

FORGENT NETWORKS INC  
Form 10-Q  
June 14, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended April 30, 2007

OR

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

For the transition period from to

Commission file number: 0-20008

**FORGENT NETWORKS, INC.**

(Exact Name of Registrant as Specified in its Charter)

**Delaware**

(State of other jurisdiction of incorporation or organization)

**74-2415696**

(I.R.S. Employer Identification No.)

**108 Wild Basin Road  
Austin, Texas**

(Address of Principal Executive Offices)

**78746**

(Zip Code)

**(512) 437-2700**

(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 is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

On June 8, 2007, the registrant had outstanding 25,597,554 shares of its Common Stock, \$0.01 par value.

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## FORGENT NETWORKS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except per share data)

|   | APRIL 30,<br>2007<br>(UNAUDITED) | JULY 31,<br>2006 |
|---|----------------------------------|------------------|
| <b>ASSETS</b>   |                                  |                  |
| Current Assets:   |                                  |                  |
| Cash and cash equivalents, including restricted cash of \$0 and \$543 at April 30, 2007 and July 31, 2006   | \$ 24,614                        | \$ 16,206        |
| Short-term investments  | 1,533                            |                  |
| Accounts receivable, net of allowance for doubtful accounts of \$23 and \$13 at April 30, 2007 and July 31, 2006, respectively  | 10,806                           | 714              |
| Prepaid expenses and other current assets   | 316                              | 274              |
| <b>Total Current Assets</b>   | <b>37,269</b>                    | <b>17,194</b>    |
| Property and equipment, net   | 814                              | 788              |
| Intangible assets, net  |                                  | 4                |
| Other assets  | 3                                | 3                |
|   | <b>\$ 38,086</b>                 | <b>\$ 17,989</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                                  |                  |
| Current Liabilities:  |                                  |                  |
| Accounts payable  | \$ 12,854                        | \$ 3,631         |
| Accrued compensation and benefits   | 922                              | 547              |
| Other accrued liabilities   | 1,642                            | 907              |
| Notes payable, current position   |                                  | 313              |
| Deferred revenue  | 900                              | 683              |
| <b>Total Current Liabilities</b>  | <b>16,318</b>                    | <b>6,081</b>     |
| Long-Term Liabilities:  |                                  |                  |
| Deferred revenue  | 23                               | 11               |
| Other long-term obligations   | 1,299                            | 1,777            |
| <b>Total Long-Term Liabilities</b>  | <b>1,322</b>                     | <b>1,788</b>     |
| Stockholders Equity:  |                                  |                  |
| Preferred stock, \$.01 par value; 10,000 authorized; none issued or outstanding   |                                  |                  |
| Common stock, \$.01 par value; 40,000 authorized; 27,387 and 27,163 shares issued; 25,597 and 25,373 shares outstanding at April 30, 2007 and July 31, 2006, respectively | 274                              | 271              |
| Treasury stock at cost, 1,790 issued at April 30, 2007 and July 31, 2006  | (4,815)                          | (4,815)          |
| Additional paid-in capital  | 265,633                          | 265,406          |
| Accumulated deficit   | (240,660)                        | (250,754)        |
| Accumulated other comprehensive income  | 14                               | 12               |
| <b>Total Stockholders Equity</b>  | <b>20,446</b>                    | <b>10,120</b>    |
|   | <b>\$ 38,086</b>                 | <b>\$ 17,989</b> |

The accompanying notes are an integral part of these condensed consolidated financial statements.

## FORGENT NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

|   | FOR THE<br>THREE MONTHS ENDED<br>APRIL 30,<br>2007<br>(UNAUDITED) |                   | FOR THE<br>NINE MONTHS ENDED<br>APRIL 30,<br>2007<br>(UNAUDITED) |                   |
|---|---|-------------------|--|-------------------|
|   |   | 2006              |  | 2006              |
| <b>REVENUES:</b>  |   |                   |  |                   |
| Intellectual property licensing                               | \$ 20,000   | \$ 1,891          | \$ 28,162  | \$ 8,613          |
| Software and services   | 978   | 647               | 2,957  | 1,924             |
| Total revenues  | <b>20,978</b>   | <b>2,538</b>      | <b>31,119</b>  | <b>10,537</b>     |
| <b>COST OF SALES:</b>   |   |                   |  |                   |
| Intellectual property licensing                               | 10,592  | 1,147             | 14,135   | 5,314             |
| Software and services   | 196   | 213               | 698  | 604               |
| Total cost of sales   | <b>10,788</b>   | <b>1,360</b>      | <b>14,833</b>  | <b>5,918</b>      |
| <b>GROSS MARGIN</b>   | <b>10,190</b>   | <b>1,178</b>      | <b>16,286</b>  | <b>4,619</b>      |
| <b>OPERATING EXPENSES:</b>                                    |   |                   |  |                   |
| Selling, general and administrative                           | 3,971   | 2,561             | 9,009  | 7,721             |
| Research and development                                      | 180   | 153               | 429  | 454               |
| Amortization of intangible assets                             |   | 6                 | 4  | 23                |
| Total operating expenses                                      | <b>4,151</b>  | <b>2,720</b>      | <b>9,442</b>   | <b>8,198</b>      |
| <b>INCOME (LOSS) FROM OPERATIONS</b>                          | <b>6,039</b>  | <b>(1,542)</b>    | <b>6,844</b>   | <b>(3,579)</b>    |
| <b>OTHER INCOME AND (EXPENSES):</b>                           |   |                   |  |                   |
| Interest income   | 202   | 128               | 592  | 360               |
| Gain on sale of assets  |   |                   | 2,896  |                   |
| Interest expense and other                                    | (25)  | (12)              | (68)   | (58)              |
| Total other income and (expenses)                             | <b>177</b>  | <b>116</b>        | <b>3,420</b>   | <b>302</b>        |
| <b>INCOME (LOSS) FROM OPERATIONS, BEFORE<br/>INCOME TAXES</b> | <b>6,216</b>  | <b>(1,426)</b>    | <b>10,264</b>  | <b>(3,277)</b>    |
| Provision for income taxes                                    | (170)   | (5)               | (170)  | (15)              |
| <b>NET INCOME (LOSS)</b>                                      | <b>\$ 6,046</b>   | <b>\$ (1,431)</b> | <b>\$ 10,094</b>   | <b>\$ (3,292)</b> |
| <b>BASIC AND DILUTED INCOME (LOSS) PER SHARE:</b>             |   |                   |  |                   |
| Basic   | \$ 0.24   | \$ (0.06)         | \$ 0.40  | \$ (0.13)         |
| Diluted   | \$ 0.23   | \$ (0.06)         | \$ 0.39  | \$ (0.13)         |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING:</b>                   |   |                   |  |                   |
| Basic   | 25,596  | 25,372            | 25,488   | 25,262            |
| Diluted   | 26,202  | 25,372            | 26,022   | 25,262            |

The accompanying notes are an integral part of these condensed consolidated financial statements.

## FORGENT NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

|  | FOR THE NINE<br>MONTHS ENDED<br>APRIL 30,<br>2007 |                  | 2006             |
|--|---|------------------|------------------|
|  | (UNAUDITED)                                       |                  |                  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |   |                  |                  |
| Net income (loss)  | \$  | 10,094           | \$ (3,292 )      |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operations: |   |                  |                  |
| Depreciation and amortization  |   | 423              | 952              |
| Amortization of leasehold advance and lease impairment                                   |   | (319 )           | (420 )           |
| Provision for doubtful accounts  |   | 19               | 28               |
| Share-based compensation   |   | 144              | 119              |
| Foreign currency translation loss (gain)   |   | 13               | (8 )             |
| Gain on disposal of fixed assets   |   |                  | (6 )             |
| Changes in operating assets and liabilities:   |   |                  |                  |
| Accounts receivable  |   | (10,104 )        | (335 )           |
| Prepaid expenses and other current assets  |   | 90               | (255 )           |
| Accounts payable   |   | 9,091            | 420              |
| Accrued expenses and other long-term obligations   |   | 1,183            | (318 )           |
| Deferred revenues  |   | 220              | 175              |
| Net cash provided by (used in) operating activities                                      |   | <b>10,854</b>    | <b>(2,940 )</b>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |   |                  |                  |
| Net (purchases) sales of short-term investments  |   | (1,533 )         | 1,491            |
| Net purchases of property and equipment  |   | (445 )           | (42 )            |
| Net cash (used in) provided by investing activities                                      |   | <b>(1,978 )</b>  | <b>1,449</b>     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |   |                  |                  |
| Net proceeds from issuance of stock  |   | 86               | 240              |
| Proceeds from notes payable  |   |                  | 297              |
| Payments on notes payable  |   | (543 )           | (297 )           |
| Net cash (used in) provided by financing activities                                      |   | <b>(457 )</b>    | <b>240</b>       |
| Effect of exchange rate changes on cash and cash equivalents                             |   |                  |                  |
|  |   | (11 )            |                  |
| Net change in cash and cash equivalents  |   | 8,408            | (1,251 )         |
| Cash and cash equivalents at beginning of period   |   | 16,206           | 15,861           |
| Cash and cash equivalents at end of period   |   | <b>\$ 24,614</b> | <b>\$ 14,610</b> |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**FORGENT NETWORKS, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Amounts in thousands, except per share data unless otherwise noted)

**NOTE 1 - GENERAL AND BASIS OF FINANCIAL STATEMENTS**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and accordingly, do not include all information and footnotes required under U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, these interim financial statements contain all adjustments, consisting of normal, recurring adjustments, necessary for a fair presentation of the financial position of Forgent Networks, Inc. ( Forgent or the Company ) as of April 30, 2007 and July 31, 2006, the results of operations for the three and nine months ended April 30, 2007 and April 30, 2006, and the cash flows for the nine months ended April 30, 2007 and April 30, 2006. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto filed with the Securities and Exchange Commission in the Company's annual report on Form 10-K/A for the fiscal year ended July 31, 2006. The results for the interim periods are not necessarily indicative of results for a full fiscal year.

**NOTE 2 LITIGATION SETTLEMENTS**

Forgent was in legal proceedings with multiple companies in the United States District Court for the Eastern District of Texas, Tyler Division (the 746 Litigation ), regarding the infringement of its U.S. Patent No. 6,285,746 (the 746 patent). Effective April 26, 2007, Forgent entered into settlement and license agreements with nine of the defendants: Cable One, Inc.; Charter Communications, Inc.; Comcast Corporation; Comcast STB Software DVR, LLC; Coxcom, Inc.; Digeo, Inc.; Motorola, Inc.; Scientific-Atlanta, Inc.; and Time Warner Cable, Inc. These defendants were dismissed from the 746 Litigation with prejudice. Under these agreements, Forgent granted the defendants a patent license and other benefits and the defendants agreed to pay the Company a total of \$20,000. Additionally, all parties agreed to release all claims against each other. The \$20,000 was recorded as intellectual property licensing revenue on the Consolidated Statement of Operations for the three months ended April 30, 2007.

Forgent was in legal proceedings with multiple companies in the United States District Court for the Northern District of California (the 672 Litigation) regarding the infringement of its U.S. Patent No. 4,698,672 (the 672 patent). On October 25, 2006, Forgent signed a Patent License and Settlement Agreement with the remaining defendants in the 672 Litigation. Under this agreement, Forgent granted the defendants a patent license and the defendants paid Forgent \$8,000. Additionally, all parties agreed to release all claims against each other. The \$8,000 was recorded as intellectual property licensing revenue on the Consolidated Statement of Operations for the three months ended October 31, 2006.

**NOTE 3 - INTELLECTUAL PROPERTY LEGAL CONTRACTS**

In April 2006, Forgent engaged Hagans Burdine Montgomery Rustay & Winchester ( Hagans ) and Bracewell & Giuliani, L.L.P. ( Bracewell ) to provide legal services related to the litigation of the 746 Litigation. Hagans is the lead counsel on the 746 Litigation.

On December 1, 2006, Forgent signed an amendment to the Legal Services Fee Agreement with Hagans and Bracewell. This amendment increased the contingency fee payable to Hagans and Bracewell from 30% (15% to each law firm) of all license and litigation proceeds related to the 746 patent and other patents, net of expenses, to 37.5% (20% to Hagans and 17.5% to Bracewell). Additionally, effective September 1, 2006, all related expenses, including consultant fees, travel expenses, document production expenses, etc. are allocated as follows: 25% to Forgent, 50% to Hagans, and 25% to Bracewell, until total expenses reach \$2,500. Prior to the amendment, Forgent was liable for all related expenses. During the third fiscal quarter, the \$2,500 threshold was exceeded and Forgent is liable for all subsequent expenses which exceed the \$2,500 threshold. In addition to Hagans and Bracewell, Forgent is also liable for contingency fees to The Roth Law Firm, P.C. for 10% of the 746 and other patents litigation proceeds, net of expenses, and to Jenkens & Gilchrist for 10% of all gross license and litigation proceeds related to the 746 patent.

Legal expenses for contingency fees and legal counsel's time incurred are recorded as part of cost of sales from Forgent's intellectual property licensing business on the Consolidated Statements of Operations. Cost of sales for the intellectual property licensing business for the three and nine months ended April 30, 2007 were \$10,592 and





\$14,135, respectively. Cost of sales for the intellectual property licensing business for the three and nine months ended April 30, 2006 were \$1,147 and \$5,314, respectively. Other legal expenses incurred related to the Patent Licensing Program are recorded as part of operating expenses on the Consolidated Statements of Operations. Other related legal expenses for the three and nine months ended April 30, 2007 were \$1,522 and \$2,396, respectively. Other related legal expenses for the three and nine months ended April 30, 2006 were \$562 and \$1,379, respectively.

**NOTE 4 SALE OF ASSETS**

In November 2006, Forgent sold certain patents and applications associated with videoconferencing and related fields and technology, together with related goodwill, rights and documentation, to Tandberg Telecom AS ( Tandberg ) for \$3,150. Upon closing, Forgent received \$2,900 of the purchase price, all of which was recorded as a gain on sale of assets. The remaining balance of \$250 will be held in escrow for two years for indemnity claims. Following this sale, Forgent maintained several active patents and patent applications, including the 746 patent.

**NOTE 5 - COMPREHENSIVE INCOME (LOSS)**

In accordance with the disclosure requirements of Statement of Financial Accounting Standard No. 130, *Reporting Comprehensive Income*, the Company's comprehensive income (loss) is comprised of net income (loss), foreign currency translation adjustments and unrealized gains and losses on short-term investments held as available-for-sale securities. Comprehensive income for the three and nine months ended April 30, 2007 was \$6,060 and \$10,096, respectively. Comprehensive loss for the three and nine months ended April 30, 2006 was \$1,443 and \$3,296, respectively.

**NOTE 6 - RECENT ACCOUNTING PRONOUNCEMENTS**

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In February 2007, the Financial Accounting Standard Board ( FASB ) issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. Statement No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. The standard's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. This new statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in Statement No. 157, *Fair Value Measurements*, and Statement No. 107, *Disclosures about Fair Value of Financial Instruments*. Statement No. 159 is effective as of the beginning of fiscal years beginning after November 15, 2007. Forgent is currently evaluating the effect that the adoption of Statement No. 159 will have on its financial position and results of operations.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. Statement No. 157 defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements. Statement No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Forgent is currently evaluating the effect that the adoption of Statement No. 157 will have on its financial position and results of operations.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement No. 109, *Accounting for Income Taxes*. This interpretation defines the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. Forgent believes the adoption of FIN 48 will not have a material effect on its consolidated financial statements.

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**NOTE 7 SHARE BASED COMPENSATION**

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Share based compensation for the Company's stock option, restricted stock and stock purchase plans for the three months ended April 30, 2007 and 2006 was \$14 and \$18, respectively. Share based compensation for the Company's stock option, restricted stock and stock purchase plans for the nine months ended April 30, 2007 and 2006 was \$144 and \$119, respectively.

On August 1, 2006 the Company's Board of Directors approved the repricing of all employee stock options with an exercise price greater than \$0.385 (the average of the high and low for August 1, 2006). The new exercise price is \$0.385. The Board of Directors determined that the repricing was the most cost effective way to motivate employees with options that had exercise prices greater than the current fair market value. The repricing resulted in a charge of \$88 based on the incremental fair value of the new options versus the fair value of the old options for the nine months ended April 30, 2007. Previously, on September 14, 2005 the Company's Board of Directors approved the repricing of all employee stock options with an exercise price greater than \$1.42 (the average of the high and low for September 14, 2005). The new exercise price was \$1.42. The repricing resulted in a charge of \$65 based on the incremental fair value of the new options versus the fair value of the old options for the nine months ended April 30, 2006.

The Company issued 2 and 3 shares of common stock related to exercises of stock options granted from its stock option and stock purchase plans for the three months ended April 30, 2007 and 2006, respectively. The Company issued 224 and 173 shares of common stock related to exercises of stock options granted from its stock option and stock purchase plans for the nine months ended April 30, 2007 and 2006, respectively.

### **NOTE 8 - SEGMENT INFORMATION**

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Currently, the Company operates in two distinct segments: intellectual property licensing and software and services. During the nine months ended April 30, 2007, Forgent's intellectual property licensing business focused on generating licensing revenues relating to the Company's technologies embodied in the 672 patent and its foreign counterparts, as well as in the 746 patent. In October 2006, the Company settled with the remaining defendants in the 672 Litigation and does not anticipate generating additional licensing revenues from non-defendants going forward. In April 2007, Forgent settled with some of the defendants in the 746 Litigation and received the jury's verdict related to this litigation in May 2007. See Note 9 Contingencies for more detail. Forgent's software and services business provides customers with scheduling and asset management software as well as software maintenance and support, installation and training services. In order to evaluate the intellectual property and software segments as stand-alone businesses, the Company records all unallocated corporate operating expenses in the Corporate segment.

The Company evaluates the performance as well as the financial results of its segments. Included in the segment operating income (loss) is an allocation of certain corporate operating expenses. The Company does not identify assets or capital expenditures by reportable segments, and the Company's Chief Executive Officer and Chief Financial Officer do not evaluate the segments based on these criteria.

The table below presents segment information about revenue from unaffiliated customers, gross margins, and operating income (loss) for the three and nine months ended April 30, 2007 and 2006:

|  | Intellectual<br>Property<br>Licensing | Software &<br>Services | Corporate | Total     |
|--|---------------------------------------|------------------------|-----------|-----------|
| <b>For the Three Months Ended April 30, 2007</b> |                                       |                        |           |           |
| Revenues from unaffiliated customers             | \$ 20,000                             | \$ 978                 | \$        | \$ 20,978 |
| Gross margin                                     | 9,408                                 | 782                    |           | 10,190    |
| Operating income (loss)                          | 7,229                                 | (500)                  | (690)     | 6,039     |
| <b>For the Three Months Ended April 30, 2006</b> |                                       |                        |           |           |
| Revenues from unaffiliated customers             | \$ 1,891                              | \$ 647                 | \$        | \$ 2,538  |
| Gross margin                                     | 744                                   | 434                    |           | 1,178     |
| Operating income (loss)                          | (237)                                 | (535)                  | (770)     | (1,542)   |
| <b>For the Nine Months Ended April 30, 2007</b>  |                                       |                        |           |           |
| Revenues from unaffiliated customers             | \$ 28,162                             | \$ 2,957               | \$        | \$ 31,119 |
| Gross margin                                     | 14,027                                | 2,259                  |           | 16,286    |
| Operating income (loss)                          | 10,118                                | (941)                  | (2,333)   | 6,844     |
| <b>For the Nine Months Ended April 30, 2006</b>  |                                       |                        |           |           |
| Revenues from unaffiliated customers             | \$ 8,613                              | \$ 1,924               | \$        | \$ 10,537 |
| Gross margin                                     | 3,299                                 | 1,320                  |           | 4,619     |
| Operating income (loss)                          | 788                                   | (1,503)                | (2,864)   | (3,579)   |

**NOTE 9 - CONTINGENCIES**

Forgent is the defendant or plaintiff in various actions that arose in the normal course of business. With the exception of the proceedings described below, none of the pending legal proceedings to which the Company is a party are material to the Company.

**Re-examination of United States Patent No. 4,698,672**

In January 2006, the United States Patent and Trademark Office (the USPTO ) granted a petition to re-examine the 672 patent and subsequently issued its first office action on May 25, 2006. Forgent responded to this first office action, which confirmed 27 of the 46 claims in the 672 patent. On March 26, 2007, the USPTO issued its final office action, which affirmed its first office action. Forgent responded to the USPTO on May 11, 2007 and is currently waiting for the USPTO s reply.

**Litigation and Re-examination of United States Patent No. 6,285,746**

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Forgent was in legal proceedings with multiple companies in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of its 746 patent.

Effective April 26, 2007, Forgent entered into settlement and license agreements with nine of the defendants, who were dismissed from the 746 Litigation with prejudice.

Effective May 13, 2007, Forgent reached an agreement in principle to settle the 746 Litigation with respect to DIRECTV, Inc. ( DIRECTV ). Pursuant to such agreement in principle, Forgent and DIRECTV have agreed to work in good faith to reach a final definitive settlement agreement. The terms of a final definitive settlement agreement, which have been agreed to in principle, include Forgent's agreement to grant DIRECTV a patent license, DIRECTV's agreement to pay the Company \$8,000 and the parties' agreement to release all claims against each other. The Company anticipates it will finalize a definitive settlement and license agreement with DIRECTV during the fourth fiscal quarter.

On May 16, 2007, TiVo Inc. ( TiVo ) filed a complaint for declaratory judgment in the United States District Court for the Northern District of California against Forgent relating to the 746 patent. TiVo is seeking declarations of equitable estoppel and patent noninfringement and invalidity, among other relief sought. Forgent is currently reviewing its options to resolve this matter.

On May 21, 2007, a jury for the United States District Court for the Eastern District of Texas, Tyler Division, found the four asserted claims of the 746 patent to be invalid. This finding was in favor of EchoStar Technologies Corporation and Echosphere L.L.C., the two remaining defendants in the 746 Litigation. The Company continues to believe in the validity of the 746 patent and is currently assessing its options.

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On October 2, 2006, the USPTO ordered an *inter partes* re-examination of the 746 patent and issued its first office action related to this re-examination on October 30, 2006. This first action, which is not the final conclusion of the re-examination, rejected the five claims in the 746 patent. Forgent responded to the USPTO and anticipates working to vigorously defend all of the claims of the 746 patent. If the Company is unsuccessful in defending its patent's claims with the USPTO examiner, Forgent could pursue the appeal process within the USPTO and within the federal court system, if necessary. The USPTO has not issued any additional office actions related to this re-examination.

Forgent continues to monitor the progress of the 746 Litigation and the USPTO's re-examinations of its 746 and 672 patents. Resolution of some or all of these matters could materially affect the Company's business, future results of operations, financial position or cash flows in a particular period.

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

The following review of Forgent's financial position as of April 30, 2007 and July 31, 2006, and for the three and nine months ended April 30, 2007 and 2006, should be read in conjunction with the Company's 2006 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission. Forgent's internet website address is <http://www.forgent.com>. The Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the investor relations page of the Company's internet website free of charge as soon as reasonably practicable after they are electronically filed, or furnished to, the Securities and Exchange Commission. Forgent's internet website and the information contained therein or connected thereto are not intended to be incorporated into this Quarterly Report on Form 10-Q.

### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this report represent forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results of operations, levels of activity, economic performance, financial condition or achievements to be materially different from future results of operations, levels of activity, economic performance, financial condition or achievements as expressed or implied by such forward-looking statements.

Forgent has attempted to identify these forward-looking statements with the words believes, estimates, plans, expects, anticipates, may, and other similar expressions. Although these forward-looking statements reflect management's current plans and expectations, which are believed to be reasonable as of the filing date of this report, they inherently are subject to certain risks and uncertainties. Such risks and uncertainties include, but are not limited to, those described under "Risk Factors" in this report and other risks indicated in Forgent's filings with the Securities and Exchange Commission from time to time. Additionally, Forgent is under no obligation to update any of the forward-looking statements after the date of this Form 10-Q to conform such statements to actual results.

### RESULTS OF OPERATIONS

The following table sets forth for the periods indicated the percentage of total revenues represented by certain items in Forgent's Consolidated Statements of Operations:

|  | FOR THE THREE MONTHS ENDED<br>APRIL 30,<br>2007 |   | FOR THE THREE MONTHS ENDED<br>APRIL 30,<br>2006 |   | FOR THE NINE MONTHS ENDED<br>APRIL 30,<br>2007 |   | FOR THE NINE MONTHS ENDED<br>APRIL 30,<br>2006 |   |
|--|---|---|---|---|--|---|--|---|
|  |   | % |   | % |  | % |  | % |
| Intellectual property licensing revenues | 95  | % | 75  | % | 90   | % | 82   | % |
| Software and services revenues           | 5   |   | 25  |   | 10   |   | 18   |   |
| Gross margin                             | 49  |   | 46  |   | 52   |   | 44   |   |
| Selling, general and administrative      | 19  |   | 101   |   | 29   |   | 73   |   |
| Research and development                 | 1   |   | 6   |   | 1  |   | 4  |   |
| Total operating expenses                 | 20  |   | 107   |   | 30   |   | 78   |   |
| Other income, net                        | 1   |   | 5   |   | 11   |   | 3  |   |
| Net income (loss)                        | 29  | % | (56)  | % | 32   | % | (31)   | % |

### THREE AND NINE MONTHS ENDED APRIL 30, 2007 AND 2006

#### Revenues

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Revenues for the three months ended April 30, 2007 were \$20.9 million, an increase of \$18.4 million, or 727%, from the \$2.5 million reported for the three months ended April 30, 2006. Revenues for the nine months ended April 30, 2007 were \$31.1 million, an increase of \$20.6 million, or 195%, from the \$10.5 million reported for the nine months ended April 30, 2006. Consolidated revenues represent the combined revenues of the Company and

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its subsidiaries, including royalties and settlements received from licensing the Company's intellectual property as well as sales of Forgent's NetSimplicity software, installation and training and software maintenance services.

*Intellectual Property Licensing Business*

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Intellectual property licensing revenues for the three months ended April 30, 2007 were \$20.0 million, an increase of \$18.1 million, or 958%, from the \$1.9 million reported for the three months ended April 30, 2006. Intellectual property licensing revenues for the nine months ended April 30, 2007 were \$28.1 million, an increase of \$19.5 million, or 227%, from the \$8.6 million reported for the nine months ended April 30, 2006. Intellectual property licensing revenues as a percentage of total revenues were 95% and 75% for the three months ended April 30, 2007 and 2006, respectively. Intellectual property licensing revenues as a percentage of total revenues were 90% and 82% for the nine months ended April 30, 2007 and 2006, respectively. Forgent's licensing revenues relate primarily to one-time intellectual property license agreements with companies for Forgent's technologies embodied in U.S. Patent No. 4,698,672 (the 672 patent) and its foreign counterparts as well as in U.S. Patent No 6,285,746 (the 746 patent). Additionally, the 672 patent is included in a group of Moving Picture Experts Group (MPEG) patents that garner royalties. Forgent's licensing revenues include royalties received from this MPEG-2 consortium.

Forgent's intellectual property licensing business was in legal proceedings with multiple companies in the United States District Court for the Eastern District of Texas, Tyler Division (the 746 Litigation), regarding the infringement of its U.S. Patent No. 6,285,746 (the 746 patent) and in legal proceedings with multiple other companies in the United States District Court for the Northern District of California (the 672 Litigation), regarding the infringement of its U.S. Patent No. 4,698,672 (the 672 patent).

Effective April 26, 2007, Forgent entered into settlement and license agreements with nine of the defendants in the 746 Litigation, who were dismissed from the 746 Litigation with prejudice. Under these agreements, Forgent granted the defendants a patent license and other benefits and the defendants agreed to pay the Company a total of \$20.0 million. Additionally, all parties agreed to release all claims against each other. The \$20.0 million was recorded as intellectual property licensing revenue on the Consolidated Statement of Operations for the three months ended April 30, 2007. Effective May 13, 2007, Forgent reached an agreement in principle to settle the 746 Litigation with respect to DIRECTV, Inc. (DIRECTV). Pursuant to such agreement in principle, Forgent and DIRECTV have agreed to work in good faith to reach a final definitive settlement agreement. The terms of a final definitive settlement agreement, which have been agreed to in principle, include Forgent's agreement to grant DIRECTV a patent license, DIRECTV's agreement to pay the Company \$8.0 million and the parties' agreement to release all claims against each other. The Company anticipates it will finalize a definitive settlement and license agreement with DIRECTV during the fourth fiscal quarter. On May 21, 2007, a jury for the United States District Court for the Eastern District of Texas, Tyler Division, found the four asserted claims of the 746 patent to be invalid. This finding was in favor of EchoStar Technologies Corporation and Echosphere L.L.C., the two remaining defendants in the 746 Litigation. The Company continues to believe in the validity of the 746 patent and is currently assessing its options.

On October 25, 2006, Forgent signed a Patent License and Settlement Agreement with the remaining defendants in the 672 Litigation. Under this agreement, Forgent granted the defendants a patent license and the defendants paid Forgent \$8.0 million. Program to date, the Company has achieved approximately \$121.6 million in aggregate revenues generated from one-time license agreements related to its 672 patent. Since a settlement was reached with the remaining defendants and since the Company is not actively pursuing additional 672 license agreements, no additional licensing revenues from one-time license agreements were generated during the three months ended April 30, 2007.

The one-time license agreements related to the 746 patent and the 672 patent generated approximately 100% and 99% of the intellectual property segment's licensing revenues for the three and nine months ended April 30, 2007, respectively, and approximately 96% and 96% of the intellectual property segment's licensing revenues for the three and nine months ended April 30, 2006, respectively. The other licensing revenues generated during the first two fiscal quarters of 2007 and during fiscal 2006 relate to royalties received from the MPEG-2 consortium. The 672 patent expired in October 2006 in the United States; therefore, Forgent will not receive any additional royalties from the consortium.

*Software and Services Business*

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Software and services revenues for the three months ended April 30, 2007 were \$0.9 million, an increase of \$0.3 million, or 51%, from the \$0.6 million reported for the three months ended April 30, 2006. Software and services revenues for the nine months ended April 30, 2007 were \$2.9 million, an increase of \$1.0 million, or 54%, from the \$1.9 million reported for the nine months ended April 30, 2006. Software and services revenues as a percentage of total revenues were 5% and 25% for the three months ended April 30, 2007 and 2006, respectively. Software and services revenues as a percentage of total revenues were 10% and 18% for the nine months ended April 30, 2007 and 2006, respectively. Revenues from this line of business include sales of Forgent's NetSimplicity scheduling and asset management software, which includes Meeting Room Manager ( MRM ), Visual Asset Manager ( VAM ) and Resource Scheduler. Also included in this segment's revenues are software maintenance and professional services, such as add-on software customization, installation and training.

During the three and nine months ended April 30, 2007, increases in software, hardware and maintenance revenues accounted for approximately 78% and 86%, of the total increases in the software segment's revenues, respectively. Software sales increased by \$0.1 million and \$0.4 million, for the three and nine months ended April 30, 2007, respectively, due to (1) growing average sales price resulting primarily from increased sales to larger enterprise customers, (2) improved overall sales performance resulting from an increase in Forgent's sales and marketing teams as well as stronger individual sales achievements and (3) additional sales to existing customers who further invested in their original software purchases. The increase in software sales, as well as the continued pursuit of maintenance renewals, led to additional sales of maintenance and support contracts, which increased maintenance revenues by \$0.1 million and \$0.3 million during the three and nine months ended April 30, 2007, respectively. Towards the end of fiscal year 2006, Forgent partnered with several vendors, which enabled the Company to resell touch screen and display panel hardware to complement its MRM software and barcode scanning hardware devices to complement its VAM software. Revenues from hardware sales during the three and nine months ended April 30, 2007 increased by \$0.1 million and \$0.2 million, respectively, since the Company had minimal hardware sales during the 2006 fiscal periods. Forgent will continue to target North American and international companies in the education, governmental, healthcare and legal sectors, which generated approximately 61% and 55% of its software revenues during the three and nine months ended April 30, 2007, respectively. Forgent is currently exploring opportunities to acquire profitable businesses, products or technologies to complement its current software products and services in order to grow the software segment and become profitable for this segment. As the Company continues to make progress on its sales performance, release new software updates and enhancements, and explore these opportunities, management believes its software and services revenues will continue to increase.

### Gross Margin

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Gross margin for the three months ended April 30, 2007 was \$10.2 million, an increase of \$9.0 million, or 765%, from the \$1.2 million reported for the three months ended April 30, 2006. Gross margin for the nine months ended April 30, 2007 was \$16.3 million, an increase of \$11.7 million, or 253%, from the \$4.6 million reported for the nine months ended April 30, 2006. Gross margin as a percentage of total revenues were 49% and 46% for the three months ended April 30, 2007 and 2006, respectively. Gross margin as a percentage of total revenues were 52% and 44% for the nine months ended April 30, 2007 and 2006, respectively.

The \$9.0 million increase in gross margin for the three months ended April 30, 2007, as compared to the three months ended April 30, 2006, is due primarily to the \$8.7 million increase in gross margin resulting from intellectual property segment. Similarly, the \$11.7 million increase in gross margin for the nine months ended April 30, 2007, as compared to the nine months ended April 30, 2006, is due primarily to the \$10.7 million increase in gross margin resulting from intellectual property segment. Because the 746 Litigation may be wrapping up, the 672 Litigation is concluded and the U.S. 672 patent expired in October 2006, intellectual property licensing revenues will decline unless alternative sources of revenue are found. If intellectual property licensing revenues decline, total gross margins will be adversely affected.

### *Intellectual Property Licensing Business*

Intellectual property gross margin for the three months ended April 30, 2007 was \$9.4 million, an increase of \$8.7 million, or 1,165%, from the \$0.7 million reported for the three months ended April 30, 2006. Intellectual property gross margin for the nine months ended April 30, 2007 was \$14.0 million, an increase of \$10.7 million, or 325%, from the \$3.3 million reported for the nine months ended April 30, 2006. Intellectual property gross margin



as a percentage of total revenues were 47% and 39% for the three months ended April 30, 2007 and 2006, respectively. Intellectual property gross margin as a percentage of total revenues were 50% and 38% for the nine months ended April 30, 2007 and 2006, respectively.

The cost of sales from the intellectual property segment relates to the legal contingency fees incurred on successfully achieving signed license agreements as well as legal expenses incurred from legal counsel's time in connection with licensing and litigating the Company's patents. Since the 672 Litigation was concluded during the first fiscal quarter, cost of sales related to legal expenses incurred from legal counsel's time decreased \$0.3 million and \$1.4 million for the three and nine months ended April 30, 2007, respectively, as Forgent is not liable for any legal expenses for legal counsel's time related to the 746 Litigation. Additionally, the contingency fees related to the 672 Litigation decreased \$0.8 million and \$0.4 million for the three and nine months ended April 30, 2007, respectively, as a result of the final 672 settlement in the first fiscal quarter. These decreases were offset by an increase of \$10.6 million in contingency fees during the three and nine months ended April 30, 2007, as Forgent recognized its first licensing revenues related to the 746 Litigation during the third fiscal quarter. The contingency fees related to the 746 Litigation are management's current best estimate, based on known and estimated expenses related to the licensing revenues from the 746 patent. As these expenses are finalized, the related contingency fees may be adjusted in a future period.

Despite the increase in total cost of sales from the intellectual property segment, the decrease in contingency fees to *Jenkins & Gilchrist* during fiscal 2006 and the decrease in legal expenses for legal counsel's time during fiscal 2007 led to an increase in intellectual property licensing gross margins for the three and nine months ended April 30, 2007. The increase in total intellectual property gross margin resulted in Forgent's gross margins as a percentage of revenues from the intellectual property licensing business to increase to 47% and 50% for the three and nine months ended April 30, 2007, respectively, as compared to 39% and 38% for the three and nine months ended April 30, 2006, respectively.

#### *Software and Services Business*

Software and services gross margin for the three months ended April 30, 2007 was \$0.7 million, an increase of \$0.3 million, or 80%, from the \$0.4 million reported for the three months ended April 30, 2006. Software and services gross margin for the nine months ended April 30, 2007 was \$2.2 million, an increase of \$0.9 million, or 71%, from the \$1.3 million reported for the nine months ended April 30, 2006. Software and services gross margins as a percentage of total revenues were 80% and 67% for the three months ended April 30, 2007 and 2006, respectively. Software and services gross margins as a percentage of total revenues were 76% and 69% for the nine months ended April 30, 2007 and 2006, respectively.

The cost of sales associated with the software segment relates primarily to the amortization of the Company's purchased software development costs, compensation expenses and hardware expenses. For the three and nine months ended April 30, 2007, these expenses represented 68% and 73% of cost of sales for the software segment, respectively. For the three and nine months ended April 30, 2006, these expenses represented 91% and 92% of cost of sales for the software segment, respectively. During the first fiscal quarter of 2007, the purchased software development costs were fully amortized, which reduced cost of sales by \$0.2 million and \$0.4 million for the three and nine months ended April 30, 2007, respectively. This reduction was offset by increases in compensation expenses and hardware expenses. As of July 31, 2006, the Company formalized a group dedicated to providing maintenance and support. The compensation expenses and related expenses for this group were classified as cost of sales during the three and nine months ended April 30, 2007. Since the group did not exist during the three and nine months ended April 30, 2006, no related expenses were recorded during the fiscal periods in 2006. Additionally, Forgent incurred increased hardware expenses during the three and nine months ended April 30, 2007, as compared to the three and nine months ended April 30, 2006, since the Company had minimal hardware sales during fiscal 2006.

The decrease in amortization expenses was offset by increases in compensation expenses and hardware expenses, which resulted in the cost of sales for the software segment to remain relatively flat during the three and nine months ended April 30, 2007. Therefore, the \$0.3 million and \$1.0 million increases in software and services revenues for the three and nine months ended April 30, 2007, respectively, directly led to the \$0.3 million and \$0.9 million increases in software and services gross margins, respectively. As a result, gross margin as a percentage of revenues increased to 80% and 76% for the three and nine months ended April 30, 2007, respectively, as compared to 67% and 69% for the three and nine months ended April 30, 2006. Since the purchased software development



costs were fully amortized and since Forgent expects to generate more business from its software segment, management expects continued similar gross margin from its software and services business in terms of dollars and percentage of revenue.

#### **Selling, General and Administrative**

Selling, general and administrative ( SG&A ) expenses for the three months ended April 30, 2007 were \$4.0 million, an increase of \$1.4 million, or 55%, from the \$2.6 million reported for the three months ended April 30, 2006. SG&A expenses for the nine months ended April 30, 2007 were \$9.0 million, an increase of \$1.3 million, or 17%, from the \$7.7 million reported for the nine months ended April 30, 2006. SG&A expenses as a percentage of total revenues were 19% and 101% for the three months ended April 30, 2007 and 2006, respectively. SG&A expenses as a percentage of total revenues were 29% and 73% for the nine months ended April 30, 2007 and 2006, respectively.

During the third fiscal quarter, the Company expended significant efforts related to the 746 Litigation. As a result of these efforts, Forgent achieved \$20.0 million in intellectual property licensing revenues during the three months ended April 30, 2007 and anticipates recording an additional \$8.0 million in intellectual property licensing revenues during the fourth fiscal quarter. The legal fees and other expenses incurred related to the 746 Litigation led to an increase of \$1.2 million and \$1.4 million in SG&A expenses for the intellectual property segment for the three and nine months ended April 30, 2007, respectively. These increases represent 85% and 109% of the Company's total SG&A increases for the three and nine months ended April 30, 2007, respectively.

With the conclusion of the 746 trial in May 2007, management expects its SG&A expenses to decrease from its current levels during the fourth fiscal quarter. Forgent will continue to make modest investments in its sales and marketing teams, as necessary, in order to further grow its software and services business. Forgent will also continue to evaluate and reduce any unnecessary SG&A expenses that do not directly support the generation of revenues for the Company.

#### **Research and Development**

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Research and development ( R&D ) expenses for the three months ended April 30, 2007 were \$0.2 million, a decrease of \$27 thousand, or 186%, from the \$0.2 million reported for the three months ended April 30, 2006. R&D expenses for the nine months ended April 30, 2007 were \$0.4 million, a decrease of \$25 thousand, or 6%, from the \$0.4 million reported for the nine months ended April 30, 2006. R&D expenses as a percentage of total revenues were 1% and 6% for the three months ended April 30, 2007 and 2006, respectively. R&D expenses as a percentage of total revenues were 1% and 4% for the nine months ended April 30, 2007 and 2006, respectively.

During the third fiscal quarter, Forgent finalized its development of MRM 7.5, which includes an Advanced Services Management feature for its Enterprise edition. The Advanced Services Management feature replaces the prior Advanced Catering Module and is able to manage equipment and other meeting service requests beyond only catering. MRM 7.5, which also includes an improved Outlook Scheduling interface with new capabilities, was released on May 21, 2007. With the goal of accelerating the delivery of new features and enhancements by releasing more frequent and focused software updates, Forgent also implemented a new agile software development methodology during the third fiscal quarter. As such, the Company is dividing the formerly announced VAM 6.0 release into multiple smaller releases. The first of these releases will be VAM 5.7 and MRM 5.7.1, both of which include minor enhancement updates. Forgent expects both to be released by the end of the fourth fiscal quarter. Management will attempt to maintain R&D expenses at reasonable levels in terms of percentage of revenue and anticipates R&D expenses to remain relatively flat during the next fiscal quarter.

### **Other Income and Expenses**

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Other income and expenses for the three months ended April 30, 2007 were \$0.2 million, an increase of \$0.1 million, or 53%, from the \$0.1 million reported for the three months ended April 30, 2006. Other income and expenses for the nine months ended April 30, 2007 were \$3.4 million, an increase of \$3.1 million, or 1,032%, from the \$0.3 million reported for the nine months ended April 30, 2006. Other income and expenses as a percentage of total revenues were 1% and 5% for the three months ended April 30, 2007 and 2006, respectively. Other income and expenses as a percentage of total revenues were 11% and 3% for the nine months ended April 30, 2007 and 2006, respectively.

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The \$3.1 million increase for the nine months ended April 30, 2007 resulted from the sale of assets during the second fiscal quarter of 2007. In November 2006, Forgent sold certain patents and applications associated with videoconferencing and related fields and technology, together with related goodwill, rights and documentation, to Tandberg Telecom AS for \$3.2 million. Upon closing, Forgent received \$2.9 million of the purchase price, all of which was recorded as a gain on sale of assets. The remaining balance of \$0.3 million will be held in escrow for two years for indemnity claims. Following this sale, Forgent continued to maintain several active patents and patent applications, including the 746 patent.

### Net Income (Loss)

Forgent generated net income of \$6.0 million, or \$0.23 per share, during the three months ended April 30, 2007 compared to a net loss of \$1.4 million, or \$0.06 per share, during the three months ended April 30, 2006. Forgent generated net income of \$10.1 million, or \$0.39 per share, during the nine months ended April 30, 2007 compared to a net loss of \$3.3 million, or \$0.13 per share, during the nine months ended April 30, 2006. Net income (loss) as a percentage of total revenues were 29% and (56%) for the three months ended April 30, 2007 and 2006, respectively. Net income (loss) as a percentage of total revenues were 32% and (31%) for the nine months ended April 30, 2007 and 2006, respectively. The \$7.5 million increase in the Company's net income during the three months ended April 30, 2007, as compared to the three months ended April 30, 2006, is primarily attributable to the \$8.7 million increase in gross margin from the intellectual property segment, which is offset by the \$1.4 million increase in SG&A expenses. The \$13.4 million increase in the Company's net income during the nine months ended April 30, 2007, as compared to the nine months ended April 30, 2006, is primarily attributable to the \$10.7 million increase in gross margin from the intellectual property segment and the \$2.9 million gain from the sale of assets, which are offset by the \$1.3 million increase in SG&A expenses.

### LIQUIDITY AND CAPITAL RESOURCES

|   | <b>FOR THE NINE<br/>MONTHS ENDED<br/>APRIL 30,<br/>2007</b> |         | <b>2006</b> |
|---|---|---------|-------------|
|   | (in thousands)  |         |             |
| Working capital                                   | \$  | 20,951  | \$ 11,225   |
| Cash, cash equivalents and short-term investments |   | 26,147  | 14,610      |
| Cash provided by (used in) operating activities   |   | 10,854  | (2,940)     |
| Cash (used in) provided by investing activities   |   | (1,978) | 1,449       |
| Cash (used in) provided by financing activities   |   | (457)   | 240         |

Cash provided by operating activities was \$10.9 million for the nine months ended April 30, 2007 due primarily to the \$10.1 million in net income and a \$9.1 million increase in accounts payables, which were offset by a \$10.1 million increase in accounts receivables. Cash used in operating activities was \$2.9 million for the nine months ended April 30, 2006 due primarily to a \$3.3 million net loss, which was offset by \$0.5 million in non-cash depreciation and amortization expenses. During the nine months ended April 30, 2007, Forgent collected \$28.0 million in cash receipts from its intellectual property licensing business. Management plans to utilize these cash receipts to pay its legal counsel for services rendered and to support the growth of its software operations, organically as well as inorganically. Forgent's average days sales outstanding was 46 for the third fiscal quarter, a decrease of 15 days from the 61 days reported for the second fiscal quarter.

Cash used in investing activities was \$2.0 million for the nine months ended April 30, 2007 due primarily to \$1.5 million in net purchases of short-term investments. Cash provided by investing activities was \$1.4 million for the nine months ended April 30, 2006 due primarily to \$1.5 million in net sales/maturities of short-term investments. Forgent manages its investments portfolio in order to fulfill corporate liquidity requirements and maximize investment returns while preserving the quality of the portfolio. As the Company's cash balances have grown during fiscal 2007, Forgent has shifted its investment portfolio to investments with slightly longer maturities in order to capitalize on the increases in interest rates. These investments achieved a 64% increase in interest income during the nine months ended April 30, 2007, as compared to the nine months ended April 30, 2006. During

the third fiscal quarter, Forgent made a one-time purchase for software related to the barcode scanners utilized with its VAM software. This purchase and payments for leasehold improvements, primarily for new subtenants and subtenant expansions, account for approximately 88% of Forgent's purchased fixed assets during the nine months ended April 30, 2007. Management does not anticipate any significant purchases of fixed assets during the fourth fiscal quarter.

The Company leases office space and equipment under non-cancelable operating leases that expire at various dates through 2013. Certain leases obligate Forgent to pay property taxes, maintenance and insurance and include escalation clauses. The total amount of base rentals over the term of the Company's leases is charged to expense on a straight-line basis, with the amount of the rental expense in excess of the lease payments recorded as a deferred rent liability. During the second fiscal quarter of 2007, Forgent fully repaid its loans from Silicon Valley Bank. As of April 30, 2007, Forgent had \$1.0 million available in notes payable from Silicon Valley Bank. Additional notes payable obtained from Silicon Valley Bank would bear interest at prime plus 0.75% and require monthly installments over a three year term. Forgent may periodically make other commitments and thus become subject to other contractual obligations. Forgent's future minimum lease payments under all operating and capital leases as of April 30, 2007 are as follows:

|                             | Payments Due By Period<br>(in thousands) |                     |                 |                 |                      |
|-----------------------------|--|---------------------|-----------------|-----------------|----------------------|
|                             | Total                                    | Less than<br>1 year | 1 - 3 years     | 3- 5 years      | More than<br>5 years |
| Operating lease obligations | \$ 20,229                                | \$ 3,517            | \$ 6,943        | \$ 6,836        | \$ 2,933             |
| Capital lease obligations   | 2  | 2                   | -               |                 |                      |
| <b>Total</b>                | <b>\$ 20,231</b>                         | <b>\$ 3,519</b>     | <b>\$ 6,943</b> | <b>\$ 6,836</b> | <b>\$ 2,933</b>      |

Approximately 99% of the Company's operating lease obligations relates to its corporate office location at 108 Wild Basin Road in Austin, Texas. As of April 30, 2007, Forgent had \$4.7 million in future minimum lease payments receivable under non-cancelable sublease arrangements. Additionally, Forgent had a \$0.9 million liability related to impairment charges for the economic value of the lost sublease rental income related to its Austin property.

Cash used in financing activities was \$0.5 million for the nine months ended April 30, 2007 due primarily to the repayment of Forgent's outstanding notes payable. Cash provided by financing activities was \$0.2 million for the nine months ended April 30, 2006 due primarily to \$0.2 million in proceeds received from the issuance of stock. Forgent's stock repurchase program allows the Company to purchase up to three million shares of the Company's common stock. No shares were repurchased during the nine months ended April 30, 2007 or 2006. As of April 30, 2007, Forgent had repurchased 1,790,401 shares for approximately \$4.8 million and had the approval to repurchase approximately 1.2 million additional shares. During the fourth fiscal quarter, management will repurchase additional shares, depending on the Company's cash position, market conditions and other factors.

As of April 30, 2007, Forgent's principal source of liquidity consisted of \$26.1 million in cash, cash equivalents, short-term investments and its ability to generate cash from its intellectual property licensing business. Management currently plans to utilize its cash balances to grow its software operations internally by making additional prudent investments, explore potential opportunities in acquiring a growing and profitable public or privately held technology business or product line and buy back shares. Forgent's ability to generate cash from its intellectual property licensing business is subject to certain risks as discussed under Risk Factors. There is no assurance that the Company will be able to limit its cash consumption and preserve its cash balances, and it is possible that the Company's future business demands may lead to cash utilization at levels greater than recently experienced due to potential acquisitions. Management believes that the Company has sufficient capital and liquidity to fund and cultivate growth of its current operations.





**CRITICAL ACCOUNTING POLICIES**

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The Company's condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles and include the accounts of Forgent's wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in the consolidation. Preparation of the condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The more significant estimates made by management include the valuation allowance for the gross deferred tax asset, contingency reserves, useful lives of fixed assets and the determination of the fair value of its long-lived assets. These estimates could be materially different under different conditions and assumptions. Additionally, the actual amounts could differ from the estimates made. Management periodically evaluates estimates used in the preparation of the financial statements for continued reasonableness. Appropriate adjustments, if any, to the estimates used are made prospectively based upon such periodic evaluation.

Management believes the following represent Forgent's critical accounting policies:

### Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. The Company recognizes software revenue in accordance with Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-4, *Deferral of the Effective Date of a Provision of SOP 97-2*, and SOP 98-9, *Modification of SOP 97-2 With Respect to Certain Transactions*, Securities and Exchange Commission Staff Accounting Bulletin 104, *Revenue Recognition* and Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*.

Intellectual property licensing revenue is derived from the Company's Patent Licensing Program, which has generated licensing revenues relating to the Company's technologies embodied in the 672 patent and the 746 patent. Gross intellectual property licensing revenue is recognized at the time a license agreement has been executed and collection has been deemed probable. Related costs are recorded as cost of sales. The cost of sales on the intellectual property licensing business relates to contingent legal fees incurred on successfully achieving signed agreements, as well as legal fees incurred based upon legal counsel's time.

Software and service revenue consists of software license and service fees. Revenue from the software element is earned through the licensing or right to use the Company's software and from the sale of specific software products. Service fee income is earned through the sale of maintenance and technical support, training and installation. Forgent sells multiple elements within a single sale. The Company allocates the total fee to the various elements based on the relative fair values of the elements specific to the Company. The Company determines the fair value of each element in the arrangement based on vendor-specific objective evidence (VSOE) of fair value. VSOE of fair value for the software, maintenance, and training and installation services are based on the prices charged for the software, maintenance and services when sold separately. Revenue allocated to maintenance and technical support is recognized ratably over the maintenance term (typically one year). Revenue allocated to installation and training is recognized upon completion of these services. The Company's training and installation services are not essential to the functionality of its products as such services can be provided by a third party or the customers themselves. For instances in which VSOE cannot be determined for undelivered elements, and these undelivered elements do not provide significant customization or modification of its software product, Forgent recognizes the entire contract amount ratably over the period during which the services are expected to be performed.

The Company does not recognize revenue for agreements with rights of return, refundable fees, cancellation rights or acceptance clauses until such rights of return, refund or cancellation have expired or acceptance has occurred. The Company's arrangements with resellers do not allow for any rights of return.

Deferred revenue includes amounts received from customers in excess of revenue recognized, and is comprised of deferred maintenance, service and other revenue. Deferred revenues are recognized in the Condensed Consolidated Statements of Operations when the service is completed and over the terms of the arrangements, primarily ranging from one to three years.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's primary market risk exposure relates to interest rate risk. Forgent's interest income is sensitive to changes in U.S. interest rates. However, due to the short-term nature of the Company's investments, Forgent does not consider these risks to be significant. For additional Quantitative and Qualitative Disclosures about Market Risk, reference is made to Part II, Item 7A, Quantitative and Qualitative Disclosures about Market Risk, in the Company's Annual Report on Form 10-K/A for the year ended July 31, 2006.

### ITEM 4. CONTROLS AND PROCEDURES

Management established and is responsible for maintaining internal control over the Company's financial reporting. Under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, management of the Company has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15 under the Securities Exchange Act of 1934) as of a date within 90 days prior to the filing date of this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the date of the evaluation, the Company's disclosure controls and procedures are effective in timely alerting them to the material information relating to the Company required to be included in its periodic filings with the Securities and Exchange Commission. No changes were made in the Company's internal controls over financial reporting during the quarter ended April 30, 2007, that have materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Forgent is the defendant or plaintiff in various actions that arose in the normal course of business. With the exception of the proceedings described below, none of the pending legal proceedings to which the Company is a party are material to the Company.

#### Litigation of United States Patent No. 6,285,746

In July 2005, Forgent initiated litigation against 15 companies for infringement of the United States Patent No. 6,285,746 (the '746 patent') in the United States District Court for the Eastern District of Texas, Marshall Division (the '746 Litigation'), seeking injunctive relief against sales of infringing products and monetary damages, among other relief sought. Since the initial '746 Litigation, Forgent has dismissed six defendants and three other defendants have been added. The '746 Litigation was moved to the United States District Court for the Eastern District of Texas, Tyler Division.

Effective April 26, 2007, Forgent entered into settlement and license agreements with nine of the defendants: Cable One, Inc.; Charter Communications, Inc.; Comcast Corporation; Comcast STB Software DVR, LLC; Coxcom, Inc.; Digeo, Inc.; Motorola, Inc.; Scientific-Atlanta, Inc.; and Time Warner Cable, Inc. These defendants were dismissed from the '746 Litigation with prejudice. Under the agreements, Forgent granted the defendants a patent license and other benefits and the defendants agreed to pay the Company a total of \$20.0 million. Additionally, all parties agreed to release all claims against each other.

Effective May 13, 2007, Forgent reached an agreement in principle to settle the '746 Litigation with respect to one of the remaining defendants: DIRECTV, Inc. (DIRECTV). Pursuant to such agreement in principle, Forgent and DIRECTV have agreed to work in good faith to reach a final definitive settlement agreement. The terms of a final definitive settlement agreement, which have been agreed to in principle, include Forgent's agreement to grant DIRECTV a patent license, DIRECTV's agreement to pay the Company \$8.0 million, and the parties' agreement to release all claims against each other. The Company anticipates it will finalize a definitive settlement and license agreement with DIRECTV during the fourth fiscal quarter.

On May 16, 2007, TiVo Inc. (TiVo) filed a complaint for declaratory judgment in the United States District Court for the Northern District of California against Forgent relating to the '746 patent. TiVo is seeking

declarations of equitable estoppel and patent noninfringement and invalidity, among other relief sought. Forgent is currently reviewing its options to resolve this matter.

On May 21, 2007, a jury for the United States District Court for the Eastern District of Texas, Tyler Division, found the four asserted claims of the 746 patent to be invalid. This finding was in favor of EchoStar Technologies Corporation and Echosphere L.L.C., the two remaining defendants in the 746 Litigation. The Company continues to believe in the validity of the 746 patent and is currently assessing its options.

#### **Re-examination of United States Patent No. 6,285,746**

On October 2, 2006, the United States Patent and Trademark Office (the USPTO) ordered an *inter partes* re-examination of the 746 patent and issued its first office action related to this re-examination on October 30, 2006. This first action, which is not the final conclusion of the re-examination, rejected the five claims in the 746 patent. Forgent responded to the USPTO and anticipates working to vigorously defend all of the claims of the 746 patent. If the Company is unsuccessful in defending its patent's claims with the USPTO examiner, Forgent could pursue the appeal process within the USPTO and within the federal court system, if necessary. The USPTO has not issued any additional office actions related to this re-examination.

#### **Litigation of United States Patent Nos. 5,720,023 and 6,295,527**

On February 14, 2007, Cisco Systems, Inc. and Cisco Technology, Inc. (collectively Cisco) initiated litigation in the United States District Court for the Western District of Wisconsin against Forgent for alleged infringement of United States Patent Nos. 5,720,023 and 6,295,527. Cisco sought injunctive relief against sales of Forgent's Virtual Asset Manager software product and monetary damages, among other relief sought. On April 30, 2007, Cisco dismissed its claims with prejudice and Forgent likewise dismissed its counterclaims.

#### **Litigation of United States Patent No. 4,698,672**

Between April 2004 and November 2004, Forgent's wholly-owned subsidiary, Compression Labs, Incorporated (CLI), initiated litigation against multiple companies for infringement of the 672 patent in the United States District Court for the Eastern District of Texas, Marshall Division, seeking royalties from sales of infringing products and monetary damages, among other relief sought. Prior to fiscal year 2007, Forgent settled with defendants Adobe Systems, Inc.; Apple Computer, Incorporated; AudioVox Corporation; Axis Communications, Incorporated; BenQ America Corporation; Color Dreams, Inc.; JASC Software; Google Inc.; Macromedia, Inc.; ScanSoft, Inc.; Oce North America, Incorporated; Onkyo Corporation; Riverdeep, Incorporated; Xerox Corporation and Yahoo! Inc. On October 25, 2006, Forgent signed a Patent License and Settlement Agreement with the remaining defendants. Under this agreement, Forgent granted the defendants a patent license and the defendants paid Forgent \$8.0 million. Additionally, all parties agreed to release all claims against each other.

#### **Re-examination of United States Patent No. 4,698,672**

In January 2006, the USPTO granted a petition to re-examine the 672 patent and subsequently issued its first office action on May 25, 2006. Forgent responded to this first office action, which confirmed 27 of the 46 claims in the 672 patent. On March 26, 2007, the USPTO issued its final office action, which affirmed its first office action. Forgent responded to the USPTO on May 11, 2007 and is currently waiting for the USPTO's reply.

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

There are many factors that affect Forgent's business, prospects, liquidity and the results of operations, some of which are beyond the control of the Company. The following is a discussion of important risk factors that may cause the actual results of the Company's operations in future periods to differ materially from those currently expected or desired. Additional risks not presently known to management or risks that are currently believed to be immaterial, but which may become material, may also affect the Company's business, prospects, liquidity and results of operations.

**INTELLECTUAL PROPERTY LICENSING BUSINESS**

**If the Company is unable to obtain new license agreements, operating results will decline.**

The Company's Patent Licensing Program involves risks inherent in licensing intellectual property, including risks of protracted delays, legal or regulatory challenges that would lead to disruption or curtailment of the program, increasing expenditures associated with the pursuit of the program and other risks. Failure to sign new license agreements would cause operating results to suffer. There can be no assurance that the Company will be able to continue to license its technology to others. Additionally, quarterly operating results may fail to meet expectations for a number of reasons, including a decline in the demand for the Company's patented technology, higher than expected operating expenses and license delays due to legal and other factors.

**Forgent's litigation is dependent on highly competent, experienced and qualified legal counsel. If the Company changes its legal counsel, the Company's operating results and financial condition could suffer.**

Forgent's litigation involves intensive legal due diligence and negotiations. In the past, the Company changed its legal counsel, which cost the Company in terms of time and money. The Company may still encounter a number of risks associated with its current legal counsel, including but not limited to (1) turnover of individual attorneys working on the Company's Patent Licensing Program; (2) availability of key attorneys working on the program; (3) financial and other resources available to legal counsel; and (4) the financial strength of legal counsel. These risks may cause delays in Forgent's ability to pursue licensing agreements and settlements, which could require significant additional legal expenditures and could result in declining revenues and earnings for the Company.

**The Federal Trade Commission is conducting a non-public inquiry into the Company's Patent Licensing Program, as it relates to the 672 patent. Any negative results from the inquiry could adversely affect the Company.**

In December 2003, the Company received notification from the Federal Trade Commission (the "FTC") that it is conducting a non-public investigation to determine whether the Company may have engaged in violation of the Federal Trade Commission Act by reason of the alleged involvement of CLI in the JPEG standard-setting process during the 1980's and very early 1990's and its subsequent licensing of the 672 patent. The Company responded to the FTC's subpoena and the civil investigative demand in 2005. Forgent has not received any final conclusion from the FTC on its inquiries. If the FTC proceeds with its inquiry and thereafter determines that the Company acted improperly, further proceedings before the FTC could ensue.

**SOFTWARE & SERVICES BUSINESS**

**Claims of intellectual property infringement by third parties may adversely affect Forgent's business.**

On February 14, 2007, Cisco Systems, Inc. and Cisco Technology, Inc. (collectively "Cisco") initiated litigation in the United States District Court for the Western District of Wisconsin against Forgent for alleged infringement of United States Patent Nos. 5,720,023 and 6,295,527. Cisco sought injunctive relief against sales of Forgent's Virtual Asset Manager software product and monetary damages, among other relief sought. On April 30, 2007, Cisco dismissed its claims with prejudice and Forgent likewise dismissed its counterclaims.

However, Forgent may become subjected to other claims of intellectual property infringement by third parties as the number of competitors and available software products continues to grow and the functionality of such products increasingly overlap. Any infringement claims, with or without merit, could be time-consuming, result in costly litigation, divert management's attention and financial resources, cause the loss or deferral of sales or require Forgent to enter into royalty or license agreements. In the event of a successful claim of intellectual property infringement against Forgent, the Company's business, operating results and financial condition could be materially adversely affected, if Forgent is unable to either license the technology or similar technology or develop alternative technology on a timely basis. If Forgent is able to license the technology, such royalty or license agreements may not be available on terms acceptable to the Company.

**If Forgent is unable to successfully market and sell its software products and services, future software revenues will decline.**

The future success of the Company's software segment is dependent in significant part on its ability to generate demand for its NetSimplicity software products and services. To this end, Forgent's marketing and sales operations must increase market awareness of its products and services to generate increased revenue. All sales new hires will require training and may take time to achieve full productivity. Forgent cannot be certain that its new hires

will become as productive as necessary or that it will be able to hire enough qualified individuals or retain existing employees in the future. The Company cannot be certain that it will be successful in its efforts to market and sell its products and services. If it is not successful in building greater market awareness and generating increased sales, future software revenues may decline.

**Lack of new customers or additional sales from current customers could negatively affect the Company's ability to grow revenues.**

Forgent's business model depends on the expanded use of its software and Forgent must execute on its growth objectives. If the Company fails to grow its customer base or generate repeat and expanded business from its current customers, Forgent's software revenues could be adversely affected. Since the Company's maintenance and other service fees depend largely on the size and number of licenses that are sold, any downturn in Forgent's software license revenue would negatively impact the Company's deployment services revenue and future maintenance revenue. Additionally, if customers elect not to renew their maintenance agreements, Forgent's maintenance revenue could be adversely affected.

**Increased competition may have an adverse effect on the Company's profitability.**

The Company may encounter new entrants or competition from competitors in some or all aspects of its software business. The Company currently competes on the basis of price, technology, availability, performance, quality, reliability, service and support. There can be no assurance that the Company will be able to maintain a competitive advantage with respect to any of these factors. Many of Forgent's current and possibly future competitors have greater resources than the Company and, therefore, may be able to compete more effectively on price and other terms.

**Open source software may increase competition, resulting in decreases in Forgent's prices of its software products.**

Many different formal and informal groups of software developers and individuals have created a wide variety of software and have made that software available for use, distribution and modification, often free of charge. Such open source software has been gaining in popularity among business users, particularly small to medium sized businesses, which are some of Forgent's targeted customers. Although management is currently unaware of any competing open source software, if developers make scheduling or asset management software applications available to the open source community, and that software has competitive features, Forgent may need to change its pricing and distribution strategy in order to compete.

**Forgent's software products' functionality may be impaired if third-party hardware products associated with the NetSimplicity software do not operate successfully.**

In addition to its software products, Forgent currently sells hardware from partnered vendors to its customers. The effective implementation of Forgent's software products depends upon the successful operation of these third-party hardware products. Any undetected defects in these third-party products could prevent the implementation of or impair the functionality of Forgent's software or blemish the Company's reputation.

**If Forgent fails to introduce new versions and releases of functional and scalable software products in a cost-effective and timely manner, customers may license competing products and Forgent's revenues will decline.**

The technology industry is characterized by continuing improvements in technology, resulting in the frequent introduction of new products, short product life cycles, changes in customer needs and continual improvement in product performance characteristics. Forgent expects that its future financial performance will depend, in part, on revenue generated from its existing and future software products and the related products that the Company plans to develop and/or acquire. To be successful, Forgent must be cost-effective and timely in enhancing its existing software applications, developing new software technology and solutions that address the increasingly sophisticated and varied needs of its existing and prospective clients, and anticipating technological advances and evolving industry standards and practices.

Forgent spends a large portion of its research and development resources on product upgrades and may need to invest further in research and development in order to keep its software applications and solutions viable in the rapidly changing marketplace. This research and development effort, which may require significant resources, could ultimately be unsuccessful if Forgent does not achieve market acceptance for its new products or enhancements. Additionally, if the Company fails to anticipate and respond effectively to technological improvements or if Forgent's competitors release new products that are superior to Forgent's products in



performance and/or price, demand for the Company's software products may decline and Forgent may lose sales and fail to achieve anticipated revenues.

**Errors or defects in Forgent's software could reduce demand for its software and result in decreased revenues, decreased market acceptance and injury to the Company's reputation.**

Errors or defects in the Company's software, sometimes called bugs, may be found from time-to-time, particularly when new versions or enhancements are released. Any significant software errors or defects may result in loss of sales, decreased revenues, delay in market acceptance and injury to the Company's reputation. Despite extensive product testing during development, new versions or enhancements of Forgent's software may still have errors after commencement of commercial shipments. Forgent corrects the bugs and delivers the corrections in subsequent maintenance releases and patches. However, errors or defects could put Forgent at a competitive disadvantage and can be costly and time-consuming to correct.

**If Forgent is unable to develop or maintain strategic relationships with its resellers and vendor partners who market and sell the Company's products, software revenues may decline.**

Forgent supplements its direct sales force by contracting with resellers to generate international sales and vendor partners to help increase sales. Currently, resellers generate a relatively small portion of Forgent's software sales. Therefore, Forgent's software revenue growth will depend, in part, on adding new resellers and partners to expand its sales channels, as well as leveraging the relationships with existing resellers and partners. If the Company is unable to enter into successful new strategic relationships in the future or if the Company's current relationships with its resellers and partners deteriorate or terminate, Forgent may lose sales and software revenues may decline.

**OTHER**

**Historically, the Company has not been profitable and Forgent may continue to incur losses, which may result in decreases in revenues if customers raise viability concerns.**

Although Forgent generated net income for the nine months ended April 30, 2007, the Company incurred losses during the prior fiscal quarters. As of April 30, 2007, Forgent had an accumulated deficit of \$240.7 million and Forgent may incur additional losses in the future. Continued losses may cause existing and new customers to question the Company's viability and be reluctant to purchase from the Company. If Forgent is unable to increase its sales due to such concerns, revenues will decline, which would further adversely affect the Company's operating results. Therefore, there are no assurances that the Company can achieve or generate sufficient revenues to continue its current profitability.

**Forgent may not be able to protect or enforce its intellectual property rights which could cause the Company's ability to license its technologies to be impaired.**

The Company's success and ability to compete are substantially dependent on its proprietary technology and trademarks. The Company seeks to protect these assets through a combination of patent and trademark laws as well as confidentiality procedures and contractual provisions. These legal protections afford only limited protection and enforcement of these rights may be time consuming and expensive. If Forgent cannot protect or enforce these rights, the Company's ability to obtain future licenses could be impaired. Furthermore, despite best efforts, the Company may be unable to prevent third parties from infringing upon or misappropriating its intellectual property. Competitors may also independently develop similar, but not infringing, technology, duplicate products or design around the Company's patents or other intellectual property. Additionally, the Company's patent applications or trademark registrations may not be approved. Moreover, even if approved, the resulting patents or trademarks may not provide Forgent with any competitive advantage or may be challenged by third parties. If challenged, patents might not be upheld or claims could be narrowed. Any litigation surrounding the Company's rights would force Forgent to divert important financial and other resources away from business operations.

Although Forgent is unable to determine the extent to which piracy of its software products occurs, management believes software piracy could be a problem. Since Forgent has international resellers and customers, piracy may occur in foreign countries where laws do not protect proprietary rights to the same extent as the laws in the United States.

**Forgent may face problems in connection with future acquisitions, which could create business difficulties and adversely affect operations.**

As part of Forgent's business strategy, Forgent may acquire additional businesses, products and technologies that could complement or expand its ongoing business. However, Forgent may be unable to identify

suitable acquisitions or investment candidates. Even if Forgent identifies suitable candidates, there are no assurances that the Company will be able to make the acquisitions or investments on favorable terms. Negotiations of potential acquisitions could divert management time and resources and the Company may incorrectly judge the value or worth of an acquired business, product or technology. Additionally, Forgent may incur significant debt or be required to issue equity securities to pay for such future acquisitions or investments.

If Forgent acquires a company, Forgent may have difficulties integrating the products, services, technologies, personnel and operations into the Company's ongoing business. These difficulties could disrupt Forgent's ongoing business, distract management and the workforce, increase expenses and adversely affect operating results. If Forgent is unable to fully integrate acquired businesses, products or technologies with its existing operations, Forgent may not achieve the intended benefits of such acquisitions and related expenditures.

**If Forgent elects to raise additional capital, funds may not be available or if available, may not be on favorable terms to the Company.**

In the future, Forgent may elect to raise additional capital to fund its operations and/or acquisitions. However, Forgent cannot be certain that it will be able to obtain additional financing on favorable terms, if at all. If Forgent takes out additional loans, the Company may incur significant interest expense, which could adversely affect results of operations. If Forgent issues equity securities, its stockholders' percentage of ownership would be reduced and the new equity securities may have rights, preferences or privileges senior to those existing stockholders of the Company's common stock. If Forgent is unable to raise funds on acceptable terms, Forgent may not be able to acquire additional businesses, products or technologies, develop or enhance its existing products, respond to competitive pressures or unanticipated requirements, or take advantage of future opportunities, all of which could adversely affect Forgent's business, operating results and financial condition.

**Forgent may experience significant fluctuations in its quarterly results and if the Company's future results are below expectations, the price for the Company's common stock may decline.**

In the past, Forgent's revenues and operating results have varied significantly from quarter to quarter. Additionally, management expects that revenues and operating results may continue to fluctuate significantly from quarter to quarter. These fluctuations may lead to reduced prices for the Company's common stock. Several factors may cause the quarterly results to fluctuate, including:

- timing of intellectual property license agreements and related recording of licensing revenues;
- resolution of the FTC's non-public investigation;
- timing and costs related to the Company's 746 Litigation;
- market demand for NetSimplicity's software products and services;
- timing of customers' budget cycles;
- timing of customer orders and deployment of NetSimplicity's software products and services;
- the mix of software license and services revenues;
- timing of introducing new products and services or enhancements to existing products and services;
- new product releases or pricing policies by Forgent's competitors;
- seasonal fluctuations in capital spending;
- changes in the rapidly evolving market for web-based applications;
- management's ability to manage operating costs, a large portion of which are relatively fixed in advance of any particular quarter;
- timing and costs related to possible acquisitions of businesses, products or technologies;

- costs of attracting, retaining and training skilled personnel;
- management's ability to manage future growth;
- changes in U.S. generally accepted accounting principles; and
- general economic climate.

Some of these factors are within management's control while others are not. Accordingly, management believes that quarter-to-quarter comparisons of the Company's revenues and operating results are not necessarily meaningful and that market analysts and investors should not rely on the results of any particular quarter as an indication of future performance.

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**The loss of key management and personnel could hinder the development of Forgent's technology and otherwise adversely affect the Company's business.**

Forgent relies on the continued contributions of its senior management, sales and marketing, professional services and finance personnel. Forgent's success depends upon its ability to attract, hire and retain highly qualified and experienced personnel, especially software developers and engineers who design and develop software applications in order to keep pace with client demand for rapidly evolving technologies and varying client needs. The Company's operations are also dependent on the continued efforts of its executive officers and senior management and Forgent will likely depend on the senior management of any business it may acquire in the future. If any of the Company's key personnel or senior management are unable or unwilling to continue in his or her present role, or if Forgent is unable to attract, train, retain and manage its employees effectively, Forgent could encounter difficulties in developing new products and product enhancements, generating revenue through increased sales efforts and providing high quality customer service.

**Forgent executed a new shareholders rights plan that could make it difficult for another company to acquire control of the Company.**

In December 2005, Forgent's Board of Directors approved and executed a shareholder rights plan ( Rights Plan ) whereby one preferred share purchase right was distributed for each outstanding share of Forgent's common stock for all stockholders of record on December 31, 2005. The Rights Plan, which was not adopted in response to any threat to the Company, was designed to guard against any proposed takeover, partial tender offers, open market accumulations and other tactics designed to gain control of the Company. Under the new plan, the rights become exercisable if a person or group thereafter acquires 15% or more of Forgent's common stock or announces a tender offer for 15% or more of Forgent's common stock. Such events, or if the Company is acquired in a merger or other business combination transaction after a person or group acquires 15% or more of its common stock, would entitle the right holder to purchase, at an exercise price of \$13.00, a number of shares of common stock having a market value at that time of twice the right's exercise price. The Rights Plan may have the effect of discouraging, delaying or preventing unsolicited acquisition proposals, but there are no assurances a change of control will not occur.

Due to the risk factors noted above and elsewhere in Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company, Forgent's past earnings and stock price have been, and future earnings and stock price potentially may be, subject to significant volatility, particularly on a quarterly basis. Past financial performance should not be considered a reliable indicator of future performance and investors are cautioned in using historical trends to anticipate results or trends in future periods. Any shortfall in revenue or earnings from the levels anticipated by market analysts and investors could have an immediate and significant effect on the trading price of the Company's common stock.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

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

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

Exhibits:

- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's quarterly report on Form 10-Q for the three months ended October 31, 2004).

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- 3.2 Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Company's quarterly report on Form 10-Q for the three months ended October 31, 2004).
- 4.1 Specimen Certificate for the Common Stock (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 4.2 Rights Agreement, dated as of December 19, 2005, between Forgent Networks, Inc. and American Stock Transfer & Trust Company, which includes the form of Series A Preferred Stock, \$0.01 par value, the form of Rights Certificate, and the Summary of Rights (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated December 19, 2005).
- 10.38\* Settlement and Patent License Agreement, effective April 25, 2007, by and among Forgent Networks, Inc., Motorola, Inc, and Digeo, Inc.
- 10.39\* Settlement and License Agreement, effective April 25, 2007, between Forgent Networks, Inc. and Cisco Systems, Inc.
- 31.1\*\* Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\*\* Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\*\* Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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\* Filed herewith; confidential treatment has been requested for certain portions of the Exhibit.

\*\* Filed herewith.

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**SIGNATURES**



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Pursuant to the requirements 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.

FORGENT NETWORKS, INC.

Date: June 14, 2007

By: /s/ RICHARD N. SNYDER  
Richard N. Snyder  
Chief Executive Officer

Date: June 14, 2007

By: /s/ JAY C. PETERSON  
Jay C. Peterson  
Chief Financial Officer

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