

SONIC FOUNDRY INC
Form 10-Q
August 09, 2018
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the Quarterly period ended June 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 39-1783372
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
222 West Washington Ave, Madison, WI 53703
(Address of principal executive offices)
(608) 443-1600
(Registrant's telephone number including area code)

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

Yes 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

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

Exchange Act.

Yes No

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

Yes No

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

Class	Outstanding August 3, 2018
Common Stock, \$0.01 par value	4,916,864

Table of Contents

PART I. FINANCIAL INFORMATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. For a more complete discussion of accounting policies and certain other information, refer to the Company’s annual report filed on Form 10-K for the fiscal year ended September 30, 2017.

Table of Contents

TABLE OF CONTENTS

	PAGE NO.
<u>PART I FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets (Unaudited) – June 30, 2018 and September 30, 2017</u>	<u>4</u>
<u>Condensed Consolidated Statements of Operations (Unaudited) – Three and nine months ended June 30, 2018 and 2017</u>	<u>6</u>
<u>Condensed Consolidated Statements of Comprehensive Loss (Unaudited) - Three and nine months ended June 30, 2018 and 2017</u>	<u>7</u>
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) – Nine months ended June 30, 2018 and 2017</u>	<u>8</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>9</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>28</u>
Item 4. <u>Controls and Procedures</u>	<u>28</u>
<u>PART II OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>29</u>
Item 1A. <u>Risk Factors</u>	<u>29</u>
Item 2. <u>Unregistered Sale of Equity Securities and Use of Proceeds</u>	<u>29</u>
Item 6. <u>Exhibits</u>	<u>29</u>
<u>Signatures</u>	<u>33</u>

Table of Contents

Item 1

Sonic Foundry, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except for share data)

(Unaudited)

	June 30, 2018	September 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$2,129	\$ 1,211
Accounts receivable, net of allowances of \$475 and \$375	7,084	7,903
Financing receivables, current, net of allowances of \$400 and \$200	229	925
Inventories	917	986
Investment in sales-type lease, current	154	148
Prepaid expenses and other current assets	803	1,085
Total current assets	11,316	12,258
Property and equipment:		
Leasehold improvements	1,045	1,041
Computer equipment	7,005	6,101
Furniture and fixtures	928	789
Total property and equipment	8,978	7,931
Less accumulated depreciation and amortization	6,983	6,181
Property and equipment, net	1,995	1,750
Other assets:		
Goodwill	10,486	10,455
Customer relationships, net of amortization of \$1,189 and \$990	1,337	1,505
Product rights, net of amortization of \$504 and \$411	169	261
Financing receivables, long-term	201	1,310
Investment in sales-type lease, long-term	290	407
Other long-term assets	463	410
Total assets	\$26,257	\$ 28,356
Liabilities and stockholders' equity		
Current liabilities:		
Revolving lines of credit	\$2,239	\$ 2,065
Accounts payable	1,390	1,314
Accrued liabilities	1,417	1,387
Unearned revenue	10,325	11,332
Current portion of capital lease and financing arrangements	265	256
Current portion of notes payable and warrant debt, net of discounts	369	737
Total current liabilities	16,005	17,091
Long-term portion of unearned revenue	1,626	2,970
Long-term portion of capital lease and financing arrangements	241	244
Long-term portion of notes payable and warrant debt, net of discounts	1,540	123
Derivative liability, at fair value	26	12
Other liabilities	240	372
Deferred tax liability	3,051	4,426
Total liabilities	22,729	25,238
Commitments and contingencies		
Stockholders' equity:		

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

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; 3,324 and 1,510 shares issued and outstanding, respectively, at amounts paid in	2,143	1,280
5% Preferred stock, Series B, voting, cumulative, convertible, \$.01 par value (liquidation preference at par), authorized 1,000,000 shares, none issued	—	—
Common stock, \$.01 par value, authorized 10,000,000 shares; 4,920,057 and 4,470,791 shares issued and 4,907,341	49	45
and 4,458,075 shares outstanding, respectively		
Additional paid-in capital	199,471	197,836
Accumulated deficit	(197,402)	(195,253)
Accumulated other comprehensive loss	(538)	(595)

4

Table of Contents

Receivable for common stock issued	(26)	(26)
Treasury stock, at cost, 12,716 shares	(169)	(169)
Total stockholders' equity	3,528	3,118
Total liabilities and stockholders' equity	\$26,257	\$28,356

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Revenue:				
Product and other	\$3,214	\$ 4,335	\$8,927	\$ 11,363
Services	5,485	5,498	17,127	16,337
Total revenue	8,699	9,833	26,054	27,700
Cost of revenue:				
Product and other	1,388	1,475	3,814	4,548
Services	916	1,111	3,446	3,132
Total cost of revenue	2,304	2,586	7,260	7,680
Gross margin	6,395	7,247	18,794	20,020
Operating expenses:				
Selling and marketing	3,882	4,368	11,859	13,186
General and administrative	1,631	1,482	4,713	4,400
Product development	1,796	1,768	5,361	5,581
Total operating expenses	7,309	7,618	21,933	23,167
Loss from operations	(914)	(371)	(3,139)	(3,147)
Non-operating income (expenses):				
Interest expense, net	(266)	(130)	(461)	(396)
Other income (expense), net	88	34	98	(43)
Total non-operating expenses	(178)	(96)	(363)	(439)
Loss before income taxes	(1,092)	(467)	(3,502)	(3,586)
Benefit (provision) for income taxes	72	(22)	1,353	132
Net loss	(1,020)	(489)	(2,149)	(3,454)
Dividends on preferred stock	(67)	(75)	(189)	(75)
Net loss attributable to common stockholders	\$(1,087)	\$(564)	\$(2,338)	\$(3,529)
Loss per common share				
– basic	\$(0.23)	\$(0.13)	\$(0.51)	\$(0.80)
– diluted	\$(0.23)	\$(0.13)	\$(0.51)	\$(0.80)
Weighted average common shares				
– basic	4,709,516	4,449,893	4,542,955	4,429,006
– diluted	4,709,516	4,449,893	4,542,955	4,429,006
See accompanying notes to the condensed consolidated financial statements				

Table of Contents

Sonic Foundry, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(Unaudited)

	Three Months		Nine Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Net loss	\$(1,020)	\$(489)	\$(2,149)	\$(3,454)
Foreign currency translation adjustment	(272)	70	57	(430)
Comprehensive loss	\$(1,292)	\$(419)	\$(2,092)	\$(3,884)
See accompanying notes to the condensed consolidated financial statements				

7

Table of Contents

Sonic Foundry, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Nine Months Ended June 30,	
	2018	2017
Operating activities		
Net loss	\$(2,149)	\$(3,454)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of other intangibles	482	420
Depreciation and amortization of property and equipment	822	1,096
Loss on sale of fixed assets	—	8
Provision for doubtful accounts	300	150
Deferred taxes	(1,387)	(42)
Stock-based compensation expense related to stock options	392	487
Conversion of accrued interest to preferred stock	31	—
Beneficial conversion feature recognized on debt converted to preferred stock	71	—
Remeasurement gain on subordinated debt	—	(6)
Remeasurement gain on derivative liability	(16)	(42)
Changes in operating assets and liabilities:		
Accounts receivable	834	2,365
Financing receivables	1,614	(174)
Inventories	70	771
Prepaid expenses and other current assets	356	(190)
Accounts payable and accrued liabilities	(126)	(8)
Other long-term liabilities	(136)	158
Unearned revenue	(2,347)	(823)
Net cash provided by (used in) operating activities	(1,189)	716
Investing activities		
Purchases of property and equipment	(657)	(676)
Net cash used in investing activities	(657)	(676)
Financing activities		
Proceeds from notes payable	3,000	—
Proceeds from revolving lines of credit	16,706	17,531
Payments on notes payable	(815)	(1,317)
Payments to settle warrant debt	(200)	—
Payments on revolving lines of credit	(16,546)	(16,999)
Payment of debt issuance costs	(97)	(26)
Proceeds from issuance of preferred stock, common stock and warrants	1,008	771
Payments on capital lease and financing arrangements	(228)	(255)
Net cash provided by (used in) financing activities	2,828	(295)
Changes in cash and cash equivalents due to changes in foreign currency	(64)	66
Net increase (decrease) in cash and cash equivalents	918	(189)
Cash and cash equivalents at beginning of period	1,211	1,794
Cash and cash equivalents at end of period	\$2,129	\$1,605
Supplemental cash flow information:		
Interest paid	\$290	\$403

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

Income taxes paid, foreign	\$48	\$27
Non-cash financing and investing activities:		
Property and equipment financed by capital lease or accounts payable	\$414	\$358
Stock issued for board of director's fees	\$—	\$133
Debt discount and warrant	\$127	\$—
Deemed dividend for beneficial conversion feature of preferred stock	\$28	\$69
Preferred stock dividends paid in additional shares	\$161	\$6
Subordinated note payable converted to preferred stock	\$1,000	\$—

See accompanying notes to the condensed consolidated financial statements.

8

Table of Contents

Sonic Foundry, Inc.
Notes to Condensed Consolidated Financial Statements
June 30, 2018
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Financial Statements

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the Company's financial position, results of operations and cash flows for the periods presented. All such adjustments are of a normal recurring nature. Operating results for the three and nine months ended June 30, 2018 are not necessarily indicative of the results that might be expected for the year ending September 30, 2018.

Reclassifications

Reclassifications have been made to the condensed consolidated financial statements to conform to the June 30, 2018 presentation. These reclassifications had no effect on the Company's net loss or stockholders' equity as previously reported.

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 receivables 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 were allowances of \$400 thousand and \$200 thousand as of June 30, 2018 and September 30, 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 were \$304 thousand and \$384 thousand of receivables outstanding for long-term customer support contracts as of June 30, 2018 and September 30, 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 were \$526 thousand and \$2.1 million receivable outstanding for product receivables as of June 30, 2018 and September 30, 2017, respectively. As of September 30, 2017, \$1.5 million of this balance was deferred for revenue recognition purposes due to a history of delayed payment. As a result of certain events occurring during the three months ended March 31, 2018, the \$1.5 million balance, for which revenue had previously been deferred, was written off as of March 31, 2018. These events include continued delayed payment, effective cancellation of the distributor's exclusivity status, and updated information regarding their capital position. Although the fee amounts previously included in deferred revenue are still owed by the distributor as of June 30, 2018, they are not considered to be fixed and determinable, and

therefore are not recognized on the condensed consolidated balance sheets.

The entire allowance for losses on financing receivables of \$400 thousand is considered attributable to the product receivables class of customer as of June 30, 2018.

Table of Contents

As of June 30, 2018 financing receivables consisted of the following (in thousands):

	June 30, 2018	September 30, 2017
Customer support contracts, current and long-term, gross	\$304	\$ 384
Product receivables, gross	526	2,051
Allowance for losses on financing receivables	(400)	(200)
	\$430	\$ 2,235

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 consists of the following (in thousands):

	June 30, 2018	September 30, 2017
Investment in sales-type lease	\$444	\$ 555
	\$444	\$ 555

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):

	June 30, 2018	September 30, 2017
Raw materials and supplies	\$163	\$ 156
Finished goods	754	830
	\$917	\$ 986

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, as incurred. Upon product release, the amortization of software development costs is determined annually as the greater of the amount computed using the ratio of current gross revenues for the products to their total of current and anticipated future gross revenues, or the straight-line method over the estimated economic life of the products, expected to be three years. No amortization expense of software development costs was recorded in the three or nine months ended June 30, 2018 or 2017. The gross amount of capitalized external and internal development costs was \$533 thousand at both June 30, 2018 and September 30, 2017, and was fully amortized during the fiscal year ended September 30, 2016. There were no software development efforts that qualified for capitalization for the three or nine months ended June 30, 2018 or 2017.

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

10

Table of Contents

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.

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 Recurring Basis

The initial fair values of PFG IV and PFG V debt and warrant debt (see Note 4) 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 present in each debt agreement is 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):

	Level 1	Level 2	Level 3	Total Fair Value
June 30, 2018				
Derivative liability	\$ —	\$ 26	\$ —	\$ 26
	\$ —	\$ 26	\$ —	\$ 26
September 30, 2017				
	Level 1	Level 2	Level 3	Total Fair Value

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

Derivative liability	\$	—\$ 12	\$	—\$ 12
	\$	—\$ 12	\$	—\$ 12

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

11

Table of Contents

	PFG IV Debt, Net of Discount	Warrant Debt, PFG IV	PFG V Debt, Net of Discount	Warrant Debt, PFG V
Balance at September 30, 2017	\$ 491	\$ 123	\$ —	\$ —
Activity during the current period:				
Disbursement of Tranche 1, net of discount			1,873	97
Payments to PFG	(538)	(200)	—	—
Change in fair value	47	77	13	2
Balance at June 30, 2018	\$ —	\$ —	\$ 1,886	\$ 99

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, accounts payable and debt instruments, excluding the PFG V debt. The book values of cash and cash equivalents, accounts receivable, debt (excluding the PFG V 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 V 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

When legal proceedings are brought or claims are made against the Company and the outcome is uncertain, we are required to determine whether it is probable that an asset has been impaired or a liability has been incurred. If such impairment or liability is probable and the amount of loss can be reasonably estimated, the loss must be charged to earnings.

When it is considered probable that a loss has been incurred, but the amount of loss cannot be estimated, disclosure but not accrual of the probable loss is required. Disclosure of a loss contingency is also required when it is reasonably possible, but not probable, that a loss has been incurred and there is a possibility the loss could be material.

No legal contingencies were recorded or were required to be disclosed for the three and nine months ended June 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 fair value of each option grant is estimated using the assumptions in the following table:

	Nine Months Ended June 30,	
	2018	2017
Expected life	4.3-4.4 years	4.8-4.9 years
Risk-free interest rate	1.79%-2.75%	1.08%-1.49%
Expected volatility	60.62%-63.49%	56.98%-61.88%

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

Expected forfeiture rate	12.53%-14.58%	10.17%-11.72%
Expected exercise factor	1.16-1.2	1.32-1.35
Expected dividend yield	0%	0%

12

Table of Contents

A summary of option activity at June 30, 2018 and changes during the nine months then ended is presented below:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Period in Years
Outstanding at October 1, 2017	1,805,443	\$ 8.33	5.0
Granted	410,749	2.24	9.5
Exercised	—	—	0.0
Forfeited	(157,677)	8.31	4.0
Outstanding at June 30, 2018	2,058,515	7.02	6.4
Exercisable at June 30, 2018	1,371,839	8.61	5.1

A summary of the status of the Company's non-vested shares and changes during the nine months ended June 30, 2018 is presented below:

	2018	Weighted-Average Grant Date Fair Value
Non-vested Shares	Shares	
Non-vested at October 1, 2017	544,834	\$ 2.42
Granted	410,749	0.95
Vested	(255,776)	2.48
Forfeited	(13,131)	1.78
Non-vested at June 30, 2018	686,676	\$ 1.46

The weighted average grant date fair value of options granted during the nine months ended June 30, 2018 was \$0.95. As of June 30, 2018, there was \$566 thousand of total unrecognized compensation cost related to non-vested stock-based compensation, with total forfeiture adjusted unrecognized compensation cost of \$416 thousand. The cost is expected to be recognized over a weighted-average remaining life of 2.2 years.

Stock-based compensation recorded in the three and nine months ended June 30, 2018 was \$70 thousand and \$386 thousand, respectively. Stock-based compensation recorded in the three and nine months ended June 30, 2017 was \$99 thousand and \$477 thousand, respectively. There was no cash received from exercises under all stock option plans and warrants for the three and nine months ended June 30, 2018 or 2017. There were no tax benefits realized for tax deductions from option exercises for the three and nine months ended June 30, 2018 or 2017, respectively. The Company currently expects to satisfy share-based awards with registered shares available to be issued.

The Company also has an Employee Stock Purchase Plan (Purchase Plan) under which an aggregate of 200,000 common shares may be issued. A total of 47,867 shares are available to be issued under the plan. The Company recorded stock compensation expense under this plan of \$2 thousand and \$6 thousand for the three and nine months ended June 30, 2018, respectively. The Company recorded stock compensation expense of \$2 thousand and \$10 thousand for the three and nine months ended June 30, 2017, respectively.

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") with a stated value and liquidation preference of \$1,000 per share. In May 2018, 2,000 additional shares were authorized for an aggregated total of 4,500 shares. Holders of the Preferred Stock, Series A 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. There were 3,324 and 1,510 shares of Preferred Stock, Series A issued and are

outstanding as of June 30, 2018 and September 30, 2017, respectively.

Table of Contents

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 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.

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) attributable to common stockholders. The following table sets forth the computation of basic and diluted weighted average shares used in the earnings per share calculations:

	Three Months Ended		Nine Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2018	2017	2018	2017
Denominator for basic net income (loss) per share - weighted average common shares	4,709,516	4,449,893	4,542,955	4,429,006
Effect of dilutive options (treasury method)	—	—	—	—
Denominator for diluted net income (loss) per share - adjusted weighted average common shares	4,709,516	4,449,893	4,542,955	4,429,006
Options, warrants and convertible shares outstanding during each period, but not included in the computation of diluted net income (loss) per share because they are antidilutive	2,428,675	1,968,330	2,428,675	1,968,330

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"); ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12"); and ASU 2014-17, "Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606)" ("ASU 2017-14"). The Company must adopt ASU 2016-08, ASU 2016-10, ASU 2016-12, and ASU 2017-14 with ASU 2014-09.

We anticipate that adoption of FASB Topic 606 will have a material impact on our consolidated financial statements. While we are continuing to assess all potential impacts of the standard, particularly regarding expenses, the Company believes the most significant impact will relate to accounting for software license revenue for on-premises customers. We expect revenue related to recorders, customer support, hosting services, and events services to remain largely unchanged. Specifically, under the new standard we expect to recognize revenue for annual or multi-year software licenses for on-premises customers predominantly at the time of billing rather than ratably over the license term as is current practice. Due to the complexity of certain of our customer contracts,

Table of Contents

the actual revenue recognition treatment required under the standard will be dependent on contract-specific terms, and may vary in some instances from recognition at the time of billing.

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 consolidated 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 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 consolidated financial statements, which includes continuing to monitor activities of the FASB, including the impact of ASU 2018-11, Targeted Improvements. ASU 2018-11 allows entities to adopt the standard with a cumulative effect adjustment as of the beginning of the adoption year, while maintaining prior year comparative financial information and disclosures as reported. The Company's evaluation process also includes evaluating the impact, if any, on changes to business processes, systems and controls to support recognition and disclosure under the new guidance; however, at this time the Company is unable to determine the impact this standard will have on the consolidated financial statements and related disclosures.

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 the consolidated 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 consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740)", ("ASU 2016-16"). ASU 2016-16 prohibits the recognition of current and deferred income taxes for an intra-entity transfer until the asset has been sold to an outside party. The amendment in ASU 2016-16 are effective for annual reporting periods 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 consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01 "(ASC Topic 805), Business Combination: Clarifying the Definition of a Business", ("ASU 2017-01"). The amendments in this ASU change the definition of a business to assist with evaluating when a set of transferred assets and activities is a business. The Company is required to adopt the guidance in the first quarter of fiscal 2019. Early adoption is permitted. The Company is in the process of assessing the impact, if any, of this ASU on its consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05, "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets", ("ASU 2017-05"). ASU 2017-05 clarifies the scope of Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets, which provides guidance for recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. The amendments in ASU 2017-05 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 March 2017, the FASB issued ASU 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost", ("ASU 2017-07"). ASU 2017-07 was issued to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost within an entity's financial statements.

Table of Contents

The amendments in ASU 2017-07 are effective for annual reporting periods 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 consolidated 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.

In February 2018, the FASB issued ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments-Overall (Subtopic 825-10); Recognition and Measurement of Financial Assets and Financial Liabilities", ("ASU 2018-03"). The standard was issued to address certain unintended impacts related to changes outlined in ASU 2016-01. ASU 2018-03 is effective for fiscal years beginning after December 31, 2017. The Company does not expect the ASU to have a material impact on the consolidated financial statements.

In March 2018, the FASB issued ASU 2018-05, "Income Taxes (Topic 740); Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118", ("ASU 2018-05"). The standard clarifies certain SEC positions on accounting for the impacts of the Tax Cuts and Jobs Act; specifically regarding the use of estimates when an entity is still assessing the full impact of the tax act. The Company does not believe the standard will have a significant impact on its financial statements, as no estimates related to the Tax Cuts and Jobs Act have been utilized.

In June 2018, the FASB issued ASU 2018-07, "Compensation - Stock Compensation (Topic 718); Improvements to Nonemployee Share-Based Payment Accounting", ("ASU 2018-07"). The amendments expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees, to be more consistent with current accounting requirements for employee share-based payment awards. The amendments in ASU 2018-07 are effective for annual reporting periods beginning after December 15, 2018, including interim reporting periods within those annual reporting periods. The Company does not believe the ASU will have a significant impact on its consolidated 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 consolidated financial statements upon adoption.

2. Related Party Transactions

During the three and nine months ended June 30, 2018, the Company incurred fees of \$56 thousand and \$168 thousand, respectively, to a law firm, a partner of which is a director and stockholder of the Company. The Company incurred similar fees of \$48 thousand and \$110 thousand, respectively, during the three and nine months ended June 30, 2017. The Company had accrued liabilities for unbilled services of \$60 thousand and \$55 thousand at

June 30, 2018 and September 30, 2017, respectively, to the same law firm.

At June 30, 2018 and September 30, 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 Mark Burish entered into a Subscription Agreement (the “Subscription Agreement”). Pursuant to the Subscription Agreement, (i) on January 19, 2018, Mr. Burish purchased a 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash; and (ii) on February 15, 2018, Mr. 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

Table of Contents

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 Andrew D. Burish. 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. Mr. Burish 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.

Mark Burish is a director of the Company and beneficially owns more than 5% of the Company's common stock. Andrew Burish beneficially owns more than 5% of the Company's common stock.

3. Commitments

Inventory Purchase Commitments

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. At June 30, 2018, the Company has an obligation to purchase \$627 thousand of Mediasite product, which is not recorded on the Company's Condensed Consolidated Balance Sheets.

Operating Leases

In November 2011, the Company occupied office space related to a lease agreement entered into on June 28, 2011. The lease term is from November 2011 through December 2018. The lease includes a tenant improvement allowance of \$613 thousand that was recorded as a leasehold improvement liability and is being amortized as a credit to rent expense on a straight-line basis over the lease term. At June 30, 2018 and September 30, 2017, the unamortized balance was \$29 thousand and \$95 thousand, respectively.

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 totalling \$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 June 30, 2018 and September 30, 2017, the unamortized balance was \$86 thousand and \$110 thousand, respectively.

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

4. 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 7.00%. 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) 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

Table of Contents

measurement period, of at least Zero Dollars (\$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 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 June 30, 2018, there was no balance outstanding on the term loan with Silicon Valley Bank. There was a balance of \$2.0 million outstanding on the revolving line of credit, with an effective interest rate of seven percent (7.00%). 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 June 30, 2018, there was a remaining amount of \$2.0 million available under the line of credit facility for advances. The Second Amended Agreement, as amended, contains events of default that include, among others, non-payment of principal or interest, inaccuracy of any representation or warranty, violation of covenants, bankruptcy and insolvency events, material judgments, cross defaults to certain other indebtedness, and material adverse changes. The occurrence of an event of default could result in the acceleration of the Companies’ obligations under the Second Amended Agreement, as amended. At June 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, and plans to do so for at least the next 12 months. At June 30, 2018, we had a balance of \$2.0 million outstanding on this line of credit, which matures January 31, 2019. The Company may not have sufficient liquidity available to repay the line of credit at the time of maturity. The Company expects to renew the line of credit prior to the due date, however, the decision to renew is solely at the discretion of Silicon Valley Bank.

While the Company expects the line of credit will be renewed at terms similar to those that are currently in place, management’s analysis of the Company’s ability to continue as a going concern must consider the possibility that SVB will not consent to renew the agreement. The Company believes it has access to other sources of capital, but has no plans, nor taken any action to refinance the Silicon Valley Bank debt.

To evaluate the Company's likelihood that the line of credit agreement would be renewed on or before January 31, 2019, the Company considered its long-term relationship with the lender, consistent payment history on both the line of credit and term loans held by Silicon Valley Bank, and the fact that the line is secured by the Company's accounts receivable, which was \$6.6 million at June 30, 2018.

Accordingly, the Company believes that it is probable that management's plans to renew the line of credit agreement will fully mitigate the conditions identified.

Partners for Growth

18

Table of Contents

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

The 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 continuing until May 1, 2018.

The principal of the Term Loan could have been prepaid at any time, without a prepayment fee.

Coincident with execution of the 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 was also entitled, under certain conditions, to require the Company to exchange the Warrant for the sum of \$200,000. Each warrant issued had 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 was 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 was an embedded derivative; thus, for accounting purposes, the conversion feature was 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 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 June 30, 2018, the estimated fair value of the derivative liability associated with the warrants issued in connection with the 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 for the three and nine months ended June 30, 2018, was recorded as a gain of \$3 thousand and \$12 thousand, respectively, included in the other income (expense).

The proceeds from the 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 carrying values of \$1.8 million and \$216 thousand, respectively. The conversion feature of \$216 thousand was 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 the three and nine months ended June 30, 2018, the Company recorded accretion of discount expense associated with the warrants issued with

the PFG IV loan of \$67 thousand and \$79 thousand, respectively, as well as \$10 thousand and \$47 thousand related to amortization of the debt discount. The Company recorded accretion of discount expense of \$5 thousand and \$15 thousand, as well as \$18 thousand and \$55 thousand related to amortization of the debt discount in the three and nine months ended June 30, 2017. At June 30, 2018, the fair values of the PFG IV Debt and the 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 June 30, 2018, there was no balance outstanding on the term debt with PFG IV. At September 30, 2017, a balance of \$491 thousand was outstanding with PFG IV, net of discount.

Table of Contents

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

The Loan and Security Agreement provides for a Term Loan in the amount of \$2,500,000, which will be 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 will be in the amount of \$500,000, and can be disbursed at any time, at Sonic Foundry’s discretion, following disbursement of Tranche 1 and on or before December 31, 2018, so long as at no Default or Event of Default (as defined) shall have occurred and be continuing.

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 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 (or \$200,000, if the Company does not draw on Tranche 2 of the Term Loan).

At June 30, 2018, the estimated fair value of the derivative liability associated with the warrants issued in connection with the Loan and Security Agreement, was \$26 thousand. The change in the fair value of the derivative liability for each of the three and nine months ended June 30, 2018, was recorded as a gain of \$4 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 conversion feature 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. For each of the three and nine months ended June 30, 2018, the Company recorded accretion of discount expense associated with the warrants issued with the PFG V loan of \$2 thousand, as well as \$6 thousand related to amortization of the debt discount. At June 30, 2018, the fair values of the PFG V Debt and the Warrant Debt (inclusive of its conversion feature) were \$1.89 million and \$125 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. For each of the three and nine months ended June 30, 2018, the Company recorded interest expense of \$7 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 June 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).

Edgar Filing: SONIC FOUNDRY INC - Form 10-Q

At June 30, 2018, a gross balance of \$2.0 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.

Other Indebtedness

At June 30, 2018, a balance of \$271 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 credit facility is related to Mediasite K.K., and accrues interest at an annual rate of approximately one-and-one half percent (1.5%).

Table of Contents

On January 19, 2018, the Company and Mark Burish entered into a Subscription Agreement (the “Subscription Agreement”). Pursuant to the Subscription Agreement, (i) on January 19, 2018, Mr. Burish purchased a 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash; and (ii) on February 15, 2018, Mr. Burish 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 June 30, 2018, there was no balance outstanding on the Notes.

5. Income Taxes

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 June 30, 2018 or September 30, 2017, and has not recognized any interest or penalties in the Condensed Consolidated Statements of Operations for the three and nine months ended June 30, 2018 or 2017, respectively.

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 is 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 the three and nine months ended June 30, 2018, we recorded an income tax benefit of zero and \$1.3 million, respectively, resulting from the application of TCJA to existing deferred tax balances based on reasonable estimates for those tax effects. The deemed repatriation of undistributed foreign earnings is not expected to result in a material change to our financial results. Our accounting for the tax effects of the TCJA will be completed during the measurement period, which should not extend beyond one year from the enactment date. The final impact of the TCJA may differ due to and among other things, changes in interpretations, assumptions made by the Company, the issuance of additional guidance, and actions the Company may take as a result.

6. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended June 30, 2018 are as follows:

Balance at September 30, 2017	\$10,455
Foreign currency translation adjustment	31
Balance at June 30, 2018	\$10,486

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Risks and Uncertainties

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,” “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 I, Item 1A of the Company’s Annual Report on Form 10-K for the Fiscal Year ended September 30, 2017

and Part II, Item 1A of this Form 10-Q), “Quantitative and Qualitative Disclosures about Market Risk” (Part I, Item 3 of this Form 10-Q and Part II, Item 7A of the Company’s Annual Report on Form 10-K for the Fiscal Year ended September 30, 2017), and “Management’s Discussion and Analysis” (Part I, Item 2 of this Form 10-Q). We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

Table of Contents

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.

RESULTS OF OPERATIONS

Revenue

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

Q3-2018 compared to Q3-2017

Revenue in Q3-2018 decreased \$1.1 million, or 12% to \$8.7 million, from Q3-2017 revenue of \$9.8 million. Revenue consisted of the following:

Product and other revenue from sales of Mediasite recorder units and server software was \$3.2 million in Q3-2018 and \$4.3 million in Q3-2017. 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. Recorder billings in Q3-2018 were buoyed by 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 quarter were 211 compared to 142 last year.

	Q3-2018	Q3-2017
Recorders sold	421	410
Rack units to mobile units ratio	12.6 to 1	10.7 to 1
Average sales price, excluding service (000's)	\$ 5.7	\$ 7.3
Refresh Units	139	184

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 remained consistent at \$5.5 million from Q3-2017 to Q3-2018. At June 30, 2018, \$12.0 million of revenue was deferred, of which we expect to recognize \$10.3 million in the next twelve months, including approximately \$3.7 million in the quarter ending September 30, 2018. At September 30, 2017, \$14.3 million of revenue was deferred. The decrease is primarily due to \$1.5 million of deferred revenue being written off at March 31, 2018, as a result of continued delayed payment and slower than anticipated growth in sales from an international distributor.

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

YTD-2018 (nine months) compared to YTD-2017 (nine months)

Revenues for YTD-2018 totaled \$26.1 million compared to YTD-2017 revenues of \$27.7 million. Revenues included the following:

\$8.9 million product and other revenue from the sale of 1,059 Mediasite recorders and software during YTD-2018 versus \$11.4 million from the delivery of 1,099 Mediasite recorders and software in YTD-2017. Revenue related to 208 recorders billed in Q4-2015 and shipped in Q1-2017 for an international customer was recognized during Q1-2017, and the units are included in the units sold figures. New mini recorder models were also introduced in the current year, 150 units of which have been sold in YTD-2018.

Table of Contents

\$17.1 million from Mediasite customer support contracts, installation, training, event and hosting services versus \$16.3 million in 2017. Services revenue increased primarily due to an increase in support contract billings.

Gross Margin

Q3-2018 compared to Q3-2017

Gross margin for Q3-2018 was \$6.4 million or 74% of revenue compared to Q3-2017 gross margin of \$7.2 million or 74%. The significant components of cost of revenue include:

Material and freight costs for the Mediasite recorders. Costs for Q3-2018 Mediasite recorder hardware and other costs totaled \$914 thousand, along with \$54 thousand of freight costs, and \$380 thousand of labor and allocated costs, compared to Q3-2017 Mediasite recorder costs of \$884 thousand for hardware and other costs, \$64 thousand for freight and \$463 thousand of labor and allocated costs. This resulted in gross margin on products of 57% in Q3-2018 and 66% in Q3-2017. Approximately 3.5% of the variance in gross margin is the result of a significant software transaction occurring in Q3 2017 related to a large international customer. The remainder is largely due to product mix; lower-cost recorders (including minis), which generally have a lower margin than our higher capability models, represented a greater proportion of total recorder sales in Q3 2018 as compared with Q3 2017.

Services costs. Staff wages and other costs allocated to cost of service revenue were \$916 thousand in Q3-2018 and \$1.1 million in Q3-2017, resulting in gross margin on services of 83% in Q3-2018 and 80% in Q3-2017.

YTD-2018 (nine months) compared to YTD-2017 (nine months)

Gross margin for YTD-2018 was \$18.8 million or 72% of revenue compared to YTD-2017 gross margin of \$20.0 million or 72%. The significant components of cost of revenue include:

Material and freight costs for the Mediasite recorders. Costs for YTD-2018 Mediasite recorder hardware and other costs totaled \$2.3 million, along with \$179 thousand of freight costs, and \$1.2 million of labor and allocated costs, compared to YTD-2017 Mediasite recorder costs of \$2.7 million for hardware and other costs, \$202 thousand for freight and \$1.4 million of labor and allocated costs. This resulted in gross margin on products of 57% in YTD-2018 and 60% in YTD-2017.

Services costs. Staff wages and other costs allocated to cost of service revenue were \$3.4 million in YTD-2018 and \$3.1 million in YTD-2017, resulting in gross margin on services of 80% in YTD-2018 and 81% in YTD-2017.

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 tradeshow.

Q3-2018 compared to Q3-2017

Selling and marketing expenses decreased \$486 thousand or 11% from \$4.4 million in Q3-2017 to \$3.9 million in Q3-2018. Differences in the major categories include:

Salary, commissions, and benefits expense decreased by \$336 thousand as a result of reduced headcount.

Advertising & tradeshow expenses decreased by \$80 thousand.

Expenses related to meetings and travel decreased by \$90 thousand as a result of strategic initiatives implemented during the second half of FY17.

Table of Contents

Selling and marketing expenses for Sonic Foundry International and Mediasite KK accounted for \$113 thousand and \$676 thousand respectively, an aggregate increase of \$29 thousand from Q3-2017.

YTD-2018 (nine months) compared to YTD-2017 (nine months)

Selling and marketing expenses decreased \$1.3 million or 10% from \$13.2 million in YTD-2017 to \$11.9 million in YTD-2018. Differences in the major categories include:

Salary, commissions, and benefits expense decreased by \$994 thousand as a result of reduced headcount.

Advertising & tradeshow expenses decreased by \$123 thousand.

Expenses related to meetings and travel decreased by \$65 thousand.

Selling and marketing expenses for Sonic Foundry International and Mediasite KK accounted for \$331 thousand and \$2.0 million respectively, an aggregate decrease of \$98 thousand from YTD-2017.

We anticipate selling and marketing headcount to remain consistent throughout the remainder of the fiscal year.

General and Administrative Expenses

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

Q3-2018 compared to Q3-2017

G&A expenses increased \$149 thousand or 10% from \$1.48 million in Q3-2017 to \$1.63 million in Q3-2018.

Differences in the major categories include:

Increase in compensation and benefits of \$45 thousand.

Increase in professional services of \$26 thousand, primarily due to an increase in bank fees, audit related expenses, and annual report issuance.

Increase in travel expenses of \$31 thousand.

- G&A expenses for Sonic Foundry International and Mediasite KK accounted for \$49 thousand and \$231 thousand respectively, an aggregate increase of \$31 thousand compared to Q3-2017.

YTD-2018 (nine months) compared to YTD-2017 (nine months)

G&A expenses increased \$313 thousand or 7% from \$4.4 million in YTD-2017 to \$4.7 million in YTD-2018.

Differences in the major categories include:

Increase in bad debt expense of \$116 thousand due to increasing allowance for doubtful accounts.

Increase in professional services of \$170 thousand, primarily due to an increase in legal and audit related expenses.

Increase in travel expenses of \$42 thousand.

G&A expenses for Sonic Foundry International and Mediasite KK accounted for \$132 thousand and \$678 thousand respectively, an aggregate decrease of \$4 thousand compared to YTD-2017.

We anticipate general and administrative headcount to remain consistent throughout the remainder of the fiscal year.

Product Development Expenses

24

Table of Contents

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

Q3-2018 compared to Q3-2017

Product development expenses increased by \$28 thousand, or 2% from \$1.77 million in Q3-2017 to \$1.80 million in Q3-2018. Differences in the major categories include:

• Increase in salaries and benefits of \$40 thousand, related primarily to our international quality assurance team.

• Decrease in professional services of \$40 thousand, mainly due to decreased use of outsourced development.

• Product development expense for Sonic Foundry International and Mediasite KK accounted for \$111 thousand and \$77 thousand respectively, an aggregate increase of \$19 thousand compared to Q3-2017.

YTD-2018 (nine months) compared to YTD-2017 (nine months)

Product development expenses decreased by \$220 thousand, or 4% from \$5.6 million in YTD-2017 to \$5.4 million in YTD-2018. Differences in the major categories include:

• Increase in salaries and benefits of \$30 thousand, related primarily to our international quality assurance team.

• Decrease in professional services of \$252 thousand, due to decreased use of outsourced development.

• Decrease in recruiting costs of \$45 thousand related primarily to our international quality assurance team, which incurred recruiting costs during Q1 2017 upon establishment of the team.

• Product development expense for Sonic Foundry International and Mediasite KK accounted for \$298 thousand and \$224 thousand respectively, an aggregate increase of \$37 thousand compared to YTD-2017.

We anticipate product development headcount to remain consistent throughout the remainder of the fiscal year. We do not anticipate that any fiscal 2018 software development efforts will qualify for capitalization.

Other Income and Expense, Net

Interest expense for the three and nine months ended June 30, 2018 increased \$136 thousand and \$65 thousand compared to the same periods last year, which includes \$102 thousand related to the conversion of debt to preferred stock.

The Company recorded \$67 thousand and \$79 thousand of interest expense for the three and nine months ended June 30, 2018, respectively, related to the accretion of discounts on the PFG IV Loan and Warrant Debt. The Company recorded accretion of discount expense of \$5 thousand and \$15 thousand for the three and nine months ended June 30, 2017, respectively. 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 three and nine months ended June 30, 2018, gains of \$3 thousand and \$12 thousand, respectively, were recorded related to the fair value remeasurement on the derivative liability associated with the Loan and Security Agreement and Warrant Debt with PFG IV. Gains of \$21 thousand and \$42 thousand were recorded related to the fair value remeasurement for the three and nine months ended June 30, 2017, respectively.

The Company recorded \$2 thousand of interest expense for each of the three and nine months ended June 30, 2018, related to the accretion of discounts on the PFG V Loan and Warrant Debt. The Company recorded no accretion of discount expense for the three and nine months ended June 30, 2017.

During each of the three and nine months ended June 30, 2018, a gain of \$4 thousand was recorded related to the fair value remeasurement on the derivative liability associated with the Loan and Security Agreement and Warrant Debt

with PFG V. No gain or loss related to the fair value remeasurement was recorded for the three and nine months ended June 30, 2017, respectively.

Benefit for Income Taxes

25

Table of Contents

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 is 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 the three and nine months ended June 30, 2018, we recorded an income tax benefit of zero and \$1.3 million, respectively, resulting from the application of TCJA to existing deferred tax balances based on reasonable estimates for those tax effects. The deemed repatriation of undistributed foreign earnings is not expected to result in a material change to our financial results. Our accounting for the tax effects of the TCJA will be completed during the measurement period, which should not extend beyond one year from the enactment date. The final impact of the TCJA may differ due to and among other things, changes in interpretations, assumptions made by the Company, the issuance of additional guidance, and actions the Company may take as a result.

Liquidity and Capital Resources

The Company’s primary sources of liquidity are its cash and revolving line of credit. During the first nine months of fiscal 2018, the Company used \$1.2 million of cash from operating activities compared with \$716 thousand of cash generated by operating activities in the same period of fiscal 2017. Although the Company had a decrease in net loss in fiscal 2018 as compared to fiscal 2017 of \$1.3 million, 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.

Capital expenditures were \$657 thousand in the first nine months of fiscal 2018 compared to \$676 thousand in the same period in fiscal 2017. During Q3 2018, the Company acquired new servers and equipment related to international hosting services. A majority of the expenditures in 2017 relate to costs associated with the leasehold improvements and office furniture and equipment purchases for the new Mediasite KK office.

The Company generated \$2.8 million of cash from financing activities during the first nine months of fiscal 2018, primarily due to proceeds from the issuance of term debt of \$2.0 million with PFG V in May 2018. 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 \$1.2 million. For the same period in fiscal 2017, the Company used \$295 thousand of cash from financing activities, mainly due to line of credit proceeds, partially offset by debt payments. At June 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. The Company increased borrowing by a net of \$320 thousand during the first nine months of fiscal 2018. At June 30, 2018, the outstanding balance was \$2.0 million. The highest balance on the line of credit during the quarter was \$2.6 million. At June 30, 2018, there was a remaining amount of \$2.0 million available under the line of credit for advances.

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, and plans to do so for at least the next 12 months. At June 30, 2018 we had a balance of \$2.0 million outstanding on this line of credit, which matures January 31, 2019. The Company may not have sufficient liquidity available to repay the line of credit at the time of maturity. The Company expects to renew the line of credit prior to the due date, however, the decision to renew is solely at the discretion of Silicon Valley Bank.

While the Company expects the line of credit will be renewed at terms similar to those that are currently in place, management’s analysis of the Company’s ability to continue as a going concern must consider the possibility that Silicon Valley Bank will not consent to renew the agreement. The Company believes it has access to other sources of capital, but has no plans, nor taken any action to refinance the Silicon Valley Bank debt.

To evaluate the likelihood that the line of credit agreement would be renewed on or before January 31, 2019, the Company considered its long-term relationship with the lender, consistent payment history on both the line of credit and term loans held by Silicon Valley Bank, and the fact that the line is secured by the Company's accounts receivable, which was \$6.6 million at June 30, 2018.

Accordingly, the Company believes that it is probable that management's plans to renew the line of credit agreement will fully mitigate the conditions identified. The Company expects that it will have sufficient liquidity to fund operations for at least the next twelve months from the date of financial statement issuance.

Table of Contents

At June 30, 2018, a balance of \$271 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 June 30, 2018, the Company had \$1.9 million outstanding, net of warrant debt and debt discounts, related to notes payable with PFG IV and PFG V. The Company received proceeds of \$3.0 million from loan agreements with Mark D. Burish 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 nine months ended June 30, 2018 compared to net payments of \$1.3 million on notes in the same period of fiscal 2017. The Company also fully converted \$1.0 million of subordinated debt due to Mark D. Burish into preferred stock shares, which did not and will not require cash settlement.

At June 30, 2018, approximately \$1.7 million of cash and cash equivalents was held by the Company's foreign subsidiaries.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes from those reported in the Company's Annual Report on Form 10-K for the year-ended September 30, 2017. At June 30, 2018, \$2.0 million of the Company's \$4.2 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.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Based on evaluations at June 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) and determined that our disclosure controls and procedures were effective. 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.

During the most recent fiscal year end, our principal executive officer and principal financial officer concluded that our internal controls over financial reporting were not effective as of September 30, 2017 due to an identified material weakness in internal control. The material weakness related 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, which was remediated as of Q1 2018.

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 was engaging with outside valuation experts to assist with the application of best practices in determining fair values used for purposes of testing goodwill and other long-lived and intangible assets, as required by ASC topics 350 and 360, respectively. In future periods, we will continue to utilize outside experts for the determination of fair values when applicable, including measuring the fair value of reporting units during the annual test for goodwill impairment when quantitative analysis is performed. There can be no assurances that we have fully remediated the weakness in controls over financial reporting. However, we feel that our remediation efforts to strengthen processes and controls in place related to measurement of goodwill have adequately addressed the aforementioned material weakness.

Changes in Internal Controls

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

Table of Contents

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in our Form 10-K for the fiscal year ended September 30, 2017 filed with the SEC.

ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS

On January 19, 2018, the Company and Mark Burish entered into a Subscription Agreement (the "Subscription Agreement"). Pursuant to the Subscription Agreement, (i) on January 19, 2018, Mr. Burish purchased a 10.75% Convertible Secured Subordinated Promissory Note for \$500,000 in cash; and (ii) on February 15, 2018, Mr. Burish 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 Andrew D. Burish. 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. Mr. Burish 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, of which 663 were held by Mark Burish and 242 of which were held by Andrew Burish, 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.

The Company relied on Section 4(a)(2) of the Securities Act of 1933, as amended, to issue the Notes and stock, inasmuch as Mr. Mark Burish and Andrew Burish 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.

ITEM 6. EXHIBITS

NUMBERS DESCRIPTION

- 3.1 Articles of Amendment of Amended and Restated Articles of Incorporation, effective November 16, 2009, Amended and Restated Articles of Incorporation, effective January 26, 1998, and Articles of Amendment, effective April 9, 2000, filed as Exhibit No. 3.1 to the Annual Report on Form 10-K for the year ended September 30, 2009, and hereby incorporated by reference.
- 3.2 Amended and Restated By-Laws of the Registrant, filed as Exhibit No. 3.1 to the Form 8-K filed on October 11, 2011, and hereby incorporated by reference.
- 3.3 Articles Supplementary to the Company Charter of the Registrant, as relates to Series A Preferred Stock, dated May 30, 2017, filed as Exhibit 5.03 to the 8-K filed on June 5, 2017, and hereby incorporated by reference.

3.4 Articles Supplementary to the Company Charter of the Registrant, as relates to Series A Preferred Stock, dated November 6, 2017, filed as Exhibit 3.1 to the Form 8-K filed on November 21, 2017, and hereby incorporated by reference.

3.5 Amended and Restated By-Laws of the Registrant, filed as Exhibit No. 3.1 to the Form 8-K filed on January 25, 2018, and hereby incorporated by reference.

Table of Contents

- 3.6 Articles Supplementary to the Company Charter of the Registrant, as relates to Series A Preferred Stock, filed as Exhibit 3.1 to the Form 8-K filed on May 23, 2018, and hereby incorporated by reference.
- 10.1* Amended and Restated Employment Agreement between Registrant and Gary Weis dated as of September 30, 2011, filed as Exhibit 10.1 to the Form 8-K filed on October 4, 2011, and hereby incorporated by reference.
- 10.2* Registrant's 2008 Non-Employee Directors' Stock Option Plan, as amended, filed as Exhibit 3 to the Form 14A filed on January 26, 2017, and hereby incorporated by reference.
- 10.3* Registrant's 2008 Employee Stock Purchase Plan, as amended, filed as Exhibit 1 to the Form 14A filed on January 26, 2017, and hereby incorporated by reference.
- 10.4* Registrant's 2009 Stock Incentive Plan, as amended, filed as Exhibit 2 to the Form 14A filed on January 26, 2017, and hereby incorporated by reference.
- 10.5 Lease Agreement between Registrant, as tenant, and West Washington Associates, LLC as landlord, dated June 28, 2011, filed as Exhibit 10.1 to the Form 8-K filed on July 1, 2011, and hereby incorporated by reference.
- 10.6 Second Amended and Restated Loan and Security Agreement dated June 27, 2011 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.2 to the Form 8-K filed on July 1, 2011, and hereby incorporated by reference.
- 10.7 First Amendment to Second Amended and Restated Loan and Security Agreement dated May 31, 2013 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on June 3, 2013, and hereby incorporated by reference.
- 10.8 Second Amendment to Second Amended and Restated Loan and Security Agreement dated January 10, 2014 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on January 16, 2014, and hereby incorporated by reference.
- 10.9* Employment Agreement dated March 21, 2014 between Sonic Foundry, Inc. and Kenneth A. Minor, filed as Exhibit 10.2 to the Form 8-K filed on March 26, 2014, and hereby incorporated by reference.
- 10.10* Employment Agreement dated March 21, 2014 between Sonic Foundry, Inc. and Robert M. Lipps, filed as Exhibit 10.1 to the Form 8-K filed on March 26, 2014, and hereby incorporated by reference.
- 10.11 Third Amendment to Second Amended and Restated Loan and Security Agreement dated March 24, 2014 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on March 28, 2014, and hereby incorporated by reference.
- 10.12 Forms of Subscription Agreements, Lock-Up Agreements and Warrant Agreements dated December 22, 2014 among Sonic Foundry, Inc. and Mark Burish, and Sonic Foundry, Inc. and Andrew Burish, filed as Exhibits 10.1, 10.2, and 10.3 to the Form 8-K filed on December 30, 2014

and hereby incorporated by reference.

- 10.13 Fourth Amendment to Second Amended and Restated Loan and Security Agreement dated January 27, 2015 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on February 2, 2015, and hereby incorporated by reference.
- 10.14 Lease Agreement between Mediasite KK, as tenant, and Ollie Company as landlord, dated September 1, 2011, filed as Exhibit 10.23 to the form 10-Q filed on February 6, 2015, and hereby incorporated by reference.
- 10.15 Lease Agreement between Mediasite KK, as tenant, and Ollie Company as landlord, dated September 1, 2011, filed as Exhibit 10.24 to the form 10-Q filed on February 6, 2015, and hereby incorporated by reference.
- 10.16 Lease Agreement between Sonic Foundry International, as tenant, and Prinsen Geerligs as landlord, dated February 1, 2014, filed as Exhibit 10.25 to the form 10-Q on February 6, 2015, and hereby incorporated by reference.
- 10.17 Fifth Amendment to Second Amended and Restated Loan and Security Agreement, dated May 13, 2015 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.26 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
- 10.18 Loan and Security Agreement, dated May 13, 2015 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.27 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
- 10.19 Warrant, dated as of May 13, 2015, between Registrant and Partners for Growth IV, L.P., filed as Exhibit 10.28 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
- 10.20 Warrant, dated as of May 13, 2015, between Registrant and Silicon Valley Bank, filed as Exhibit 10.29 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
- 10.21 Warrant dated as of May 13, 2015, between Registrant and PFG Equity Investors, LLC, filed as Exhibit 10.30 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.

Table of Contents

- 10.22 Intellectual Property Security Agreement, dated as of May 13, 2015, between Registrant and Partners for Growth IV, L.P., filed as Exhibit 10.31 to form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
- 10.23 Sixth Amendment to Second Amended and Restated Loan and Security Agreement, dated October 5, 2015 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on October 9, 2015, and hereby incorporated by reference.
- 10.24 Modification No. 1 to Loan and Security Agreement, dated September 30, 2015 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit No. 10.2 to the Form 8-K filed on October 9, 2015, and hereby incorporated by reference.
- 10.25 Seventh Amendment to Second Amended and Restated Loan and Security Agreement, dated February 8, 2016 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit No. 10.28 to the Form 10-Q filed on February 11, 2016, and hereby incorporated by reference.
- 10.26 Lease Agreement between Mediasite KK, as tenant, and Sumitomo Metal Mining Co., Ltd., as landlord, dated August 1, 2016, filed as Exhibit 10.1 to the Form 8-K filed on August 3, 2016, and hereby incorporated by reference.
- 10.27 Eighth Amendment to Second Amended and Restated Loan and Security Agreement, dated December 9, 2016 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit No. 10.1 to the Form 8-K filed on December 14, 2016, and hereby incorporated by reference.
- 10.28 Modification No. 2 to Loan and Security Agreement, dated February 8, 2017 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.28 to the Form 10-Q filed on February 9, 2017, and hereby incorporated by reference.
- 10.29 Ninth Amendment to Second Amended and Restated Loan and Security Agreement, dated March 22, 2017 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit No. 10.1 to the Form 8-K filed on March 28, 2017, and hereby incorporated by reference.
- 10.30 Waiver and Tenth Amendment to Second Amended and Restated Loan and Security Agreement, dated May 10, 2017 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.30 to the Form 10-Q filed on May 11, 2017, and hereby incorporated by reference.
- 10.31 Waiver and Modification No. 3 to Loan and Security Agreement, dated May 11, 2017 among Registrant Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.31 to the Form 10-Q filed on May 11, 2017, and hereby incorporated by reference.
- 10.32 Subscription Agreement between Registrant and Mark D. Burish, dated May 30, 2017, filed as Exhibit 3.02 to the 8-K filed on June 5, 2017, and hereby incorporated by reference.
- 10.33 Agreement Not to Convert between Registrant and Mark D. Burish, dated November 17, 2017, filed as Exhibit 10.1 to the Form 8-K filed on November 21, 2017, and hereby incorporated by reference.
- 10.34 Subscription Agreement between Registrant and Mark D. Burish, dated August 23, 2017, filed as Exhibit 10.1 to the Form 8-K filed on August 25, 2017, and hereby incorporated by reference.

10.35 Eleventh Amendment to Second Amended and Restated Loan and Security Agreement, dated December 22, 2017 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on December 29, 2017, and hereby incorporated by reference.

10.36 Modification No. 4 to Loan and Security Agreement, dated December 28, 2017 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.2 to the Form 8-K filed on December 29, 2017, and hereby incorporated by reference.

10.37 Subscription Agreement between Registrant and Mark D. Burish, dated January 19, 2018, filed as Exhibit 10.1 to the Form 8-K filed on January 25, 2018, and hereby incorporated by reference.

10.38 10.75% Convertible Secured Subordinated Promissory Note between Registrant and Mark D. Burish, filed as Exhibit 10.2 to the Form 8-K filed on January 25, 2018, and hereby incorporated by reference.

10.39 Subscription Agreement between Registrant and Andrew D. Burish, dated April 16, 2018, filed as Exhibit 10.1 to the Form 8-K filed on April 18, 2018, and hereby incorporated by reference.

10.40 Warrant, dated April 16, 2018, filed as Exhibit 10.2 to the Form 8-K filed on April 18, 2018, and hereby incorporated by reference.

Table of Contents

- 10.41 Loan and Security Agreement, dated May 11, 2018 among Registrant, Sonic Foundry, Inc. and Partners for Growth V, L.P., filed as Exhibit 10.41 to the Form 10-Q filed on May 15, 2018, and hereby incorporated by reference.
- 10.42 Warrant, dated as of May 11, 2018, between Registrant and Partners for Growth V, L.P., filed as Exhibit 10.42 to the Form 10-Q filed on May 15, 2018, and hereby incorporated by reference.
- 10.43 Twelfth Amendment to Second Amended and Restated Loan and Security Agreement, dated May 11, 2018 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.43 to the Form 10-Q filed on May 15, 2018, and hereby incorporated by reference.
- 31.1 Section 302 Certification of Chief Executive Officer
- 31.2 Section 302 Certification of Chief Financial Officer and Secretary
- 32 Section 906 Certification of Chief Executive Officer and Chief Financial Officer and Secretary

101 The following materials from the Sonic Foundry, Inc. Form 10-Q for the quarter ended June 30, 2018 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations, (ii) the Condensed Consolidated Balance Sheets, (iii) the Condensed Consolidated Statement of Comprehensive Loss, (iv) the Condensed Consolidated Statements of Cash Flows and (v) Notes to Condensed Consolidated Financial Statements.

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

*Compensatory Plan or Arrangement

Table of Contents

SIGNATURES

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

Sonic Foundry, Inc.
(Registrant)

August 9, 2018 By: /s/ Gary R. Weis
Gary R. Weis
Chief Executive Officer

August 9, 2018 By: /s/ Kenneth A. Minor
Kenneth A. Minor
Chief Financial Officer and Secretary