review**

Our strategy to make video creation more accessible, powerful and easy has been resonating very well with our largest customer base — higher education — as Mediasite is continually selected by leading educational institutions around the globe. Sonic Foundry continues to be the market leader, with more customers and higher revenue than our competitors, a fact that is supported by the independent research of industry analysts like Wainhouse Research and Frost & Sullivan who cover our market.

By increasing the breadth and depth of our offerings and expanding our product leadership in mission critical, wide-scale campus video adoption, we've secured numerous new Mediasite customers including Iqra University in Pakistan, Deakin University in Australia, Cuyahoga Community College in Ohio and University of the Witwatersrand, Johannesburg in South Africa.

Among the new customers are a number of key wins from our competitors from this past year. Leading the way were several large-scale deployments which helped shore up our belief that we have the best offering to revolutionize the modern academic experience. Schools like Texas A&M College of Engineering, Florida Atlantic University and University of North Texas Health Sciences Center have all reported tens of thousands of video views in a short time with Mediasite.

In our efforts to make progress across the entire campus footprint, long term customers have expanded into other professional schools, including Duquesne University Law, University of Chicago Booth School of Business and Duke Engineering. We also see an increasing number of customers in emerging markets such as India and China. It's exciting to see all the innovative ways schools and organizations globally are finding to use Mediasite.

With this appetite for adoption, customers are increasingly looking at us to provide additional service offerings. Over the past year we formalized a customer success initiative to promote more effective product use. When our customers can better realize Mediasite's benefits, they're more likely to stick with us and expand. Whether they rely on our customer success team, our managed services or our cloud solutions, these customers are finding Mediasite an economically sensible way to accomplish their online video needs without adding internal personnel or equipment.

As higher education and enterprises mature to expect flawless user experiences, we plan to place more emphasis on our cloud offering. This is a trend we expect will accelerate as it clearly matches the preference of our existing users.



This past year we saw our Mediasite Join video and web conference capture and management solution find a new home in the fast-growing unified communications space. The workplace and classrooms are increasingly becoming more collaborative and geographically dispersed, and a lot of valuable knowledge is being shared across distance via video and web conferences in heterogeneous environments. We're seeing demand strengthen for the ability to intelligently capture, manage and route that knowledge. The medical/healthcare, pharmaceutical and technology segments are particularly strong enterprise markets for Mediasite Join, which will continue to be a primary focus for us over the next year.

Our integration with IBM Watson speech-to-text technology gives our customers deeper insights into their video content. This integration enables new workflows to create cleaner video transcripts, something especially important in higher education where accessibility requirements are high. We plan to continue to focus on and expand upon this exciting area in the coming year and see endless possibilities for how artificial intelligence can enhance our customers' video experiences.

### **Strategic Perspective**

Even as we celebrate these positive trends, our past performance cannot be ignored. We have fallen short of our revenue-growth targets for several years, and our quarterly numbers have been unsatisfactory from a profitability standpoint. These dynamics have translated directly into poor shareholder value.

To remedy this, I decided to refocus our resources and trim our cost base. That will help drive us to profitability with urgency, while working to support our customers and refine our long-term strategy.

Our number one priority is to sustainably grow the top line of the business. By listening to the evolving needs and desires of our customers we can continue to be creative and add functions, features and services to Mediasite while attracting new customers and expanding existing ones. Traditionally we've leveraged our technology as a platform. Moving forward, we're exploring adding a more solutions-based approach to make even more customers successful with their Mediasite rollout and foster additional growth.

As we look at the next three to five years, we need to be better at creating our own markets. We're exploring how we can apply our best-in-class solutions and services beyond our important commitment to the existing customer base.

Continued success means meaningful expansion of our customer relationships, bringing new high-impact solutions to the market and delivering a support backbone to ensure the success of our customers at every step.

We have a fantastic team in place that will be able to respond to what comes our way in the marketplace. I'm optimistic about our position and our ability to impact our destiny and look forward to the journey.

Sincerely,



Michael Norregaard  
CEO

sonicfoundry®

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

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
To Be Held September 12, 2019**

The Annual Meeting of Stockholders of **SONIC FOUNDRY, INC.**, a Maryland corporation (“Sonic”) will be held at the Overture Center for the Arts, Wisconsin Studio, 201 State Street, Madison, Wisconsin 53703 on September 12, 2019 at 9:00 a.m. local time, for the following purposes:

1. To elect two directors to hold office for the terms set forth herein and until their successors are duly elected and qualified.
2. To ratify the appointment of Wipfli LLP as our independent auditors for the fiscal year ending September 30, 2019.
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 and, Series A Preferred Stock, at the close of business on July 22, 2019 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,

Madison, Wisconsin  
August 2, 2019

Kenneth A. Minor  
Secretary

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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**

August 2, 2019

**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 Nelson A. Murphy and David F. Slayton, for terms expiring in 2024;

**FOR** the ratification of the appointment of Wipfli LLP as independent auditors of Sonic for the fiscal year ending September 30, 2019.

In the event that the nominees 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 August 8, 2019.

Each holder of Common Stock 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 July 22, 2019 (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 6,758,865 shares of Common Stock, held by approximately 3,100 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 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 Directors require a plurality of the votes present and entitled to vote. Therefore, the two directors who receive 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 Wipfli 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 wipfli, LLP as our independent auditor is considered a discretionary matter.

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

The Annual Meeting will be held on September 12, 2019 at 9:00 a.m. (Central time) at the Overture Center for the Arts, Wisconsin Studio, 201 State Street, Madison, Wisconsin 53703.

#### **PROPOSAL ONE: ELECTION OF DIRECTORS**

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 not be less than three or more than twelve. The currently authorized number of directors is six. The seats on the Board of Directors currently held by David F. Slayton and Nelson A. Murphy are designated as Class I Board seats, with terms expiring at the Annual Meeting. The Board of Directors has nominated Nelson A. Murphy and David F. Slayton as Class I Directors for election at the Annual Meeting.

If elected at the Annual Meeting, Messrs. Murphy and Slayton would serve until the 2024 Annual Meeting until their successors are elected and qualified or until their earlier death, resignation or removal.

**The election of Messrs. Murphy and Slayton require a plurality of the votes present and entitled to vote.**

#### **Nominees for Director for a Five-Year term expiring on the 2024 Annual Meeting**

##### **Nelson A. Murphy**

Mr. Murphy, age 59, has been a Director since November 2017. Since January 2015, Mr. Murphy has been the Executive VP, Finance & Operations for Catawba College, a private liberal arts college. From August 2013 to June 2015 Mr. Murphy was VP, International Finance at Syniverse Technologies, Inc. in Luxembourg, a provider of mobile technologies, and from October 2010 to August 2013 served as VP – Finance, Defensive Systems Division at Northrop Grumman Corporation, a global security company. Previously, Mr. Murphy served in various senior finance roles at AT&T including responsibility for finance in operations located in Europe, the Middle East and Latin America. Mr. Murphy has a B.S. in Accounting from Wake Forest University.

##### **David F. Slayton**

Mr. Slayton, age 50, has been a Director since November 2017. Since April 2013, Mr. Slayton has been the Chief Financial Officer of Ovative Group, a digital media agency and analytics firm. From July 2008 to March 2013, Mr. Slayton was co-founder, Executive Vice President – CFO and a member of the board of Alice.com, an e-commerce retail marketplace. Prior to his service at Alice.com, Mr. Slayton served in senior financial management roles at numerous companies including as Chief Financial Officer at Shavlik Technologies from June 2005 to July 2008, Managing Director and co-founder at Haviland Partners Inc. from August 2003 to February 2005 and as Chief Financial of NameProtect Inc. from July 2000 to July 2003. Mr. Slayton earned a BS in Economics from the Massachusetts Institute of Technology



(June 1991) and an MBA in Business Administration from Harvard University (June 1996).

**The members of the Board of Directors unanimously recommend a vote FOR the election of Messrs. Murphy and Slayton as Class I Directors.**

#### **DIRECTORS CONTINUING IN OFFICE**

**Mark D. Burish**

**Term Expires in 2020  
(Class II Director)**

Mr. Burish, age 66, 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, Madison, WI, which he co-founded in 1983. He is President and principal owner of Steakhouse, LLC, a chain of steakhouse restaurants and co-founder and principal of MB Solutions, a pharmaceutical company. He sits on the board of Forward Health Group, a healthcare analytics software company and serves as a director of Monona Bank, a Madison based banking Company. Mr. Burish also presently serves on the board of VIP Crowd, an online business that rewards customers, employees, prospects, and networks for helping grow and improve their business. Previously, Mr. Burish was the founder, CEO and owner of Our House Senior Living, LLC, Milestone Senior Living, LLC and Milestone Management Services, LLC which he started in 1997. Our House Senior Living was sold in 2010 and Milestone was sold in 2017. Mr. Burish received his BA degree in communications from Marquette University in 1975 and his JD degree from the University of Wisconsin in 1978.

**Frederick H. Kopko, Jr.**

**Term Expires in 2021  
(Class III Director)**

Frederick H. Kopko, age 64, 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. He also serves on the board of Mercury Air Group Inc. subsidiaries, as well as on the board of managers of Altathera Pharmaceuticals LLC. 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 2022  
(Class IV Director)**

Mr. Wiegand, age, 50, 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 Gravy, Inc., a video platform for brands and influencers to host live mobile shopping parties to drive brand engagement and impulse purchases. Mr. Wiegand founded and served as 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, where Mr. Wiegand served as SVP of Growth and Strategy from the date of purchase to August 2016. 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 presently serves on the board of VIP Crowd, an online business that rewards customers, employees, prospects, and networks for helping grow and improve their business. Mr. Wiegand attended the University of Wisconsin – Madison.

**Gary R. Weis**

**Term Expires in 2023  
(Class V Director)**

Mr. Weis, age 72, served as Chief Executive Officer from March 2011 until April 2019, Chief Technology Officer from September 2011 to April 2019 and a Director of Sonic since February 2004. Presently, he serves as a senior advisor to the Company. 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.

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 served as CEO of the Company from March 2011 to April 2019. 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. Mr. Murphy has significant experience in finance and accounting both in the higher education field as well as with technology companies and Mr. Slayton has substantial financial experience in growing technology companies.

## **CORPORATE GOVERNANCE**

### **Director Independence**

Although the Company's stock is no longer listed on the NASDAQ Stock Market ("NASDAQ"), the Company intends to comply with most of the listing requirements for such market and all of the requirements of the OTC Markets, where the Company's stock is currently quoted. Both NASDAQ and the OTC Markets require 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, Nelson A. Murphy, David F. Slayton 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.

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

Mark D. Burish serves as Non-Executive Chairman of the Board and Michael Norregaard serves as our Chief Executive 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 six times during Fiscal 2018. 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 2018.

The Board of Directors has three standing committees, the Audit Committee, the Executive Compensation Committee and the Nominations Committee. The Board of Directors also established a special committee of independent and disinterested members to investigate, evaluate and negotiate on behalf of the Board with respect to various corporate transactional opportunities with which the Board may from time to time be presented, as well as to consider and negotiate the terms of transactions by Mark D. Burish, the Company's chair.

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. Murphy (chair), Slayton and Wiegand. 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. 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 experience serving in senior financial roles at several companies as well as his degree in accounting and designation as a certified public accountant, Mr. Murphy meets the definition of audit committee financial expert as that term is defined under the rules of the Securities and Exchange Commission. The members of the Audit Committee also meet the Nasdaq Stock Market requirements regarding the financial sophistication and the financial literacy of members of the Audit Committee.

The Compensation Committee consists of Messrs. Burish (chair) and Wiegand. 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. A copy of the charter of the Compensation Committee is available on Sonic's website.

The Nominations Committee consists of Messrs. Burish (chair) and Wiegand. 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 2020 Annual Meeting of Stockholders, the nomination must be delivered or mailed to and received by Sonic's Secretary between May 14, 2020 and June 13, 2020 (or, if the 2020 annual meeting is advanced by more than 30 days or delayed by more than 60 days from September 12, 2020, 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, will receive reduced compensation from prior years with an annual retainer of \$10,000 (down from \$20,000) in addition to a fee of \$750 for attendance at each meeting of the Board of Directors (down from \$750) and \$500 per committee meeting attended (down from \$1,000). Special independent and disinterested committee members will continue to be paid a fee of \$1,000 for each meeting attended. In addition, the chair of the Audit Committee receives an Audit Committee annual retainer of \$4,000 and the chair of the Compensation Committee receives a \$1,500 Compensation Committee annual retainer. Mr. Burish receives an annual retainer of \$17,500 as compensation for his services as Chair of the Board of Directors. The total fee compensation earned by the five non-employee directors combined in Fiscal 2018 was \$227,160. 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 150,000 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, 2018.

Name (a)	Fees Earned Or Paid In Cash \$(1) (b)	Stock Awards \$(2) (c)	Option Awards \$(3) (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	—	67,000	1,360	—	—	—	68,360
Frederick H. Kopko	—	30,000	1,360	—	—	—	31,360
Nelson A. Murphy	4,500	45,095	1,700	—	—	—	51,295
David F. Slayton	—	38,425	1,360	—	—	—	39,785
Brian T. Wiegand	—	35,000	1,360	—	—	—	36,360

- (1) The amount reported in column (b) is the total of retainer fees and meeting attendance fees paid in cash.
- (2) The amount reported in column (c) is the total of retainer fees and meeting attendance fees awarded in common stock.
- (3) The amount reported in column (d) is the aggregate grant date fair value of options granted during the fiscal year ended September 30, 2018 in accordance with FASB ASC Topic 718. Each director received an option award of 2,000 shares on May 17, 2018 at an exercise price of \$2.24 with a grant date fair value of \$1,360. In addition, Mr. Murphy received a grant of 500 shares on May 17, 2018 at an exercise price of \$2.24 with a grant date fair value of \$340 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.

**Michael Norregaard**, age 58, has been Chief Executive Officer since May 2019 and joined the Company in January 2013. During Mr. Norregaard's tenure with the Company he served in various sales and operations roles including as Chief Operating Officer, Vice President of Business Development and Senior Vice President of Sales Operations. From 2007 to January 2013 Mr. Norregaard served as Managing Director / Divisions Director Outsourcing Services for Logica PLC, a multinational IT and management consulting company headquartered in the United Kingdom. Prior to his role with Logica, Mr. Norregaard held various other executive roles in European technology companies as well as client manager and sales executive at IBM and general manager at AT&T. Mr. Norregaard has a Bachelor of Business from the Copenhagen Business School and a Master of Social Economics from the University of Copenhagen.

**Kenneth A. Minor**, age 57, has been our Chief Financial Officer since June 1997, Assistant Secretary from December 1997 to February 2001 and Secretary since February 2001. Effective October 1, 2019, Mr. Minor will transition from Chief Financial Officer to Senior Financial Advisor and will, among other things, continue to coordinate the preparation of the Company's financial statements and certify financial statements filed with the SEC. 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 48, 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 July 22, 2019, 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 July 22, 2019, which we refer to as Presently Exercisable Options or Presently Exercisable Stock Warrants, 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>		
Mark D. Burish(3) 33 East Main St. Madison, WI 53703	2,211,783	32.5%
Andrew D. Burish(4) 8020 Excelsior Drive Madison, WI, 53717	1,080,845	15.4
Wealth Trust Axiom LLC (5) 4 Radnor Corp Center, suite 520 Radnor PA 19087	352,435	5.2
Gary R. Weis(6)	302,440	4.3
Kenneth A. Minor(7)	161,834	2.4
Robert M. Lipps(7)	120,430	1.8
Frederick H. Kopko, Jr.(8) 209 west Jackson, Suite 900 Chicago, IL 60603	91,532	1.4
Brian T. Wiegand (9) 1600 Aspen Commons Middleton, WI 53562	84,385	1.2
David F. Slayton(10) 701 Washington Ave N., Suite 400 Minneapolis, MN 55401	65,274	1.0
Nelson A. Murphy(11) 2300 W. Innes St. Salisbury, NC 28144	50,592	*
Michael Norregaard(12)	21,229	*
All current Executive Officers and Directors as a Group (9 persons)(13)	3,109,502	42.5%

\* 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 note (5) where such information is based on a Schedule 13G, have, except as set forth in note (5), sole voting and dispositive power with respect to the number of shares indicated as beneficially owned by them.

(2) Applicable percentages are based on 6,758,865 shares outstanding, adjusted as required by rules promulgated by the Securities and Exchange Commission.

(3) Includes 35,905 shares subject to presently Exercisable Warrants and 18,000 shares subject to Presently Exercisable Options.

(4) Includes 271,455 shares subject to Presently Exercisable Common Stock Warrants.



- (5) Information is based on Schedule 13G filed on January 7, 2019 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.
- (6) Includes 206,554 shares subject to Presently Exercisable Options.
- (7) Includes 118,355 shares subject to Presently Exercisable Options.
- (8) Includes 20,000 shares subject to Presently Exercisable Options, and include all shares owned by Neltjeberg Bay Enterprises LLC, which is controlled and owned by Mr. Kopko.
- (9) Includes 14,000 shares subject to Presently Exercisable Options.
- (10) Includes 4,500 shares subject to Presently Exercisable Options.
- (11) Includes 4,000 shares subject to Presently Exercisable Options.
- (12) Includes 15,416 shares subject to Presently Exercisable Options.
- (13) Includes an aggregate of 555,086 Presently Exercisable Options and warrants.

## **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 “Named 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 2018 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 the Chief 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 12 publicly-traded technology companies with annual revenues ranging from approximately \$10 million to just under \$100 million; market capitalization from approximately \$10 million to approximately \$200 million and approximately 300 employees or less. The following companies comprised the peer group for the study: Adesto Technologies, Corp., Asure Software Inc., Bsquare Corporation, Datawatch Corp., FalconStor Software Inc., GlobalSCAPE Inc., Glowpoint Inc., GSE Systems Inc., Inuvo Inc., MAM Software Group, Inc., Qumu Corporation and Smith Micro Software Company. 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.

### *Peer Group Analysis*

Compensation data came from a peer group of twelve 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 compensation review, 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 met on February 1, 2019 for consideration of base wage changes for Messrs. Weis, Minor and Lipps which have been frozen since December 1, 2016. At the recommendation of management, the Committee agreed to reduce compensation for Messrs. Weis and Minor and Lipps. Base wages for Messrs. Weis and Minor were reduced to \$350,000 and \$250,000 on an annual basis from \$489,880 and \$301,986, respectively. Base wages for Mr. Lipps were maintained at \$242,810 but his incentive compensation was capped at \$7,190 on an annual basis. After its review of all sources of market data as described above, the Committee believes that the base salaries and the bonuses described are below its targeted range for total cash compensation. Mr. Norregaard was appointed Chief Operating Officer in March 2019 and Chief Executive Officer in May 2019 and received an annual base salary of \$231,750. In July 2019 the Board agreed to increase the annual base wage for Mr. Norregaard to \$281,750, subject to final negotiation of his amended employment agreement.

### *Annual Performance-Based Variable Compensation*

The performance-based variable compensation reported for each executive officer represents compensation that was earned based on incentive plans. 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 2018, 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 and (2) adjusted EBITDA. Messrs. Weis, Minor and Lipps were included in the plan. Mr. Lipps’ short term incentive plan included a separate component based solely on the level of customer billings achieved.

*Payout Based on Performance Against Goals.* For fiscal 2018 the Company’s performance, as evaluated by the Compensation Committee, lead to the determination that none of the objectives were met with regard to financial performance of the Company and therefore, no incentives were earned under the STIP compensation plan. Total billings – based incentives paid to Mr. Lipps during fiscal 2018 was \$68,862. No variable compensation plan was approved for fiscal 2019.

### *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.

No additional option grants were made to Messrs. Weis, Minor and Lipps following the end of fiscal 2018. At a compensation committee meeting held February 1, 2019, the executive management team proposed cancelling certain vested stock options they held in order to make them available for future employee grants. The impact was to cancel 175,764 options for Mr. Weis and 109,690 options each for Messrs. Minor and Lipps. The committee accepted the management recommendation and authorized cancelation immediately.

### *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*

The Company has employment agreements with Messrs. Norregaard, Minor and Lipps. Pursuant to such employment agreements, Messrs. Norregaard, Minor and Lipps receive annual base salaries subject to increase each year at the discretion of the Board of Directors. Messrs. Norregaard, 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. Norregaard, 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. Norregaard, 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. Norregaard, 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.

For illustrative purposes, if Sonic terminated Messrs. Minor, Norregaard and Lipps on September 30, 2018, (not for cause), or if Messrs. Minor, Norregaard and Lipps elected to terminate their employment following a demotion or alteration of duties on September 30, 2018, and a change of control as defined in the employment agreements had occurred, Sonic would be obligated to pay \$334,237, \$232,186 and \$329,018, respectively (based on fiscal 2016 compensation which was the fiscal year with highest cash compensation in three year period preceding September 30, 2018 for Messrs. Minor and Lipps and fiscal 2018 for Mr. Norregaard). In addition, any non-vested rights of Messrs. Weis, Minor, Norregaard 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 \$122,000 for Mr. Weis, \$13,000 for Mr. Norregaard and \$67,000 for both Messrs. Minor and Lipps.

In July 2019, the Board approved a change to the employment agreement for Mr. Minor that includes the resignation of Mr. Minor from all his positions with the Company effective September 30, 2019 pursuant to a retirement and transition agreement. Such agreement provides that Minor will provide transitional assistance to the Company, and is subject to final negotiation and execution. Pursuant to the transition agreement Mr. Minor will receive \$200,000 over the year ending September 30, 2020 unless he elects to have the Company provide health insurance coverage to him, in which case he will receive \$185,000 over the period. In addition, Mr. Minor’s options will fully vest and not expire by virtue of the termination of Mr. Minor’s active employment but rather his termination will be considered to be September 30, 2020 for determination of expiration of his options. In addition, a non-recourse note payable by Mr. Minor to the Company in the original amount of \$25,000 will be forgiven. Mr. Minor will also continue to provide services to the Company in connection with the preparation and certification of financial statements and other related financial matters pursuant to a consulting agreement which provides for a monthly fee of \$7,500.

In July 2019, the Board agreed to increase the base salary of Mr. Norregaard from \$231,750 to \$281,750 and change the calculation of severance from an amount equal to the highest cash compensation during the last three fiscal years to his base compensation at the time of his severance.

#### *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 2018.

#### **COMPENSATION COMMITTEE REPORT**

The Compensation Committee of Sonic Foundry 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 Company's 2019 Proxy Statement included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2018, as amended and filed in a Form 10-K.  
Proxy Statement.

#### **COMPENSATION COMMITTEE**

Mark D. Burish, Chair  
Brian T. Wiegand

## Summary Compensation

The following table sets forth the compensation of our principal executive officer, our principal financial officer and our other executive officer for the fiscal year ended September 30, 2018.

Name and Principal Position (a)(4)	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 Earnings (\$) (h)		
Gary R. Weis	2018	489,880	—	—	—	—	—	4,304	494,184
Chief Executive and Chief Technology Officer	2017	487,136	—	—	89,143	—	—	7,537	583,819
	2016	475,615	—	—	157,350	95,123	—	9,021	737,109
Kenneth A. Minor	2018	301,990	—	—	—	—	—	17,548	319,538
Chief Financial Officer and Secretary	2017	300,298	—	—	49,028	—	—	13,826	363,152
	2016	293,190	—	—	76,355	41,047	—	17,299	435,883
Robert M. Lipps	2018	242,810	—	—	—	68,862	—	8,614	320,286
Executive Vice President - Sales	2017	241,450	—	—	49,028	61,997	—	6,149	358,624
	2016	235,739	—	—	76,355	93,279	—	9,950	415,323

- (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 2018 includes Sonic's matching contribution under our 401(k) plan of \$4,304, \$10,398 and \$8,614 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.
- (4) Mr. Norregaard was appointed Chief Operating Officer on March 4, 2019 and Chief Executive Officer on April 22, 2019, following the retirement of Mr. Weis as Chief Executive Officer.

### Grants of Plan-Based Awards

The following table shows the plan-based awards granted to the Named Executive Officers during fiscal 2018.

Name	Grant Date	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	All other option awards: Number of Securities Underlying Options	Exercise or base price of option awards (\$/Sh)	Grant Date fair Value of Stock and option awards (\$)
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (\$)	Target (\$)	Maximum (\$)	(#)	(#)	(1)	(2)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)
Gary R. Weis	1/17/18	—	—	—	—	—	—	—	92,857	2.49	89,143
Kenneth A. Minor	1/17/18	—	—	—	—	—	—	—	51,071	2.49	49,028
Robert M. Lipps	1/17/18	—	—	—	—	—	—	—	51,071	2.49	49,028

- (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, 2018 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, 2018, options to purchase a total of 2,029,741 shares were outstanding under the plans, and options to purchase 739,259 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, 2018 held by the Named Executive Officers.

Name (a)	<u>Option Awards</u>					<u>Stock Awards</u>				
	Number of Securities Underlying Unexercised Options (#) Exercisable (1) (b)	Number of Securities Underlying Unexercised Options (#) Unexercisable (1) (c)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#) (d)	Option Exercise Price (\$) (1) (e)	Option Expiration Date (1) (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	5,000	0	None	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(2)	3/3/2021					
	50,000	0		8.68(2)	9/30/2021					
	73,000	0		7.80	10/17/2022					
	61,500	0		9.45(2)	10/28/2023					
	62,264	0		9.36(2)	11/10/2024					
	33,716	16,858		7.17	11/5/2025					
	25,014	50,028		4.75	12/27/2026					
	92,857	0		2.49	1/17/2028					
Kenneth A. Minor	6,000	0	None	5.26	12/2/2019					
	14,120	0		15.21(2)	11/24/2020					
	27,500	0		9.46(2)	10/24/2021					
	40,000	0		7.80	10/17/2022					
	33,825	0		9.45(2)	10/28/2023					
	34,245	0		9.36(2)	11/10/2024					
	18,546	9,273		7.17	11/5/2025					
	13,758	27,515		4.75	12/27/2026					
	51,071	0		2.49	1/17/2028					
	Robert M. Lipps	6,000	0	None	5.26	12/2/2019				
		14,120	0		15.21(2)	11/24/2020				
27,500		0		9.46(2)	10/24/2021					
40,000		0		7.80	10/17/2022					
33,825		0		9.45(2)	10/28/2023					
34,245		0		9.36(2)	11/10/2024					
18,546		9,273		7.17	11/5/2025					
13,758		27,515		4.75	12/27/2026					
51,071		0		2.49	1/17/2028					

- (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.
- (2) Denotes option cancelled February 1, 2019



### Option Exercises and Stock Vested

The following table shows information concerning option exercises in fiscal 2018 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	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuance
	(a)	(b)	(c)
Equity compensation plans approved by security holders (1)	2,011,241	\$ 6.93	695,759
Equity compensation plans not approved by security holders (2)	18,500	5.90	—
Total	<u>2,029,741</u>	<u>\$ 7.03</u>	<u>695,759</u>

(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 2018 were those named in the Executive Compensation Committee Report. No member of the Committee was at any time during fiscal 2018 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 Wipfli LLP (“Wipfli”) as independent auditors to audit our financial statements for the year ending September 30, 2019, and has further directed that management submit the selection of independent public accountants for ratification by the stockholders at the annual meeting. Representatives of Wipfli 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 Wipfli as our independent auditors is not required by our Bylaws or otherwise. However, the Board is submitting the selection of Wipfli 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 Wipfli 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 Wipfli as independent auditors for Sonic Foundry.**

### **Relations with Independent Auditors**

The Company, upon the recommendation of its audit committee has selected Wipfli, LLP (“Wipfli”) as its independent auditor for the fiscal year ending September 30, 2019.

On April 2, 2019, the Company, upon the recommendation of its audit committee, notified Baker Tilly Virchow Krause (“BT”) that it had selected an alternative auditor for the fiscal year commenced October 1, 2018, and appointed Wipfli, LLP (“Wipfli”) as its independent auditor for that fiscal year.

During the years ended September 30, 2018 and 2017 and through April 22, 2019, neither the Company nor its audit committee consulted Wipfli 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 Wipfli 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 Wipfli to serve as our independent auditors for the fiscal year ending September 30, 2019.

Audit services performed by BT for Fiscal 2018 and 2017 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 BT to perform certain audit related services associated with the audit of our benefit plan. All fees paid to BT 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 2018 and 2017 Audit Firm Fee Summary

During fiscal years 2018 and 2017, we retained our principal accountant, Baker Tilly Virchow Krause LLP to provide services in the following categories and amounts:

	Years Ended September 30,	
	2018	2017
Audit Fees	360,237	\$327,186
Audit Related	13,200	13,222
Tax Fees	—	—

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 five meetings during fiscal 2018.

Messrs. Murphy, Slayton and Wiegand 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 predecessor 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 audit related 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 2018, 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, 2018, for filing with the SEC effective March 15, 2019. Respectfully submitted,

AUDIT COMMITTEE  
Nelson A. Murphy, Chair  
David F. Slayton  
Brian T. Wiegand

#### **CERTAIN TRANSACTIONS**

On November 7, 2017, the Company entered into an Agreement with Mark Burish, the Chair of the Company, (“Burish”), such that Burish waived his right to convert any of his holdings of Series A Preferred into common stock until shareholder approval has been obtained, and also to waive his right to vote his shares of Series A Preferred Stock to approve the issuance of the Series A Preferred Stock.

On November 9, 2017, the Company sold to Burish \$500 thousand of shares of Preferred Stock, Series A, at \$762.85 per share. Burish beneficially owns more than 5% of the Company’s common stock. All sales of Preferred Stock, Series A, were approved by a special committee of disinterested directors.

On January 19, 2018, the Company and a director entered into a Subscription Agreement (the “Subscription Agreement”). Pursuant to the Subscription Agreement, (i) on January 19, 2018, Burish purchased a 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash; and (ii) on February 15, 2018, Burish purchased an additional 10.75% Convertible Secured Promissory Note for \$500,000 in cash (each, a “Note”, and collectively, the “Notes”).

On May 17, 2018, following approval by the stockholders of the Company of the conversion of the Notes sufficient to comply with rules and regulations of Nasdaq, the Notes were automatically converted into 1,902 shares of Series A Preferred stock. The number of shares was determined by dividing the total principal and accrued interest due on each Note by \$542.13 (the “Conversion Rate”).

On April 16, 2018, the Company issued 232,558 shares of common stock to an affiliated party. The shares were issued at a price of \$2.15 per share, representing the closing price on April 13, 2018. On April 16, 2018, the closing price of the Company’s common stock was \$2.18 per share. The affiliated party also received warrants to purchase

232,558 shares of common stock at an exercise price of \$2.50 per share, respectively, which expire on April 16, 2025.

On November 15, 2018, 718 shares of Preferred Stock, Series A were automatically converted by the Company into 169,741 shares of common stock. The amount of shares converted represents all preferred shares issued on November 9, 2017, including related dividends.

On January 4, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "Promissory Note") pursuant to which Burish purchased a 9.25% Unsecured Promissory Note for \$1,000,000 in cash. The terms of the Promissory Note were ratified by the special committee of independent and disinterested directors as being in the best interest of the Company and its shareholders.

Interest accrued and outstanding principal on the Promissory Note is due and payable on January 4, 2020.

The Promissory Note may be prepaid at any time without penalty.

The Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.

On January 31, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "January 31, 2019 Promissory Note") pursuant to which Burish purchased a 9.25% Unsecured Promissory Note for \$1,000,000 in cash.

Interest accrued and outstanding principal on the January 31, 2019 Promissory Note is due and payable on January 31, 2020.

The January 31, 2019 Promissory Note may be prepaid any time without penalty. The note may be paid by the Company by issuing common stock to Burish, with each share valued at \$1.30 per share.

The January 31, 2019 Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.

The Disinterested Directors also ratified as fair and in the best interest of the Company and its shareholders the transaction on February 14, 2019, between Sonic Foundry, Inc. and Burish, whereby Burish purchased a 9.25% Unsecured Promissory Note for \$1,000,000 in cash (the "February 14, 2019 Promissory Note").

Interest accrued and outstanding principal on the February 14, 2019 Promissory Note is due and payable on February 14, 2020.

The February 14, 2019 Promissory Note may be prepaid any time without penalty. The note may be paid by the Company by issuing common stock to Burish, with each share valued at \$1.30 per share.

The February 14, 2019 Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.

On April 25, 2019, Burish exercised his warrant to purchase 728,155 shares of common stock of the Company at an exercise price of \$1.18 per share, which was entered into coincident with the execution of the Note Purchase Agreement on February 28, 2019. The special committee of disinterested directors approved the issuance of the warrant coincident with the execution of a note purchase agreement with Burish.

On May 17, 2019, 2,080 shares of Preferred Stock Series A were automatically converted by the Company into 491,753 shares on common stock. The amount of shares converted represents all preferred shares issued on May 17, 2018, including related dividends.

Burish beneficially owns more than 5% of the Company's common stock. The affiliated party beneficially owns more than 5% of the Company's common stock. All transactions with Burish and with the affiliated party were approved by the Disinterested Directors.

Frederick H. Kopko, Jr., a director and stockholder of Sonic Foundry, is a partner in McBreen & Kopko. Pursuant to the 2008 Non-Employee Directors Plan, Mr. Kopko was granted options to purchase 20,000 shares of Common Stock at exercise prices ranging from \$2.24 to \$14.83. During fiscal 2018, we paid the Chicago law firm of McBreen & Kopko certain compensation for legal services rendered subject to standard billing rates.

### **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.

### **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 2020 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 2020 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 (April 9, 2020). 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 2020 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 May 14, 2020 and June 13, 2020. However, in the event that the annual meeting is advanced by more than 30 days or delayed by more than 60 days from September 12, 2020, 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 2020 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 (June 23, 2020) and (ii) any other proposal, if the 2019 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, 2018 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, 2018, 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

August 2, 2019



**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, 2018**

**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, a non-accelerated filer, a small reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 \$8,661,176.

The number of shares outstanding of the registrant's common equity was 5,278,778 as of March 12, 2019.

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

Portions of the Proxy Statement for the 2019 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 for required sections.

**Sonic Foundry, Inc.**  
**Annual Report on Form 10-K**  
**For the Year Ended September 30, 2018**

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**Sonic Foundry, Inc.**  
**Annual Report on Form 10-K**  
**For the Year Ended September 30, 2018**

*This annual report on Form 10-K (this "Report") contains statements that are considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and its rules and regulations (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended, and its rules and regulations (the "Exchange Act"). When used in this Report, the words "anticipate", "expect", "plan", "believe", "seek", "estimate" and similar expressions are intended to identify such 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 (OTC Pink Sheets:SOFO) (the "Company") is the global leader for video capture, management and streaming solutions. Trusted by more than 4,900 educational institutions, corporations, health organizations and government entities in over 65 countries, its Mediasite Video Platform quickly and cost-effectively automates the capture, management, delivery and search of live and on-demand streaming videos.

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 Sonic Foundry International B.V. ("Sonic Foundry International") (formerly Media Mission B.V.) office is located in the Netherlands, and our Mediasite K.K. ("Mediasite KK" or "MSKK") office is located in Japan. 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. Businesses strive for effective communication and collaboration among employees 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 how to:

- Improve learners' academic and professional success
- Keep geographically-dispersed audiences and mobile teams connected
- Boost productivity and overall organizational knowledge
- Reduce logistical and financial impacts of day-to-day communications

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### **Sonic Foundry Solutions**

Sonic Foundry transforms the way organizations share and use information with these video solutions:

#### **Mediasite Video Platform**

Mediasite Video Platform is a scalable on-premises solution to publish, stream, manage, search and analyze all video. With Mediasite Video Platform, enterprises and education institutions:

- **Stream live and on-demand** video to any device
- **Create an enterprise or campus YouTube** with Mediasite Showcase
- **Automatically publish video** to their learning management system (LMS), content management system (CMS), training portal or any website
- **Deepen engagement** and improve learning with quizzing, annotations, comments, polls, surveys and other interactive tools
- **Search everything** with fully indexed audio, video and slide content
- **Monitor who is watching** what videos when to measure learner engagement and outcomes
- **Centrally manage** and secure any video

#### **Mediasite Video Cloud**

Mediasite Video Cloud is a secure, reliable SaaS (Software as a Service) solution offering the same capabilities as Mediasite Video Platform to publish, stream, manage, search and analyze all video. Customers conveniently host and manage all of their content with Mediasite Video Cloud, or use it as needed for large events to divert heavy viewing traffic from their on-premises Mediasite Video Platform. Our co-located and high availability data center and experienced team successfully manage customers' cloud-based video streaming in a secure, fault-tolerant environment.

#### **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 video-based content from anywhere.

- **My Mediasite:** My Mediasite makes it a snap for instructors, employees and students to create great looking videos, screencasts and slideshows from their computers or mobile devices. From demos and video training to flipped classes, lectures and assignments, everything to record, upload, manage and publish personal videos is in one simple-to-use tool, requiring no pro video skills.
- **Mediasite RL Recorders:** The RL Series of built-in room appliances uses schedule-based capture and advanced audio/video integration to fully automate video and content recording in lecture halls, training rooms, simulation labs and auditoriums. Instructors and speakers teach and present as they are most comfortable, free from technology worries and confident that everything they say and show is captured.
- **Mediasite RL Mini:** The Mini provides the automation and high-quality capture Mediasite is known for in a compact, affordable device, ensuring even more students never miss a lecture. With the Mini, there's no need for AV in the room. Instructors simply plug in their laptop and camera and start teaching. The plug-and-play device makes it easy to build or expand an automated lecture capture programs in community colleges, vocational-tech schools, small departments and even K12 classrooms.
- **Mediasite Catch:** Mediasite Catch provides a scalable, economical solution to extend video capture to any classrooms on campus, even if they're not equipped with extensive audio/video capabilities. Combining the reliability of Mediasite's recorder-based scheduling automation with the affordability and simplicity of podium-based software, Mediasite Catch provides faculty a worry-free classroom recording experience.
- **Mediasite ML Recorders:** Anyone can be a video producer with the ML Series of portable recording solutions to capture and stream broadcast-quality video. Designed for on-the-go webcasting, hybrid events, guest speakers and conferences, Mediasite ML's lightweight design moves easily from location to location and can be set up and ready to record in only a few minutes.

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- **Mediasite Join:** Real-time video is how today's best teams, businesses and schools collaborate, exchange ideas and get things done. But too often great ideas, subject matter expertise and important details are forgotten or left behind when a video call ends. Mediasite Join automatically records video and web conferences, transforming them into valuable, searchable video on demand.

### **Mediasite Events**

Mediasite Events is a leading global provider of live and on-demand webcasting services for conferences, hybrid events and high-profile broadcasts, supplying turnkey streaming solutions for hundreds of events each year. Fortune 500 companies, universities, associations, sporting events and charitable organizations use Mediasite Events to produce high-quality online event experiences.

With Mediasite Events, customers:

- Expand their audience reach by streaming to those that cannot attend in person
- Maximize event ROI by generating additional revenue streams from video recordings
- Differentiate themselves from competing events
- Bolster training and communication effectiveness with interactive video and audience engagement tools
- 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 grows 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 Monitoring Service: Customers get near real time monitoring of all Mediasite assets, proactive incident notification and Sonic Foundry support response for critical issues, exceptions and anticipated issues that may impact day-to-day Mediasite operations.

### **Mediasite Customer Care**

Standard and Enhanced Customer Care plans give customers peace of mind knowing that they have access to expert technical skills at the level they need.

With a Mediasite Standard Customer Care plan, customers are entitled to:

- Software upgrades and updates for Mediasite 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 Care Portal for 24/7 case management, software downloads, documentation, the Mediasite Knowledge Base and other technical resources
- Authorized access to the Mediasite Community for online training videos, customer-exclusive webcasts, peer-to-peer best practice sharing and more

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Enhanced Customer Care clients receive the most comprehensive access to Sonic Foundry's world-class technical expertise by selecting the services that are of greatest value to their organization. The Enhanced Plan includes everything in the Standard Plan, plus any combination of these services:

- Priority technical support with queue bypass and support case escalation
- Proactive Mediasite version administration and management
- Mediasite roadmap discussions with Sonic Foundry's executive team
- Exclusive training and an annual call with a Mediasite consultant

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

Annual service contracts for Mediasite Video Cloud include a Standard Customer Care plan.

### **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. Mediasite provides:

- **Complete platform addressing the entire video lifecycle** - From content creation and delivery to retention and management. Mediasite's portfolio of video solutions provides customers maximum flexibility and scalability to develop a comprehensive enterprise video strategy.
- **Interactive, consistent playback experiences across devices** - 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** - As a video search pioneer for over a decade, we have substantial experience in search precision. Mediasite SmartSearch automatically makes all videos as searchable as text, so keywords can be found *anywhere* - in audio, slides, handwriting, video or tags.
- **Deep viewership analytics** - Mediasite's powerful video analytics and built-in reports show exactly who is watching what and when. It's the deep insight users need to understand viewing behaviors and engagement, to measure video's impact and value and make informed decisions.
- **Unmatched support network** - 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 resources committed to their success. Plus, with nearly 2,000 active customers, 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, customer-exclusive webcasts and unrivaled networking and learning opportunities at the global 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
- Blended, hybrid and distance learning
- Continuing education
- Campus YouTube
- Special events: commencement, guest speakers, sporting events, etc.
- Faculty training and development

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- Student video projects
- Recruitment and admissions
- University business: leadership meetings, alumni relations, outreach

Higher education institutions consistently 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

To remain relevant, colleges and universities are striving to differentiate themselves through technical leadership as a means to attract 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.

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.

Frost & Sullivan analysts report that the academic lecture capture market is “characterized by growing cloud-based deployments, enormous shifts in the technological demands of students, growing use of data analytics to measure student engagement, the increasing use of multi-source video capture to enrich user experience, and deeper in-video metadata schema to improve searchability.” Further, they estimate the lecture capture market crossed \$270 million in revenue in 2017. (*Global Academic Lecture Capture Systems Market report, 2018*)

The visible integration of video-based learning 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™, 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 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.

**Sonic Foundry Solutions in the Enterprise:**

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.

Mediasite has numerous applications within medium to large corporate, healthcare and government enterprises:

In corporate enterprises it is used for:

- Executive communications: town hall meetings, all-hands meetings
- Workforce development: onboarding and training, HR communications, 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



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In health-related enterprises it is used for:

- Continuing medical education, medical conferences and seminars
- Grand rounds, simulations and procedural training
- Pharmaceutical and new product education
- Caregiver and patient education
- Emergency response coordination and public health announcements
- Research and collaboration

In government agencies it is used for:

- Training and compliance
- Inter- and intra-agency communications
- Legislative proceedings
- Constituent outreach, committee meetings, public safety announcements
- Relief work, military coordination, emergency preparedness

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 and employee communications

Wainhouse Research reports that healthcare organizations are making increased investments in streaming video, which is poised for explosive growth. In an August 2017 survey, nearly 9 out of 10 (89%) healthcare respondents described streaming video as an effective tool for communicating work-related information. In addition, 77% percent said online training sessions can match or exceed the opportunities in the traditional classroom setting. "Healthcare managers are embracing emerging technologies (like streaming video) that can help them communicate with their teams more effectively," the firm wrote. (Prescribing New Solutions for Communications in Healthcare, 2017)

### **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 focus 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.
- 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 collaborative platforms like video and web conferencing, learning and course management systems (LMS/CMS), content management systems and student information systems (SIS).
- Introducing market-driven innovations to our Mediasite Video Cloud offering.

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### **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, 2018.

### **Billings and Distribution**

Our services are typically billed and collected in advance of providing the service. 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.

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 2018 and 2017 one master distributor, Synnex Corporation (“Synnex”), contributed 6% and 11%, respectively, of total world-wide billings. A second master distributor, Starin Marketing, Inc. (“Starin”), contributed 11% and 15% of total world-wide billings in fiscal 2018 and 2017, respectively. As master distributors, Synnex and Starin fulfill transactions to VARs, end users and other distributors. No other customer represented over 10% of billings in 2018 or 2017.

### **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 2018, we utilized two master distributors in the U.S. and approximately 250 resellers, and sold our products to over 1,225 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 date, we have sold our products to customers in over 65 countries outside the United States. Total non-GAAP billings for Mediasite product and support outside the United States totaled 36% and 43% in fiscal 2018 and 2017, respectively.

**Market expansion:** Over two-thirds of 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.

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 streaming. 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.

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**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 Video Platform or Mediasite Video Cloud capacity. In fiscal 2018, 91% of billings were to preexisting customers compared to 92% of billings in fiscal 2017.

**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 Care plan with their initial Mediasite Recorders and Mediasite Video Platform, and the majority renew their contracts annually.

## **Marketing**

In the enterprise, our marketing strategy is based on a cross-industry approach with programs targeting a blend of IT and line of business decision makers responsible for video initiatives in corporate communications, training and development, live webcasting and/or corporate events. The addition of Mediasite Join to our family of enterprise video solutions boosts demand generation marketing to specifically target use cases for streaming and managing the rapidly growing amount of unified communication and collaboration (UCC)-generated video. The medical/healthcare, pharmaceutical and technology segments are particularly strong enterprise markets for us.

Across higher education institutions, Mediasite maintains its market leadership position for scalable and affordable lecture capture and video management. Our marketing focuses on professional schools of business, academic health, law and engineering. Mediasite Join provides new demand generation opportunities as UCC technologies are the basis of many distance learning programs.

Spanning both education and enterprise are marketing programs targeting continuing education. Across these two macro markets we maintain a balanced blend of new demand generation and customer nurturing, to drive Mediasite expansion and add-on business in existing accounts.

Our integrated marketing strategy leverages:

- Customer success stories regularly shared through our best practices webinar series, speaking placements at industry events, email marketing, industry guest columns and blog
- Thought leadership content created and curated from customer successes, Sonic Foundry subject matter experts (SMEs) and industry experts in the form of ebooks, whitepapers, videos, best practice toolkits and more
- The Mediasite Community, a vibrant online community of 2000+ users and its companion community events including the global Mediasite User Conference, Unleash; Mediasite Summits in Europe and Australia/New Zealand; and year-round regional chapter meetings

Sonic Foundry also has field sales/support personnel in Europe, Japan and China to deliver its marketing message and execute region-specific marketing programs.

## **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 Care 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

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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.
- 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** 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.

### **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 three 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 the fiscal years ended September 30, 2018 and 2017, we spent \$7.1 million and \$7.2 million, respectively, on internal research and development activities in our business. These amounts represent 21% and 20%, respectively, of total revenue in each of those years. The decrease is a result of flat spending as well as a decrease in revenue compared to last year.

### **Global Expansion**

We acquired Sonic Foundry International in the Netherlands and Mediasite KK in Japan in fiscal 2014. With these acquisitions, we significantly expanded 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, 2018 and 2017, we had 198 and 188 full-time employees, respectively. Our employees are not represented by a labor union, nor are they subject to a collective bargaining agreement. We have never experienced a work stoppage and believe that our employee relations are satisfactory.

### **ITEM 1A. RISK FACTORS**

*YOU SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED BELOW BEFORE MAKING AN INVESTMENT DECISION. THE RISKS DESCRIBED BELOW ARE NOT THE ONLY ONES WE FACE. ADDITIONAL RISKS THAT WE ARE NOT PRESENTLY AWARE OF OR THAT WE CURRENTLY BELIEVE ARE IMMATERIAL MAY ALSO IMPAIR OUR BUSINESS OPERATIONS. OUR BUSINESS COULD BE HARMED BY ANY OR ALL OF THESE RISKS. THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE SIGNIFICANTLY DUE TO ANY OF THESE RISKS, AND YOU MAY LOSE ALL OR*

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*PART OF YOUR INVESTMENT. IN ASSESSING THESE RISKS, YOU SHOULD ALSO REFER TO THE OTHER INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS ANNUAL REPORT ON FORM 10-K, INCLUDING OUR CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES.*

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

At September 30, 2018, we had cash of \$1.2 million, \$1.1 million of which was in our foreign operations. There was a remaining amount of \$3.4 million available under our line of credit facility with Silicon Valley Bank at September 30, 2018, with \$621 thousand outstanding and a credit limit of \$4.0 million in total. The credit facility with Silicon Valley Bank expired on January 31, 2019. In addition, \$500 thousand on the term facility with Partners for Growth was subsequently disbursed on November 8, 2018. The Company has a history of losses and 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 goal to increase revenue in fiscal 2019 and maintain flat operating expense, in an effort to reach an adjusted EBITDA breakeven point. We cannot ensure that revenue will grow as anticipated and, if revenue is determined to be growing at a rate less than anticipated and expenses are not sufficiently reduced, our line of credit may not be sufficient to support working capital needs, and our ability to develop, maintain, and sell our products could be negatively impacted. Our financial condition may, in the future, cause us to be in non-compliance with the provisions of our debt facilities. If our debt facilities are not sufficient to support working capital needs, our financial condition causes us to be in non-compliance with certain provisions of our debt facilities, we may have to borrow additional money from other debt providers or raise additional equity capital.

On February 28, 2019, a special committee of independent and disinterested directors (“Disinterested Directors”) unanimously authorized us to enter into a Note Purchase Agreement (“NPA”) with Mark Burish, the Chairman of the Board of the Company, for \$5.0 million in cash. Following extended negotiations with an independent third party for a similar financing (“Independent Third-Party Financing”) that was not consummated, the Disinterested Directors engaged in extensive deliberations and negotiations with its Chairman for an alternative financing. The Disinterested Directors approved the alternative financing on terms and conditions as set forth in the NPA, which it believes is fair and superior to the Independent Third-Party Financing, and is in the best interest of the Company and its stockholders.

In the event we need to borrow additional money or raise additional equity capital, we may not be able to do so on acceptable terms and conditions. If we are in non-compliance with the covenants of our existing debt facility, other lenders may be unwilling to lend us capital and we may not be able to raise equity from independent investors. In that event, we may seek to raise money from entities that are affiliated with the Company, as we have done in the past. However, most investors will require that their investment be in the form of convertible preferred stock or convertible debt. It is also likely that access to capital will be limited due to the time constraints associated with the need for capital, and the Company may need to rely on its Chairman, Mark Burish, to provide additional capital on terms reasonable and acceptable to the independent members of the Board of Directors.

As a result of the non-cash goodwill and other intangible assets impairment charges recorded in fiscal 2018, the Company is no longer able to satisfy the NASDAQ requirement to maintain \$2.5 million of stockholders' equity. On December 18, 2018, the Board of Directors approved the voluntary transfer of its common stock from the NASDAQ Stock Exchange to the OTCQB Market (“the “OTCQB”). The OTCQB Market is operated by OTC Markets Group, a centralized electronic quotation service for over-the-counter-securities. The Company ceased trading on NASDAQ at the close of business on December 28, 2018 and began trading on the OTCQB on December 31, 2018 under its current trading symbol “SOFO”. The Company ceased trading on the OTCQB at the close of business on February 15, 2019 and began trading on the OTC Pink Sheets on February 18, 2019 under its current trading symbol “SOFO”. The Company has remained a reporting company under the Securities Exchange Act of 1934, as amended, notwithstanding its voluntary withdrawal from the NASDAQ. As a result of the Company's inability to satisfy the NASDAQ requirements, its ability to raise equity capital may be adversely affected.

In the event we are able to 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. In the event we are able to 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 debt or equity financing upon acceptable terms, if at all. If we

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cannot raise funds on acceptable terms, our business, operating results, and financial condition could be negatively impacted. The Company believes its cash position and available credit is adequate to accomplish its business plan through at least the next twelve months.

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.

***Our common stock is subject to low trading volume and broad price swings.***

Our common stock is quoted on the OTC Market (“OTC Pink Sheets”) administered by the Financial Industry Regulatory Authority under the symbol “SOFO” since December 31, 2018. Prior to that our common stock was traded on the NASDAQ exchange under the same symbol. Trading of our stock on the NASDAQ exchange has often been subject to very low volumes, broad price swings and often at times with no company news. Stocks traded on the OTC Pink Sheets are often characterized by similar behavior so the price of our stock is likely to continue to be volatile. Due to recent price levels of our common stock, needs for additional capital may cause substantial dilution to existing shareholders.

***Provisions of our charter documents and Maryland law could also discourage an acquisition of our company that would benefit our stockholders and our insiders control a substantial percentage of our stock.***

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 five 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.” In addition, even when there are no interested stockholders involved in a transaction, Maryland law requires that a transaction involving a merger, consolidation, transfer of assets, or share exchange, must be approved by the affirmative vote of at least two-thirds of the Company’s stockholders.

Our executive officers and directors together beneficially own, on an “as converted basis”, over 40% of our outstanding common stock, and Mark Burish, individually, owns 33% on an as converted basis. As a result, these stockholders, if they act together or in a block, or individually in the case of Burish, could have significant influence over most matters that require approval by our stockholders, including the approval of significant corporate transactions, even if other stockholders oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial. In the event additional capital is provided by executive officers or directors, then, due to the low price levels of our common stock, control by such executive officers or directors may substantially increase.

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

Our investments in growing revenues have generated losses in most years. Despite our plans to grow revenue and maintain flat expenses in fiscal 2019, we may not realize sufficient revenues to reach or sustain profitability on a quarterly or annual basis. For the year ended September 30, 2018, we had a gross margin of \$24.9 million on revenue of \$34.5 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, the relatively long period required to convert leads into sales associated with selling products that are not yet considered “mainstream” technology investments and the cost of developing and maintaining those products. 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 2018 and fiscal 2017, 91% and 92% of billings were 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

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existing customers, better address the needs of potential new customers, and close multiple unit transactions, a customer may choose not to make expected purchases of our products. The failure of our customers to make expected purchases will harm our business.

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

Part of our strategic challenge is to convince enterprise customers of the productivity, improved communications, cost savings, suitability and other benefits of our products. In higher education the decision to include lecture capture technology in the classroom is often influenced by the professor teaching the class, who sometimes views lecture capture technology as a threat to their job. The market for content delivery solutions is very complex, includes many products and solutions that address various aspects of customer needs and as a result it is often difficult for customers and channel partners to understand how our products and services compare. Further, corporate customers may use video as a tool, but may choose to rely upon their own IT infrastructure and resources to manage their video content. Because many companies generally are predisposed to maintaining control of their IT systems and infrastructure, there may be resistance to using software as a service provided by a third party. 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.

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

We subcontract the manufacturing of our recorders to a 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. Likewise, we are susceptible to any material change in terms; such as pricing, level of services performed or changes to payment terms by our contract manufacturer. 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 the past. In order to compensate for supply delays, we have sourced components from off-shore locations, used cross component parts, paid significantly higher prices or premium fees to expedite delivery for short supply components and converted inventory from one version to another. We have typically maintained greater amounts of inventory as insurance against delays but currently hold substantially lower quantities of inventory in order to improve liquidity. 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 despite frequent changes in configuration and scheduling imposed by us. 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 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 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 on a timely basis. 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 fiscal 2019 business plan includes an expectation for revenue contribution from both new and existing customers associated with the introduction of lower priced hardware and software recorders in locations that can't support our more comprehensive solutions. There can be no assurance that we will be successful in achieving our revenue expectations from these new products or that we are able to retain existing customers in our more comprehensive solutions. 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



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products and services will be accepted in preference to the products and services of our current and future competitors. Some of our prospective customers may delay the purchase of our products or services until certain features are completed, may require custom development of certain features as part of the purchase decision, or may condition additional payments tied to completion of such features. Prioritizing such custom features can be difficult to adapt to other customers and distracts our engineering team from implementing features required by other customers.

***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 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.

***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.***

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 has, and will likely continue to result in price reductions, reduced gross margins and may result in 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 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.

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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.

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.

***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. If our retention rates decrease, we may need to provide more incentives, reduce pricing or generate greater lead generation through marketing in order to increase revenues, all of which could reduce profitability.

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

International product and service billings ranged from 36% to 43% 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 growth in the operations of businesses acquired 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;
- Difficulties in managing the demands of large international deployments, many of which distract key sales personnel from opportunities in other parts of the world;
- Challenges associated with management transition;
- Challenges related to language or cultural differences;
- The uncertainty of laws and enforcement in certain countries, such as China, relating to the protection of intellectual property or requirements for product certification, protection of personal data or other restrictions;
- Competitive pressure impacting other parts of the world;
- Multiple and possibly overlapping tax structures;
- Currency and exchange rate fluctuations and imposition of tariffs or quotas;
- Difficulties in collecting accounts receivable in foreign countries, including complexities in documenting letters of credit;
- Economic or political changes in international markets;
- Restrictions on access to the Internet; and
- Difficulty in complying with international employment related requirements

***Changes in U.S. trade policy, including the imposition of tariffs and the resulting consequences, may have a material adverse impact on our business, operating results and financial condition.***

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The U.S. government has indicated its intent to adopt a new approach to trade policy and in some cases to renegotiate, or potentially terminate, certain existing bilateral or multi-lateral trade agreements, such as the U.S.-Mexico-Canada Agreement and the North American Free Trade Agreement ("NAFTA"). It has also initiated tariffs on certain foreign goods and has raised the possibility of imposing significant, additional tariff increases or expanding the tariffs to capture other types of goods. In response, certain foreign governments have imposed retaliatory tariffs on goods that their countries import from the U.S. Changes in U.S. trade policy could result in one or more foreign governments adopting responsive trade policies that make it more difficult or costly for us to do business in or import our products from those countries. This in turn could require us to increase prices to our customers, which may reduce demand, or, if we are unable to increase prices, result in lowering our margin on products sold.

We cannot predict the extent to which the U.S. or other countries will impose quotas, duties, tariffs, taxes or other similar restrictions upon the import or export of our products in the future, nor can we predict future trade policy or the terms of any renegotiated trade agreements and their impact on our business. The adoption and expansion of trade restrictions, the occurrence of a trade war, or other governmental action related to tariffs or trade agreements or policies has the potential to adversely impact demand for our products, our costs, our customers, our suppliers, and the U.S. economy, which in turn could have a material adverse effect on our business, operating results and financial condition.

***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. 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 and 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, existing infrastructure technical issues 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.

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***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 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. Our hosting customers typically require a high level of access, data security and need to capture and store multiple high definition streams. Such requirements require costly enhancements to our 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 and delay recognition of revenue, 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.

***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 history and the pipeline of sales opportunities we manage, rather than on firm channel partner orders. The mix of product demand varies significantly from quarter to quarter, further complicating our estimated product needs. Our expense and inventory levels are based largely on these estimates. In addition, our events 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.

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We have experienced growing demand for our hosting and event services as well as a growing preference from our customers in purchasing our annually licensed software. As a result, we have seen an increase in service billings and recurring revenue as a percentage of total billings. We expect this trend to continue which we expect to improve predictability of revenue and gross margins but will delay the impact on revenue of any increase or decrease in billings during any particular quarter. 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.

***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 international distributors and 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, dissatisfaction with inventory turn rates or profitability 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 certain distributors. Price protection rights require that we grant retroactive price adjustments for inventories of our products held by distributors if we lower our prices for those products within a specified time period. To cover our exposure to these product returns and price adjustments, we establish reserves based on our evaluation of historical product trends and current marketing plans. However, we cannot be assured that our reserves will be sufficient to cover our future product returns and price adjustments. If we inadequately forecast reserves, it may compromise our ability to recognize revenue to these distributors at the time of shipment. As a result, we would not be able to recognize revenue until these three 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.

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

Weakness in domestic markets and global uncertainties exist in many areas of focus for us including the United Kingdom, Japan and the Middle East. Many of our customers rely on local, state or Federal government funding, both domestically and international. The Japanese government provides subsidies to support higher education from time to time but has not been consistent. Any future delay or elimination of government programs will have a negative impact on our operations 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.***

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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.

***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 General Data Protection Regulation that was enacted in May 2018, and an amended Act on the Protection of Personal Information in Japan, impose new obligations directly on us both as a data controller and a data processor, as well as on many of our customers. These new laws may require us to make changes to our services and/or our customers to meet the new legal requirements, and may also increase our potential liability exposure through higher potential penalties for non-compliance. Further, laws such as the European Union's proposed e-Privacy Regulation are increasingly aimed at the use of personal information for marketing purposes, and the tracking of individuals' online activities. These new or proposed laws and regulations are subject to differing interpretations and may be inconsistent among jurisdictions. These and other requirements could reduce demand for our services, require us to take on more onerous obligations in our contracts, restrict our ability to store, transfer and process data or, in some cases, impact our ability to offer our services in certain locations or our customers' ability to deploy our solutions globally. For example, ongoing legal challenges in Europe to the mechanisms allowing companies to transfer personal data from the European Economic Area to the United States could result in further limitations on the ability to transfer data across borders, particularly if governments are unable or unwilling to reach new or maintain existing agreements that support cross-border data transfers, such as the EU-U.S. and Swiss-U.S. Privacy Shield framework. Additionally, certain countries have passed or are considering passing laws requiring local data residency. The costs of compliance with, and other burdens imposed by, privacy laws, regulations and standards may limit the use and adoption of our services, reduce overall demand for our services, make it more difficult to meet expectations from or commitments to customers, lead to significant fines, penalties or liabilities for noncompliance, or slow the pace at which we close sales transactions, any of which could harm our business.

We likely will need to acquire software and hardware in order to enhance our ability to defend and to detect intrusions to our network infrastructure. These enhancements will be expensive and require significant staff time to deploy and develop, and there is no assurance that they will be effective.

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. Many of our customers in the European Union face increasingly complex procurement requirements that have delayed some projects and caused us not to be successful in winning other opportunities. 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.

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Furthermore, concerns regarding data privacy may cause the users of our customers' data 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 and outsourced most aspects of our network infrastructure to multiple providers. We also rely on Internet systems and infrastructure to operate our business and provide our services. 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. These hardware, data, and cloud computing platforms may not be available at reasonable terms or prices.

***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. Further, there are third-party applications our products and services are dependent on, or integrate with, such as operating systems and learning management systems. These integrations require specialized knowledge that is difficult and expensive to maintain. Failure to maintain compatibility with such applications or identification of 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; and/or
- 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.

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***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, 17% of our billings in fiscal 2018 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. Our distributor in China has been unsuccessful in building a team to address demand in China, is under-funded and, significantly behind in their payments to us causing us to record approximately \$326 thousand and \$200 thousand of bad debt in fiscal 2018 and 2017. 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, exclude certain countries and are limited to \$1.0 million. 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.

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

In the past, the trading prices of the securities of technology companies have been highly volatile, although volatility has declined substantially in the last several years and in 2018. 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 investor 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;



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- The issuance of shares of common stock and preferred stock by us, whether in connection with an acquisition or a capital raising transaction;
- Low trading volumes of our shares and inconsistent trading activity;
- Issuance of debt, changes to, defaults or non-renewal of debt facilities and other convertible securities;
- Failure to meet NASDAQ requirements; 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.

***Accounting regulations and related interpretations and policies, particularly those related to revenue recognition, cause us to defer revenue recognition into future periods for all or 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, we may have to defer the entire amount of revenue from a transaction, even when the product has already shipped. This may occur when the customer has delayed payment on the transaction, or in certain other circumstances, such as when we agree to extend payment terms on other invoices from such customer. In addition, we always defer revenue when services are included in a transaction, and not performed. Other 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 or, in certain circumstances with respect to a particular customer, all 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 be significant and may vary from quarter to quarter depending on, among other factors, compliance with payment terms, the mix of products sold, combination of products and services sold together or contractual terms.

Additional changes in authoritative guidance, including the interpretation of "Revenue from Contracts with Customers (Topic 606)", 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. See Note 1 - Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

***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 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

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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 is difficult due to the limited number of qualified professionals. The loss of any key employee could result in significant disruptions to our operations, including adversely affecting the timeliness of product releases, the successful implementation and completion of company initiatives and the results of our operations. In 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.

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

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

***Currency exchange rate fluctuations could result in higher costs and decreased margins and earnings.***

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. The conversion rate of the Yen to the US Dollar varied from about 106 to approximately 114 during fiscal 2018. Similarly, the Euro varied from about .87 to approximately .80 to the US Dollar during fiscal 2018. The strength of the dollar impacts our ability to export profitably to other countries, and will likely continue to fluctuate. Any increase in the exchange rate of the US Dollar compared to the Euro or the Japanese Yen will impact our future operating results and financial position.

***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.

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***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 fines 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.

***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, software products and cloud solutions to better address the more cost-conscious customers. Such products have more limited features compared to our existing products. While we believe we can preserve the market for our full-featured products due to differentiation between the two and migration to full featured products, release of lower cost products could reduce gross margin and demand for products sold at higher prices. Potential large-scale deployments of our products often include the lower cost products we sell, putting greater pressure on gross margin due to expectations for greater volume discounts.

If we fail to build long-term customer relationships, develop features that distinguish our products in the market place and address the market for lower function and cost solutions, 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.
- 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 three 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, particularly in foreign countries where the laws may not protect our proprietary rights as fully or as readily as United States laws. Our recent growth in activities in China will likely increase this risk.

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- There have been attacks on certain patent systems, increasing the likelihood of changes to established laws, including in the United States. We cannot predict the long-term effects of any potential changes, which could be detrimental to our licensing program.
- 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 cost prohibitive or 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.

***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 Sonic Foundry International, could be difficult to integrate, disrupt our business and dilute stockholder value.***

We completed the acquisitions of Mediasite KK in Japan and MediaMission (now Sonic Foundry International) 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;
- 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.

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Our failure to successfully manage the acquisitions of Mediasite KK and Sonic Foundry International, 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 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.

***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. Certain countries have implemented, or may implement, legislative and technological actions that either do or can effectively regulate access to the Internet, including the ability of Internet Service Providers to limit access to specific websites or content. 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, 2018, we had 370 thousand outstanding warrants and 2.0 million of outstanding stock options granted under our stock option plans, 1.7 million of which are immediately exercisable.

While nearly all outstanding warrants and options are currently priced above the market price of our common stock, dilution to the interests of our stockholders will likely occur if or when they are exercised. 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.

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

The use of our net operating loss carryforwards may have limitations resulting from certain future ownership changes or other factors under the Internal Revenue Code and other taxing authorities. The Tax Cuts and Jobs Act of 2017 changed both the federal deferred tax value of the net operating loss carryforwards and the rules of utilization of federal net operating loss carryforwards. The Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate from 35% to 21% effective for our 2018 fiscal year. For net operating loss carryforwards generated in years prior to 2018, there is no annual limitation on the utilization and the carryforward period remains at 20 years. However, net operating loss carryforwards generated in years after 2017 will only be available to offset 80% of future taxable income in any single year but will not expire.

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

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

As a publicly traded company we are subject to significant regulations, including the Sarbanes-Oxley Act of 2002. While we have developed and instituted a corporate compliance program based on what we believe are the current best practices and continue to update the program in response to newly implemented regulatory requirements and guidance, we cannot assure that we are or will be in compliance with all potentially applicable regulations.

Although our non-affiliate market capitalization was less than \$75 million at March 31, 2018 and we were therefore not required to have an auditor attestation on our internal controls over financial reporting for fiscal 2018, 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 material weaknesses 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.

On June 28, 2018, the SEC adopted amendments that raise the thresholds in the smaller reporting company ("SRC") definition, thereby expanding the number of smaller reporting companies eligible to comply with the scaled disclosure requirements in several Regulation S-K and Regulation S-X items. The amended definition of a smaller reporting company reduces the likelihood that the Company would be required to have auditor attestation on our internal controls over financial reporting in future periods.

**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 for our needs. The current lease term for this office expires on December 31, 2021. The rent for the remainder of the lease period is approximately \$60 thousand per month.

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Our operations in Japan are managed in Tokyo, Japan in a leased facility of approximately 9,874 square feet with a term expiring on December 31, 2020. The facility includes sales, technical and administrative functions. The rent for the remainder of the lease period is approximately \$39 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, 2022. The facility includes sales, technical and administrative functions. The rent for the remainder of the lease period is approximately \$6 thousand per month.

**ITEM 3. LEGAL PROCEEDINGS**

None.

**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**

**Price Range of Common Stock**

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. Effective December 31, 2018, we transferred the listing of our common stock to the OTCQB Market under the symbol "SOFO". Effective February 18, 2019, we transferred the listing of our common stock to the OTC Pink Sheets under the symbol "SOFO". The following table sets forth, for the periods indicated, the high and low sale prices per share of our common stock as reported on the NASDAQ Capital Market, the OTCQB Market, and the OTC Pink Sheets.

	High	Low
<b>Year Ended September 30, 2019:</b>		
First Quarter	1.71	0.60
Second Quarter (through March 12, 2019)	1.77	0.62
<b>Year Ended September 30, 2018:</b>		
First Quarter	3.87	2.05
Second Quarter	3.18	2.20
Third Quarter	2.91	2.01
Fourth Quarter	2.32	1.51
<b>Year Ended September 30, 2017:</b>		
First Quarter	5.92	3.75
Second Quarter	5.35	4.50
Third Quarter	5.25	3.72
Fourth Quarter	4.13	3.03

**Dividends**

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.

**Unregistered Sale of Equity Securities and Use of Proceeds**

On January 19, 2018, the Company and a director entered into a Subscription Agreement (the “Subscription Agreement”). Pursuant to the Subscription Agreement, (i) on January 19, 2018, the director purchased a 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash; and (ii) on February 15, 2018, the director purchased an additional 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash (each, a “Note”, and collectively, the “Notes”).

On May 17, 2018, following approval by the stockholders of the Company of the conversion of the Notes sufficient to comply with rules and regulations of NASDAQ, the Notes were automatically converted into 1,902 shares of Series A Preferred stock. The number of shares was determined by dividing the total principal and accrued interest due on each Note by \$542.13 (the “Conversion Rate”).

On April 16, 2018, the Company issued 232,558 shares of common stock to an affiliated party. The shares were issued at a price of \$2.15 per share, representing the closing price on April 13, 2018. On April 16, 2018, the closing price of the Company’s



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common stock was \$2.18 per share. The affiliated party also received warrants to purchase 232,558 shares of common stock at an exercise price of \$2.50 per share, respectively, which expire on April 16, 2025.

On June 8, 2018, 905 shares of Preferred Stock, Series A, were automatically converted by the Company into 213,437 shares of common stock. The amount of shares converted represents all preferred shares issued on May 30, 2017 and June 8, 2017, including related dividends.

On August 23, 2018, 717 shares of Preferred Stock, Series A were automatically converted by the Company into 169,485 shares of common stock. The amount of shares converted represents all preferred shares issued on August 23, 2017.

The Company relied on Section 4(a)(2) of the Securities Act of 1933, as amended, to issue the Notes and stock, inasmuch as the director and the affiliated party both received from the Company information that registration would provide and neither the Company nor any person acting on its behalf offered or sold the Notes or stock by any form of general solicitation or general advertising.

**Holders**

At March 12, 2019, there were 226 common stockholders of record and approximately 2,700 total shareholders. Many shares are held by brokers and other institutions on behalf of shareholders.

**Equity Compensation Plan Information**

Plan category	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuance
	(a)	(b)	(c)
Equity compensation plans approved by security holders (1)	2,011,241	\$ 6.93	695,759
Equity compensation plans not approved by security holders (2)	18,500	5.90	—
<b>Total</b>	<b>2,029,741</b>	<b>\$ 7.03</b>	<b>695,759</b>

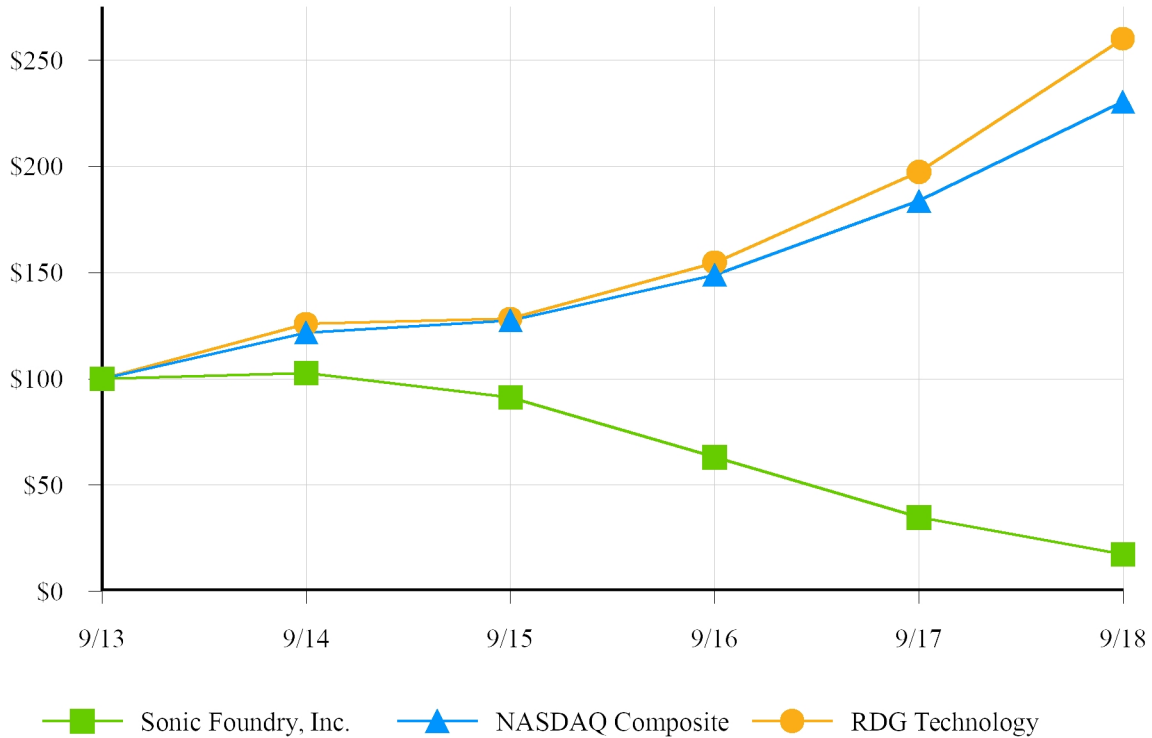
- (1) Consists of the 2009 Stock Incentive Plan, Employee Incentive Stock Option Plan and the Directors Stock Option Plans. For further information regarding these plans, reference is made to Note 5 of the financial statements.
- (2) Consists of the Non-Qualified Stock Option Plan. For further information 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, 2013 through and including September 30, 2018 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, 2013 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 9/30/13 in stock or index, including reinvestment of dividends fiscal year ending September 30.

**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).

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	Years Ended September 30,				
	2018	2017	2016	2015	2014
<b>Statement of Operations Data:</b>					
Revenue	\$ 34,544	\$ 36,000	\$ 37,975	\$ 36,459	\$ 35,830
Cost of revenue	9,656	9,867	9,985	10,635	10,275
Gross margin	24,888	26,133	27,990	25,824	25,555
Operating expenses	29,118	30,091	30,266	29,916	28,637
Impairment of goodwill & intangible assets	11,809	600	—	—	—
Loss from operations	(16,039)	(4,558)	(2,276)	(4,092)	(3,082)
Gain on investment in Mediasite KK	—	—	—	—	1,390
Equity in earnings from investment in Mediasite KK	—	—	—	—	38
Other income (expense), net	142	(65)	(178)	46	173
Interest expense, net	(601)	(495)	(594)	(372)	(231)
Benefit (provision) for income taxes	4,332	79	(269)	(107)	(1,104)
Net loss	\$ (12,166)	\$ (5,039)	\$ (3,317)	\$ (4,525)	\$ (2,816)
Dividends on preferred stock	\$ (257)	\$ (169)	\$ —	\$ —	\$ —
Net loss attributable to shareholders	\$ (12,423)	\$ (5,208)	\$ (3,317)	\$ (4,525)	\$ (2,816)
Basic net loss per common share	\$ (2.67)	\$ (1.17)	\$ (0.76)	\$ (1.04)	\$ (0.67)
Diluted net loss per common share	\$ (2.67)	\$ (1.17)	\$ (0.76)	\$ (1.04)	\$ (0.67)
Weighted average common shares:					
– Basic	4,655,520	4,436,333	4,389,421	4,332,576	4,174,191
– Diluted	4,655,520	4,436,333	4,389,421	4,332,576	4,174,191
<b>Balance Sheet Data at September 30:</b>					
Cash and cash equivalents	\$ 1,189	\$ 1,211	\$ 1,794	\$ 1,976	\$ 4,344
Working capital	(5,765)	(4,833)	(3,720)	(618)	18
Total assets	13,583	28,356	33,082	34,803	34,623
Long-term liabilities	3,451	8,147	7,249	8,435	7,268
Stockholders' equity	(6,458)	3,118	6,516	7,803	11,315

**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.

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: "Management's Discussion and Analysis," and "Risk Factors." These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in "Risk Factors" (Part 1, Item 1A of this Form 10-K), "Quantitative and Qualitative Disclosures about Market Risk" (Part II, Item 7A of this Form 10-K), and in this Item 7. We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

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## Overview

Sonic Foundry, Inc. is the trusted global leader for video capture, management and streaming solutions. Trusted by educational institutions, corporations and government entities, Mediasite Video Platform quickly and cost-effectively automates the capture, management, delivery and search of live and on-demand streaming video and rich media. Mediasite transforms communications, training, education and events for our customers.

## Critical Accounting Policies

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

- Revenue recognition, allowance for doubtful accounts and reserves;
- Impairment of long-lived assets;
- Valuation allowance for net deferred tax assets; and
- Accounting for stock-based compensation.

### *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.

We currently are evaluating the impact of a new standard related to revenue recognition, which we anticipate will have a material impact on our consolidated financial statements. See Note 1 - Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

#### 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 our customers, typically one year in length, and records the related revenue ratably over the contractual period. Our support contracts cover phone and electronic technical support availability over and above the level provided by our distributors, software upgrades on a when and if available basis, advance hardware replacement and an extension of the standard hardware warranty from 90 days to one year. The manufacturers the Company contracts with to build the units provide a limited one-year warranty on the hardware. The Company also sells installation, training, event webcasting, and customer content hosting services. Revenue for those services is recognized when performed in the case of installation, training and event webcasting services. 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

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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, 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 structures its deals, future changes in the pricing model are not expected to materially affect our allocation of arrangement consideration.

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

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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, it may compromise our ability to recognize revenue to these distributors at the time of shipment. 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.

#### 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 and financing receivables was \$1.0 million at September 30, 2018 and \$575 thousand at September 30, 2017.

#### Impairment of long-lived assets

Goodwill has an indefinite useful life and is recorded at cost and 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, the Company compares the estimated fair value of the reporting unit to which goodwill is allocated to its carrying value. The amount of impairment, if any, is equal to the amount by which the carrying value of the reporting unit exceeds its fair value.

For purposes of the fiscal 2018 and 2017 tests, goodwill balances are evaluated within three separate reporting units. In fiscal 2018, we performed a quantitative analysis and determined that the fair value of all three of the Company's reporting units is less than its carrying value. The Company recognized an impairment charge of \$10.4 million, or the remaining balance of goodwill, as of September 30, 2018. In fiscal 2017, we performed a quantitative analysis and determined that the fair value of one of the Company's reporting units is less than its carrying value, and that the fair value of the remaining reporting units is greater than their respective carrying values. The Company recognized an impairment charge of \$600 thousand as of September 30, 2017.

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 year ended September 30, 2018, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year and past performance. For the year ended September 30, 2018, the Company determined that intangible assets, consisting of customer relationships and product rights, were impaired and recognized an impairment charge of \$1.4 million. For the year ended September 30, 2017, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year. However, after performing analysis of undiscounted cash flows attributable to our long-lived assets along with other relevant factors, such as the continued use of the assets, it was determined that, for the year ended September 30, 2017, there was no

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impairment of long-lived and intangible assets other than goodwill. Key assumptions utilized in the analysis of undiscounted cash flows for each asset or asset group being tested included 1) whether cash flows were attributable solely to the asset or group, or to an entire reporting unit; and 2) the useful lives of the asset or asset group. Forecasts used in the analysis were also consistent with those used in determining fair value of reporting units during goodwill impairment testing.

#### 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, 2018 and 2017, 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 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.

All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measured.

## **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.

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**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 2018 totaled \$34.5 million, compared to \$36.0 million in fiscal 2017, a decrease of 4%. Revenue consisted of the following:

- Product and other revenue from the sale of Mediasite recorder units and server software decreased from \$14.9 million in fiscal 2017 to \$12.3 million in fiscal 2018. Prior year product revenue included a large sales-type lease transaction with a customer in Japan as well as software revenue recorded pursuant to another large international transaction originally billed in Q4-2015. The average sales price per unit decreased in fiscal 2018 primarily due to an increase in sales of lower-cost versions including the new mini recorder model as well as the Company's RL 220. Lower-cost units shipped in the current fiscal year were 811 compared to 541 last year.

	2018	2017
Units sold	1,507	1,544
Rack to mobile ratio	13.9 to 1	9.1 to 1
Average sales price, excluding support (000's)	\$5.9	\$7.1
Refresh Units	421	457

- 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 \$21.1 million in fiscal 2017 to \$22.2 million in fiscal 2018 due primarily to an increase in events revenue as well as a slight increase in customer support contract revenues as compared to fiscal 2017. At September 30, 2018, \$13.3 million of revenue was deferred, of which we expect to recognize \$11.6 million in the next twelve months, including approximately \$4.6 million in the quarter ending December 31, 2018. At September 30, 2017, \$14.3 million of revenue was deferred.
- Other revenue relates to freight charges billed separately to our customers.

**Gross Margin**

Total gross margin in fiscal 2018 was \$24.9 million or 72% compared to \$26.1 million or 73% in fiscal 2017. The significant components of cost of revenue include:

- Material and freight costs for Mediasite recorders. Costs for fiscal 2018 Mediasite recorder hardware and other costs totaled \$3.2 million compared to \$3.5 million in fiscal 2017. Freight costs were \$262 thousand, and labor and allocated costs were \$1.5 million in fiscal 2018 compared to \$259 thousand and \$1.7 million, respectively, in fiscal 2017. The remaining \$217 thousand in fiscal 2018 and \$644 thousand in fiscal 2017 relate to material and freight costs for Sonic Foundry International and MSKK. The reduction in material and freight costs related to the subsidiaries is a result of a decrease of 74 units sold year over year as well as the trend in mix of recorders sold toward a greater number of lower cost versions.
- Services costs. Staff wages and other costs allocated to cost of service revenues were \$1.9 million in fiscal 2018 and \$1.9 million in fiscal 2017, resulting in gross margin on services of 80% in fiscal 2018 and 82% in fiscal 2017, respectively. The remaining \$2.5 million in fiscal 2018 and \$1.8 million in fiscal 2017 relate to costs of providing content hosting, events and technical support services at Sonic Foundry International and MSKK. The increase in services costs for Sonic



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Foundry International and MSKK is a result of a \$911 thousand increase in services revenues for the subsidiaries year over year.

The Company expects the gross margin percentage to remain consistent or slightly increase in fiscal 2019 mainly as a result of an expected increase in software and services revenue.

## **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 decreased \$1.3 million, or 8%, from \$16.9 million in fiscal 2017 to \$15.6 million in fiscal 2018. Fluctuations in the major categories include:

- Public relations expense decreased by \$65 thousand.
- Salary, commissions and benefits expenses decreased by \$900 thousand as a result of reduced headcount for Sonic Foundry only (as shown below, headcount at our foreign subsidiaries increased) as well as lower commissions due to lower sales than fiscal 2017.
- Expenses related to business meetings decreased by \$88 thousand as a result of strategic initiatives implemented during the second half of fiscal 2017.
- Selling and marketing expenses for Sonic Foundry International and MSKK accounted for \$431 thousand and \$2.5 million, respectively in fiscal 2018, an aggregate decrease of \$159 thousand from the prior year.

At September 30, 2018, we had 122 employees in selling and marketing, an increase from 119 employees at September 30, 2017. Of the 122 employees in selling and marketing at September 30, 2018, 57 are employed by our foreign subsidiaries. We do not anticipate growth in selling and marketing headcount in fiscal 2019.

### **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 by \$413 thousand, or 7%, to \$6.4 million in fiscal 2018 from \$5.9 million in fiscal 2017. Fluctuations in major categories include:

- Increase in compensation and benefits of \$165 thousand due to an increase in compensation rates and benefits.
- Professional services increased by \$158 thousand primarily due to an increase in legal and audit related expenses.
- Supplies expense increased \$103 thousand due to European hosting infrastructure upgrade.
- G&A expenses for Sonic Foundry International and MSKK accounted for \$179 thousand and \$883 thousand, respectively in fiscal 2018, an aggregate decrease of \$13 thousand from the prior year.

At September 30, 2018, we had 27 full-time employees in G&A, an increase from 26 full-time employees at September 30, 2017. Of the 27 employees in G&A at September 30, 2018, 10 are employed by our foreign subsidiaries. We do not anticipate growth in G&A headcount in fiscal 2019.

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**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.

Product development expenses decreased \$96 thousand, or 1%, from \$7.2 million in fiscal 2017 to \$7.1 million in fiscal 2018. Fluctuations include:

- Increase in compensation and benefits of \$291 thousand related primarily to our international quality assurance team.
- Professional services decreased by \$414 thousand due to decreased use of outsourced development.
- Recruiting costs decreased by \$62 thousand due to less turnover.
- Product development expenses for Sonic Foundry International and MSKK accounted for \$419 thousand and \$290 thousand, respectively for fiscal 2018, an aggregate increase of \$67 thousand from the prior year related to the subsidiaries.

At September 30, 2018, we had 49 full-time employees in product development compared to 43 employees at September 30, 2017. Of the 49 employees in product development at September 30, 2018, 11 are employed by our foreign subsidiaries. There were no software development efforts in fiscal 2018 or 2017 that qualified for capitalization. We do not anticipate growth in product development headcount in fiscal 2019.

**Impairment of Goodwill & Intangible Assets**

The Company recorded an impairment loss of \$10.4 million for goodwill related to all three reporting units during the quarter ended September 30, 2018. This non-cash loss was primarily due to the fall in the Company's stock price and the decrease of our market capitalization and past performance. As a consequence, management forecasts were revised and additional risk factors were applied. The Company also recorded an impairment loss of \$1.4 million for intangible assets, consisting of customer relationships and product rights, during the quarter ended September 30, 2018.

The Company recognized an impairment loss of \$600 thousand for goodwill related to the Mediasite KK reporting unit during the quarter ended September 30, 2017. This non-cash loss was primarily due to delays in expected growth related to partner relationships in Japan, resulting in revenues and operating cash flows being lower than expected for the reporting unit in fiscal 2017. As a consequence, management forecasts were revised and additional risk factors were applied. There was no impairment charge related to the remaining intangible assets during fiscal 2017.

The Company's operating loss, net of the one-time impairment charges, was \$4.2 million in fiscal 2018 and \$4.0 million in fiscal 2017. Net loss, net of the one-time impairment charges and the benefit from the write-off of the related deferred tax liability, was \$3.4 million in fiscal 2018 and \$4.4 million in fiscal 2017.

**Other Income and Expense, Net**

Interest expense for fiscal 2018 increased \$106 thousand compared to fiscal 2017, which includes \$31 thousand of interest and \$71 thousand of debt discount amortization related to a note payable funded during the fiscal year that was converted to preferred stock.

The Company recorded \$77 thousand of interest expense during fiscal 2018 related to the accretion of discounts on the PFG IV Loan and Warrant Debt with PFG IV. There was \$95 thousand of expense related to the discounts and related accretion on the PFG Loan and Warrant Debt included in interest expense in fiscal 2017. The accretion of the discount was impacted by early settlement of the put feature of the warrants which occurred upon the close of the PFG V loan.

During the year ended September 30, 2018, a gain of \$12 thousand was recorded related to the fair value remeasurement on the derivative liability associated with the PFG IV Loan and Warrant Debt. In the year ended September 30, 2017, a gain of \$55 thousand was recorded related to the fair value remeasurement on this derivative liability.

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The Company recorded \$6 thousand of interest expense during fiscal 2018 related to the accretion of discounts on the PFG V loan and Warrant Debt. The Company recorded no accretion of discount expense related to this loan and warrant debt during fiscal 2017.

During fiscal 2018, a gain of \$14 thousand was recorded related to the fair value remeasurement on the derivative liability associated with the PFG V Loan and Warrant Debt. No gain or loss related to the fair value measurement was recorded during fiscal 2017.

In the year ended September 30, 2018, no foreign currency exchange gain or loss was recorded related to re-measurement of the subordinated notes payable related to the Company's foreign subsidiaries. In the year ended September 30, 2017, a foreign currency loss of \$6 thousand was recorded related to the remeasurement.

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

The Company records a non-cash deferred tax liability related to tax amortization of goodwill acquired in 2001. The income tax benefit related to this amortization was \$8 thousand in fiscal 2018 and 2017, respectively. The remaining balance of the deferred tax liability related to goodwill was fully written off as of September 30, 2018 as a result of the impairment.

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changes existing U.S. tax law and includes provisions that affect our business. The TCJA reduces the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. The TCJA was effective in the second quarter of fiscal year 2018 and the effective tax rate for the quarter ended December 31, 2017 is a blended rate reflecting the anticipated benefit of the three quarters of federal tax rate reductions for fiscal 2018. During fiscal 2018, we recorded an income tax benefit of \$4.3 million, with \$1.5 million resulting from the application of TCJA to existing deferred tax balances based on reasonable estimates for those tax effects and \$3.0 million resulting from the write-off of the deferred tax liability associated with goodwill and customer relationships as a result of the full impairment. The deemed repatriation of undistributed foreign earnings is not expected to result in a material change to our financial results.

### **Foreign Currency Translation Adjustment**

The Company's wholly-owned subsidiaries operate in Japan and the Netherlands, and utilize the Japanese Yen and Euro, respectively, as their functional currency. Assets and liabilities of the Company's foreign operations are translated into US dollars at period end exchange rates while revenues and expenses are translated using average rates for the period. Gains and losses from the translation are deferred and included in accumulated other comprehensive loss on the consolidated statements of operations.

For the year ended September 30, 2018, the Company's foreign currency translation adjustment was a loss of \$81 thousand compared to a loss of \$412 thousand in the year ended September 30, 2017. The loss in fiscal 2018 is attributable to the weakening in the Japanese Yen and the Euro compared to the U.S. dollar during the period as compared to fiscal 2017.

### **LIQUIDITY AND CAPITAL RESOURCES**

The Company's primary sources of liquidity are its cash and debt and equity financing. During fiscal 2018, the Company used \$638 thousand of cash from operating activities compared with \$671 thousand of cash generated from operating activities in fiscal 2017. The Company had an increase in net loss in fiscal 2018 as compared to fiscal 2017 of \$7.1 million, mainly due to the full impairment of goodwill and intangible assets of \$11.8 million recorded in Q4-2018. The change in net cash flow from operating activities was primarily a result of changes in deferred tax liability and changes in unearned revenue, the latter of which includes a write-off of \$1.5 million that occurred in Q2-2018. For additional information on the write-off, see Financing Receivables section of Note 1.

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Capital expenditures for property and equipment were \$840 thousand in fiscal 2018 compared to \$839 thousand in fiscal 2017.

The Company generated \$1.5 million of cash from financing activities during fiscal 2018, primarily due to proceeds from the issuance of term debt of \$2.0 million with PFG V. In addition, the Company issued two convertible notes totaling \$1.0 million in Q2-2018, which were fully converted to preferred stock in May 2018. The Company also received \$500 thousand as a result of issuing preferred stock in Q1-2018 and \$500 thousand from the issuance of common stock and 232,558 warrants during Q3-2018. These transactions were partially offset by debt and capital lease payments of \$1.3 million. For the same period in fiscal 2017, the Company used \$474 thousand of cash from financing activities, mainly due to line of credit proceeds, that were more than offset by term debt payments.

At September 30, 2018, the Company had a \$4.0 million revolving line of credit with Silicon Valley Bank. The line of credit bears interest at prime rate plus 2.00%. Collections from accounts receivable are directly applied to the outstanding obligations under the revolving line of credit. At September 30, 2018, the outstanding balance was \$621 thousand. The highest balance on the line of credit during the year was \$3.1 million. At September 30, 2018, there was a remaining amount of \$3.4 million available under the line of credit for advances. At September 30, 2017, outstanding borrowings were \$1.6 million.

Historically, the Company has relied on the ability to draw proceeds as needed from its revolving line of credit with Silicon Valley Bank to fund operations. At September 30, 2018, we had a balance of \$621 thousand outstanding on this line of credit, which matures January 31, 2019. The Company does not plan to renew the line of credit prior to the maturity date.

At September 30, 2018, a balance of \$264 thousand was outstanding on the line of credit with Mitsui Sumitomo Bank. At September 30, 2017, a balance of \$417 thousand was outstanding on the line of credit. The notes and credit facility are both related to Mediasite K.K., and both accrue interest at an annual rate of approximately one-and-one half percent (1.5%).

At September 30, 2018, the Company had \$1.9 million outstanding, net of warrant debt and debt discounts, related to notes payable with PFG V. The Company received proceeds of \$3.0 million from loan agreements with a director and PFG V, and made payments of \$815 thousand on term debt related to PFG IV and SVB (both of which are paid in full) resulting in net proceeds of \$2.2 million from notes during the fiscal 2018 compared to net payments of \$1.7 million on notes in the fiscal 2017. The Company also fully converted \$1.0 million of subordinated debt due to that same director into preferred stock shares, which did not and will not require cash settlement.

At September 30, 2018 approximately \$1.1 million of cash and cash equivalents was held by the Company's foreign subsidiaries.

On February 28, 2019, Sonic Foundry, Inc. entered into a Note Purchase Agreement with a director of the Company for \$5.0 million in cash.

See Note 14 - Subsequent Events for additional information on this transaction.

The Company believes its cash position plus available resources is adequate to accomplish its business plan through at least the next twelve months. We will likely evaluate operating and capital leases opportunities to finance equipment purchases in the future and anticipate utilizing proceeds from the recently issued promissory notes to support working capital needs. We may also seek additional equity financing, or issue additional shares previously registered in our available shelf registration and there are no assurances that these will be on terms acceptable to the Company.

### **Contractual Obligations**

The following summarizes our contractual obligations at September 30, 2018 and the effect those obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

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<b>Contractual Obligations:</b>	<u>Total</u>	<u>Less than 1 Year</u>	<u>Years 2-3</u>	<u>Years 4-5</u>	<u>Over 5 years</u>
Product purchase commitments	\$ 745	\$ 745	\$ —	\$ —	\$ —
Operating lease obligations	3,614	1,248	2,164	202	—
Capital lease obligations (a)	458	265	191	2	—
Notes payable (a)	2,464	855	1,609	—	—

(a) Includes fixed and determinable interest payments

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

**Derivative Financial Instruments**

Pursuant to Item 305 of Regulation S-K, the Company, as a smaller reporting company, is not required to provide the information required by this item.

**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, 2018, \$621 thousand of the Company's \$2.8 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

**Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of Sonic Foundry, Inc. and Subsidiaries (the "Company") as of September 30, 2018 and 2017, the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the two years in the period ended September 30, 2018, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at September 30, 2018 and 2017, and the results of its operations and its cash flows for each of the two years in the period ended September 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. 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, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting 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.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2014.

/s/ BAKER TILLY VIRCHOW KRAUSE, LLP

Madison, Wisconsin  
March 15, 2019

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

	September 30,	
	2018	2017
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,189	\$ 1,211
Accounts receivable, net of allowances of \$524 and \$375	7,418	7,903
Financing receivables, current, net of allowances of \$526 and \$200	100	925
Inventories	1,027	986
Investment in sales-type lease, current	150	148
Prepaid expenses and other current assets	941	1,085
Total current assets	10,825	12,258
Property and equipment:		
Leasehold improvements	1,105	1,041
Computer equipment	5,718	6,101
Furniture and fixtures	1,099	789
Total property and equipment	7,922	7,931
Less accumulated depreciation and amortization	6,009	6,181
Property and equipment, net	1,913	1,750
Other assets:		
Goodwill	—	10,455
Customer relationships, net of amortization of \$1,256 and \$990	—	1,505
Product rights, net of amortization of \$534 and \$411	—	261
Financing receivables, long-term	181	1,310
Investment in sales-type lease, long-term	249	407
Other long-term assets	415	410
Total assets	\$ 13,583	\$ 28,356
<b>Liabilities and stockholders' equity (deficit)</b>		
Current liabilities:		
Revolving lines of credit	\$ 885	\$ 2,065
Accounts payable	1,610	1,314
Accrued liabilities	1,609	1,387
Unearned revenue	11,645	11,332
Current portion of capital lease and financing arrangements	248	256
Current portion of notes payable and warrant debt, net of discounts	593	737
Total current liabilities	16,590	17,091
Long-term portion of unearned revenue	1,691	2,970
Long-term portion of capital lease and financing arrangements	187	244
Long-term portion of notes payable and warrant debt, net of discounts	1,357	123
Derivative liability, at fair value	14	12
Other liabilities	202	372
Deferred tax liability	—	4,426
Total liabilities	20,041	25,238
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred stock, \$.01 par value, authorized 500,000 shares; none issued	—	—
9% Preferred stock, Series A, voting, cumulative, convertible, \$.01 par value (liquidation preference of \$1,000 per share), authorized 4,500 shares; 2,678 and 1,510 shares issued and outstanding, respectively, at amounts paid in	1,651	1,280
5% Preferred stock, Series B, voting, cumulative, convertible, \$.01 par value (liquidation preference at par), authorized 1,000,000 shares, none issued	—	—

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

Common stock, \$.01 par value, authorized 10,000,000 shares; 5,113,400 and 4,470,791 shares issued and 5,100,684 and 4,458,075 shares outstanding	51	45
Additional paid-in capital	200,130	197,836
Accumulated deficit	(207,419)	(195,253)
Accumulated other comprehensive loss	(676)	(595)
Receivable for common stock issued	(26)	(26)
Treasury stock, at cost, 12,716 shares	(169)	(169)
Total stockholders' equity (deficit)	(6,458)	3,118
<b>Total liabilities and stockholders' equity (deficit)</b>	<b>\$ 13,583</b>	<b>\$ 28,356</b>

See accompanying notes to the consolidated financial statements.



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

	Years Ended September 30,	
	2018	2017
<b>Revenue:</b>		
Product and other	\$ 12,311	\$ 14,883
Services	22,233	21,117
Total revenue	<u>34,544</u>	<u>36,000</u>
<b>Cost of revenue:</b>		
Product and other	5,231	6,097
Services	4,425	3,770
Total cost of revenue	<u>9,656</u>	<u>9,867</u>
<b>Gross margin</b>	24,888	26,133
<b>Operating expenses:</b>		
Selling and marketing	15,622	16,912
General and administrative	6,354	5,941
Product development	7,142	7,238
Impairment of goodwill and intangible assets	11,809	600
Total operating expenses	<u>40,927</u>	<u>30,691</u>
<b>Loss from operations</b>	(16,039)	(4,558)
<b>Non-operating income (expenses):</b>		
Interest expense, net	(601)	(495)
Other income (expense), net	142	(65)
Total non-operating expenses	<u>(459)</u>	<u>(560)</u>
Loss before income taxes	(16,498)	(5,118)
Income tax benefit	4,332	79
<b>Net loss</b>	<u>\$ (12,166)</u>	<u>\$ (5,039)</u>
Dividends on preferred stock	<u>(257)</u>	<u>(169)</u>
<b>Net loss attributable to common stockholders</b>	<u>\$ (12,423)</u>	<u>\$ (5,208)</u>
<b>Loss per common share:</b>		
Basic net loss per common share	<u>\$ (2.67)</u>	<u>\$ (1.17)</u>
Diluted net loss per common share	<u>\$ (2.67)</u>	<u>\$ (1.17)</u>
Weighted average common shares – Basic	<u>4,655,520</u>	<u>4,436,333</u>
– Diluted	<u>4,655,520</u>	<u>4,436,333</u>

See accompanying notes to the consolidated financial statements.

**Sonic Foundry, Inc.**  
**Consolidated Statements of Comprehensive Loss**  
**(in thousands)**

	<b>Years Ended September 30,</b>	
	<u>2018</u>	<u>2017</u>
Net loss	\$ (12,166)	\$ (5,039)
Foreign currency translation adjustment	(81)	(412)
<b>Comprehensive loss</b>	<u>\$ (12,247)</u>	<u>\$ (5,451)</u>

See accompanying notes to the consolidated financial statements.

**Sonic Foundry, Inc.**  
**Consolidated Statements of Stockholders' Equity (Deficit)**  
(in thousands)

	Preferred stock	Common stock	Additional paid-in capital	Accumulate d deficit	Accumulated other comprehensive loss	Receivable for common stock issued	Treasury stock	Total
<b>Balance, September 30, 2016</b>	—	\$ 44	\$ 197,064	\$ (190,214)	\$ (183)	\$ (26)	\$ (169)	\$ 6,516
Stock compensation	—	—	754	—	—	—	—	754
Issuance of preferred stock	1,250	—	—	—	—	—	—	1,250
Issuance of common stock	—	1	48	—	—	—	—	49
Preferred stock dividends	30	—	(30)	—	—	—	—	—
Foreign currency translation adjustment	—	—	—	—	(412)	—	—	(412)
Net loss	—	—	—	(5,039)	—	—	—	(5,039)
<b>Balance, September 30, 2017</b>	1,280	\$ 45	\$ 197,836	\$ (195,253)	\$ (595)	\$ (26)	\$ (169)	\$ 3,118
Stock compensation	—	—	476	—	—	—	—	476
Issuance of preferred stock	1,531	—	—	—	—	—	—	1,531
Conversion of preferred stock	(1,390)	4	1,386	—	—	—	—	—
Issuance of common stock	—	2	592	—	—	—	—	594
Beneficial conversion feature on convertible debt	—	—	70	—	—	—	—	70
Preferred stock dividends	230	—	(230)	—	—	—	—	—
Foreign currency translation adjustment	—	—	—	—	(81)	—	—	(81)
Net loss	—	—	—	(12,166)	—	—	—	(12,166)
<b>Balance, September 30, 2018</b>	<u>\$ 1,651</u>	<u>\$ 51</u>	<u>\$ 200,130</u>	<u>\$ (207,419)</u>	<u>\$ (676)</u>	<u>\$ (26)</u>	<u>\$ (169)</u>	<u>\$ (6,458)</u>

See accompanying notes to the consolidated financial statements.

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

	<b>Years Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Operating activities</b>		
Net loss	\$ (12,166)	\$ (5,039)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of other intangibles	621	555
Depreciation and amortization of property and equipment	1,118	1,422
Impairment of goodwill and intangible assets	11,809	600
Loss on sale of fixed assets	—	8
Provision for doubtful accounts - including financing receivables	475	349
Deferred taxes	(4,450)	(103)
Stock-based compensation expense related to stock options and warrants	476	622
Conversion of accrued interest to preferred stock	31	—
Beneficial conversion feature recognized on debt converted to preferred stock	70	—
Remeasurement gain on subordinated debt	—	(6)
Remeasurement gain on derivative liability	(28)	(55)
Changes in operating assets and liabilities:		
Accounts receivable	348	1,613
Financing receivables	1,630	(558)
Inventories	(41)	904
Prepaid expenses and other current assets	290	89
Accounts payable and accrued liabilities	268	(109)
Other long-term liabilities	(169)	129
Unearned revenue	(920)	250
Net cash provided by (used in) operating activities	(638)	671
<b>Investing activities</b>		
Purchases of property and equipment	(840)	(839)
Net cash used in investing activities	(840)	(839)
<b>Financing activities</b>		
Proceeds from notes payable	3,000	—
Proceeds from lines of credit	22,236	23,257
Payments on notes payable	(815)	(1,727)
Payments on lines of credit	(23,422)	(22,928)
Payments of debt issuance costs	(97)	(26)
Payments to settle put on term debt	(200)	—
Proceeds from issuance of preferred stock and common stock	1,094	1,298
Payments on capital lease and financing arrangements	(298)	(348)
Net cash provided by (used in) financing activities	1,498	(474)
Changes in cash and cash equivalents due to changes in foreign currency	(42)	59
Net decrease in cash and cash equivalents	(22)	(583)
Cash and cash equivalents at beginning of year	1,211	1,794
Cash and cash equivalents at end of year	\$ 1,189	\$ 1,211
Supplemental cash flow information:		
Interest paid	\$ 409	\$ 505
Income taxes paid, foreign	370	111
Non-cash financing and investing activities:		

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

Property and equipment financed by capital lease or accounts payable	460	341
Debt discount	127	—
Stock issued for board of director's fees	—	133
Deemed dividend for beneficial conversion feature of preferred stock	28	139
Preferred stock dividend paid in additional shares	230	30
Subordinated note payable converted to preferred stock	1,000	—

**See accompanying notes to the consolidated financial statements.**

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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., Sonic Foundry International B.V. (formerly Media Mission B.V.) and Mediasite K.K. All significant intercompany transactions and balances have been eliminated.

### ***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 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.

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#### 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, 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 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 1 year, 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

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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, it may compromise our ability to recognize revenue to these distributors at the time of shipment. 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, 2018, of the \$1.2 million in cash and cash equivalents, \$118 thousand is deposited with 2 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 \$1.1 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 and financing receivables was \$1.0 million at September 30, 2018 and \$575 thousand at September 30, 2017.

We had billings for Mediasite product and support services as a percentage of total billings to one distributor of approximately 6% in 2018 and 11% in 2017 and to a second distributor of approximately 11% in 2018 and 15% in 2017. At September 30, 2018 and 2017, these two distributors represented 28% and 23% of total accounts receivable, respectively.

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, 2018 and 2017, this supplier represented 29% and 27%, 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.



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***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, 2018, of the \$1.2 million aggregate cash and cash equivalents held by the Company, the amount of cash and cash equivalents held by our foreign subsidiaries was \$1.1 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.

***Financing Receivables***

Financing receivables consist of customer receivables resulting from the sale of the Company's products and services, primarily software and long-term customer support contracts, and are presented net of allowance for losses. The Company has a single portfolio consisting of fixed-term receivables, which is further segregated into two classes based on products, customer type, and credit risk evaluation.

The Company generally determines its allowance for losses on financing receivables at the customer class level by considering a number of factors, including the length of time financing receivable are past due, historical and anticipated experience, the customer's current ability to pay its obligation, and the condition of the general economy and the industry as a whole. The Company writes-off financing receivables when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for financing receivable losses. Interest is not accrued on past due receivables. There was an allowance of \$526 thousand and \$200 thousand at September 30, 2018 and 2017, respectively.

The Company's financing receivables are aggregated into the following categories:

Long-term customer support contracts: These contracts are typically entered into in conjunction with sale-type lease arrangements, over the life of which the Company agrees to provide support services similar to those offered within Mediasite Customer Care plans. Contract terms range from 3-5 years, and payments are generally due from the customer annually on the contract anniversary. There was \$281 thousand and \$384 thousand of receivables outstanding for long-term customer support contracts as of September 30, 2018 and 2017, respectively. All amounts due were current as of the balance sheet date and there are no credit losses expected to be incurred related to long-term support contracts.

Product receivables: Amounts due primarily represent sales of perpetual software licenses to a single international distributor on invoices outstanding for product delivered from March 2016 through June 2017. There was \$2.1 million receivable as of September 30, 2017, \$1.5 million of which was deferred for revenue recognition purposes due to a history of delayed payment. As of September 30, 2018, the deferred balance related to this receivable was zero as it was fully allowed for as a loss. The Company delivered \$901 thousand of product to this customer and received payment of \$726 thousand in fiscal 2017. As a result of the circumstances described, the entire allowance for losses on financing receivables of \$526 thousand is considered attributable to this class of customer as of September 30, 2018.

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Financing receivables consisted of the following (in thousands) as of:

	<u>September 30,</u> <u>2018</u>	<u>September 30,</u> <u>2017</u>
Customer support contracts, current and long-term, gross	\$ 281	\$ 384
Product receivables, gross	526	2,051
Allowance for losses on financing receivables	(526)	(200)
	<u>\$ 281</u>	<u>\$ 2,235</u>

***Investment in Sales-Type Lease***

The Company has entered into sales-type lease arrangements with certain customers, consisting of recorders leased with terms ranging from 3-5 years. All amounts due are current as of the balance sheet date.

Investment in sales-type leases consisted of the following (in thousands) as of:

	<u>September 30,</u> <u>2018</u>	<u>September 30,</u> <u>2017</u>
Investment in sales-type lease	\$ 399	\$ 555
	<u>\$ 399</u>	<u>\$ 555</u>

***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 net realizable value, with cost determined on a first-in, first-out basis.

Inventory consists of the following (in thousands):

	<u>September 30,</u>	
	<u>2018</u>	<u>2017</u>
Raw materials and supplies	\$ 358	\$ 156
Finished goods	669	830
	<u>\$ 1,027</u>	<u>\$ 986</u>

***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. There was no amortization expense in either of the years ending September 30, 2018 or 2017, respectively. The gross amount of capitalized external and internal development costs was \$533 thousand at September 30, 2018 and 2017. There were no software development efforts that qualified for capitalization for the years ended September 30, 2018 or 2017, respectively.

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***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:

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

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

Goodwill has an indefinite useful life and is recorded at cost and 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, the Company compares the estimated fair value of the reporting unit to which goodwill is allocated to its carrying value. The amount of impairment, if any, is equal to the amount by which the carrying value of the reporting unit exceeds its fair value.

For purposes of the fiscal 2018 and 2017 tests, goodwill balances are evaluated within three separate reporting units. In fiscal 2018, we performed a quantitative analysis and determined that the fair value of all three of the Company's reporting units is less than its carrying value. The Company recognized an impairment charge of \$10.4 million, or the remaining balance of goodwill, as of September 30, 2018. In fiscal 2017, we performed a quantitative analysis and determined that the fair value of one of the Company's reporting units is less than its carrying value, and that the fair value of the remaining reporting units is greater than their respective carrying values. The Company recognized an impairment charge of \$600 thousand as of September 30, 2017.

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 year ended September 30, 2018, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year. For the year ended September 30, 2018, the Company determined that intangible assets, consisting of customer relationships and product rights, were impaired and recognized an impairment charge of \$1.4 million. For the year ended September 30, 2017, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year and past performance. However, after performing analysis of undiscounted cash flows attributable to our long-lived assets along with other relevant factors, such as the continued use of the assets, it was determined that there was no impairment of long-lived and intangible assets other than goodwill. Key assumptions utilized in the analysis of undiscounted cash flows for each asset or asset group being tested included 1) whether cash flows were attributable solely to the asset or group, or to an entire reporting unit; and 2) the useful lives of the asset or asset group. Forecasts used in the analysis were also consistent with those used in determining fair value of reporting units during goodwill impairment testing.

***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.

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***Advertising Expense***

Advertising costs included in selling and marketing, are expensed when the advertising first takes place. Advertising expense was \$451 thousand and \$479 thousand for years ended September 30, 2018 and 2017, 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.

***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.

As of September 30, 2018 and 2017, 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.

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 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 and the public company guideline method 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.

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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.

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 Liabilities Measured at Fair Value on a Recurring Basis**

The initial fair values of PFG debt and warrant debt (see Note 3) were based on the present value of expected future cash flows and assumptions about current interest rates and the creditworthiness of the Company (Level 3). The fair value of the bifurcated conversion feature represented by the warrant derivative liability, which is measured at fair value on a recurring basis is based on a Black Scholes option pricing model with assumptions for stock price, exercise price, volatility, expected term, risk free interest rate and dividend yield similar to those described for share-based compensation which were generally observable (Level 2).

Financial liabilities measured at fair value on a recurring basis are summarized below (in thousands):

<b>September 30, 2018</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>
Derivative liability	\$ —	\$ 14	\$ —	\$ 14
<b>September 30, 2017</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>
Derivative liability	\$ —	\$ 12	\$ —	\$ 12

Included below is a summary of the changes in our Level 3 fair value measurements (in thousands):

	<b>PFG IV Debt, Net of Discount</b>	<b>Warrant Debt, PFG IV</b>	<b>PFG V Debt, Net of Discount</b>	<b>Warrant Debt, PFG V</b>
<b>Balance as of September 30, 2017</b>	\$ 491	\$ 123	\$ —	\$ —
Activity during the period:				
Disbursement of Tranche 1, net of discount			1,873	97
Payments to PFG	(538)	(200)	—	—
Change in fair value	47	77	32	6
<b>Balance as of September 30, 2018</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 1,905</b>	<b>\$ 103</b>

**Financial Instruments Not Measured at Fair Value**

The Company's other financial instruments consist primarily of cash and cash equivalents, accounts receivable, investment in sales-type lease, financing receivables, accounts payable and debt instruments, excluding the PFG debt. The book values of cash

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and cash equivalents, accounts receivable, investment in sales-type lease, debt (excluding the PFG debt) and accounts payable are considered to be representative of their respective fair values. The carrying value of capital lease obligations and debt (excluding the PFG debt), including the current portion, approximates fair market value as the variable and 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) a grant of a non-revocable license of Astute patents to the Company; 2) a grant of 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) a payment of \$1.35 million to Astute. Pursuant to the settlement agreement, the payments were made in three equal amounts with the first paid in June 2014, the second paid in October 2014 and the final installment paid in March 2015. The Company contributed \$1.1 million of the \$1.35 million payable to Astute with our customer paying the residual amount. Of the \$1.1 million, \$428 thousand related to prior use and was recorded as a charge to income during fiscal 2014. The remaining \$672 thousand was recorded as a product right asset, which is being amortized, on a straight-line basis, over the remaining life of the patents, through 2020. Future amounts due to Astute were accrued for as of the time of settlement. In Q4-2018, product rights were determined to be fully impaired and fully written off. See Note 8, Goodwill and Other Intangible Assets, for additional information on the impairment.

No legal contingencies were recorded for either of the years ended September 30, 2018 or 2017, respectively.

***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 homogeneous 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 expected exercise factor and forfeiture rates are calculated using historical exercise and forfeiture activity for the previous three years.

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

	<b>Years Ending September 30,</b>	
	<b>2018</b>	<b>2017</b>
Expected life	4.3 - 4.4 years	4.7 - 4.9 years
Risk-free interest rate	1.79%-2.75%	1.08%-1.51%
Expected volatility	60.62%-63.49%	56.98%-62.21%
Expected forfeiture rate	12.53%-14.58%	10.17%-11.72%
Expected exercise factor	1.00-1.17	1.29-1.35
Expected dividend yield	—%	—%

***Common Stock Warrants***

On April 16, 2018, the Company issued 232,558 shares of common stock to an affiliated party. The shares were issued at a price of \$2.15 per share, representing the closing price on April 13, 2018. On April 16, 2018, the closing price of the Company’s common stock was \$2.18 per share. The affiliated party also received warrants to purchase 232,558 shares of common stock at an exercise price of \$2.50 per share, respectively, which expire on April 16, 2025.

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***Preferred stock and dividends***

In May 2017, the Company created a new series of preferred stock entitled "9% Cumulative Voting Convertible Preferred Stock, Series A" (the "Preferred Stock, Series A"). One thousand shares were authorized with a stated value and liquidation preference of \$1,000 per share. In August 2017, 1,500 additional shares were authorized for an aggregated total of 2,500 shares. In May 2018, 2,000 additional shares were authorized for an aggregated total of 4,500 shares. Holders of the Preferred Stock, Series A will receive monthly dividends at an annual rate of 9%, payable in additional shares of Preferred Stock, Series A. Dividends declared on the preferred stock are earned monthly as additional shares and accounted for as a reduction to paid-in capital since the Company is currently in an accumulated deficit position. Each share of Preferred Stock, Series A is convertible into that number of shares of common stock determined by dividing \$4.23 into the liquidation amount. A total of 2,678 and 1,510 shares of Preferred Stock, Series A were issued and outstanding as of September 30, 2018 and 2017, respectively.

The Company considered relevant guidance when accounting for the issuance of preferred stock, and determined that the preferred shares meet the criteria for equity classification. Dividends accrued on preferred shares will be shown as a reduction to net income (or an increase in net loss) for purposes of calculating earnings per share.

On May 17, 2018, \$1.0 million of subordinated convertible debt was fully converted into 1,902 shares of Preferred Stock, Series A, following approval by the stockholders of the Company of the conversion sufficient to comply with rules and regulations of NASDAQ. See Note 4 related to accounting for the conversion.

On June 8, 2018, 905 shares of Preferred Stock, Series A were automatically converted by the Company into 213,437 shares of common stock. The amount of shares converted represents all preferred shares issued on May 30, 2017 and June 8, 2017, including related dividends.

On August 23, 2018, 717 shares of Preferred Stock, Series A were automatically converted by the Company into 169,485 shares of common stock. The amount of shares converted represents all preferred shares issued on August 23, 2017.

***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>2018</b>	<b>2017</b>
Denominator for basic earnings (loss) per share		
-weighted average common shares	4,655,520	4,436,333
Effect of dilutive options and warrants (treasury method)	—	—
Denominator for diluted earnings (loss) per share		
-adjusted weighted average common shares	4,655,520	4,436,333
Options and warrants outstanding during each year, but not included in the computation of diluted earnings (loss) per share because they are antidilutive	2,399,901	1,940,245

***Liquidity***

At September 30, 2018 approximately \$1.1 million of cash and cash equivalents was held by the Company's foreign subsidiaries.

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On February 28, 2019, Sonic Foundry, Inc. entered into a Note Purchase Agreement with a director of the Company for \$5.0 million in cash.

See Note 14 - Subsequent Events for additional information on this transaction.

The Company believes its cash position plus available resources is adequate to accomplish its business plan through at least the next twelve months. We will likely evaluate operating and capital leases opportunities to finance equipment purchases in the future and anticipate utilizing proceeds from the recent note purchase agreement to support working capital needs. We may also seek additional equity financing, or issue additional shares previously registered in our available shelf registration and there are no assurances that these will be on terms acceptable to the Company.

***Recent Accounting Pronouncements***

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("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 FASB subsequently issued a one-year deferral of the effective date for the new revenue reporting standard for entities reporting under U.S. GAAP. In accordance with the deferral, the guidance is effective for annual reporting periods beginning after December 15, 2017. Subsequently, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations" ("ASU 2016-08"); ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" ("ASU 2016-10"); and ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12"). The Company must adopt ASU 2016-08, ASU 2016-10 and ASU 2016-12 with ASU 2014-09.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330)" ("ASU 2015-11"). The amendments in ASU 2015-11 require an entity to measure inventory at the lower of cost and net realizable value. The amendments in ASU 2015-11 are effective for fiscal years beginning after December 15, 2016 and interim periods within those years. Early adoption is permitted. The amendments should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company adopted this standard as of October 1, 2017, and it did not have a material impact on the Company's financial position or results of operations.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740)", ("ASU 2015-17"). ASU 2015-17 simplifies the presentation of deferred income taxes. The amendments in ASU 2015-17 are effective for financial statements issued for annual periods beginning after December 15, 2016, including interim periods within those annual periods. The amendments may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The Company adopted this standard as of October 1, 2017, and it did not have a material impact on the Company's financial position or results of operations.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10)", ("ASU 2016-01"). ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments in ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values should be applied prospectively to equity investments that exist at the date of the adoption. The Company is currently evaluating this guidance and its impact to the financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)", ("ASU 2016-02"). ASU 2016-02 aims to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and



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disclosing key information about leasing arrangements. The amendments in ASU 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public entities. Early application of the amendment is permitted. The Company is currently reviewing this guidance and its impact to the financial statements.

In March 2016, the FASB issued ASU 2016-06, "Derivatives and Hedging (Topic 815)", ("ASU 2016-06"). ASU 2016-06 clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. The amendments in ASU 2016-06 are effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Entities should apply the amendments on a modified retrospective basis to existing debt instruments as of the beginning of the fiscal year for which the amendments are effective. The Company adopted this standard as of October 1, 2017, and it did not have a material impact on the Company's financial position or results of operations.

In March 2016, the FASB issued ASU 2016-09, "Compensation-Stock Compensation (Topic 718)", ("ASU 2016-09"). ASU 2016-09 simplifies the accounting for share-based payment transactions. The amendments in ASU 2016-09 are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company adopted this standard as of October 1, 2017, and it did not have a material impact on the Company's financial position or results of operations.

In May 2016, the FASB issued ASU 2016-11, "Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815)", ("ASU 2016-11"). ASU 2016-11 rescinds SEC paragraphs pursuant to the SEC Staff Announcement, "Rescission of Certain SEC Staff Observer Comments upon Adoption of Topic 606", and the SEC Staff Announcement, "Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or Equity", announced at the March 3, 2016 Emerging Issues Task Force (EITF) meeting. The effective dates in ASU 2016-11 coincide with the effective dates of Topic 606 (ASU 2014-09) and ASU 2014-16. The Company is currently evaluating the impact of adopting ASU 2014-09 and related amendments, such as ASU 2016-11, to determine the impact, if any, it may have on our financial statements. The Company previously reviewed ASU 2014-16 and determined that it is not applicable.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)", ("ASU 2016-15"). ASU 2016-15 addresses classification of certain cash receipts and cash payments within the statement of cash flows. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods with those fiscal years. The Company is currently evaluating this guidance and its impact to the financial statements.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory", ("ASU 2016-16"). ASU 2016-16 improves the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. The Company is currently evaluating this guidance and its impact to the financial statements.

In May 2017, the FASB issued ASU 2017-09, "Compensation-Stock Compensation (Topic 718)", ("ASU 2017-09"). The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The amendments in ASU 2017-09 are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. The Company is in the process of assessing the impact, if any, of this ASU on its consolidated financial statements.

In July 2017, the FASB issued ASU 2017-11, "Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815)", ("ASU 2017-11"). This update was issued to address complexities in accounting for certain equity-linked financial instruments containing down round features. The amendment changes the classification analysis of these financial instruments (or embedded features) so that equity classification is no longer precluded. The amendments in ASU 2017-11 are effective for annual reporting periods beginning after December 15, 2018, including interim reporting periods within those annual reporting periods. Early adoption is permitted. The Company is in the process of assessing the impact, if any, of this ASU on its consolidated financial statements.

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In July 2018, the FASB issued ASU 2018-10, "Codification Improvements to Topic 842, Leases", ("ASU 2018-10"). The standard clarifies certain topics related to previously issued Topic 842. The amendments in ASU 2018-10 are not yet effective, but early adoption is permitted. For entities that have not yet adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in Topic 842. The Company is currently evaluating this guidance and its impact to the financial statements.

In August 2018, the FASB issued ASU 2018-11, "Leases (Topic 842): Targeted Improvements", ("ASU 2018-11"). The ASU is intended to reduce costs and ease implementation of the leases standard for financial statement preparers. ASU 2018-11 provides a new transition method and a practical expedient for separating components of a contract. For entities that have not adopted Topic 842 before the issuance of this ASU, the effective date and transition requirements for the amendments in this update related to separating components of a contract are the same as the effective date and transition requirements in ASU 2016-02. The Company is currently evaluating this guidance and its impact to the financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurements", ("ASU 2018-13"). ASU 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820. The amendments in ASU 2018-13 are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company does not believe the ASU will have a significant impact on its consolidated financial statements.

In November 2018, the FASB issued ASU 2018-18, "Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606", ("ASU 2018-18"). ASU 2018-18 provides guidance on whether certain transactions between collaborative arrangement participants should be accounted for with revenue under Topic 606. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently reviewing this guidance and its impact to the 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.

***New Accounting Pronouncements Not Yet Effective***

In May 2014, the FASB issued a new standard related to revenue recognition. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flow arising from contracts with customers. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (the full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method).

The Company will adopt the new standard, effective October 1, 2018, using the modified retrospective method applied to those contracts which were not substantially completed as of October 1, 2018. The most significant impact of the standard on the Company's financial statements relates to multi-year software licenses for certain customers which will accelerate the recognition of revenue. We expect to recognize an adjustment to retained earnings reflecting the cumulative impact for the accounting changes related to multi-year software licenses and contract acquisition costs upon adoption of these new standards.

There are also certain considerations related to internal control over financial reporting that are associated with implementing Topic 606. We are evaluating our internal control framework over revenue recognition to identify any changes that may need to be made in response to the new guidance. We will have completed the design and implementation of the appropriate controls to obtain and disclose the information required under Topic 606 in our first quarter of 2019. In addition, disclosure requirements

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under the new guidance in Topic 606 have been significantly expanded in comparison to the disclosure requirements under the current guidance.

**2. Commitments**

***Capital Lease and Financing Agreements***

The Company leases certain equipment under capital lease and financing agreements expiring through January 2022. Capital leases that are currently outstanding on equipment included in fixed assets have a cost of \$1.3 million and accumulated depreciation of \$892 thousand at September 30, 2018. Minimum lease payments, including principal and interest, are summarized in the table below.

<b>Fiscal Year (in thousands)</b>	<u><b>Capital</b></u>
	2019 \$ 265
	2020 143
	2021 48
2022	<u>2</u>
Total payments	458
Less interest	<u>(25)</u>
Total	<u>\$ 433</u>

***Operating Leases***

The Company leases certain facilities and equipment under operating lease agreements expiring at various times through December 31, 2022. Total rent expense on all operating leases was approximately \$1.2 million and \$1.3 million for the years ended September 30, 2018 and 2017, respectively.

In November 2011, the Company occupied office space related to a lease agreement entered into on June 28, 2011. The initial lease term was from November 2011 through December 2018 and in Q3 2018, the lease was extended for three years through December 31, 2021. There are two additional three year extensions included in the initial lease agreement. 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, 2018, the unamortized balance was \$7 thousand.

In October 2016, the Company also occupied office space related to a lease agreement entered into on August 1, 2016. The lease term is from October 2016 through December 2020. The lease includes five months of free rent of \$130 thousand that was recorded as a deferred rent liability and is being amortized as a credit to rent expense on a straight-line basis over the lease term. At September 30, 2018 and 2017, the unamortized balance was \$75 thousand and \$110 thousand, respectively.

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

<b>Fiscal Year (in thousands)</b>	<u><b>Operating</b></u>
2019	\$ 1,248
2020	1,252
2021	912
2022	<u>202</u>
Total	<u>\$ 3,614</u>

***Other Commitments***

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The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. At September 30, 2018, the Company has an obligation to purchase \$745 thousand of Mediasite product, which is not recorded on the Company's Consolidated Balance Sheet.

The Company enters into license agreements that generally provide indemnification against intellectual property claims for its customers as well as indemnification agreements with certain service providers, landlords and other parties in the normal course of business. The Company has not incurred any material costs as a result of such indemnifications, or accrued any liabilities related to such obligations in the consolidated financial statements, except as noted above related to Astute (Note 1).

### **3. Credit Arrangements**

#### ***Silicon Valley Bank***

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, dated June 27, 2011, as amended by the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, and Tenth Amendments, dated May 31, 2013, January 10, 2014, March 31, 2014, January 27, 2015, May 13, 2015, October 5, 2015, February 8, 2016, December 9, 2016, March 22, 2017, and May 10, 2017 (the Second Amended and Restated Loan Agreement, as amended by the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, and Tenth Amendments, collectively, the "Second Amended and Restated Loan Agreement"). The Second Amended and Restated Loan Agreement provides for a revolving line of credit in the maximum principal amount of \$4,000,000. Interest accrues on the revolving line of credit at the variable per annum rate equal to the Prime Rate (as defined) plus two percent (2.00%), which currently equates to 7.25%. The Second Amended and Restated Loan Agreement provides for an advance rate on domestic receivables of 80%, and an advance rate on foreign receivables of 75% of the lesser of (x) Foreign Eligible Accounts (as defined) or (y) \$1,000,000. The maturity date of the revolving credit facility is January 31, 2019. Under the Second Amended and Restated Loan Agreement, a term loan was entered into on January 27, 2015 in the original principal amount of \$2,500,000 which accrued interest at the variable per annum rate equal to the Prime Rate (as defined) plus two and three-quarters percent, and was to be repaid in 36 equal monthly principal payments, beginning in February 2015. The Second Amended and Restated Loan Agreement also requires Sonic Foundry to comply with certain financial covenants, including (i) a liquidity financial covenant, which requires minimum Liquidity (as defined), tested with respect to the Company only, on a monthly basis, of at least 1.60:1.00 for each month-end that is not the last day of a fiscal quarter, and 1.75:1.00 for each month-end that is the last day of a fiscal quarter, and (ii) a covenant that requires the Company to achieve, commencing with the period ending September 30, 2017, and continuing each quarterly period thereafter, measured as of the last day of each fiscal quarter, on a trailing six (6) month basis ending as of the date of measurement, (a) EBITDA (negative EBITDA) plus (b) the net change in Deferred Revenue (as defined) during such measurement period, of at least Zero Dollar (\$0.00). Collections from accounts receivable are directly applied to the outstanding obligations under the revolving line of credit.

On December 22, 2017, the Company entered into an Eleventh Amendment to the Second Amended and Restated Loan and Security Agreement (the "Eleventh Amendment") with Silicon Valley Bank. Under the Eleventh Amendment: the Minimum EBITDA covenant was modified to require Minimum EBITDA (as defined) plus the net change in Deferred Revenue, (i) for the period ending December 31, 2017, measured on a trailing three (3) month basis, to be no less than negative (\$1,900,000); (ii) for the quarterly period ending March 31, 2018, measured on a trailing three (3) month basis, to be no less than Zero Dollars, and (iii) for the quarterly period ending June 30, 2018, and each quarterly period thereafter, in each case measured on a trailing six month basis, to be no less than Zero Dollars.

On May 11, 2018, the Company entered into a Twelfth Amendment to the Second Amended and Restated Loan and Security Agreement (the "Twelfth Amendment") with Silicon Valley Bank, which waived the minimum EBITDA covenant as defined under the Eleventh Amendment. Under the Twelfth Amendment: the Minimum EBITDA covenant was modified to require

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Minimum EBITDA (as defined) plus the net change in Deferred Revenue, (i) for the quarterly period ending June 30, 2018, measured on a trailing six (6) month basis, to be no less than negative (\$1,100,000); (ii) for the quarterly period ending September 30, 2018, measured on a trailing six (6) month basis, to be no less than \$500,000, and (iii) for the quarterly period ending December 31, 2018, measured on a trailing six (6) month basis, to be no less than negative (\$250,000), and (iv) for the quarterly period ending March 31, 2019, measured on a trailing three (3) month basis, to be no less than negative (\$250,000). The Twelfth Amendment also requires Sonic Foundry to comply with certain financial covenants, including (i) funding of tranche 1 of the PFG V note in the amount of \$2,000,000 prior to June 30, 2018, and (ii) funding of tranche 2 of the PFG V note in the amount of \$500,000 prior to December 31, 2018.

At September 30, 2018, there was no balance outstanding on the term loan with Silicon Valley Bank. There was a balance of \$621 thousand outstanding on the revolving line of credit with an effective interest rate of seven-and-one-quarter percent (7.25%). At September 30, 2017, a balance of \$278 thousand was outstanding on the term loans with Silicon Valley Bank and a balance of \$1.6 million was outstanding on the revolving line of credit. At September 30, 2018, there was a remaining amount of \$3.4 million available under the line of credit facility for advances.

The Second Amended and Restated 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. At September 30, 2018, the Company was in compliance with all financial covenants.

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.

Historically, the Company has relied on the ability to draw proceeds as needed from its revolving line of credit with Silicon Valley Bank to fund operations. At September 30, 2018, we had a balance of \$621 thousand outstanding on this line of credit, which matured on January 31, 2019 and was paid in full. The Company did not renew the line of credit.

On February 28, 2019, Sonic Foundry, Inc. entered into a Note Purchase Agreement with a director of the Company for \$5.0 million in cash.

See Note 14 - Subsequent Events for additional information on this transaction.

The Company used the proceeds from the notes issued under the Note Purchase Agreement to replace the revolving line of credit with Silicon Valley Bank, which matured on January 31, 2019.

***Partners for Growth IV, L.P.***

On May 13, 2015, Sonic Foundry, Inc., entered into a Loan and Security Agreement (the "2015 Loan and Security Agreement") with Partners for Growth IV, L.P. ("PFG"), (the "Loan and Security Agreement").

The 2015 Loan and Security Agreement provided for a Term Loan in the amount of \$2,000,000, which was disbursed in two (2) Tranches as follows: Tranche 1 was drawn in the amount of \$1,500,000 shortly after execution thereof; and Tranche 2 in the amount of \$500,000, was drawn on December 15, 2015.

Each tranche of the Term Loan bore interest at 10.75% per annum. Tranche 1 of the Term Loan was payable interest only until November 30, 2015. Beginning on December 1, 2015, principal was due in 30 equal monthly principal installments, plus accrued interest, continuing until May 1, 2018, when the principal balance was paid in full. Tranche 2 of the Term Loan was payable in 29 equal monthly principal installments, plus accrued interest, beginning January 1, 2015 and continued until May 1, 2018.

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Coincident with execution of the 2015 Loan and Security Agreement, the Company entered into a Warrant Agreement (“Warrant”) with PFG IV. Pursuant to the terms of the Warrant, the Company issued to PFG IV a warrant to purchase up to 50,000 shares of common stock of the Company at an exercise price of \$9.66 per share, subject to certain adjustments, of which 37,500 were exercisable with the disbursement of Tranche 1 and 12,500 became exercisable with the disbursement under Tranche 2. Pursuant to the Warrant, PFG IV is also entitled, under certain conditions, to require the Company to exchange the Warrant for the sum of \$200,000. Each warrant issued has an exercise term of 5 years from the date of issuance. On August 12, 2015, the Company and PFG IV entered into a waiver agreement to waive a then existing covenant default and to change the exercise price of the aforementioned warrants from \$9.66 per share to \$6.80 per share.

The warrants could have been settled for cash in the event of acquisition of the company, any liquidation of the company, or expiration of the warrant. The Company determined the cash payment date to be the expiration date (May 14, 2020). Due to the fixed payment amount on the expiration date, the warrant structure is in substance a debt arrangement (the “Warrant Debt”) with a zero interest rate, a fixed maturity date and a feature that makes the debt convertible to common stock. The Warrant Debt had a fair value of \$80 thousand at the time of issuance. The derivative had a fair value of \$136 thousand. The conversion feature is an embedded derivative; thus, for accounting purposes, the conversion feature is bifurcated and accounted for separately from the PFG IV Debt and Warrant Debt as a derivative liability measured at fair value at each reporting period. The warrants were settled for cash in the amount of \$200 thousand in May 2018 upon entering into a new loan agreement with PFG V.

On December 28, 2017, the Company and PFG IV entered into a Modification No. 4 to the 2015 Loan and Security Agreement (“Modification No. 4”). Modification No. 4: the Minimum EBITDA covenant was modified to require Minimum EBITDA (as defined) plus the net change in Deferred Revenue (i) for the period ending December 31, 2017, measured on a trailing three (3) month basis, to be no less than negative (\$1,900,000); (ii) for the quarterly period ending March 31, 2018, measured on a trailing three (3) month basis, to be no less than Zero Dollars, and (iii) for the quarterly period ending June 30, 2018, and each quarterly period thereafter, in each case measured on a trailing six month basis, to be no less than Zero Dollars.

At September 30, 2018, the estimated fair value of the derivative liability associated with the warrants issued in connection with the 2015 Loan and Security Agreement, was zero as a result of the \$200 thousand cash settlement in May 2018, compared to \$12 thousand at September 30, 2017. The change in the fair value of the derivative liability during fiscal 2018 was recorded as a gain of \$12 thousand included in other income (expense).

The proceeds from the 2015 Loan and Security Agreement were allocated between the PFG IV Debt and the Warrant Debt (inclusive of its conversion feature) based on their relative fair value on the date of issuance which resulted in initial carrying values of \$1.8 million and \$216 thousand, respectively. The conversion feature of \$216 thousand is treated together as a debt discount on the PFG IV Debt and was accreted to interest expense under the effective interest method over the three-year term of the PFG IV Debt and the five-year term of the Warrant Debt. For fiscal 2018, the Company recorded accretion of discount expense associated with the warrants issued with the PFG IV loan of \$77 thousand as well as \$47 thousand related to amortization of the debt discount. For fiscal 2017, the Company recorded accretion of discount expense associated with the warrants issued with the PFG IV loan of \$21 thousand as well as \$73 thousand related to amortization of the debt discount. At September 30, 2018, the fair values of the PFG IV Debt and Warrant Debt (inclusive of its conversion feature) were each zero, as the PFG IV Debt was paid in full as of May 1, 2018 and the Warrant Debt was settled on May 14, 2018.

At September 30, 2018, there was no balance outstanding on the term debt with PFG IV. At September 30, 2017, a balance of \$491 thousand with outstanding on the term debt with PFG IV, net of discount.

On May 11, 2018, Sonic Foundry, Inc., entered into a Loan and Security Agreement (the “2018 Loan and Security Agreement”) with Partners for Growth V, L.P. (“PFG V”), (the “Loan and Security Agreement”).

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The 2018 Loan and Security Agreement provides for a Term Loan in the amount of \$2,500,000, which was disbursed in two (2) Tranches as follows: Tranche 1 was disbursed on May 14, 2018 in the amount of \$2,000,000; and Tranche 2 in the amount of \$500,000, was disbursed on November 8, 2018.

Each tranche of the Term Loan bears interest at 10.75% per annum. Tranche 1 of the Term Loan is payable interest only until November 30, 2018. Thereafter, principal is due in 30 equal monthly principal installments, plus accrued interest, beginning December 1, 2018 and continuing until May 1, 2021, when the principal balance is to be paid in full. Tranche 2 of the Term Loan is payable using the same repayment schedule as Tranche 1. Upon maturity, Sonic Foundry is required to pay PFG V a cash fee of \$150,000.

The principal of the Term Loan may be prepaid at any time, provided that Sonic Foundry pays to PFG V a prepayment fee equal to 1% of the principal amount prepaid, if the prepayment occurs in the first year from disbursement of Tranche 1.

The Term Loan is collateralized by substantially all the Company's assets, including intellectual property, subject to a first lien held by Silicon Valley Bank. The Term Loan requires compliance with the same financial covenants as set forth in the loan from Silicon Valley Bank.

Coincident with execution of the 2018 Loan and Security Agreement, the Company entered into a Warrant Agreement ("Warrant") with PFG V. Pursuant to the terms of the Warrant, the Company issued to PFG V a warrant to purchase up to 66,000 shares of common stock of the Company at an exercise price of \$2.57 per share, subject to certain adjustments. Pursuant to the Warrant, PFG V is also entitled, under certain conditions, to require the Company to exchange the Warrant for the sum of \$250,000.

At September 30, 2018, the estimated fair value of the derivative liability associated with the warrants issued in connection with the Loan and Security Agreement, was \$14 thousand. The change in the fair value of the derivative liability during fiscal 2018 was recorded as a gain of \$14 thousand, included in the other income (expense).

The proceeds from the Loan and Security Agreement were allocated between the PFG V Debt and the Warrant Debt (inclusive of its conversion feature) based on their relative fair value on the date of issuance which resulted in carrying values of \$1.9 million and \$127 thousand, respectively. The warrant debt of \$127 thousand is treated together as a debt discount on the PFG V Debt and will be accreted to interest expense under the effective interest method over the three-year term of the PFG V Debt and the five-year term of the Warrant Debt. During fiscal 2018, the Company recorded accretion of discount expense associated with the warrants issued with the PFG V loan of \$6 thousand, as well as \$17 thousand related to amortization of the debt discount. At September 30, 2018, the fair values of the PFG V Debt and the Warrant Debt (inclusive of its conversion feature) were \$1.9 million and \$117 thousand, respectively. In addition, the Company agreed to pay PFG V a cash fee of up to \$150,000 payable upon maturity (the "back-end fee"), which will be earned ratably over the three year term of the PFG V loan. During fiscal 2018, the Company recorded interest expense of \$19 thousand associated with recognition of the back-end fee.

The fair values of term debt and warrant debt are based on the present value of expected future cash flows and assumptions about current interest rates and the creditworthiness of the Company (Level 3). At September 30, 2018, the derivative liability was remeasured at fair value. The fair value of the bifurcated conversion feature represented by the warrant derivative liability is based on a Black Scholes option pricing model with assumptions for stock price, exercise price, volatility, expected term, risk free interest rate and dividend yield similar to those described previously for share-based compensation which were generally observable (Level 2).

At September 30, 2018, a gross balance of \$1.9 million was outstanding on the term debt with PFG V, net of discount, with an effective interest rate of ten-and-three-quarters percent (10.75%). At September 30, 2017, there was no balance outstanding with PFG V.

See Note 14 - Subsequent Events for additional information related to PFG.

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**Other Indebtedness**

At September 30, 2018, a balance of \$264 thousand was outstanding on the line of credit with Mitsui Sumitomo Bank. At September 30, 2017, a balance of \$417 thousand was outstanding on the line of credit. The notes and credit facility are both related to Mediasite K.K., and both accrue an annual interest rate of approximately one-and-one half percent (1.575%).

On January 19, 2018, the Company and a director entered into a Subscription Agreement (the “Subscription Agreement”). Pursuant to the Subscription Agreement, (i) on January 19, 2018, the director purchased a 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash; and (ii) on February 15, 2018, the director purchased an additional 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash (each, a “Note”, and collectively, the “Notes”).

On May 17, 2018, following approval by the stockholders of the Company of the conversion of the Notes sufficient to comply with rules and regulations of NASDAQ and the Securities and Exchange Commission, the Notes were automatically converted into 1,902 shares of Series A Preferred stock. The number of shares was determined by dividing the total principal and accrued interest due on each Note by \$542.13 (the “Conversion Rate”).

At September 30, 2018, there was no balance outstanding on the Notes.

In the year ended September 30, 2018, no foreign currency gain or loss was realized related to re-measurement of the subordinated notes payable related to the Company’s foreign subsidiaries. In the year ended September 30, 2017, a foreign currency gain of \$6 thousand was recorded related to the remeasurement.

The annual principal payments on the note payable to PFG V are as follows:

<b>Fiscal Year (in thousands)</b>		
2019	\$	667
2020		800
2021		533
Total	\$	<u>2,000</u>

**4. Accrued Liabilities**

Accrued liabilities consists of the following (in thousands):

	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
Accrued compensation	\$ 972	\$ 871
Accrued expenses	359	211
Accrued interest & taxes	223	288
Other accrued liabilities	55	17
Total	<u>\$ 1,609</u>	<u>\$ 1,387</u>

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.

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



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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. On March 7, 2017, Stockholders approved an amendment to increase the number of shares of common stock subject to the 2009 Plan by 900,000 to an aggregated total of 2,700,000 shares of common stock. Stockholders also approved an increase in the number of shares for the directors’ stock option plan of 50,000. The Company maintains a directors’ stock option plan under which options may be issued to purchase up to an aggregate of 150,000 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 stockholder approved 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, 2016	366,889	6,500
Stockholder approval to increase shares	900,000	50,000
Options granted	(312,020)	(8,500)
Options forfeited	53,521	—
Shares available for grant at September 30, 2017	1,008,390	48,000
Options granted	(398,749)	(14,500)
Options forfeited	86,118	10,000
Shares available for grant at September 30, 2018	695,759	43,500

The following table summarizes information with respect to outstanding stock options under all plans:

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	Years Ended September 30,			
	2018		2017	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of year	1,805,443	\$ 8.33	1,602,822	\$ 9.51
Granted	413,249	2.49	320,520	4.73
Exercised	(14,332)	4.75	—	—
Forfeited	(174,619)	9.82	(117,899)	14.62
Outstanding at end of year	<u>2,029,741</u>	<u>\$ 7.04</u>	<u>1,805,443</u>	<u>\$ 8.33</u>
Exercisable at end of year	<u>1,349,021</u>		<u>1,260,609</u>	
Weighted average fair value of options granted during the year	<u>\$ 0.95</u>		<u>\$ 1.82</u>	

The options outstanding at September 30, 2018 have been segregated into three ranges for additional disclosure as follows:

Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding at September 30, 2018	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable at September 30, 2018	Weighted Average Exercise Price
\$2.18 to \$4.88	680,427	8.87	\$ 3.39	97,343	\$ 4.72
5.00 to 9.81	1,104,389	4.84	8.20	1,024,813	8.26
10.00 to 15.21	244,925	4.26	11.93	226,865	12.06
	<u>2,029,741</u>			<u>1,349,021</u>	

As of September 30, 2018, there was \$475 thousand of total unrecognized compensation cost related to non-vested stock-based compensation, with total forfeiture adjusted unrecognized compensation costs of \$359 thousand. The cost is expected to be recognized over a weighted-average life of 1.9 years.

A summary of the status of the Company's non-vested shares under all plans at September 30, 2018 and for the year then ended is presented below:

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares at October 1, 2017	544,834	\$ 2.42
Granted	413,249	0.95
Vested	(258,938)	2.47
Forfeited	(18,425)	1.73
Non-vested shares at September 30, 2018	<u>680,720</u>	<u>\$ 1.46</u>

Stock-based compensation recorded in the year ended September 30, 2018 was \$477 thousand. Stock-based compensation recorded in the year ended September 30, 2017 was \$611 thousand. There was no cash received from exercises under all stock options plans and warrants for the years ended September 30, 2018 or 2017. There were no tax benefits realized for tax deductions from option exercises for the years ended September 30, 2018 and 2017. The Company currently expects to satisfy stock-based awards with registered shares available to be issued.

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The Company also has an Employee Stock Purchase Plan (Purchase Plan) under which an aggregate of 200,000 common shares may be issued. The Stockholders approved an amendment to increase the number of shares of common stock subject to the plan from 150,000 to 200,000 at the Company's annual meeting in March 2017. 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 6 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 47,867 shares are available to be issued under the plan. There were 12,794 and 13,046 shares purchased by employees during fiscal 2018 and 2017, respectively. The Company recorded stock compensation expense under this plan of \$8 thousand and \$12 thousand during fiscal 2018 and 2017, respectively. Cash received from issuance of stock under this plan was \$27 thousand and \$48 thousand during fiscal 2018 and 2017, respectively.

At September 30, 2018, we had 370 thousand outstanding warrants and 2.0 million of outstanding stock options granted under our stock option plans, 1.7 million of which are immediately exercisable.

## 6. Income Taxes

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

	<u>Years Ended September 30,</u>	
	<u>2018</u>	<u>2017</u>
Current income tax expense (benefit)	\$ —	\$ —
Current income tax expense foreign	\$ 101	\$ 17
Deferred income tax benefit	(4,433)	(96)
Benefit for income taxes	<u>\$ (4,332)</u>	<u>\$ (79)</u>

U.S. and foreign components of loss before income taxes were as follows (in thousands):

	<u>Years Ended September 30,</u>	
	<u>2018</u>	<u>2017</u>
U.S.	\$ (16,934)	\$ (5,225)
Foreign	436	107
Loss before income taxes	<u>\$ (16,498)</u>	<u>\$ (5,118)</u>

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

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	<b>Years Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
Income tax benefit at statutory rate	\$ (4,111)	\$ (1,800)
State income tax benefit	(823)	(192)
Foreign tax activity	101	41
R&D tax credit expiration	—	—
Permanent differences, net	771	469
Adjustment of temporary differences to income tax returns	—	—
Change in valuation allowance	1,285	1,403
Tax rate change	(1,545)	—
Other	(10)	—
Income tax benefit	<u>\$ (4,332)</u>	<u>\$ (79)</u>

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

	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
Deferred tax assets:		
Net operating loss and other carryforwards	\$ 24,262	\$ 35,529
Common stock options	919	1,246
Unearned revenue	510	520
Other	369	650
Total deferred tax assets	<u>26,060</u>	<u>37,945</u>
Deferred tax liabilities:		
Other	(103)	(146)
Total deferred tax liabilities	<u>(103)</u>	<u>(146)</u>
Net deferred tax asset	25,957	37,799
Valuation allowance	(25,881)	(37,702)
Equity gains on investment in Mediasite KK	—	(916)
Customer relationships	—	(570)
Goodwill amortization	—	(2,940)
Net deferred tax asset (liability) for goodwill and intangible assets amortization	<u>\$ 76</u>	<u>\$ (4,329)</u>

The Company has a \$76 thousand and \$97 thousand deferred tax asset at September 30, 2018 and 2017, respectively, recorded within the prepaid expenses and other current assets and other long-term assets lines on the consolidated balance sheet and is primarily related to net operating losses of MSKK.

At September 30, 2018, the Company had net operating loss carryforwards of approximately \$102 million for U.S. Federal and \$43 million for state tax purposes. For Federal tax purposes, the carryforwards expire in varying amounts between 2019 and 2038. For state tax purposes, the carryforwards expire in varying amounts between 2018 and 2038. 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.

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The Company maintains an additional paid-in-capital (APIC) pool which represents the excess tax benefits related to share-based compensation that are available to absorb future tax deficiencies. If the amount of future tax deficiencies is greater than the available APIC pool, the Company records the excess as income tax expense in its consolidated statements of income. For fiscal 2018 and fiscal 2017, the Company had a sufficient APIC pool to cover any tax deficiencies recorded and as a result, these deficiencies did not affect its results of operations. At September 30, 2018, the Company has \$1.1 million of net operating loss carry forwards for which a benefit would be recorded in APIC when realized.

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. No deferred tax liability has been recognized with regard to the remittance of such earnings after MSKK and Sonic Foundry International BV acquisitions were completed. At September 30, 2018, unremitted earnings of \$1.0 million for foreign subsidiaries were deemed to be indefinitely reinvested.

Beginning with an acquisition in fiscal year 2002, the Company has amortized Goodwill for tax purposes over a 15 year life. 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 was \$0 thousand at September 30, 2018 and \$4.4 million at September 30, 2017, respectively. The remaining balance of the deferred tax liability related to goodwill was fully written off as of September 30, 2018 as a result of the impairment. The Company recorded a deferred tax liability related to the Customer Relationship intangibles value acquired as part of the purchase of Sonic Foundry International BV and Mediasite KK.

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, 2018 or September 30, 2017 and has not recognized any interest or penalties in the Condensed Consolidated Statements of Operations for either of the years ended September 30, 2018 or 2017.

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.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act, which is generally effective for tax years beginning on January 1, 2018, makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (2) eliminating the corporate alternative minimum tax (AMT); (3) bonus depreciation that will allow for full expensing of qualified property; (4) creating a new limitation on deductible interest expense; (5) the repeal of the domestic production activity deduction; (6) the creation of the base erosion anti-abuse tax (BEAT), a new minimum tax; (7) a general elimination of U.S. federal income taxes on dividends from foreign subsidiaries and imposing a one-time repatriation tax on deemed repatriated earnings and profits of U.S.-owned foreign subsidiaries (the Transition Tax); (8) a new provision designed to tax global intangible low-taxed income (GILTI), which allows for the possibility of using foreign tax credits (FTCs) and a deduction of up to 50 percent to offset the income tax liability (subject to some limitations); and (9) changing rules related to uses and limitation of net operating loss carryforwards created in tax years beginning after December 31, 2017.

Shortly after enactment, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 ("SAB 118") which provided US GAAP guidance on the accounting for the Act's impact at December 31, 2017. A reporting entity may recognize

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provisional amounts, where the necessary information is not available, prepared or analyzed (including computations) in reasonable detail or where additional guidance is needed from the taxing authority to determine the appropriate application of the Act. A reporting entity's provisional impact analysis may be adjusted within the 12-month measurement period provided for under SAB 118.

The reduction in the corporate tax rate to 21 percent due to the Tax Act is effective January 1, 2018. Consequently, the Company has recorded a decrease related to the net deferred tax assets of approximately \$1.5 million with a corresponding net adjustment to the valuation allowance of approximately \$1.5 million for the year ended September 30, 2018.

## **7. Savings Plan**

The Company's defined contribution 401(k) savings plan covers substantially all employees meeting certain minimum eligibility requirements. Participating employees can elect to defer a portion of their compensation and contribute it to the plan on a pretax basis. The Company may also match certain amounts and/or provide additional discretionary contributions, as defined. The Company made matching contributions of \$365 thousand and \$321 thousand during the years ended September 30, 2018 and 2017, respectively. The Company made no additional discretionary contributions during 2018 and 2017.

## **8. 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, Sonic Foundry International and Mediasite KK. For purposes of the test, goodwill on the Company's books is evaluated within three separate reporting units.

The fair values of the reporting units were initially measured as of July 1, 2018, in accordance with annual testing procedures. Goodwill related to all three reporting units, Sonic Foundry (Mediasite), Sonic Foundry International and Mediasite KK, was found to be impaired. The Company recognized an impairment loss of \$10.4 million, or the remaining balance of goodwill, as of July 1, 2018. This non-cash loss was primarily due to the fall in the Company's stock price and the decrease of the Company's market capitalization as well as past performance, which was deemed to have negatively impacted all three of the Company's reporting units. As a consequence, management forecasts were revised and additional risk factors were applied. The fair value of the three reporting units was estimated using a combination of market comparables (level 1 inputs) and expected present value of future cash flows (level 3 inputs).

In fiscal 2017, the fair values of the reporting units were measured as of July 1, 2017, in accordance with annual testing procedures, and were reevaluated at the end of Q4 2017 as a result of the decline in the Company's stock price during the quarter. Goodwill related to the Sonic Foundry (Mediasite) and Sonic Foundry International reporting units was found not to be impaired, however, the Company recognized an impairment loss of \$600 thousand for goodwill related to the Mediasite KK reporting unit as of September 30, 2017. This non-cash loss was primarily due to delays in expected growth related to partner relationships in Japan, resulting in revenues and operating cash flows being lower than expected for the reporting unit in fiscal 2017. As a consequence, management forecasts were revised and additional risk factors were applied. The fair value of the Mediasite KK reporting unit was estimated using a combination of market comparables (level 1 inputs) and expected present value of future cash flows (level 3 inputs). The Sonic Foundry (Mediasite) reporting unit, to which \$7.6 million of goodwill is allocated, had a negative carrying amount on September 30, 2017. This reporting unit is considered to be an operating segment on its own and is not part of any other reportable segment.

See *Fair Value of Financial Instruments* section in Note 1 for additional discussion regarding fair value measurement of reporting units.

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The changes in the carrying amount of goodwill for the years ended September 30, 2018 and 2017, respectively, are as follows:

Balance as of September 30, 2016	\$ 11,310
Accumulated impairment losses	(600)
Foreign currency translation adjustment	(255)
Balance as of September 30, 2017	<u>10,455</u>
Accumulated impairment losses	(10,423)
Foreign currency translation adjustment	(32)
Balance as of September 30, 2018	<u><u>\$ —</u></u>

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 year ended September 30, 2018, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year and past performance. For the year ended September 30, 2018, the Company determined that intangible assets, consisting of customer relationships and product rights, were impaired and recognized an impairment charge of \$1.4 million. For the year ended September 30, 2017, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year. However, after performing analysis of undiscounted cash flows attributable to the Company's long-lived assets along with other relevant factors, such as the continued use of the assets, it was determined that there was no impairment of long-lived and intangible assets other than goodwill. Key assumptions utilized in the analysis of undiscounted cash flows for each asset or asset group being tested included 1) whether cash flows were attributable solely to the asset or group, or to an entire reporting unit; and 2) the useful lives of the asset or asset group. Forecasts used in the analysis were also consistent with those used in determining fair value of reporting units during goodwill impairment testing.

The following tables present details of the Company's total intangible assets that are being amortized at September 30, 2018 and 2017:

(in thousands)	Life (years)	Gross, Net of Impairment	Accumulated Amortization at September 30, 2018	Balance at September 30, 2018
Amortizable:				
Customer relationships	10	\$ 1,256	\$ 1,256	\$ —
Software development costs	3	533	533	—
Product rights	6	534	534	—
Total		<u>\$ 2,323</u>	<u>\$ 2,323</u>	<u>\$ —</u>

(in thousands)	Life (years)	Gross	Accumulated Amortization at September 30, 2017	Balance at September 30, 2017
Amortizable:				
Customer relationships	10	\$ 2,495	\$ 990	\$ 1,505
Software development costs	3	533	533	—
Product rights	6	672	411	261
Total		<u>\$ 3,700</u>	<u>\$ 1,934</u>	<u>\$ 1,766</u>

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**9. Related-Party Transactions**

The Company incurred fees of \$212 thousand and \$143 thousand during the years ended September 30, 2018 and 2017, 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 \$60 thousand and \$55 thousand at September 30, 2018 and 2017, respectively.

As of September 30, 2018 and 2017, the Company had a loan outstanding to an executive totaling \$26 thousand. The loan is collateralized by Company stock.

On January 19, 2018, the Company and a director entered into a Subscription Agreement (the "Subscription Agreement"). Pursuant to the Subscription Agreement, (i) on January 19, 2018, the director purchased a 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash; and (ii) on February 15, 2018, the director purchased an additional 10.75% Convertible Secured Promissory Note for \$500,000 in cash (each, a "Note", and collectively, the "Notes").

On May 17, 2018, following approval by the stockholders of the Company of the conversion of the Notes sufficient to comply with rules and regulations of NASDAQ, the Notes were automatically converted into 1,902 shares of Series A Preferred stock. The number of shares was determined by dividing the total principal and accrued interest due on each Note by \$542.13 (the "Conversion Rate").

On April 16, 2018, the Company issued 232,558 shares of common stock to an affiliated party. The shares were issued at a price of \$2.15 per share, representing the closing price on April 13, 2018. On April 16, 2018, the closing price of the Company's common stock was \$2.18 per share. The affiliated party also received warrants to purchase 232,558 shares of common stock at an exercise price of \$2.50 per share, respectively, which expire on April 16, 2025.

See Note 14 - Subsequent Events for additional information on subsequent transactions with a director of the Company.

Both the director of the Company and the affiliated party beneficially own more than 5% of the Company's common stock.

**10. 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, 2018.



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

	<b>Years Ended September 30.</b>	
	<b>2018</b>	<b>2017</b>
United States	\$ 21,152	\$ 21,476
Europe and Middle East	4,482	4,720
Asia	7,418	8,267
Other	1,492	1,537
<b>Total</b>	<b>\$ 34,544</b>	<b>\$ 36,000</b>

### 11. Customer Concentration

In the fiscal year ended September 30, 2018 and 2017, two distributors represented 17% and 26% of total revenue, respectively. At September 30, 2018 and 2017, these two distributors represented 28% and 23% of total accounts receivable, respectively.

### 12. 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, 2018, 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.

### 13. Quarterly Financial Data (unaudited)

The following table sets forth selected quarterly financial information for the years ended September 30, 2018 and 2017. The operating results are not necessarily indicative of results for any future period.

(in thousands except per share data)	<b>Quarterly Financial Data</b>							
	<b>Q4-'18</b>	<b>Q3-'18</b>	<b>Q2-'18</b>	<b>Q1-'18</b>	<b>Q4-'17</b>	<b>Q3-'17</b>	<b>Q2-'17</b>	<b>Q1-'17</b>
Revenue	\$ 8,490	\$ 8,699	\$ 8,460	\$ 8,895	\$ 8,300	\$ 9,833	\$ 8,560	\$ 9,307
Gross margin	6,095	6,395	5,929	6,470	6,113	7,247	6,064	6,709
Loss from operations	(12,900)	(914)	(1,259)	(966)	(1,411)	(371)	(1,274)	(1,502)
Net income (loss)	(10,018)	(1,020)	(1,449)	320	(1,585)	(489)	(1,456)	(1,509)
Basic and diluted net income (loss) per share	\$ (2.01)	\$ (0.23)	\$ (0.34)	\$ 0.06	\$ (0.37)	\$ (0.13)	\$ (0.33)	\$ (0.34)

### 14. Subsequent Events

In connection with the Loan and Security Agreement with Partners for Growth V, L.P. entered into on May 11, 2018, Tranche 2 of the Term Loan, in the amount of \$500,000, was disbursed on November 8, 2018.

On November 15, 2018, 718 shares of Preferred Stock, Series A were automatically converted by the Company into 169,741 shares of common stock. The amount of shares converted represents all preferred shares issued on November 9, 2017.

#### Initial Notes of the February 28, 2019 Note Purchase Agreement

On January 4, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "Promissory Note") pursuant to which the director purchased a 9.25% Unsecured Promissory Note for \$1,000,000 in cash.

Interest accrued and outstanding principal on the Promissory Note is due and payable on January 4, 2020.

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The Promissory Note may be prepaid at any time without penalty.

The Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.

On January 31, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "January 31, 2019 Promissory Note") pursuant to which the director purchased a 9.25% Unsecured Promissory Note for \$1,000,000 in cash.

Interest accrued and outstanding principal on the January 31, 2019 Promissory Note is due and payable on January 31, 2020.

The January 31, 2019 Promissory Note may be prepaid any time without penalty. The note may be paid by the Company by issuing common stock to the director, with each share valued at \$1.30 per share.

The January 31, 2019 Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.

On February 14, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "February 14, 2019 Promissory Note") pursuant to which the director purchased a 9.25% Unsecured Promissory Note for \$1,000,000 in cash.

Interest accrued and outstanding principal on the February 14, 2019 Promissory Note is due and payable on February 14, 2020.

The February 14, 2019 Promissory Note may be prepaid any time without penalty. The note may be paid by the Company by issuing common stock to the director, with each share valued at \$1.30 per share.

The February 14, 2019 Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.

#### **February 28, 2019 Note Purchase Agreement**

On February 28, 2019, Sonic Foundry, Inc. entered into a Note Purchase Agreement (the "Note Purchase Agreement") with Mr. Mark Burish ("Mr. Burish").

The Note Purchase Agreement provides for subordinated secured promissory notes (the "Subordinated Promissory Notes") in an aggregate original principal amount of up to \$5,000,000. Mr. Burish will acquire from the Company (a) on the initial closing date, the notes in an aggregate principal amount of \$3,000,000 (the "Initial Notes") and (b) two additional tranches, each in the amount of \$1,000,000 and payable at any time prior to the first anniversary of the Agreement (the "Additional Notes" and together with the Initial Notes, collectively, the "Purchase Price"). The Initial Notes were previously disbursed in January and February of 2019, as detailed above (the Promissory Note, the January 31st, 2019 Promissory Note, and the February 14, 2019 Promissory Note, collectively referred to as the "Initial Notes").

The Subordinated Promissory Notes accrue interest at the variable per annum rate equal to the Prime Rate (as defined) plus four percent (4.00%). The outstanding principal balance of the Subordinated Promissory Notes, plus all unpaid accrued interest, plus all outstanding and unpaid obligations, shall be due and payable on February 28, 2024 (the "Maturity Date"). Principal installments of \$100,000 are payable on the last day of each month end beginning with the month ending August 31, 2020, and continuing through the Maturity Date.

The principal of the Subordinated Promissory Notes may be prepaid at any time in whole or in part, by payment of an amount equal to the unpaid principal balance to be pre-paid, plus all unpaid interest accrued thereon through the prepayment date, plus all outstanding and unpaid fees and expenses payable through the prepayment date.

At each anniversary of the Closing, an administration fee will be payable to Mr. Burish equal to 0.5% of the purchase price less principal payments made.

The Subordinated Promissory Notes are collateralized by substantially all the Company's assets, including intellectual property, subject to the rights of Partners for Growth V, L.P., which shall be senior to the Subordinated Promissory Notes.

The Note Purchase Agreement requires compliance with the following financial covenants: (i) Minimum Coverage Ratio, which requires, as of the last day of each month on or after the closing date, the Minimum Coverage Ratio (as defined) to be equal to or greater than (x) 0.7:1.00 for the December through May calendar months, (y) 0.9:1.00 for the June through November calendar

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months; (ii) Minimum Qualifying Revenue (as defined), as of the last day of any calendar month, on or after December 1, 2018, on a trailing twelve-month basis, to be less than \$13,000,000.

The Note Purchase Agreement dated February 28, 2019 is subordinated to the existing PFG loan.

The Company used the proceeds from the notes issued under the Note Purchase Agreement to replace the revolving line of credit with Silicon Valley Bank, which matured on January 31, 2019.

#### **February 28, 2019 Warrant**

Coincident with execution of the Note Purchase Agreement, the Company entered into a Warrant Agreement ("Warrant") with Mr. Burish. Pursuant to the terms of the Warrant, the Company issued to Mr. Burish a warrant to purchase up to 728,155 shares of common stock of the Company at an exercise price of \$1.18 per share, subject to certain adjustments.

#### **Partners for Growth V, L.P.**

On March 11, 2019, Sonic Foundry, Inc. entered into a Consent, Waiver & Modification to the Loan and Security Agreement dated May 11, 2018 (the "Modification") with Partners for Growth V, L.P. ("PFG"). Under the Modification: PFG waived the Company's default on the Minimum EBITDA financial covenant for the quarterly reporting period ending December 31, 2018; modified the existing financial covenants to be as follows: (i) Minimum Coverage Ratio (as defined), which requires, as of the last day of each month on or after the closing date, to be equal to or greater than (x) 0.7: 1.00 for the December through May calendar months, (y) 0.9:1.00 for the June through November calendar months; (ii) Minimum Qualifying Revenue (as defined), which requires, as of the last day of each calendar month, on or after December 1, 2018, on a trailing twelve-month basis, to be less than \$13,000,000; and modified the negative covenants to be as follows: the Company (x) shall not cause or permit (a) Japanese subsidiary indebtedness under its revolving line of credit facility to exceed at any time \$1,000,000 outstanding, or (b) aggregate subsidiary indebtedness to exceed \$1,200,000 at any time.

Under the Modification, the Company is required to draw the next tranche of \$1,000,000 in proceeds on the Note Purchase Agreement (detailed above) on or before March 31, 2019 as well as the final tranche of \$1,000,000 in proceeds on or before April 30, 2019.

The Modification acknowledges that Silicon Valley Bank, the named "Senior Lender" in the May 11, 2018 Loan Agreement has been repaid and the related senior loan documents terminated.

The existing terms of the PFG loan in terms of amortization, interest rate, payment schedule and maturity date are unchanged.

### **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 at September 30, 2018, 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 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

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and principal financial officer concluded that our disclosure controls and procedures were not effective as of September 30, 2018. See Management's Report on Internal Control over Financial Reporting below related to the material weakness identified.

**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 *2013 Internal Control- Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "2013 COSO Framework") on May 14, 2013. The 2013 COSO Framework outlines the 17 underlying principles and the following fundamental components of a company's internal control: (i) control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring. The 2013 Framework was adopted in the fiscal year ended September 30, 2015.

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, 2018 due to an identified material weakness in internal control. The material weakness relates to controls over identifying and performing an impairment analysis and the preparation of consolidated financial information specific to the subsequent measurement of goodwill and long-lived and intangible assets as well as the related impacts on the tax provision, which will be remediated in fiscal 2019.

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.

Based on evaluations at September 30, 2018, 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 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, 2018 as a result of a material weakness identified, which is described in the paragraphs above.

This Annual Report on Form 10-K does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm, as allowed by the SEC.

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**Changes in Internal Control Over Financial Reporting**

We have not made any change to our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Remediation**

We have made changes to our methods and processes used in evaluating the Company's goodwill and other long-lived and intangible assets for potential impairment. The primary change in the current year will be timely preparation of the analysis required by ASC topic 360 to analyze the Company's long-lived assets for impairment. Further, the Company has added personnel with skills and experience in this area that will assist with the computation in future periods and will allow the Company to more timely identify issues and resolve them prior to the calculation date. Further, technical training related to highly complex issues, such as this, is now a requirement of personnel performing the evaluation. The Company's goodwill and the majority of the company's long-lived assets were fully impaired in fiscal 2018 and therefore, no longer require analysis. The only long-lived assets remaining are property, plant and equipment items which are less subjective and complex than goodwill and intangibles. Therefore, the ASC 350 test will no longer be performed and only the ASC 360 test will apply to the company in regard to the property, plant and equipment long-lived assets. Additional technical training related to the tax provision (ASC 740 - Income Taxes) is also now a requirement for personnel to ensure adequate review of the work performed by outside consultants. There can be no assurances that we will fully remediate the weakness in controls over financial reporting.

**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 2018 Annual Meeting of Stockholders, which will be filed no later than January 28, 2019 (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.

**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.

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**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 2017 and 2018 Audit Fee Summary” in the Proxy Statement.





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