OMEGA HEALTHCARE INVESTORS INC
Form S-11/A
March 27, 2007

As filed with the Securities and Exchange Commission on March 27, 2007

Registration No. 333-141242

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

Amendment No. 1
to
FORM S-11

FOR REGISTRATION UNDER THE SECURITIES ACT OF 1933
OF SECURITIES OF CERTAIN REAL ESTATE COMPANIES

OMEGA HEALTHCARE INVESTORS, INC.
(Exact name of registrant as specified in its charter)

MARYLAND	**38-3041398**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9690 Deereco Road, Suite 100
Timonium, Maryland 21093
(410) 427-1700
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

C. Taylor Pickett
Chief Executive Officer
Omega Healthcare Investors, Inc.
9690 Deereco Road, Suite 100
Timonium, Maryland 21093
(410) 427-1700
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies of communications to:

Richard H. Miller, Esq.
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Fourteenth Floor
1201 West Peachtree Street NW
Atlanta, Georgia 30309
(404) 572-6600

Approximate date of commencement of proposed sale to the public: From time to time or at one time after the effective date of this registration statement.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Unit	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee (2)(3)
Common Stock, par value $.10 per share	7,130,000(1)	$ 17.21	$122,707,300	$3,768

(1) Includes 930,000 shares of the Registrant's common stock which may be issued upon exercise of a 30 day option granted to underwriters to cover over-allotments, if any.

(2) A registration fee of $3,768 was paid with this Amendment No. 1 to this Registration Statement, estimated solely for purposes of computing the registration fee and computed in accordance with Rule 457(c) upon the basis of the high and low prices per share of the Registrant’s Common Stock on March 20, 2007 for 7,130,000 shares.

(3) $1,522 of the registration fee was previously paid in connection with the initial filing of this Registration Statement on March 13, 2007.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS Subject to Completion March 27, 2007

6,200,000 Shares

OMEGA HEALTHCARE INVESTORS, INC.
Common Stock

We are offering for sale 6,200,000 shares of our common stock to be sold in this offering. We will receive all of the net proceeds from the sale of such common stock.

Our common stock is listed on the New York Stock Exchange, or NYSE, under the symbol "OHI." On March 26, 2007, the last reported sale price of our common stock on the NYSE was $17.72 per share.

Investing in our common stock involves a high degree of risk. Before buying any shares, you should read the discussion of material risks of investing in our common stock in "Risk factors" beginning on page 9 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us	$	$

The underwriters may also purchase up to an additional 930,000 shares of common stock from us at the public offering price, less underwriting discounts and commissions payable by us, to cover over-allotments, if any, within 30 days from the date of this prospectus. If the underwriters exercise the option in full, the total underwriting discounts and commissions will be $, and the total proceeds, before expenses, to us will be $.

The underwriters are offering the shares of our common stock as set forth under "Underwriting." Delivery of the shares of common stock will be made on or about March , 2007.

Sole Book Running Manager
UBS Investment Bank

Co-Managers

Banc of America Securities LLC

Deutsche Bank Securities

Stifel Nicolaus

You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized anyone to provide you with additional information or information different from that contained in this prospectus. We are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of shares of common stock.

TABLE OF CONTENTS

This prospectus includes market share, industry data and forecasts that we obtained from the United States Census Bureau and the Centers for Medicare and Medicaid Services, or CMS. In this prospectus, we refer to additional information regarding market data obtained from internal sources, market research, publicly available information and industry publications. Although we believe the information is reliable, we cannot guarantee the accuracy or completeness of the information and have not independently verified it.

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission, or the SEC, on Form S-11 to register the shares offered by this prospectus. This prospectus does not include all of the information contained in the registration statement. For further information about us and the common stock offered in this prospectus, you should review the registration statement. You should read this prospectus together with additional information described under the heading "Available Information."

All references to "you" in this prospectus refer to those persons who invest in the common stock being offered by this prospectus, and all references to "we," "us" and "our" in this prospectus refer to Omega Healthcare Investors, Inc., a Maryland corporation, and its subsidiaries.

Prospectus summary

The following summary may not contain all the information that may be important to you. You should read the entire prospectus and the documents we have filed with the SEC before making a decision to invest in our common stock.

OUR COMPANY

We are a self-administered real estate investment trust, or REIT, investing in income-producing healthcare facilities, principally long-term care facilities located in the United States. We provide lease or mortgage financing to qualified operators of skilled nursing facilities, or SNFs, and, to a lesser extent, assisted living facilities, or ALFs and rehabilitation and acute care facilities. We have historically financed investments through borrowings under our revolving credit facilities, private placements or public offerings of debt or equity securities, the assumption of secured indebtedness, or a combination of these methods.

Our portfolio of investments, as of December 31, 2006, consisted of 239 healthcare facilities, located in 27 states and operated by 32 third-party operators. This portfolio is made up of:

- 228 long-term healthcare facilities and two rehabilitation hospitals owned and leased to third parties; and
- fixed rate mortgages on nine long-term healthcare facilities.

As of December 31, 2006, our gross investments in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately $1.3 billion. In addition, we also held miscellaneous investments of approximately $22 million at December 31, 2006, consisting primarily of secured loans to third-party operators of our facilities.

For the year ended December 31, 2006, we generated operating revenue of $135.7 million, net income of $55.7 million, and $76.7 million of funds from operations, or FFO. FFO is not a financial measure recognized under generally accepted accounting principles in the United States of America, or GAAP, and, therefore, should not be considered a measure of liquidity, an alternative to net income or an indicator of any other performance measure determined in accordance with GAAP. For more information with respect to FFO and a reconciliation of FFO to GAAP net income, see footnote 2 in the section entitled "Summary Historical Financial Information."

OUR PROPERTY INVESTMENTS

We own a diversified portfolio of assets. The following table summarizes our property investments as of December 31, 2006:

Investment Structure/Operator	Number of Beds[(1)]	Number of Facilities	Occupancy Percentage [(1)]	Gross Investment (in thousands)
Purchase/Leaseback[(2)]				
Sun Healthcare Group, Inc.	4,523	38	86%	$ 210,222
CommuniCare Health Services, Inc.	2,781	18	89	185,821
Haven Healthcare	1,787	15	91	117,230
HQM of Floyd County, Inc	1,466	13	87	98,368
Advocat Inc	2,925	28	78	94,432
Guardian LTC Management, Inc.[(4)]	1,308	17	83	85,981

Nexion Health Inc	2,412	20	78	80,211
Essex Health Care Corporation	1,388	13	78	79,354
Seacrest Healthcare	720	6	92	44,223

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Investment Structure/Operator	Number of Beds	Number of Facilities	Occupancy Percentage (1)	Gross Investment (in thousands)
Senior Management	1,413	8	70	35,243
Mark Ide Limited Liability Company	832	8	77	25,595
Harborside Healthcare Corporation	465	4	92	23,393
StoneGate Senior Care LP	664	6	87	21,781
Infinia Properties of Arizona, LLC	378	4	63	19,289
USA Healthcare, Inc	489	5	65	15,703
Rest Haven Nursing Center, Inc	200	1	90	14,400
Conifer Care Communities, Inc.	204	3	89	14,367
Washington N&R, LLC	286	2	75	12,152
Triad Health Management of Georgia II, LLC	304	2	98	10,000
Ensign Group, Inc	271	3	92	9,656
Lakeland Investors, LLC	300	1	73	8,893
Hickory Creek Healthcare Foundation, Inc.	138	2	85	7,250
Liberty Assisted Living Centers, LP	120	1	85	5,997
Emeritus Corporation	52	1	66	5,674
Longwood Management Corporation(5)	185	2	91	5,425
Generations Healthcare, Inc.	60	1	84	3,007
Skilled Healthcare(6)	59	1	92	2,012
Healthcare Management Services(6)	98	1	48	1,486
	25,828	224	83	1,237,165
Assets Held for Sale				
Active Facilities(7)	354	5	58	3,443
Closed Facility	—	1	—	125
	354	6	58	3,568
Fixed Rate Mortgages(3)				
Advocat Inc	423	4	82	12,587
Parthenon Healthcare, Inc	300	2	73	10,730
CommuniCare Health Services, Inc.	150	1	91	6,454
Texas Health Enterprises/HEA Mgmt. Group, Inc.	147	1	68	1,230
Evergreen Healthcare	100	1	67	885
	1,120	9	80	31,886
Total	27,302	239	82	$ 1,272,619

(1) Represents the most recent data provided by our operators.

(2) Certain of our lease agreements contain purchase options that permit the lessees to purchase the underlying properties from us. Some of these purchase options could result in us receiving less than fair market value for such facility. As of the date of this prospectus, leases applicable to approximately 9.16% of our total gross investments contain purchase options. The purchase options relating to .16% are currently exercisable, the purchase options relating to .70% are exercisable at specified times during the next four years, and the purchase options relating to 8.30% are exercisable in ten years.

(3) In general, many of our mortgages contain prepayment provisions that permit prepayment of the outstanding principal amounts thereunder.

(4) All 17 facilities are subject to a purchase option on September 1, 2015.

(5) Both facilities are subject to a purchase option on November 1, 2007.

(6) The facility is subject to a purchase option on November 1, 2007.
(7) Two facilities representing $1.9 million were purchased on January 31, 2007 pursuant to a purchase option.

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OUR COMPETITIVE STRENGTHS

Geographically Diverse Property Portfolio. Our portfolio of properties is broadly diversified by geographic location. We have healthcare facilities located in 27 states. Only two states comprised more than 10% of our rental and mortgage income in 2006. In addition, the majority of our 2006 rental and mortgage income was derived from facilities in states that require state approval for development and expansion of healthcare facilities. We believe that such state approvals may limit competition for our operators and enhance the value of our properties.

Large Number of Tenants. Our facilities are operated by 32 different public and private healthcare providers. Except for Sun Healthcare Group, Inc., or Sun, and CommuniCare Health Services, Inc., or CommuniCare, which together hold approximately 32% of our portfolio (by gross investment value), no single tenant holds greater than 10% of our portfolio (by gross investment value).

Significant Number of Long-term Leases and Mortgage Loans. A large portion of the properties in our core portfolio are subject to long-term lease and mortgage agreements. At December 31, 2006, approximately 94% of our leases and mortgages had primary terms that expire in 2010 or later. Our leased real estate properties are leased under provisions of single facility leases or master leases with initial terms typically ranging from 5 to 15 years, plus renewal options. Substantially all of the leases and master leases provide for minimum annual rentals that are subject to annual increases based upon increases in the Consumer Price Index, or CPI, or increases in revenues of the underlying properties, with certain limits. Under the terms of the leases, the lessee is responsible for all maintenance, repairs, taxes and insurance on the leased properties.

Experienced Management Team. The top four members of our executive team average over 19 years of experience in the long-term healthcare industry. We believe that the long, accomplished tenure of our management team helps to distinguish us from our competitors in the long-term healthcare industry.

OUR STRATEGY

In making investments in properties, we generally have focused on established, creditworthy, middle-market healthcare operators that meet our standards for quality and experience of management. We have sought to diversify our investments in terms of geographic locations and operators. In evaluating potential investments, we consider such factors as:

- the quality and experience of management and the creditworthiness of the operator of the facility;
- the facility's historical and forecasted cash flow and its ability to meet operational needs, capital expenditure requirements and lease or debt service obligations, providing a competitive return on our investment;
- the construction quality, condition and design of the facility;
- the geographic area of the facility;
- the tax, growth, regulatory and reimbursement environment of the jurisdiction in which the facility is located;
- the effect of an investment in such facility on our ability to qualify as a REIT;
- the occupancy and demand for similar healthcare facilities in the same or nearby communities; and
- the payor mix of private, Medicare and Medicaid patients.

We prefer to invest in equity ownership of properties. Due to regulatory, tax or other considerations, we sometimes pursue alternative investment structures that can achieve returns comparable to equity investments.

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OUR INDUSTRY

We are a REIT that invests in income-producing healthcare facilities, principally long-term care facilities located in the United States. Within the long-term care industry, we focus specifically on the approximately $122 billion United States nursing home market by providing lease or mortgage financing to operators of SNFs and, to a lesser extent, assisted living and acute care facilities. According to Centers for Medicare and Medicaid Services, or CMS, as of December 2006, there were approximately 16,000 nursing homes with approximately 1.7 million total beds certified to provide Medicare and/or Medicaid services in the United States. The nursing home industry is highly fragmented. As of May 2003, the ten largest for-profit chains combined control approximately 16% of the industry's beds, with the largest company operating just under 3% of the industry's beds.

The aging population and increased life expectancies are the primary growth drivers for long-term care facilities. According to the United States Census Bureau, in 2005, there were approximately 35 million Americans aged 65 or older, comprising approximately 12% of the total United States population. The number of Americans aged 65 or older is expected to climb to approximately 40.2 million by 2010 and to approximately 54.6 million by 2020. In addition to positive demographic trends, the demand for the services provided by operators of long-term care facilities is expected to increase substantially during the next decade due primarily to the impact of cost containment measures by government and private-pay sources resulting in higher acuity patients being transferred more quickly from hospitals to less expensive care settings such as SNFs. According to CMS, national nursing home expenditures are expected to grow from $122 billion in 2005 to $211 billion in 2016, representing a 5.1% compounded annual growth rate. We believe that these trends will support a growing demand for the services provided by nursing and assisted living facility operators, which in turn will support a growing demand for our properties.

In recent years, Congress has enacted three significant laws that have dramatically altered payments to operators of SNFs under Medicare. Beginning with the enactment of the Balanced Budget Act of 1997, or Balanced Budget Act, payments for Medicare services were reduced and extensive changes in the Medicare and Medicaid programs were made. Congress twice enacted legislation intended to mitigate temporarily the reduction in Medicare reimbursement rates for SNFs caused by the Balanced Budget Act. These bills were the Medicare, Medicaid, and SCHIP Balanced Budget Refinement Act of 1999, or Balanced Budget Refinement Act, and the Medicare, Medicaid and SCHIP Benefits Improvement and Protection Act of 2000, or Benefits Improvement and Protection Act. These acts implemented several temporary payment increases for services provided under Medicare in SNFs.

On August 4, 2005, CMS published a final rule, effective October 1, 2005, establishing Medicare payments for SNFs under the prospective payment system for federal fiscal year 2006, thereby triggering the elimination of the remaining temporary payment increases arising from the Balanced Budget Refinement Act and the Benefits Improvement and Protection Act. CMS estimated that the increases in Medicare reimbursements to SNFs arising from refinements to the prospective payment system under the final rule would offset the reductions stemming from the elimination of the temporary increases during federal fiscal year 2006 (October 1, 2005 through September 30, 2006), resulting in a overall increase in Medicare payments to SNFs of $20 million in fiscal year 2006 compared to 2005. We cannot accurately predict what effect, if any, these changes will have on individual operators, and as a result, our business in 2007 and beyond.

Furthermore, Medicaid programs, which are administered at the state level and are a significant source of revenues for our operators, are impacted by fluctuations in state budgets. The recent economic climate has had a detrimental effect on state revenues in most regions of the United States. Given that Medicaid outlays are a significant component of state budgets, we expect continuing cost containment pressures on Medicaid outlays for skilled nursing services in the states in which we maintain facilities.

In large part as a result of the 1997 changes in Medicare reimbursement of services provided by SNFs and reimbursement cuts imposed under state Medicaid programs, a number of operators of our properties have encountered significant financial difficulties in recent years. Some of these operators, including Sun and Integrated Health Services, or IHS, who is no longer one of our operators, filed for bankruptcy protection. Other operators were required to undertake significant restructuring efforts. We have restructured our arrangements with many of our operators by renegotiating lease and mortgage terms, re-leasing properties to new operators and closing and/or disposing of properties.

RECENT DEVELOPMENTS

Increase in Credit Facility

Pursuant to Section 2.01 of our Credit Agreement, dated as of March 31, 2006, as amended, by and among OHI Asset, LLC, a Delaware limited liability company, OHI Asset (ID), LLC, a Delaware limited liability company, OHI Asset (LA), LLC, a Delaware limited liability company, OHI Asset (TX), LLC, a Delaware limited liability company, OHI Asset (CA), LLC, a Delaware limited liability company, Delta Investors I, LLC a Maryland limited liability company, Delta Investors II, LLC, a Maryland limited liability company and Texas Lessor - Stonegate, LP, a Maryland limited partnership, the Lenders identified therein, and Bank of America, N.A., as Administrative Agent, we are permitted under certain circumstances to increase our available borrowing base under the Credit Agreement from $200 million up to an aggregate of $300 million. Effective as of February 22, 2007, we exercised our right to increase our available revolving commitment under Section 2.01 of the Credit Agreement from $200 million to $255 million and we consented to the addition of 18 of our properties to the borrowing base assets under the Credit Agreement. For additional information regarding our Credit Agreement, see Management’s discussion and analysis of financial condition and results of operations - Liquidity and capital resources - *Financing activities and borrowing arrangements.*

Restatement

In December 2006, we filed an amended Annual Report on Form 10-K/A to correct our previously issued historical consolidated financial statements as of December 31, 2005 and 2004, and for each of the three years in the period ended December 31, 2005, for errors in previously reported amounts related to income tax matters and asset values, as well as the recording of straight-line rental income. Please see the sections of this prospectus entitled "Certain federal income tax consequences - Taxation of Omega" and "Risk Factors - Tax Risks" for additional information.

CORPORATE INFORMATION

We were incorporated in the State of Maryland on March 31, 1992. Our principal executive offices are located at 9690 Deereco Road, Suite 100, Timonium, Maryland 21093, and our telephone number is (410) 427-1700.

The offering

Common stock we are offering	6,200,000 shares.
Common stock to be outstanding immediately after the offering	66,300,859 shares.
New York Stock Exchange symbol	OHI
Use of proceeds	We intend to use all of the net proceeds of this offering to repay indebtedness outstanding under our senior revolving credit facility. If and to the extent there are net proceeds remaining after we have repaid all indebtedness under our senior revolving credit facility, we will use these proceeds for working capital and general corporate purposes. See "Use of Proceeds."
Risk factors	This investment involves a high degree of risk. See the section entitled "Risk Factors" beginning on page 9 of this prospectus for a discussion of certain factors you should consider before deciding to invest in our common stock.

The number of shares of our common stock outstanding after this offering is based on approximately 60,100,859 shares outstanding as of March 26, 2007 and excludes:

- 47,244 shares of our common stock issuable upon exercise of options outstanding as of December 31, 2006 at a weighted average exercise price of $12.70 per share;
- 1,516,428 shares of our common stock available for issuance under our dividend reinvestment and common stock purchase plan as of December 31, 2006;
- 2,891,980 shares of our common stock available for future grant under our 2000 Stock Incentive Plan and our 2004 Stock Incentive Plan; and
- 930,000 shares of our common stock that may be purchased by underwriters to cover over-allotments, if any.

Unless otherwise stated, all information in this prospectus supplement assumes that the underwriters do not exercise their over-allotment option.

Summary historical financial information

The following table sets forth summary consolidated financial data as of the dates and for the periods presented. The operating data and other financial data as of, and for each of the years during the three-year period ended, December 31, 2006 have been derived from, and should be read in conjunction with, our audited consolidated financial statements and the related notes included elsewhere in this prospectus. The operating data and other financial data as of and for each of the years ended December 31, 2002 and 2003 are derived from our audited consolidated financial statements.

	Year ended December 31,				
	2002	**2003**	**2004**	**2005**	**2006**
			(in thousands)		
Operating data:					
Revenues:					
Core operations	$ 80,572	$ 76,803	$ 86,972	$ 109,644	$ 135,693
Nursing home operations	42,203	4,395	—	—	—
Total revenues	122,775	81,198	86,972	109,644	135,693
Interest expense	27,381	20,802	24,902	32,021	44,126
(Loss) income from continuing operations	(2,561)	27,770	13,371	37,355	56,042
Net (loss) income available to common shareholders	(32,801)	3,516	(36,715)	25,355	45,774
Other financial data:					
Depreciation and amortization (1)	17,495	18,129	18,842	23,856	32,113
Funds from operations(2)	(15,025)	25,091	(18,474)	42,663	76,683

	Twelve months ended December 31, 2006	
	Actual	**As adjusted(3)**
Balance sheet data:	(in thousands)	
Cash	$ 729	729
Gross investment	1,294,697	1,294,697
Total assets	1,175,370	1,175,370
Total debt(4)	676,141	572,270
Stockholders' equity	465,454	569,325

(1) Excludes amounts included in discontinued operations

(2) We consider funds from operations, or FFO, to be a key measure of a REIT's performance which should be considered along with, but not as an alternative to, net income and cash flow as a measure of operating performance

and liquidity. We calculate and report FFO in accordance with the definition and interpretive guidelines issued by the National Association of Real Estate Investment Trusts, or NAREIT, and, consequently, FFO is defined as net income available to common stockholders, adjusted for the effects of asset dispositions and certain non-cash items, primarily depreciation and amortization. We believe that FFO is an important supplemental measure of our operating performance. Because the historical cost accounting convention used for real estate assets requires depreciation (except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time, while real estate values instead have historically risen or fallen with market conditions. The term FFO was designed by the real estate industry to address this issue. FFO herein is not necessarily comparable to FFO of other REITs that do not use the same definition of implementation guidelines or interpret the standards differently from us.

We use FFO as one of several criteria to measure operating performance of our business. We further believe that by excluding the effect of depreciation, amortization and gains or losses from sales of real estate, all of which are based on historical costs and which may be of limited relevance in evaluating current performance, FFO can facilitate comparisons of operating performance between periods and between other REITs. We offer this measure to assist the users of our financial performance under GAAP and FFO should not be considered a measure of liquidity, an alternative to net income or an indicator of any other performance measure determined in accordance with GAAP. Investor and potential investors in our securities should not rely on this measure as a substitute for any GAAP measure, including net income.

In February 2004, NAREIT informed its member companies that it was adopting the position of the SEC with respect to asset impairment charges and would no longer recommend that impairment write-downs be excluded from FFO. In the table included below, we have applied this interpretation and have not excluded asset impairment charges in calculating our FFO. As a result, our FFO may not be comparable to similar measures reported in previous disclosures. According to NAREIT, there is inconsistency among NAREIT member companies as to the adoption of this interpretation of FFO. Therefore, a comparison of our FFO results to another company's FFO results may not be meaningful.

The following table is a reconciliation of net income (loss) available to common shareholders to FFO:

	Year ended December 31,				
	2002	**2003**	**2004**	**2005**	**2006**
			(in thousands)		
Net income (loss) available to common shareholders	(32,801)	3,516	(36,715)	25,355	45,774
(Deduct gain) add back loss from real estate dispositions[(a)]	(2,548)	149	(3,310)	(7,969)	(1,354)
	(35,349)	3,665	(40,025)	17,386	44,420
Elimination of non-cash items included in net income (loss):					
Depreciation and amortization[(b)]	21,270	21,426	21,551	25,277	32,263
Adjustments of derivatives to fair market value	(946)	—	—	—	—
FFO	(15,025)	25,091	(18,474)	42,663	76,683

(a) *The add back of loss/deduction of gain from real estate dispositions includes the facilities classified as discontinued operations in our audited consolidated financial statements included in our Annual Reports on Form 10-K for the three year period ended December 31, 2006.*

(b) *The add back of depreciation and amortization includes the facilities classified as discontinued operations in our audited consolidated financial statements included in our Annual Reports on Form 10-K for the three year period ended December 31, 2006. The 2002, 2003, 2004, 2005 and 2006 includes depreciation of $3.8 million, $3.3 million, $2.7 million, $1.4 million , and $0.2 million, respectively, related to facilities classified as discontinued operations.*

(3) *As adjusted basis giving effect to our sale of the common stock in this offering at an assumed offering price of $17.72 per share and the receipt of the estimated net proceeds of this sale of $103.9 million, the assumed application of the approximately $103.9 million of net proceeds to repay a portion of our outstanding borrowings under our senior revolving credit facility.*

(4) *Total debt includes long-term debt and current maturities of long-term debt.*

Risk factors

You should carefully consider the risks described below. These risks are not the only ones that we may face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any of the following risks occurs, our business, financial condition or results of operations could be materially and adversely affected.

RISKS RELATED TO THE OPERATORS OF OUR FACILITIES

Our financial position could be weakened and our ability to fulfill our obligations under our indebtedness could be limited if any of our major operators were unable to meet their obligations to us or failed to renew or extend their relationship with us as their lease terms expire, or if we were unable to lease or re-lease our facilities or make mortgage loans on economically favorable terms. These adverse developments could arise due to a number of factors, including those listed below.

The bankruptcy, insolvency or financial deterioration of our operators could delay or limit our ability to collect, in full or at all, unpaid rents or require us to find new operators for rejected facilities.
We are exposed to the risk that our operators may not be able to meet their obligations, which may result in their bankruptcy or insolvency. Although our leases and loans provide us the right to terminate an investment, evict an operator, demand immediate repayment and other remedies, title 11 of the United States Code, 11 U.S.C. §§ 101-1330, as amended and supplemented, or the Bankruptcy Code, affords certain protections to a party that has filed for bankruptcy that would probably render certain of these remedies unenforceable, or, at the very least, delay our ability to pursue such remedies. In addition, an operator in bankruptcy may be able to restrict our ability to collect unpaid rent or mortgage payments during the bankruptcy case.

Furthermore, the receipt of liquidation proceeds or the replacement of an operator that has defaulted on its lease or loan could be delayed by the approval process of any federal, state or local agency necessary for the transfer of the property or the replacement of the operator licensed to manage the facility. In addition, some significant expenditures associated with real estate investment, such as real estate taxes and maintenance costs, are generally not reduced when circumstances cause a reduction in income from the investment. In order to protect our investments, we may take possession of a property or even become licensed as an operator, which might expose us to successor liability under government programs (or otherwise) or require us to indemnify subsequent operators to whom we might transfer the operating rights and licenses. Third-party payors may also suspend payments to us following foreclosure until we receive the required licenses to operate the facilities. Should such events occur, our income and cash flow from operations would be adversely affected.

A debtor may have the right to assume or reject a lease with us under bankruptcy law and his or her decision could delay or limit our ability to collect rents thereunder.
If one or more of our lessees files bankruptcy relief, the Bankruptcy Code provides that a debtor has the option to assume or reject the unexpired lease within a certain period of time. However, our lease arrangements with operators that operate more than one of our facilities are generally made pursuant to a single master lease covering all of that operator's facilities leased from us, and consequently, it is possible that in bankruptcy the debtor-lessee may be required to assume or reject the master lease as a whole, rather than making the decision on a facility by facility basis, thereby preventing the debtor-lessee from assuming only the better performing facilities and terminating the leasing arrangement with respect to the poorer performing facilities. The Bankruptcy Code generally requires that a debtor must assume or reject a contract in its entirety. Thus, a debtor cannot choose to keep the beneficial provisions of a contract

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while rejecting the burdensome ones; the contract must be assumed or rejected as a whole. However, where under applicable law a contract (even though it is contained in a single document) is determined to be divisible or severable into different agreements, or similarly where a collection of documents are determined to constitute separate agreements instead of a single, integrated contract, then in those circumstances a debtor/trustee may be allowed to assume some of the divisible or separate agreements while rejecting the others. Whether a master lease agreement would be determined to be a single contract or a divisible agreement, and hence whether a bankruptcy court would require a master lease agreement to be assumed or rejected as a whole, would depend on a number of factors some of which may include, but may not necessarily be limited to, the following:

· applicable state law;
· the parties' intent;
· whether the master lease agreement and related documents were executed contemporaneously;
· the nature and purpose of the relevant documents;
· whether the obligations in various documents are independent;
· whether the leases are coterminous;
· whether a single check is paid for all properties;
· whether rent is apportioned among the leases;
· whether termination of one lease constitutes termination of all;
· whether the leases may be separately assigned or sublet;
· whether separate consideration exists for each lease; and
· whether there are cross-default provisions.

The Bankruptcy Code provides that a debtor has the power and the option to assume, assume and assign to a third party, or reject the unexpired lease. In the event that the unexpired lease is assumed on behalf of the debtor-lessee, obligations under the lease generally would be entitled to administrative priority over other unsecured pre-bankruptcy claims. If the debtor chooses to assume the lease (or assume and assign the lease), then the debtor is required to cure all monetary defaults, or provide adequate assurance that it will promptly cure such defaults. However, the debtor-lessee may not have to cure historical non-monetary defaults under the lease to the extent that they have not resulted in an actual pecuniary loss, but the debtor-lessee must cure non-monetary defaults under the lease from the time of assumption going forward. A debtor must generally pay all rent payments coming due under the lease after the bankruptcy filing but before the assumption or rejection of the lease. The Bankruptcy Code provides that the debtor-lessee must make the decision regarding assumption, assignment or rejection within a certain period of time. For cases filed on or after October 17, 2005, the time period to make the decision is 120 days, subject to one extension ‘‘for cause.’’ A bankruptcy court may only further extend this period for 90 days unless the lessor consents in writing.

If a tenant rejects a lease under the Bankruptcy Code, it is deemed to be a pre-petition breach of the lease, and the lessor's claim arising therefrom may be limited to any unpaid rent already due plus an amount equal to the rent reserved under the lease, without acceleration, for the greater of one year, and 15%, not to exceed three years, of the remaining term of such lease, following the earlier of the petition date and repossession or surrender of the leased property. If the debtor rejects the lease, the facility would be returned to us. In that event, if we were unable to re-lease the facility to a new operator on favorable terms or only after a significant delay, we could lose some or all of the associated revenue from that facility for an extended period of time.

Risk Factors

With respect to our mortgage loans, the imposition of an automatic stay under bankruptcy law could negatively impact our ability to foreclose or seek other remedies against a mortgagor.
Generally, with respect to our mortgage loans, the imposition of an automatic stay under the Bankruptcy Code precludes us from exercising foreclosure or other remedies against the debtor without first obtaining stay relief from the bankruptcy court. Pre-petition creditors generally do not have rights to the cash flows from the properties underlying the mortgages unless their security interest in the property includes such cash flows. Mortgagees may, however, receive periodic payments from the debtor/mortgagors. Such payments are referred to as adequate protection payments. The timing of adequate protection payments and whether the mortgagees are entitled to such payments depends on negotiating an acceptable settlement with the mortgagor (subject to approval of the bankruptcy court) or on the order of the bankruptcy court in the event a negotiated settlement cannot be achieved.

A mortgagee also is treated differently from a landlord in three key respects. First, the mortgage loan is not subject to assumption, assumption and assignment, or rejection. Second, the mortgagee's loan may be divided into a secured claim for the portion of the mortgage debt that does not exceed the value of the property securing the debt and a general unsecured claim for the portion of the mortgage debt that exceeds the value of the property. A secured creditor such as our company is entitled to the recovery of interest and reasonable fees, costs and charges provided for under the agreement under which such claim arose only if, and to the extent that, the value of the collateral exceeds the amount owed. If the value of the collateral exceeds the amount of the debt, interest as well as reasonable fees, costs, and charges are not necessarily required to be paid during the progress of the bankruptcy case, but they will accrue until confirmation of a plan of reorganization/liquidation and are generally paid at confirmation or such other time as the court orders unless the debtor voluntarily makes a payment. If the value of the collateral held by a secured creditor is less than the secured debt (including such creditor's secured debt and the secured debt of any creditor with a more senior security interest in the collateral), interest on the loan for the time period between the filing of the case and confirmation may be disallowed. Finally, while a lease generally would either be assumed, assumed and assigned, or rejected with all of its benefits and burdens intact, the terms of a mortgage, including the rate of interest and the timing of principal payments, may be modified under certain circumstances if the debtor is able to effect a ''cram down'' under the Bankruptcy Code. Before such a ''cram down'' is allowed, the Bankruptcy Court must conclude that the treatment of the secured creditor's claim is ''fair and equitable.''

If an operator files bankruptcy, our leases with the operator could be recharacterized as a financing agreement, which could negatively impact our rights under the lease.
Another risk regarding our leases is that in an operator's bankruptcy the leases could be re-characterized as a financing agreement. In making such a determination, a bankruptcy court may consider certain factors, which may include, but are not necessarily limited to, the following:

- whether rent is calculated to provide a return on investment rather than to compensate the lessor for loss, use and possession of the property;
- whether the property is purchased specifically for the lessee's use or whether the lessee selected, inspected, contracted for, and received the property;
- whether the transaction is structured solely to obtain tax advantages;
- whether the lessee is entitled to obtain ownership of the property at the expiration of the lease, and whether any option purchase price is unrelated to the value of the land; and
- whether the lessee assumed many of the obligations associated with outright ownership of the property, including responsibility for maintenance, repair, property taxes and insurance.

Risk Factors

If an operator defaults under one of our mortgage loans, we may have to foreclose on the mortgage or protect our interest by acquiring title to the property and thereafter making substantial improvements or repairs in order to maximize the facility's investment potential. Operators may contest enforcement of foreclosure or other remedies, seek bankruptcy protection against our exercise of enforcement or other remedies and/or bring claims for lender liability in response to actions to enforce mortgage obligations. If an operator seeks bankruptcy protection, the automatic stay provisions of the Bankruptcy Code would preclude us from enforcing foreclosure or other remedies against the operator unless relief is first obtained from the court having jurisdiction over the bankruptcy case. High ''loan to value'' ratios or declines in the value of the facility may prevent us from realizing an amount equal to our mortgage loan upon foreclosure.

Operators that fail to comply with the requirements of governmental reimbursement programs such as Medicare or Medicaid, licensing and certification requirements, fraud and abuse regulations or new legislative developments may be unable to meet their obligations to us.

Our operators are subject to numerous federal, state and local laws and regulations that are subject to frequent and substantial changes (sometimes applied retroactively) resulting from legislation, adoption of rules and regulations, and administrative and judicial interpretations of existing law. The ultimate timing or effect of these changes cannot be predicted. These changes may have a dramatic effect on our operators' costs of doing business and on the amount of reimbursement by both government and other third-party payors. The failure of any of our operators to comply with these laws, requirements and regulations could adversely affect their ability to meet their obligations to us. In particular:

- *Medicare and Medicaid*. A significant portion of our SNF operators' revenue is derived from governmentally-funded reimbursement programs, primarily Medicare and Medicaid, and failure to maintain certification and accreditation in these programs would result in a loss of funding from such programs. Loss of certification or accreditation could cause the revenues of our operators to decline, potentially jeopardizing their ability to meet their obligations to us. In that event, our revenues from those facilities could be reduced, which could in turn cause the value of our affected properties to decline. State licensing and Medicare and Medicaid laws also require operators of nursing homes and assisted living facilities to comply with extensive standards governing operations. Federal and state agencies administering those laws regularly inspect such facilities and investigate complaints. Our operators and their managers receive notices of potential sanctions and remedies from time to time, and such sanctions have been imposed from time to time on facilities operated by them. If they are unable to cure deficiencies, which have been identified or which are identified in the future, such sanctions may be imposed and if imposed may adversely affect their ability to meet their obligations to us which could adversely affect our revenues.

- *Licensing and Certification*. Our operators and facilities are subject to regulatory and licensing requirements of federal, state and local authorities and are periodically audited by them to confirm compliance. Failure to obtain licensure or loss or suspension of licensure would prevent a facility from operating or result in a suspension of reimbursement payments until all licensure issues have been resolved and the necessary licenses obtained or reinstated. Our SNFs require governmental approval, in the form of a certificate of need that generally varies by state and is subject to change, prior to the addition or construction of new beds, the addition of services or certain capital expenditures. Some of our facilities may be unable to satisfy current and future certificate of need requirements and may for this reason be unable to continue operating in the future. In such event, our revenues from those facilities could be reduced or eliminated for an extended period of time or permanently.

Risk Factors

- *Fraud and Abuse Laws and Regulations*. There are various extremely complex and largely uninterpreted federal and state laws governing a wide array of referrals, relationships and arrangements and prohibiting fraud by healthcare providers, including criminal provisions that prohibit filing false claims or making false statements to receive payment or certification under Medicare and Medicaid, or failing to refund overpayments or improper payments. Federal and state Governments are devoting increasing attention and resources to anti-fraud initiatives against healthcare providers. The Health Insurance Portability and Accountability Act of 1996 and the Balanced Budget Act expanded the penalties for healthcare fraud, including broader provisions for the exclusion of providers from the Medicare and Medicaid programs. Furthermore, the Office of Inspector General of the U.S. Department of Health and Human Services in cooperation with other federal and state agencies continues to focus on the activities of SNFs in certain states in which we have properties. In addition, the federal False Claims Act allows a private individual with knowledge of fraud to bring a claim on behalf of the federal government and earn a percentage of the federal government's recovery. Because of these incentives, these so-called ''whistleblower'' suits have become more frequent. The violation of any of these laws or regulations by an operator may result in the imposition of fines or other penalties that could jeopardize that operator's ability to make lease or mortgage payments to us or to continue operating its facility.

- *Legislative and Regulatory Developments*. Each year, legislative proposals are introduced or proposed in Congress and in some state legislatures that would affect major changes in the healthcare system, either nationally or at the state level. The Medicare Prescription Drug, Improvement and Modernization Act of 2003, or Medicare Modernization Act, which is one example of such legislation, was enacted in late 2003. The Medicare reimbursement changes for the long term care industry under this Act are limited to a temporary increase in the per diem amount paid to SNFs for residents who have AIDS. The significant expansion of other benefits for Medicare beneficiaries under this Act, such as the expanded prescription drug benefit, could result in financial pressures on the Medicare program that might result in future legislative and regulatory changes with impacts for our operators. Other proposals under consideration include efforts by individual states to control costs by decreasing state Medicaid reimbursements, a federal ''Patient Protection Act'' to protect consumers in managed care plans, efforts to improve quality of care and reduce medical errors throughout the health care industry and cost-containment initiatives by public and private payors. We cannot accurately predict whether any proposals will be adopted or, if adopted, what effect, if any, these proposals would have on operators and, thus, our business.

Regulatory proposals and rules are released on an ongoing basis that may have major impacts on the healthcare system generally and the skilled nursing and long-term care industries in particular.

Our operators depend on reimbursement from governmental and other third-party payors and reimbursement rates from such payors may be reduced.

Changes in the reimbursement rate or methods of payment from third-party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursements for services provided by our operators has in the past, and could in the future, result in a substantial reduction in our operators' revenues and operating margins. Additionally, net revenue realizable under third-party payor agreements can change after examination and retroactive adjustment by payors during the claims settlement processes or as a result of post-payment audits. Payors may disallow requests for reimbursement based on determinations that certain costs are not reimbursable or reasonable or because additional documentation is necessary or because certain services were not covered or were not medically necessary. There also continue to be new legislative and regulatory proposals that could impose further limitations on government and private payments to healthcare providers. In some cases, states have

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enacted or are considering enacting measures designed to reduce their Medicaid expenditures and to make changes to private healthcare insurance. We cannot assure you that adequate reimbursement levels will continue to be available for the services provided by our operators, which are currently being reimbursed by Medicare, Medicaid or private third-party payors. Further limits on the scope of services reimbursed and on reimbursement rates could have a material adverse effect on our operators' liquidity, financial condition and results of operations, which could cause the revenues of our operators to decline and potentially jeopardize their ability to meet their obligations to us.

Our operators may be subject to significant legal actions that could subject them to increased operating costs and substantial uninsured liabilities, which may affect their ability to pay their lease and mortgage payments to us.

As is typical in the healthcare industry, our operators are often subject to claims that their services have resulted in resident injury or other adverse effects. Many of these operators have experienced an increasing trend in the frequency and severity of professional liability and general liability insurance claims and litigation asserted against them. The insurance coverage maintained by our operators may not cover all claims made against them nor continue to be available at a reasonable cost, if at all. In some states, insurance coverage for the risk of punitive damages arising from professional liability and general liability claims and/or litigation may not, in certain cases, be available to operators due to state law prohibitions or limitations of availability. As a result, our operators operating in these states may be liable for punitive damage awards that are either not covered or are in excess of their insurance policy limits. We also believe that there has been, and will continue to be, an increase in governmental investigations of long-term care providers, particularly in the area of Medicare/Medicaid false claims, as well as an increase in enforcement actions resulting from these investigations. Insurance is not available to cover such losses. Any adverse determination in a legal proceeding or governmental investigation, whether currently asserted or arising in the future, could have a material adverse effect on an operator's financial condition. If an operator is unable to obtain or maintain insurance coverage, if judgments are obtained in excess of the insurance coverage, if an operator is required to pay uninsured punitive damages, or if an operator is subject to an uninsurable government enforcement action, the operator could be exposed to substantial additional liabilities.

Increased competition as well as increased operating costs due to competition for qualified employees have resulted in lower revenues for some of our operators and may affect the ability of our tenants to meet their payment obligations to us.

The healthcare industry is highly competitive and we expect that it may become more competitive in the future. Our operators are competing with numerous other companies providing similar healthcare services or alternatives such as home health agencies, life care at home, community-based service programs, retirement communities and convalescent centers. We cannot be certain the operators of all of our facilities will be able to achieve occupancy and rate levels that will enable them to meet all of their obligations to us. Our operators may encounter increased competition in the future that could limit their ability to attract residents or expand their businesses and therefore affect their ability to pay their lease or mortgage payments.

The market for qualified nurses, healthcare professionals and other key personnel is highly competitive and our operators may experience difficulties in attracting and retaining qualified personnel. Increases in labor costs due to higher wages and greater benefits required to attract and retain qualified healthcare personnel incurred by our operators could affect their ability to pay their lease or mortgage payments. This situation could be particularly acute in certain states that have enacted legislation establishing minimum staffing requirements.

Risk Factors

RISKS RELATED TO US AND OUR OPERATIONS

In addition to the operator related risks discussed above, there are a number of risks directly associated with us and our operations.

In connection with the restatement of our financial statements for the year ended December 31, 2005, we identified a material weakness in our internal control over financial reporting, which could materially and adversely affect our business and financial condition.

In connection with the restatement of our financial statements for the year ended December 31, 2005, our management identified a material weakness in internal control over financial reporting and as of December 31, 2006 we still have not concluded that our internal control over financial reporting is effective. Our management determined that as of December 31, 2005, we lacked sufficient internal control processes, procedures and personnel resources necessary to address accounting for certain complex and/or non-routine transactions. This material weakness resulted in errors in accounting for financial instruments, income taxes and straight-line rental revenue and could result in a material misstatement to our consolidated financial statements that would not be prevented or detected on a timely basis. Due to this material weakness, management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2005.

While we have engaged in, and continue to engage in, substantial efforts to address the material weakness in our internal control over financial reporting, as of December 31, 2006, we have not concluded that our internal control over financial reporting is effective. We cannot be certain that any remedial measures we have taken or plan to take will ensure that we design, implement and maintain adequate controls over our financial processes and reporting in the future or will be sufficient to address and eliminate the material weakness. Our inability to remedy this identified material weakness or any additional deficiencies or material weaknesses that may be identified in the future, could, among other things, cause us to fail to file our periodic reports with the SEC in a timely manner or require us to incur additional costs or to divert management resources. Due to its inherent limitations, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and presentation. These limitations may not prevent or detect all misstatements or fraud, regardless of their effectiveness.

We rely on external sources of capital to fund future capital needs, and if we encounter difficulty in obtaining such capital, we may not be able to make future investments necessary to grow our business or meet maturing commitments.

In order to qualify as a REIT under the Internal Revenue Code of 1986, as amended, or the Code, we are required, among other things, to distribute each year to our stockholders at least 90% of our REIT taxable income. Because of this distribution requirement, we may not be able to fund, from cash retained from operations, all future capital needs, including capital needs to make investments and to satisfy or refinance maturing commitments. As a result, we rely on external sources of capital, including debt and equity financing. If we are unable to obtain needed capital at all or only on unfavorable terms from these sources, we might not be able to make the investments needed to grow our business, or to meet our obligations and commitments as they mature, which could negatively affect the ratings of our debt and even, in extreme circumstances, affect our ability to continue operations. Our access to capital depends upon a number of factors over which we have little or no control, including general market conditions and the market's perception of our results of operations, growth potential and our current and potential future earnings and cash distributions and the market price of the shares of our capital stock. Generally speaking, difficult capital market conditions in our industry during the past several years have limited our access to capital. The "related party tenant" issue discussed in "Note 10 - Taxes" to our consolidated financial statements for the year ended December 31, 2006 included elsewhere in this Prospectus may make it more difficult for

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us to raise additional capital unless and until we enter into a closing agreement with the Internal Revenue Service or IRS, or otherwise resolve such issue. While we currently have sufficient cash flow from operations to fund our obligations and commitments, we may not be in position to take advantage of attractive investment opportunities for growth in the event that we are unable to access the capital markets on a timely basis or we are only able to obtain financing on unfavorable terms.

Our ability to raise capital through sales of equity is dependent, in part, on the market price of our common stock, and failure to meet market expectations with respect to our business could negatively impact the market price of our common stock and limit our ability to sell equity.

The availability of equity capital to us will depend, in part, on the market price of our common stock which, in turn, will depend upon various market conditions and other factors that may change from time to time including:

- the extent of investor interest;
- the general reputation of REITs and the attractiveness of their equity securities in comparison to other equity securities, including securities issued by other real estate-based companies;
- our financial performance and that of our operators;
- the contents of analyst reports about us and the REIT industry;
- general stock and bond market conditions, including changes in interest rates on fixed income securities, which may lead prospective purchasers of our common stock to demand a higher annual yield from future distributions;
- our failure to maintain or increase our dividend, which is dependent, to a large part, on growth of funds from operations which in turn depends upon increased revenues from additional investments and rental increases; and
- other factors such as governmental regulatory action and changes in REIT tax laws.

The market value of the equity securities of a REIT is generally based upon the market's perception of the REIT's growth potential and its current and potential future earnings and cash distributions. Our failure to meet the market's expectation with regard to future earnings and cash distributions would likely adversely affect the market price of our common stock.

We are subject to risks associated with debt financing, which could negatively impact our business, limit our ability to make distributions to our stockholders and to repay maturing debt.

Financing for future investments and our maturing commitments may be provided by borrowings under our revolving Credit Facility, private or public offerings of debt, the assumption of secured indebtedness, mortgage financing on a portion of our owned portfolio or through joint ventures. We are subject to risks normally associated with debt financing, including the risks that our cash flow will be insufficient to make timely payments of interest, that we will be unable to refinance existing indebtedness and that the terms of refinancing will not be as favorable as the terms of existing indebtedness. If we are unable to refinance or extend principal payments due at maturity or pay them with proceeds from other capital transactions, our cash flow may not be sufficient in all years to pay distributions to our stockholders and to repay all maturing debt. Furthermore, if prevailing interest rates, changes in our debt ratings or other factors at the time of refinancing result in higher interest rates upon refinancing, the interest expense relating to that refinanced indebtedness would increase, which could reduce our profitability and the amount of dividends we are able to pay. Moreover, additional debt financing increases the amount of our leverage.

Risk Factors

Certain of our operators account for a significant percentage of our real estate investment and revenues.
At December 31, 2006, approximately 25% of our real estate investments were operated by two public companies: Sun Healthcare Group, Inc., or Sun (17%), and Advocat, Inc. or Advocat (8%). Our largest private company operators (by investment) were CommuniCare Health Services, Inc., or CommuniCare (15%), Haven Eldercare, LLC, or Haven (9%), Home Quality Management, Inc., or HQM (8%), Guardian LTC Management, Inc., or Guardian (7%), Nexion Health, Inc., or Nexion (6%) and Essex Healthcare Corporation (6%). No other operator represents more than 4% of our investments.

For the year ended December 31, 2006, our revenues from operations totaled $135.7 million, of which approximately $25.1 million were from Sun (19%), $20.3 million from CommuniCare (15%) and $15.3 million from Advocat (11%). No other operator generated more than 9% of our revenues from operations for the year ended December 31, 2006.

The failure or inability of any of these operators to pay their obligations to us could materially reduce our revenues and net income, which could in turn reduce the amount of dividends we pay and cause our stock price to decline.

The geographic concentration of our investments could leave us vulnerable to an economic downturn, regulatory changes or acts of nature in those areas, resulting in a decrease in our revenues or otherwise negatively impacting our results of operations.
For the year ended December 31, 2006, the three states in which we had our highest concentration of investments were Ohio (22%), Florida (14%) and Pennsylvania (9%). As a result of this concentration, the conditions of local economies and real estate markets, changes in governmental rules and regulations, particularly with respect to Medicaid, acts of nature and other factors that may result in a decrease in demand for long-term care services in these states could have an adverse effect on our operators' revenues, costs and results of operations, which may limit their ability to meet their obligations to us. In addition, since some of these investments are located in Florida, our operators are particularly susceptible to revenue loss, cost increase or damage caused by hurricanes or other severe weather conditions or natural disasters. Any significant loss due to a natural disaster may not be covered by insurance and may lead to an increase in the cost of insurance for our operators.

Unforeseen costs associated with the acquisition of new properties could reduce our profitability.
Our business strategy contemplates future acquisitions that may not prove to be successful. For example, we might encounter unanticipated difficulties and expenditures relating to any acquired properties, including contingent liabilities, or newly acquired properties might require significant management attention that would otherwise be devoted to our ongoing business. If we agree to provide funding to enable healthcare operators to build, expand or renovate facilities on our properties and the project is not completed, we could be forced to become involved in the development to ensure completion or we could lose the property. These costs may negatively affect our results of operations.

Our assets may be subject to impairment charges.
We periodically, but not less than annually, evaluate our real estate investments and other assets for impairment indicators. The judgment regarding the existence of impairment indicators is based on factors such as market conditions, operator performance and legal structure. If we determine that a significant impairment has occurred, we would be required to make an adjustment to the net carrying value of the asset, which could have a material adverse affect on our results of operations and funds from operations in the period in which the write-off occurs. During the year ended December 31, 2006, we recognized an impairment loss associated with three facilities for approximately $0.5 million.

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Risk Factors

We may not be able to sell certain closed facilities for their book value.
From time to time, we close facilities and actively market such facilities for sale. To the extent we are unable to sell these properties for our book value; we may be required to take a non-cash impairment charge or loss on the sale, either of which would reduce our net income.

Our substantial indebtedness could adversely affect our financial condition.
We have substantial indebtedness and we may increase our indebtedness in the future. As of December 31, 2006, we had total debt of approximately $676 million, of which $150 million consisted of borrowings under our Credit Facility, $310 million of which consisted of our 7% senior notes due 2014 and $175 million of which consisted of our 7% senior notes due 2016 and $39 million of non-recourse debt to us resulting from the consolidation of a variable interest entity, or VIE, in accordance with Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities,* or FIN 46R. Our level of indebtedness could have important consequences to our stockholders. For example, it could:

- limit our ability to satisfy our obligations with respect to holders of our capital stock;
- limit our ability to satisfy the distribution requirements applicable to REITs;
- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to obtain additional financing to fund future working capital, capital expenditures and other general corporate requirements, or to carry out other aspects of our business plan;
- require us to dedicate a substantial portion of our cash flow from operations to payments on indebtedness, thereby reducing the availability of such cash flow to fund working capital, capital expenditures and other general corporate requirements, or to carry out other aspects of our business plan;
- require us to pledge as collateral substantially all of our assets;
- require us to maintain certain debt coverage and financial ratios at specified levels, thereby reducing our financial flexibility;
- limit our ability to make material acquisitions or take advantage of business opportunities that may arise;
- expose us to fluctuations in interest rates, to the extent our borrowings bear variable rates of interests;
- limit our flexibility in planning for, or reacting to, changes in our business and industry; and
- place us at a competitive disadvantage compared to our competitors that have less debt.

Our real estate investments are relatively illiquid.
Real estate investments are relatively illiquid and, therefore, tend to limit our ability to vary our portfolio promptly in response to changes in economic or other conditions. All of our properties are ‘‘special purpose’’ properties that could not be readily converted to general residential, retail or office use. Healthcare facilities that participate in Medicare or Medicaid must meet extensive program requirements, including physical plant and operational requirements, which are revised from time to time. Such requirements may include a duty to admit Medicare and Medicaid patients, limiting the ability of the facility to increase its private pay census beyond certain limits. Medicare and Medicaid facilities are

regularly inspected to determine compliance and may be excluded from the programs—in some cases without a prior hearing—for failure to meet program requirements. Transfers of operations of nursing homes and other healthcare-related facilities are subject to regulatory approvals not required for transfers of other types of commercial operations and other types of real estate. Thus, if the operation of any of our properties becomes unprofitable due to competition, age of improvements or other factors such that our lessee or mortgagor becomes unable to meet its obligations on the lease or mortgage loan, the liquidation value of the property may be substantially less, particularly relative to the amount owing on any related mortgage loan, than would be the case if the property were readily adaptable to other uses. The receipt of liquidation proceeds or the replacement of an operator that has defaulted on its lease or loan could be delayed by the approval process of any federal, state or local agency necessary for the transfer of the property or the replacement of the operator with a new operator licensed to manage the facility. In addition, certain significant expenditures associated with real estate investment, such as real estate taxes and maintenance costs, are generally not reduced when circumstances cause a reduction in income from the investment. Should such events occur, our income and cash flows from operations would be adversely affected.

As an owner or lender with respect to real property, we may be exposed to possible environmental liabilities.
Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner of real property or a secured lender, such as us, may be liable in certain circumstances for the costs of investigation, removal or remediation of, or related releases of, certain hazardous or toxic substances at, under or disposed of in connection with such property, as well as certain other potential costs relating to hazardous or toxic substances, including government fines and damages for injuries to persons and adjacent property. Such laws often impose liability without regard to whether the owner knew of, or was responsible for, the presence or disposal of such substances and liability may be imposed on the owner in connection with the activities of an operator of the property. The cost of any required investigation, remediation, removal, fines or personal or property damages and the owner's liability therefore could exceed the value of the property and/or the assets of the owner. In addition, the presence of such substances, or the failure to properly dispose of or remediate such substances, may adversely affect our operators' ability to attract additional residents, the owner's ability to sell or rent such property or to borrow using such property as collateral which, in turn, would reduce the owner's revenues.

Although our leases and mortgage loans require the lessee and the mortgagor to indemnify us for certain environmental liabilities, the scope of such obligations may be limited. For instance, most of our leases do not require the lessee to indemnify us for environmental liabilities arising before the lessee took possession of the premises. Further, we cannot assure you that any such mortgagor or lessee would be able to fulfill its indemnification obligations.

The industry in which we operate is highly competitive. This competition may prevent us from raising prices at the same pace as our costs increase.
We compete for additional healthcare facility investments with other healthcare investors, including other REITs. The operators of the facilities compete with other regional or local nursing care facilities for the support of the medical community, including physicians and acute care hospitals, as well as the general public. Some significant competitive factors for the placing of patients in skilled and intermediate care nursing facilities include quality of care, reputation, physical appearance of the facilities, services offered, family preferences, physician services and price. If our cost of capital should increase relative to the cost of capital of our competitors, the spread that we realize on our investments may decline if competitive pressures limit or prevent us from charging higher lease or mortgage rates.

Risk Factors

We are named as defendants in litigation arising out of professional liability and general liability claims relating to our previously owned and operated facilities that if decided against us, could adversely affect our financial condition.

We and several of our wholly-owned subsidiaries have been named as defendants in professional liability and general liability claims related to our owned and operated facilities. Other third-party managers responsible for the day-to-day operations of these facilities have also been named as defendants in these claims. In these suits, patients of certain previously owned and operated facilities have alleged significant damages, including punitive damages, against the defendants. The lawsuits are in various stages of discovery and we are unable to predict the likely outcome at this time. We continue to vigorously defend these claims and pursue all rights we may have against the managers of the facilities, under the terms of the management agreements. We have insured these matters, subject to self-insured retentions of various amounts. There can be no assurance that we will be successful in our defense of these matters or in asserting our claims against various managers of the subject facilities or that the amount of any settlement or judgment will be substantially covered by insurance or that any punitive damages will be covered by insurance.

We are subject to significant anti-takeover provisions.

Our articles of incorporation and bylaws contain various procedural and other requirements which could make it difficult for stockholders to effect certain corporate actions. Our Board of Directors is divided into three classes and the members of our Board of Directors are elected for terms that are staggered. Our Board of Directors also has the authority to issue additional shares of preferred stock and to fix the preferences, rights and limitations of the preferred stock without stockholder approval. We have also adopted a stockholders rights plan which provides for share purchase rights to become exercisable at a discount if a person or group acquires more than 9.9% of our common stock or announces a tender or exchange offer for more than 9.9% of our common stock. These provisions could discourage unsolicited acquisition proposals or make it more difficult for a third party to gain control of us, which could adversely affect the market price of our securities.

We may change our investment strategies and policies and capital structure.

Our Board of Directors, without the approval of our stockholders, may alter our investment strategies and policies if it determines in the future that a change is in our stockholders' best interests. The methods of implementing our investment strategies and policies may vary as new investments and financing techniques are developed.

We depend upon our key employees and may be unable to attract or retain sufficient numbers of qualified personnel.

Our future performance depends to a significant degree upon the continued contributions of our executive management team and other key employees. Accordingly, our future success depends on our ability to attract, hire, train and retain highly skilled management and other qualified personnel. Competition for qualified employees is intense, and we compete for qualified employees with companies that may have greater financial resources than we have. Our employment agreements with our executive officers provide that their employment may be terminated by either party at any time. Consequently, we may not be successful in attracting, hiring, and training and retaining the people we need, which would seriously impede our ability to implement our business strategy.

Risk Factors

In the event we are unable to satisfy regulatory requirements relating to internal controls, or if these internal controls over financial reporting are not effective, our business could suffer.
Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive evaluation of their internal controls. As a result, each year we evaluate our internal controls over financial reporting so that our management can certify as to the effectiveness of our internal controls and our auditor can publicly attest to this certification. Our efforts to comply with Section 404 and related regulations regarding our management's required assessment of internal control over financial reporting and our independent auditors' attestation of that assessment has required, and continues to require, the commitment of significant financial and managerial resources. If for any period our management is unable to ascertain the effectiveness of our internal controls or if our auditors cannot attest to management's certification, we could be subject to regulatory scrutiny and a loss of public confidence, which could have an adverse effect on our business.

RISKS RELATED TO OUR STOCK

The market value of our stock could be substantially affected by various factors.
The share price of our stock will depend on many factors, which may change from time to time, including:

- the market for similar securities issued by REITs;
- changes in estimates by analysts;
- our ability to meet analysts' estimates;
- general economic and financial market conditions; and
- our financial condition, performance and prospects.

Our issuance of additional capital stock, warrants or debt securities, whether or not convertible, may reduce the market price for our shares.
We cannot predict the effect, if any, that future sale of our capital stock, warrants or debt securities, or the availability of our securities for future sale, will have on the market price of our shares, including our common stock. Sales of substantial amounts of our common stock or preferred shares, warrants or debt securities convertible into or exercisable or exchangeable for common stock in the public market or the perception that such sales might occur could reduce the market price of our stock and the terms upon which we may obtain additional equity financing in the future.

In addition, we may issue additional capital stock in the future to raise capital or as a result of the following:

- The issuance and exercise of options to purchase our common stock. As of December 31, 2006, we had outstanding options to acquire approximately 0.1 million shares of our common stock. In addition, we may in the future issue additional options or other securities convertible into or exercisable for our common stock under our 2004 Stock Incentive Plan, our 2000 Stock Incentive Plan, as amended, or other remuneration plans we establish in the future. We may also issue options or convertible securities to our employees in lieu of cash bonuses or to our directors in lieu of director's fees.

- The issuance of shares pursuant to our dividend reinvestment and direct stock purchase plan.

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Risk Factors

· The issuance of debt securities exchangeable for our common stock.

· The exercise of warrants we may issue in the future.

· Lenders sometimes ask for warrants or other rights to acquire shares in connection with providing financing. We cannot assure you that our lenders will not request such rights.

There are no assurances of our ability to pay dividends in the future.
In 2001, our Board of Directors suspended dividends on our common stock and all series of preferred stock in an effort to generate cash to address then impending debt maturities. In 2003, we paid all accrued but unpaid dividends on all series of preferred stock and reinstated dividends on our common stock and all series of preferred stock. However, our ability to pay dividends may be adversely affected if any of the risks described above were to occur. Our payment of dividends is subject to compliance with restrictions contained in our Credit Facility, the indenture relating to our outstanding 7% senior notes due 2014, the indenture relating to our outstanding 7% senior notes due 2016 and our preferred stock. All dividends will be paid at the discretion of our Board of Directors and will depend upon our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future. In addition, our dividends in the past have included, and may in the future include, a return of capital.

Holders of our outstanding preferred stock have liquidation and other rights that are senior to the rights of the holders of our common stock.
Our Board of Directors has the authority to designate and issue preferred stock that may have dividend, liquidation and other rights that are senior to those of our common stock. As of the date of this filing, 4,739,500 shares of our 8.375% Series D cumulative redeemable preferred stock were issued and outstanding. The aggregate liquidation preference with respect to this outstanding preferred stock is approximately $118.5 million, and annual dividends on our outstanding preferred stock are approximately $9.9 million. Holders of our preferred stock are generally entitled to cumulative dividends before any dividends may be declared or set aside on our common stock. Upon our voluntary or involuntary liquidation, dissolution or winding up, before any payment is made to holders of our common stock, holders of our preferred stock are entitled to receive a liquidation preference of $25 per share with respect to the Series D preferred stock, plus any accrued and unpaid distributions. This will reduce the remaining amount of our assets, if any, available to distribute to holders of our common stock. In addition, holders of our preferred stock have the right to elect two additional directors to our Board of Directors if six quarterly preferred dividends are in arrears.

TAX RISKS

We have submitted to the Internal Revenue Service a request for a closing agreement and may not be able to obtain a closing agreement on satisfactory terms.
Management believes that certain of the terms of the Advocat Series B preferred stock previously held by us could be interpreted as affecting our compliance with federal income tax rules applicable to REITs regarding related party tenant income. See Note 10 - Taxes to our consolidated financial statements for the year ended December 31, 2006 included elsewhere herein.

In the fourth quarter of 2006, we were advised by tax counsel that, due to certain provisions of the Series B preferred stock issued to us by Advocat in 2000 in connection with a restructuring, Advocat may be considered to be a “related party tenant” under the rules applicable to REITs and, in such event, rental income received by us from Advocat would not be qualifying income for purposes of the REIT gross income tests. While we believe that there are valid arguments that Advocat should not be a “related party

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tenant," if Advocat is so treated, we would have failed to satisfy the 95% gross income tests during certain prior taxable years. Such a failure would have prevented us from maintaining REIT tax status during such years and from re-electing tax status for a number of taxable years. In such event, our failure to satisfy the REIT gross income tests would not result in the loss of REIT status, however, if the failure was due to reasonable cause and not to willful neglect, and we pay a tax on the non-qualifying income. Accordingly, on the advice of tax counsel in order to resolve the matter, minimize potential penalties, and obtain assurances regarding our continued REIT tax status, we submitted to the IRS a request for a closing agreement on December 15, 2006, which agreement would conclude that any failure to satisfy the gross income tests would be due to reasonable cause and not to willful neglect. Since that time, we have had ongoing conversations with the IRS and we have submitted additional documentation in furtherance of the issuance of a closing agreement, but, to date, we have not yet entered into a closing agreement with respect to the related party tenant issue with the IRS. We intend to continue to pursue a closing agreement with the IRS.

As noted above, we have completed the Second Advocat Restructuring and have been advised by tax counsel that we will not receive any non-qualifying related party tenant income from Advocat in future fiscal years. Accordingly, we do not expect to incur tax expense associated with related party tenant income in future periods commencing January 1, 2007, assuming we enter into a closing agreement with the IRS that recognizes that reasonable cause existed for any failure to satisfy the REIT gross income tests as explained above.

We have accrued $5.6 million at December 31, 2006 for a potential tax liability, including interest, arising from our ownership of the Advocat securities and we believe, but can provide no assurance, that we currently have sufficient assets to pay any such tax liabilities. The ultimate resolution of any controversy over potential tax liabilities covered by the closing agreement may have a material adverse effect on our financial position, results of operations or cash flows, including if we are required to distribute deficiency dividends to our stockholders and/or pay additional taxes, interest and penalties to the IRS in amounts that exceed the amount of our reserves for potential tax liabilities. There can be no assurance that the IRS will not assess us with substantial taxes, interest and penalties above the amount for which we have reserved. For further discussion, see Note 10 - Taxes to our consolidated financial statements for the year ended December 31, 2006 included elsewhere herein.

If we fail to maintain our REIT status, we will be subject to federal income tax on our taxable income at regular corporate rates.

We were organized to qualify for taxation as a REIT under Sections 856 through 860 of the Code. Our policy has been and is to operate in a such manner as to qualify as a REIT for Federal income tax purposes. We believe we have conducted, and we intend to continue to conduct, our operations so as to qualify as a REIT. Qualification as a REIT involves the satisfaction of numerous requirements, some on an annual and some on a quarterly basis, established under highly technical and complex provisions of the Code for which there are only limited judicial and administrative interpretations and involve the determination of various factual matters and circumstances not entirely within our control. We cannot assure you that we will at all times satisfy these rules and tests.

We have received an opinion of Powell Goldstein LLP to the effect that, in the event that Advocat is considered to be a "related party tenant" under the applicable REIT rules, our failure to meet the gross income tests for each applicable year as a result of our receipt of the Advocat stock in the 2000 restructuring and our ownership of such stock thereafter through the date of the Second Advocat Restructuring will be found to be due to reasonable cause and not due to willful neglect. Further, such opinion states to the effect that from and including the Company's taxable year December 31, 1992, the Company was and is organized in conformity with the requirements for its actual method of operation through the date hereof has permited, and its proposed method of operations as described in this

Registration Statement will permit the Company to meet the requirements for qualification and taxation as a REIT. A copy of this opinion is filed as an exhibit to the registration statement of which this prospectus is a part. It must be emphasized that the opinion of Powell Goldstein LLP is based on various assumptions relating to our organization and operation, and is conditioned upon representations and covenants made by our management regarding our income and assets, and the past, present, and future conduct of our business operations. While we intend to operate so that we qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing factual determinations, and the possibility of future changes in our circumstances, no assurance can be given by Powell Goldstein LLP or by us that we will so qualify for any particular year. The opinion of Powell Goldstein LLP is expressed as of the date issued, and will not cover subsequent periods. Powell Goldstein LLP is not obligated to advise us or the holders of our securities of any subsequent change in the matters stated, represented or assumed, or of any subsequent change of applicable law. You should be aware that opinions of counsel are not binding on the IRS or any court, and no assurance can be given that the IRS will not challenge or a court will not rule contrary to the conclusions set forth in such opinions.

If we were to fail to qualify as a REIT for any taxable year, we would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates for such year, and distributions to stockholders would not be deductible by us in computing our taxable income. Any such corporate tax liability could be substantial and would reduce the amount of cash we have available for distribution to our stockholders, which in turn could have a material adverse impact on the value of, and trading prices for, our securities. In addition, we would not be able to re-elect REIT status until the fifth taxable year following the initial year of disqualification unless we were to qualify for relief under applicable Code provisions. Thus, for example, if the IRS successfully challenges our status as a REIT solely for our taxable year ended December 31, 2005 based on our ownership of the Advocat Series B preferred stock, we would not be able to re-elect REIT status until our taxable year which began January 1, 2010, unless we were to qualify for relief.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.
Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes. Any of these taxes would decrease cash available for the payment of our debt obligations. In addition, we may derive income through our Taxable REIT Subsidiaries, or TRSs, which would be subject to corporate level income tax at regular rates.

Complying with REIT requirements may affect our profitability.
To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the nature and diversification of our assets, the sources of our income and the amounts we distribute to our stockholders. Thus, we may be required to liquidate otherwise attractive investments from our portfolio in order to satisfy the asset and income tests or to qualify under certain statutory relief provisions. We also may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution (e.g., if we have assets which generate mismatches, including timing differences, between taxable income and available cash). As a result, having to comply with the distribution requirement could cause us to: (i) sell assets in adverse market conditions; (ii) borrow on unfavorable terms; or (iii) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures, or repayment of debt. Accordingly, satisfying the REIT requirements could have an adverse effect on our business results and profitability.

Dividends payable by REITs do not qualify for the reduced tax rates applicable for some dividends.
The Jobs and Growth Tax Relief Reconciliation Act of 2003 generally reduces to 15% the maximum marginal rate of tax payable by individuals on dividends received from a regular C corporation. This reduced tax rate, however, will not apply to dividends paid to individuals by a REIT on its shares, except with respect to certain limited portions of such dividends, if at all. While the earnings of a REIT that are distributed to its stockholders still generally will be subject to less combined federal income taxation than earnings of a non-REIT C corporation that are distributed to its stockholders net of corporate-level tax, this legislation could cause individual investors to view the stock of regular C corporations as more attractive relative to the shares of a REIT than was the case prior to the enactment of the legislation. Individual investors could hold this view because the dividends from regular C corporations will generally be taxed at a lower rate while dividends from REITs will generally be taxed at the same rate as the individual's other ordinary income. We cannot predict what effect, if any, the enactment of this legislation may have on the value of the shares of REITs in general or on the value of our stock in particular, either in terms of price or relative to other investments.

REIT distribution requirements could adversely affect our ability to execute our business plan.
We generally must distribute annually at least 90% of our taxable income, subject to certain adjustments and excluding any net capital gain, in order for federal corporate income tax not to apply to earnings that we distribute. To the extent that we do not distribute all of our net capital gain or do distribute at least 90%, but less than 100% of our "REIT taxable income," as adjusted, we will be subject to tax thereon at regular ordinary and capital gain corporate tax rates. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under federal tax laws. We intend to make distributions to our stockholders to comply with the REIT requirements of the Internal Revenue Code.

Complying with REIT requirements with respect to our TRS limits our flexibility in operating or managing certain properties through our TRS.
A TRS may not directly or indirectly operate or manage a healthcare facility. For REIT qualification purposes, the definition of a "healthcare facility" means a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility, or other licensed facility which extends medical or nursing or ancillary services to patients and which, immediately before the termination, expiration, default, or breach of the lease of or mortgage secured by such facility, was operated by a provider of such services which was eligible for participation in the Medicare program under Title XVIII of the Social Security Act with respect to such facility. Thus, compliance with the REIT requirements may limit our flexibility in executing our business plan. Moreover, if the IRS were to treat a subsidiary corporation of ours as directly or indirectly operating or managing a healthcare facility, such subsidiary would not qualify as a TRS, which could jeopardize our REIT qualification under the REIT gross asset tests.

We may not be able to find a suitable tenant for our healthcare property, which could reduce our cash flow.
We may not be able to find another qualified tenant for a property if we have to replace a tenant. Accordingly, if we are unable to find a qualified tenant for one or more of our properties, rental payments could cease which could have a significant impact on our operating results and financial condition, in

which case we could be required to sell such properties or terminate our qualification as a REIT. While the REIT rules regarding foreclosure property allow us to acquire certain qualified healthcare property as the result of the termination or expiration of a lease (other than by reason of default, or the imminence of default, on the lease) of such property and, in connection with such acquisition, to operate a qualified healthcare facility through, and in certain circumstances derive income from, a qualified independent contractor for a period of two years (or up to six years if extensions are granted), once such period ends, the REIT rules prohibit the direct or indirect operation or management of such facility through our TRS. If the IRS were to treat our TRS as directly or indirectly operating or managing a qualified healthcare facility, such subsidiary would not qualify as a TRS, which could jeopardize our REIT qualification under the REIT gross asset tests.

Complying with REIT requirements may cause us to forgo otherwise attractive opportunities.
To qualify as a REIT for federal income tax purposes, we continually must satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. We may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income, asset-diversification or distribution requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make certain attractive investments.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.
To qualify as a REIT for federal income tax purposes, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets, including certain mortgage loans and mortgage backed securities. The remainder of our investment in securities (other than government securities and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities and qualified real estate assets) can consist of the securities of any one issuer, and no more than 20% of the value of our total securities can be represented by securities of one or more TRSs. See “Federal Income Tax Considerations—Taxation of Omega.” If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

Risk Factors

New legislation or administrative or judicial action, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to qualify as a REIT.

You should recognize that the present federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the federal income tax treatment of an investment in us. The federal income tax rules that affect REITs constantly are under review by persons involved in the legislative process, the IRS and the U.S. Treasury Department, which results in statutory changes as well as frequent revisions to regulations and interpretations. Revisions in federal tax laws and interpretations thereof could cause us to change our investments and commitments and affect the tax considerations of an investment in us. Any of these changes could have an adverse effect on an investment in our stock or on market value or resale potential. Stockholders are urged to consult with their own tax advisor with respect to the impact that recent legislation may have on their investment and the status of legislative, regulatory or administrative developments and proposals and their potential effect.

Cautionary language regarding forward-looking statements

This prospectus includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this prospectus may constitute forward-looking statements. These statements relate to our expectations, beliefs, intentions, plans, objectives, goals, strategies, future events, performance and underlying assumptions and other statements other than statements of historical facts. In some cases, you can identify forward-looking statements by the use of forward-looking terminology including, but not limited to, terms such as "may," "will," "anticipates," "expects," "believes," "intends," "should" or comparable terms or the negative thereof. These stat are based on information available on the date of this filing and only speak as to the date hereof and no obligation to update such forward-looking statements should be assumed. Our actual results may differ materially from those reflected in the forward-looking statements contained herein as a result of a variety of factors, including, among other things:

- uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;
- the ability of any operators in bankruptcy to reject unexpired lease obligations, modify the terms of our mortgages and impede our ability to collect unpaid rent or interest during the process of a bankruptcy proceeding and retain security deposits for the debtors' obligations;
- our ability to sell closed assets on a timely basis and on terms that allow us to realize the carrying value of these assets;
- our ability to negotiate appropriate modifications to the terms of our credit facility;
- our ability to manage, re-lease or sell any owned and operated facilities;
- the availability and cost of capital;
- competition in the financing of healthcare facilities;
- regulatory and other changes in the healthcare sector;
- the effect of economic and market conditions generally and, particularly, in the healthcare industry;
- changes in interest rates;
- the amount and yield of any additional investments;
- changes in tax laws and regulations affecting REITs;
- our ability to maintain our status as a real estate investment trust; and
- changes in the ratings of our debt and preferred securities.

Any subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth or referred to above, as well as the risk factors contained in this prospectus. Except as required by law, we disclaim any obligation to update such statements or to publicly announce the result of any revisions to any of the forward-looking statements contained in this prospectus to reflect future events or developments.

Use of proceeds

Our net proceeds from the sale of the shares of common stock, after deducting underwriting discounts and commissions and other expenses of this offering payable by us, are estimated to be approximately $103.9 million ($119.5 million if the underwriters' over-allotment option is exercised in full), assuming a public offering price of $17.72 per share. We intend to use all of the net proceeds of this offering to repay indebtedness outstanding under our Credit Facility, which currently bears an interest rate of 6.82% and matures on March 31, 2010. We entered into our Credit Facility on March 31, 2006 and have used the funds for general corporate purposes, including the acquisition of healthcare-related properties and the funding of mortgage loans secured by healthcare-related properties. Bank of America N.A., an affiliate of Banc of America Securities LLC, is the administrative agent and a lender under our senior revolving credit facility; UBS Loan Finance LLC, an affiliate of UBS Securities LLC, and Deutsche Bank AG, an affiliate of Deutsche Bank Securities Inc., are lenders under our senior revolving credit facility. UBS Securities LLC, Banc of America Securities LLC and Deutsche Bank Securities Inc. are underwriters of this offering of our common stock. If and to the extent there are net proceeds remaining after we have repaid all indebtedness under our Credit Facility, we will use these proceeds for working capital and general corporate purposes.

Price range of common stock and dividend policy

Our common stock is traded on the NYSE under the symbol “OHI.” The following table sets forth, for the periods shown, the high and low prices for our common stock as reported by the NYSE for the periods indicated, and cash dividends per share:

	High	Low	Dividends Per Share
Year ended December 31, 2005			
First Quarter	$ 11.95	$ 10.31	$ 0.20
Second Quarter	13.65	10.58	0.21
Third Quarter	14.28	12.39	0.22
Fourth Quarter	13.98	11.66	0.22
Year ended December 31, 2006			
First Quarter	$ 14.03	$ 12.36	$ 0.23
Second Quarter	13.92	11.15	0.24
Third Quarter	15.50	12.56	0.24
Fourth Quarter	18.00	14.81	0.25

The closing price on March 26, 2007 was $17.72 per share. As of March 26, 2007 there were 60,100,859 shares of common stock outstanding with 2,960 registered holders.

In 2005, we paid all regular quarterly dividend payments on our outstanding series of preferred stock and common stock. In 2006, we have paid all regular quarterly dividend payments on our outstanding series of preferred stock and common stock. We expect to continue our policy of paying regular cash dividends, although there is no assurance as to future dividends because they depend on future earnings, capital requirements and our financial condition. In addition, the payment of dividends is subject to the restrictions described in Note 14 to our consolidated financial statements for the fiscal year ended December 31, 2006 included elsewhere in this prospectus.

Capitalization

The following table sets forth our capitalization as of December 31, 2006:

- On an actual basis; and
- As adjusted to give effect to our sale of the common stock in this offering at an assumed offering price of $17.72 per share and the assumed application of the approximately $103.9 million of net proceeds to repay borrowings outstanding under our Credit Facility.

This table should be read in conjunction with ''Management's discussion and analysis of financial condition and results of operations'' and our consolidated financial statements and the related notes included in this prospectus.

	As of December 31, 2006	
	Actual	**As adjusted**
	(in thousands)	
Cash	$ 729	$ 729
Debt:		
Credit Facility	150,000	46,129
7.00% senior notes due 2014	310,000	310,000
Premium on new 7.00% senior notes due 2014	1,148	1,148
Discount on 7% Note due 2016	(1,417)	(1,417)
7.00% senior notes due 2016	175,000	175,000
Other long-term borrowings	41,410	41,410
Total Debt	676,141	572,270
Stockholders' Equity:		
Preferred Stock, $1.00 par value; authorized - 20,000 shares:		
Issued and Outstanding - 4,740 shares Series D with an aggregate liquidation preference of $118,488 as December 31, 2006	118,488	118,488
Common Stock, $0.10 par value:		
Authorized - 100,000 shares		
Issued and Outstanding - 59,703 as of December 31, 2006; pro forma as adjusted 65.903 shares	5,970	6,590
Additional paid in capital	694,207	
Cumulative net earnings	292,766	797,458
Cumulative dividends paid	(602,910)	292,766
Cumulative dividends - redemption	(43,067)	(602,910)
Total Stockholders' Equity	465,454	569,325
Total Capitalization	$ 1,141,595	$ 1,141,595

The table above excludes:

- 47,244 shares of our common stock issuable upon exercise of options outstanding as of December 31, 2006 at a weighted average exercise price of $12.70 per share;

- 1,516,428 shares of our common stock available for issuance under our dividend reinvestment and common stock purchase plan as of December 31, 2006;
- 2,891,980 shares of our common stock available for future grant under our 2000 Stock Incentive Plan and our 2004 Stock Incentive Plan; and
- 930,000 shares of our common stock that may be purchased by underwriters to cover over-allotments, if any.

Selected consolidated financial data

The following table sets forth consolidated financial data as of the dates and for the periods presented. The balance sheet data as of December 31, 2006 and 2005 and the statement of operations data, and other data for each of the years during the three-year period ended December 31, 2006 have been derived from, and should be read in conjunction with, our audited consolidated financial statements and the related notes included elsewhere in this prospectus. The balance sheet data as of December 31, 2004, 2003, and 2002, and the statement of operations data, and other data for the years ended December 31, 2003 and 2002 are derived from our audited consolidated financial statements.

	Year Ended December 31,						
	2002	2003	2004	2005	2006		
	(in thousands, except per share amounts)						
g data:							
from ations	$ 80,572	$ 76,803	$ 86,972	$ 109,644	$ 135,693		
from ome s	42,203	4,395	—	—	—		
enues	$ 122,775	$ 81,198	$ 86,972	$ 109,644	$ 135,693		
oss) inuing s	$ (2,561)	$ 27,770	$ 13,371	$ 37,355	$ 56,042		
ne ilable on	(32,801)	3,516	(36,715)	25,355	45,774		
oss) inuing s:							
	$ (0.65)	$ 0.21	$ (0.96)	$ 0.46	$ 0.79		
	(0.65)	0.20	(0.96)	0.46	0.79		
ne ilable on:							
	$ (0.94)	$ 0.09	$ (0.81)	$ 0.49	$ 0.78		
	(0.94)	0.09	(0.81)	0.49	0.78		
s,	—	0.15	0.72	0.85	0.96		
s, (1)	—	6.94	1.16	—	—		
s, (1)	—	6.47	2.16	1.09	—		
	—	29.81	2.72	—	—	—	—

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urrency n nt	—	—	—	—	(412)	—	—
	—	—	—	(5,039)	—	—	—
r 30,	1,280	$45	$ 197,836	$(195,253)	$(595)	$(26)	$(169)
	—	—	476	—	—	—	—
ation of stock	1,531	—	—	—	—	—	—
on of stock	(1,390)	4	1,386	—	—	—	—
of stock	—	2	592	—	—	—	—
l n n	—	—	70	—	—	—	—
le debt stock	230	—	(230)	—	—	—	—
urrency n nt	—	—	—	—	(81)	—	—
	—	—	—	(12,166)	—	—	—
r 30,	$1,651	$51	$ 200,130	$(207,419)	$(676)	$(26)	$(169)

See accompanying notes to the consolidated financial statements.

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

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

Supplemental cash flow information:		
Interest paid	$409	$505
Income taxes paid, foreign	370	111
Non-cash financing and investing activities:		

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

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

See accompanying notes to the consolidated financial statements.

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

1. Basis of Presentation and Significant Accounting Policies
Business
Sonic Foundry, Inc. (the Company) is in the business of providing enterprise solutions and services for the web communications market.
Principles of Consolidation
The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Sonic Foundry Media Systems, Inc., Sonic Foundry International B.V. (formerly Media Mission B.V.) and Mediasite K.K. All significant intercompany transactions and balances have been eliminated.
Use of Estimates
In preparing financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the period. Actual results could differ from those estimates.
Revenue Recognition
General
Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured. Revenue is deferred when undelivered products or services are essential to the functionality of delivered products, customer acceptance is uncertain, significant obligations remain, or the fair value of undelivered elements is unknown. Typically, the Company does not offer customers the right to return product, other than for exchange or repair pursuant to a warranty or stock rotation. The Company’s policy is to reduce revenue if it incurs an obligation for price rebates or other such programs during the period the obligation is reasonably estimated to occur. The following policies apply to the Company’s major categories of revenue transactions.
Products
Products are considered delivered, and revenue is recognized, when title and risk of loss have been transferred to the customer or upon customer acceptance if non-delivered products or services are essential to the functionality of delivered products. Under the terms and conditions of the sale, this occurs at the time of shipment to the customer. Product revenue currently represents sales of our Mediasite recorder and Mediasite related products such as our server software and other software licenses. If a license is time-based, the revenue is recognized over the term of the license agreement.

Services
The Company sells support and content hosting contracts to our customers, typically one year in length, and records the related revenue ratably over the contractual period. Our support contracts cover phone and electronic technical support availability over and above the level provided by our distributors, software upgrades on a when and if available basis, advance hardware replacement and an extension of the standard hardware warranty from 90 days to one year. The manufacturers the Company contracts with to build the units provide a limited one-year warranty on the hardware. The Company also sells installation, training, event webcasting, and customer content hosting services. Revenue for those services is recognized when performed in the case of installation, training and event webcasting services. Occasionally, the Company will sell customization services to enhance the server software. Revenue from those services is recognized when performed, if perfunctory, or under contract accounting. Service amounts invoiced to customers in excess of revenue recognized are recorded as deferred revenue until the revenue recognition criteria are met.

Revenue Arrangements that Include Multiple Elements

Sales of software, with or without installation, training, and post customer support fall within the scope of the software revenue recognition rules. Under the software revenue recognition rules, the fee from a multiple-deliverable arrangement is allocated to each of the undelivered elements based upon vendor-specific objective evidence (VSOE), which is limited to the price charged when the same deliverable is sold separately, with the residual value from the arrangement allocated to the delivered element. The portion of the fee that is allocated to each deliverable is then recognized as revenue when the criteria for revenue recognition are met with respect to that deliverable. If VSOE does not exist for all of the undelivered elements, then all revenue from the arrangement is typically deferred until all elements have been delivered to the customer.

In the case of the Company's hardware products with embedded software, the Company has determined that the hardware and software components function together to deliver the product's essential functionality, and therefore, the revenue from the sale of these products is accounted for under the revenue recognition rules for tangible products whereby the fee from a multiple-deliverable arrangement is allocated to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. A delivered item that does not qualify as a separate unit of accounting is combined with the other undelivered items in the arrangement and revenue is recognized for those combined deliverables as a single unit of accounting. The selling price used for each deliverable is based upon VSOE if available, from third-party evidence (TPE) if VSOE is not available, and best estimate of selling price (ESP) if neither VSOE nor TPE are available. TPE is the price of the Company's or any competitor's largely interchangeable products or services in stand-alone sales to similarly situated customers. ESP is the price at which the Company would sell the deliverable if it were sold regularly on a stand-alone basis, considering market conditions and entity-specific factors. All revenue arrangements, excluding the sale of all software-only products and associated services, have been accounted for under this guidance.

The selling prices used in the relative selling price allocation method are as follows: (1)the Company's products and services are based upon VSOE and (2) hardware products with embedded software, for which VSOE does not exist, are based upon ESP. The Company does not believe TPE exists for any of these products and services because they are differentiated from competing products and services in terms of functionality and performance and there are no competing products or services that are largely interchangeable. Management establishes ESP for hardware products with embedded software using a cost plus margin approach with consideration for market conditions, such as the impact of competition and geographic considerations, and entity-specific factors, such as the cost of the product and the Company's profit objectives. Management believes that ESP is reflective of reasonable pricing of that deliverable as if priced on a stand-alone basis. When a sales transaction includes deliverables that are divided between Accounting Standards Codification (ASC) Topic 605 and ASC Subtopic 985-605, the Company allocates the selling price using the relative selling price method whereas value is allocated using an ESP for software developed using a percent of list price approach. The other deliverables are valued using ESP or VSOE as previously discussed.

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

Management has established VSOE for hosting services. Billings for hosting are spread ratably over the term of the hosting agreement, with the typical hosting agreement having a term of 1 year, with renewal on an annual basis. The Company sells most hosting contracts without the inclusion of products. When the hosting arrangement is sold in conjunction with product, the product revenue is recognized immediately while the remaining hosting revenue is spread ratably over the term of the hosting agreement. The selling price is allocated between these elements using the relative selling price method. The Company uses ESP for development of the selling price for hardware products with embedded software.

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

Reserves

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

Shipping and Handling

The Company's shipping and handling costs billed to customers are included in other revenue. Costs related to shipping and handling are included in cost of revenue and are recorded at the time of shipment to the customer.

Concentration of Credit Risk and Other Risks and Uncertainties

As of September 30, 2018, of the $1.2 million in cash and cash equivalents, $118 thousand is deposited with 2 major U.S. financial institutions. At times, deposits in these institutions exceed the amount of insurance provided on such deposits. The Company has not experienced any losses on such amounts and believes that it is not exposed to any significant credit risk on these balances. The remaining $1.1 million of cash and cash equivalents is held by our foreign subsidiaries in financial institutions in Japan and the Netherlands and held in their local currency. The cash held in foreign financial institutions is not guaranteed.

We assess the realization of our receivables by performing ongoing credit evaluations of our customers' financial condition. Through these evaluations, we may become aware of a situation where a customer may not be able to meet its financial obligations due to deterioration of its financial viability, credit ratings or bankruptcy. Our reserve requirements are based on the best facts available to us and are reevaluated and adjusted as additional information is received. Our reserves are also based on amounts determined by using percentages applied to certain aged receivable categories. These percentages are determined by a variety of factors including, but not limited to, current economic trends, historical payment and bad debt write-off experience. Allowance for doubtful accounts for accounts receivable and financing receivables was $1.0 million at September 30, 2018 and $575 thousand at September 30, 2017.

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

Currently all of our product inventory purchases are from one third-party contract manufacturer. Although we believe there are multiple sources of supply from other contract manufacturers as well as multiple suppliers of component parts required by the contract manufacturers, a disruption of supply of component parts or completed products, even if short term, would have a material negative impact on our revenues. At September 30, 2018 and 2017, this supplier represented 29% and 27%, respectively, of total accounts payable. We also license technology from third parties that is embedded in our software. We believe there are alternative sources of similar licensed technology from other third parties that we could also embed in our software, although it could create potential programming related issues that might require engineering resources.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. As of September 30, 2018, of the $1.2 million aggregate cash and cash equivalents held by the Company, the amount of cash and cash equivalents held by our foreign subsidiaries was $1.1 million. If the funds held by our foreign subsidiaries were needed for our operations in the United States, the repatriation of some of these funds to the United States could require payment of additional U.S. taxes.

Trade Accounts Receivable

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

Financing Receivables

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

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

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

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

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

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

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

Investment in Sales-Type Lease

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

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

	September 30, 2018	September 30, 2017
Investment in sales-type lease	$ 399	$ 555
	$ 399	$ 555

Inventory Valuation

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

Inventory consists of the following (in thousands):

	September 30,	
	2018	2017
Raw materials and supplies	$358	$156
Finished goods	669	830
	$1,027	$986

Capitalized Software Development Costs

Software development costs incurred in conjunction with product development are charged to research and development expense until technological feasibility is established. Thereafter, until the product is released for sale, software development costs are capitalized and reported at the net realizable value of the related product. Typically the period between achieving technological feasibility of the Company’s products and the general availability of the products has been short. Consequently, software development costs qualifying for capitalization are typically immaterial and are generally expensed to research and development costs. There was no amortization expense in either of the years ending September 30, 2018 or 2017, respectively. The gross amount of capitalized external and internal development costs was $533 thousand at September 30, 2018 and 2017. There were no software development efforts that qualified for capitalization for the years ended September 30, 2018 or 2017, respectively.

Property and Equipment

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

	Years
Leasehold improvements	3 to 10 years
Computer equipment	3 to 5 years
Furniture and fixtures	5 to 7 years

Impairment of Long-Lived Assets

Goodwill has an indefinite useful life and is recorded at cost and not amortized but, instead, tested at least annually for impairment. We assess the impairment of goodwill on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value. If a qualitative assessment is used and the Company determines that the fair value of goodwill is more likely than not (i.e., a likelihood of more than 50%) less than its carrying amount, a quantitative impairment test will be performed. If goodwill is quantitatively assessed for impairment, the Company compares the estimated fair value of the reporting unit to which goodwill is allocated to its carrying value. The amount of impairment, if any, is equal to the amount by which the carrying value of the reporting unit exceeds its fair value.

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

Long-lived assets and intangible assets other than goodwill are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. For the year ended September 30, 2018, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year. For the year ended September 30, 2018, the Company determined that intangible assets, consisting of customer relationships and product rights, were impaired and recognized an impairment charge of $1.4 million. For the year ended September 30, 2017, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year and past performance. However, after performing analysis of undiscounted cash flows attributable to our long-lived assets along with other relevant factors, such as the continued use of the assets, it was determined that there was no impairment of long-lived and intangible assets other than goodwill. Key assumptions utilized in the analysis of undiscounted cash flows for each asset or asset group being tested included 1) whether cash flows were attributable solely to the asset or group, or to an entire reporting unit; and 2) the useful lives of the asset or asset group. Forecasts used in the analysis were also consistent with those used in determining fair value of reporting units during goodwill impairment testing.

Comprehensive Loss

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

Advertising Expense

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

Research and Development Costs

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

Income Taxes

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

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

As of September 30, 2018 and 2017, valuation allowances have been established for all U.S. and for certain foreign deferred tax assets which we believe do not meet the "more likely than not" criteria for recognition.

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

Fair Value of Financial Instruments

Nonfinancial Assets Measured at Fair Value on a Nonrecurring Basis

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

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

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

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

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

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

Financial Liabilities Measured at Fair Value on a Recurring Basis

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

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

September 30, 2018	Level 1	Level 2	Level 3	Total Fair Value
Derivative liability	$ —	$ 14	$ —	$ 14

September 30, 2017	Level 1	Level 2	Level 3	Total Fair Value
Derivative liability	$ —	$ 12	$ —	$ 12

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

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

Financial Instruments Not Measured at Fair Value

The Company’s other financial instruments consist primarily of cash and cash equivalents, accounts receivable, investment in sales-type lease, financing receivables, accounts payable and debt instruments, excluding the PFG debt. The book values of cash and cash equivalents, accounts receivable, investment in sales-type lease, debt (excluding the PFG debt) and accounts payable are considered to be representative of their respective fair values. The carrying value of capital lease obligations and debt (excluding the PFG debt), including the current portion, approximates fair market value as the variable and fixed rate approximates the current market rate of interest available to the Company.

Legal Contingencies

In June 2014, the Company entered into a settlement agreement with Astute Technology, LLC (“Astute”). The key terms of the agreement were: 1) a grant of a non-revocable license of Astute patents to the Company; 2) a grant of a fully paid, non-refundable license of certain Sonic Foundry patents to Astute; 3) both Astute and our customer agreed to identify three meetings they currently capture that the other party will not seek or respond to any request for proposal; and 4) a payment of $1.35 million to Astute. Pursuant to the settlement agreement, the payments were made in three equal amounts with the first paid in June 2014, the second paid in October 2014 and the final installment paid in March 2015. The Company contributed $1.1 million of the $1.35 million payable to Astute with our customer paying the residual amount. Of the $1.1 million, $428 thousand related to prior use and was recorded as a charge to income during fiscal 2014. The remaining $672 thousand was recorded as a product right asset, which is being amortized, on a straight-line basis, over the remaining life of the patents, through 2020. Future amounts due to Astute were accrued for as of the time of settlement. In Q4-2018, product rights were determined to be fully impaired and fully written off. See Note 8, Goodwill and Other Intangible Assets, for additional information on the impairment.

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

Stock-Based Compensation

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

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

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

Common Stock Warrants

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

Preferred stock and dividends

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

The Company considered relevant guidance when accounting for the issuance of preferred stock, and determined that the preferred shares meet the criteria for equity classification. Dividends accrued on preferred shares will be shown as a reduction to net income (or an increase in net loss) for purposes of calculating earnings per share.
On May 17, 2018, $1.0 million of subordinated convertible debt was fully converted into 1,902 shares of Preferred Stock, Series A, following approval by the stockholders of the Company of the conversion sufficient to comply with rules and regulations of NASDAQ. See Note 4 related to accounting for the conversion.
On June 8, 2018, 905 shares of Preferred Stock, Series A were automatically converted by the Company into 213,437 shares of common stock. The amount of shares converted represents all preferred shares issued on May 30, 2017 and June 8, 2017, including related dividends.
On August 23, 2018, 717 shares of Preferred Stock, Series A were automatically converted by the Company into 169,485 shares of common stock. The amount of shares converted represents all preferred shares issued on August 23, 2017.

Per Share Computation

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

	Years Ending September 30,	
	2018	2017
Denominator for basic earnings (loss) per share		
-weighted average common shares	4,655,520	4,436,333
Effect of dilutive options and warrants (treasury method)	—	—
Denominator for diluted earnings (loss) per share		
-adjusted weighted average common shares	4,655,520	4,436,333
Options and warrants outstanding during each year, but not included in the computation of diluted earnings (loss) per share because they are antidilutive	2,399,901	1,940,245

Liquidity

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

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

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

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

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)". The guidance substantially converges final standards on revenue recognition between the FASB and the International Accounting Standards Board providing a framework on addressing revenue recognition issues and, upon its effective date, replaces almost all existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles. The FASB subsequently issued a one-year deferral of the effective date for the new revenue reporting standard for entities reporting under U.S. GAAP. In accordance with the deferral, the guidance is effective for annual reporting periods beginning after December 15, 2017. Subsequently, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations" ("ASU 2016-08"); ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" ("ASU 2016-10"); and ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12"). The Company must adopt ASU 2016-08, ASU 2016-10 and ASU 2016-12 with ASU 2014-09.

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

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

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

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)", ("ASU 2016-02"). ASU 2016-02 aims to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in ASU 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public entities. Early application of the amendment is permitted. The Company is currently reviewing this guidance and its impact to the financial statements.

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

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

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

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

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

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

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

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

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

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

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

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

New Accounting Pronouncements Not Yet Effective

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

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

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

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

2. Commitments

Capital Lease and Financing Agreements

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

Fiscal Year (in thousands)	Capital
2019	$ 265
2020	143
2021	48
2022	2
Total payments	458
Less interest	(25)
Total	$ 433

Operating Leases

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

In November 2011, the Company occupied office space related to a lease agreement entered into on June 28, 2011. The inital lease term was from November 2011 through December 2018 and in Q3 2018, the lease was extended for three years through December 31, 2021. There are two additional three year extensions included in the initial lease agreement. The lease includes a tenant improvement allowance of $613 thousand that was recorded as a leasehold improvement liability and is being amortized as a credit to rent expense on a straight-line basis over the lease term. At September 30, 2018, the unamortized balance was $7 thousand.

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

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

Fiscal Year (in thousands)	Operating
2019	$ 1,248
2020	1,252
2021	912
2022	202
Total	$ 3,614

Other Commitments

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

The Company enters into license agreements that generally provide indemnification against intellectual property claims for its customers as well as indemnification agreements with certain service providers, landlords and other parties in the normal course

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of business. The Company has not incurred any material costs as a result of such indemnifications, or accrued any liabilities related to such obligations in the consolidated financial statements, except as noted above related to Astute (Note 1).

3. Credit Arrangements

Silicon Valley Bank

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

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

On May 11, 2018, the Company entered into a Twelfth Amendment to the Second Amended and Restated Loan and Security Agreement (the "Twelfth Amendment") with Silicon Valley Bank, which waived the minimum EBITDA covenant as defined under the Eleventh Amendment. Under the Twelfth Amendment: the Minimum EBITDA covenant was modified to require Minimum EBITDA (as defined) plus the net change in Deferred Revenue, (i) for the quarterly period ending June 30, 2018, measured on a trailing six (6) month basis, to be no less than negative

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

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

The Second Amended and Restated Agreement, as amended, contains events of default that include, among others, non-payment of principal or interest, inaccuracy of any representation or warranty, violation of covenants, bankruptcy and insolvency events, material judgments, cross defaults to certain other indebtedness, and material adverse changes. The occurrence of an event of default could result in the acceleration of the Companies' obligations under the Second Amended Agreement, as amended. At September 30, 2018, the Company was in compliance with all financial covenants.

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

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

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

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

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

Partners for Growth IV, L.P.

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

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

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

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

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

On December 28, 2017, the Company and PFG IV entered into a Modification No. 4 to the 2015 Loan and Security Agreement ("Modification No. 4"). Modification No. 4: the Minimum EBITDA covenant was modified to require Minimum EBITDA (as

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defined) plus the net change in Deferred Revenue (i) for the period ending December 31, 2017, measured on a trailing three (3) month basis, to be no less than negative ($1,900,000); (ii) for the quarterly period ending March 31, 2018, measured on a trailing three (3) month basis, to be no less than Zero Dollars, and (iii) for the quarterly period ending June 30, 2018, and each quarterly period thereafter, in each case measured on a trailing six month basis, to be no less than Zero Dollars.

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

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

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

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

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

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

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

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

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

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

The proceeds from the Loan and Security Agreement were allocated between the PFG V Debt and the Warrant Debt (inclusive of its conversion feature) based on their relative fair value on the date of issuance which resulted in carrying values of $1.9 million and $127 thousand, respectively. The warrant debt of $127 thousand is treated together as a debt discount on the PFG V

Debt and will be accreted to interest expense under the effective interest method over the three-year term of the PFG V Debt and the five-year term of the Warrant Debt. During fiscal 2018, the Company recorded accretion of discount expense associated with the warrants issued with the PFG V loan of $6 thousand, as well as $17 thousand related to amortization of the debt discount. At September 30, 2018, the fair values of the PFG V Debt and the Warrant Debt (inclusive of its conversion feature) were $1.9 million and $117 thousand, respectively. In addition, the Company agreed to pay PFG V a cash fee of up to $150,000 payable upon maturity (the "back-end fee"), which will be earned ratably over the three year term of the PFG V loan. During fiscal 2018, the Company recorded interest expense of $19 thousand associated with recognition of the back-end fee.

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

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

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

Other Indebtedness

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

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

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

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

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

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

Fiscal Year (in thousands)	
2019	$667
2020	800
2021	533
Total	$2,000

4. Accrued Liabilities

Accrued liabilities consists of the following (in thousands):

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

The Company accrues expenses as they are incurred. Accrued compensation includes wages, vacation, commissions and bonuses. Accrued expenses is mainly related to stock compensation, professional fees and amounts owed to suppliers. Other accrued liabilities is made up of employee-related expenses.

5. Stock Options and Employee Stock Purchase Plan

On March 5, 2009, Stockholders approved adoption of the 2009 Stock Incentive Plan (the "2009 Plan"). The 2009 Plan, beginning October 1, 2009, replaced two former employee stock option plans that terminated coincident with the effectiveness of the 2009 Plan. On March 7, 2012, Stockholders approved an amendment to increase the number of shares of common stock subject to this plan by 600,000 and to increase the number of shares for the directors' stock option plan by 50,000 shares. On March 6, 2014, Stockholders approved an amendment to increase the number of shares of common stock subject to the 2009 Plan by 800,000. On March 7, 2017, Stockholders approved an amendment to increase the number of shares of common stock subject to the 2009 Plan by 900,000 to an aggregated total of 2,700,000 shares of common stock. Stockholders also approved an increase in the number of shares for the directors' stock option plan of 50,000. The Company maintains a directors' stock option plan under which options may be issued to purchase up to an aggregate of 150,000 shares of common stock. Each non-employee director, who is re-elected or who continues as a member of the board of directors on each annual meeting date and on each subsequent meeting of Stockholders, will be granted options to purchase 2,000 shares of common stock under the directors' plan, or at other times or amounts at the discretion of the Board of Directors.

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

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

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

	Qualified Employee Stock Option Plans	Director Stock Option Plans
Shares available for grant at September 30, 2016	366,889	6,500
Stockholder approval to increase shares	900,000	50,000
Options granted	(312,020)	(8,500)
Options forfeited	53,521	—
Shares available for grant at September 30, 2017	1,008,390	48,000
Options granted	(398,749)	(14,500)
Options forfeited	86,118	10,000

Shares available for grant at September 30, 2018	695,759	43,500

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

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

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

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

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

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

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

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

The Company also has an Employee Stock Purchase Plan (Purchase Plan) under which an aggregate of 200,000 common shares may be issued. The Stockholders approved an amendment to increase the number of shares of common stock subject to the plan from 150,000 to 200,000 at the Company’s annual meeting in March 2017. All employees who have completed 90 days of employment with the Company on the first day of each offering period and customarily work twenty hours per week or more are eligible to participate in the Purchase Plan. An employee who, after the grant of an option to purchase, would hold common stock and/or hold outstanding options to purchase stock possessing 5% or more of the total combined voting power or value of the Company will not be eligible to participate. Eligible employees may make contributions through payroll deductions of up to 10% of their compensation. No participant in the Purchase Plan is permitted to purchase common stock under the Purchase Plan if such option would permit his or her rights to purchase stock under the Purchase Plan to accrue at a rate that exceeds $25,000 of the fair market value of such shares, or that exceeds 1,000 shares, for each calendar year. The Company makes a bi-annual offering to eligible employees of options to purchase shares of common stock under the Purchase Plan on the first trading day of January and July. Each offering period is for a period of 6 months from the date of the offering, and each eligible employee as of the date of offering is entitled to purchase shares of common stock at a purchase price equal to the lower of 85% of the fair market value of common stock on the first or last trading day of the offering period. A total of 47,867 shares are available to be issued under the plan. There were 12,794 and 13,046 shares purchased by employees during fiscal 2018 and 2017, respectively. The Company recorded stock compensation expense under this plan of $8 thousand and $12 thousand during fiscal 2018 and 2017, respectively. Cash received from issuance of stock under this plan was $27 thousand and $48 thousand during fiscal 2018 and 2017, respectively.

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

6. Income Taxes

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

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

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

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

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

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

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

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

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

At September 30, 2018, the Company had net operating loss carryforwards of approximately $102 million for U.S. Federal and $43 million for state tax purposes. For Federal tax purposes, the carryforwards expire in varying amounts between 2019 and 2038. For state tax purposes, the carryforwards expire in varying amounts between 2018 and 2038. Utilization of the Company's net operating loss may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization. In addition, the Company has research and development tax credit carryforwards of approximately $418 thousand, which expire in varying amounts between 2019 and 2020.

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

Earnings of the Company’s foreign subsidiaries are generally subject to U.S. taxation upon repatriation to the U.S. and the Company’s tax provision reflects the related incremental U.S. tax except for certain foreign subsidiaries whose unremitted earnings are considered to be indefinitely reinvested. No deferred tax liability has been recognized with regard to the remittance of such earnings after MSKK and Sonic Foundry International BV acquisitions were completed. At September 30, 2018, unremitted earnings of $1.0 million for foreign subsidiaries were deemed to be indefinitely reinvested.

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

The difference between the book and tax balance of certain of the company’s goodwill creates a deferred tax liability and an annual tax expense. Because of the long term nature of the goodwill timing difference, tax planning strategies cannot be utilized with respect to the deferred tax liability. The Company’s tax rate differs from the expected tax rate each reporting period as a result of the aforementioned items. The balance of the Deferred Tax Liability was $0 thousand at September 30, 2018 and $4.4 million at September 30, 2017, respectively. The remaining balance of the deferred tax liability related to goodwill was fully written off as of September 30, 2018 as a result of the impairment.

The Company recorded a deferred tax liability related to the Customer Relationship intangibles value acquired as part of the purchase of Sonic Foundry International BV and Mediasite KK.

In accordance with accounting guidance for uncertainty in income taxes, the Company has concluded that a reserve for income tax contingencies is not necessary. The Company’s practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accruals for interest and penalties on the Company’s Condensed Consolidated Balance Sheets at September 30, 2018 or September 30, 2017 and has not recognized any interest or penalties in the Condensed Consolidated Statements of Operations for either of the years ended September 30, 2018 or 2017.

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

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

Shortly after enactment, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 ("SAB 118") which provided US GAAP guidance on the accounting for the Act's impact at December 31, 2017. A reporting entity may recognize provisional amounts, where the necessary information is not available, prepared or analyzed (including computations) in reasonable detail or where additional guidance is needed from the taxing authority to determine the appropriate application of the Act. A reporting entity's provisional impact analysis may be adjusted within the 12-month measurement period provided for under SAB 118.

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

7. Savings Plan

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

8. Goodwill and Other Intangible Assets

Goodwill and intangible assets that have indefinite useful lives are recorded at cost and are not amortized but, instead, tested at least annually for impairment. The Company assesses the impairment of goodwill on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value. The Company performs annual goodwill impairment test as of July 1, and tested goodwill recognized in connection with the acquisitions of Mediasite, Sonic Foundry International and Mediasite KK. For purposes of the test, goodwill on the Company’s books is evaluated within three separate reporting units.

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

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

The Sonic Foundry (Mediasite) reporting unit, to which $7.6 million of goodwill is allocated, had a negative carrying amount on September 30, 2017. This reporting unit is considered to be an operating segment on its own and is not part of any other reportable segment.

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

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

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

Long-lived assets and intangible assets other than goodwill are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. For the year ended September 30, 2018, it was determined that changes in circumstances were present, primarily the decline in the Company's market capitalization during the fiscal year and past performance. For the year ended

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

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

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

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

9. Related-Party Transactions

The Company incurred fees of $212 thousand and $143 thousand during the years ended September 30, 2018 and 2017, respectively, to a law firm whose partner is a director and stockholder of the Company. The Company had accrued liabilities for unbilled services to the same law firm of $60 thousand and $55 thousand at September 30, 2018 and 2017, respectively.

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

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

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

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

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

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

10. Segment Information

We have determined that in accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 280-10, Segment Reporting, we operate in three operating segments, however these segments meet the criteria for aggregation for reporting purposes as one reporting segment as of September 30, 2018. The following summarizes revenue by geographic region (in thousands):

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

11. Customer Concentration

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

12. Legal Proceedings

From time to time, the Company is subject to legal proceedings or claims arising from its normal course of operations. The Company accrues for costs related to loss contingencies when such costs are probable and reasonably estimable. As of September 30, 2018, the Company is not aware of any material pending legal proceedings or threatened litigation that would have a material adverse effect on the Company’s financial condition or results of operations.

13. Quarterly Financial Data (unaudited)

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

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

14. Subsequent Events
In connection with the Loan and Security Agreement with Partners for Growth V, L.P. entered into on May 11, 2018, Tranche 2 of the Term Loan, in the amount of $500,000, was disbursed on November 8, 2018.
On November 15, 2018, 718 shares of Preferred Stock, Series A were automatically converted by the Company into 169,741 shares of common stock. The amount of shares converted represents all preferred shares issued on November 9, 2017.
Initial Notes of the February 28, 2019 Note Purchase Agreement
On January 4, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "Promissory Note") pursuant to which the director purchased a 9.25% Unsecured Promissory Note for $1,000,000 in cash.
Interest accrued and outstanding principal on the Promissory Note is due and payable on January 4, 2020.
The Promissory Note may be prepaid at any time without penalty.
The Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.
On January 31, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "January 31, 2019 Promissory Note") pursuant to which the director purchased a 9.25% Unsecured Promissory Note for $1,000,000 in cash.
Interest accrued and outstanding principal on the January 31, 2019 Promissory Note is due and payable on January 31, 2020.
The January 31, 2019 Promissory Note may be prepaid any time without penalty. The note may be paid by the Company by issuing common stock to the director, with each share valued at $1.30 per share.
The January 31, 2019 Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.
On February 14, 2019, Sonic Foundry, Inc. and a director entered into a Promissory Note (the "February 14, 2019 Promissory Note") pursuant to which the director purchased a 9.25% Unsecured Promissory Note for $1,000,000 in cash.
Interest accrued and outstanding principal on the February 14, 2019 Promissory Note is due and payable on February 14, 2020.
The February 14, 2019 Promissory Note may be prepaid any time without penalty. The note may be paid by the Company by issuing common stock to the director, with each share valued at $1.30 per share.
The February 14, 2019 Promissory Note was later included in the Note Purchase Agreement, dated February 28, 2019, as detailed below.
February 28, 2019 Note Purchase Agreement
On February 28, 2019, Sonic Foundry, Inc. entered into a Note Purchase Agreement (the "Note Purchase Agreement") with Mr. Mark Burish ("Mr. Burish").
The Note Purchase Agreement provides for subordinated secured promissory notes (the "Subordinated Promissory Notes") in an aggregate original principal amount of up to $5,000,000. Mr. Burish will acquire from the Company (a) on the initial closing date, the notes in an aggregate principal amount of $3,000,000 (the "Initial Notes") and (b) two additional tranches, each in the amount of $1,000,000 and payable at any time prior to the first anniversary of the

Agreement (the "Additional Notes" and together with the Initial Notes, collectively, the "Purchase Price"). The Initial Notes were previously disbursed in January and February of 2019, as detailed above (the Promissory Note, the January 31st, 2019 Promissory Note, and the February 14, 2019 Promissory Note, collectively referred to as the "Initial Notes").

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

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

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

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

The Note Purchase Agreement requires compliance with the following financial covenants: (i) Minimum Coverage Ratio, which requires, as of the last day of each month on or after the closing date, the Minimum Coverage Ratio (as defined) to be equal to or greater than (x) 0.7:1.00 for the December through May calendar months, (y) 0.9:1.00 for the June through November calendar months; (ii) Minimum Qualifying Revenue (as defined), as of the last day of any calendar month, on or after December 1, 2018, on a trailing twelve-month basis, to be less than $13,000,000.

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

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

February 28, 2019 Warrant

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

Partners for Growth V, L.P.

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

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

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

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

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

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Based on evaluations at September 30, 2018, our principal executive officer and principal financial officer, with the participation of our management team, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15 (e) and 15d-15 (e) under the Securities Exchange Act). Disclosure controls and procedures ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that material information relating to the Company is accumulated and communicated to management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective as of September 30, 2018. See Management's Report on Internal Control over Financial Reporting below related to the material weakness identified.

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

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

Management's Report on Internal Control Over Financial Reporting

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

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in the 2013 Internal Control- Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "2013 COSO Framework") on May 14, 2013. The 2013 COSO Framework outlines the 17 underlying principles and the following fundamental components of a company's internal control: (i) control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring. The 2013 Framework was adopted in the fiscal year ended September 30, 2015. Based on this evaluation, our principal executive officer and principal financial officer concluded that our internal controls over financial reporting were not effective as of September 30, 2018 due to an identified material weakness in internal control. The material weakness relates to controls over identifying and performing an impairment analysis and the preparation of consolidated financial information specific to the subsequent measurement of goodwill and long-lived and intangible assets as well as the related impacts on the tax provision, which will be remediated in fiscal 2019.

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

Based on evaluations at September 30, 2018, our principal executive officer and principal financial officer, with the participation of our management team, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15 (e) and 15d-15 (e) under the Securities Exchange Act). Disclosure controls and procedures ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that material information relating to the Company is accumulated and communicated to management,

including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective as of September 30, 2018 as a result of a material weakness identified, which is described in the paragraphs above.

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

Changes in Internal Control Over Financial Reporting

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

Remediation

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

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required by Item 10 of Form 10-K with respect to directors and executive officers is incorporated herein by reference to the information contained in the section entitled “Proposal One: Election of Directors” and “Executive Officers of Sonic”, respectively, in the Company’s definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the Company’s 2018 Annual Meeting of Stockholders, which will be filed no later than January 28, 2019 (the “Proxy Statement”).

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

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

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

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

ITEM 11. EXECUTIVE COMPENSATION

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

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

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

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

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

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 of Form 10-K is incorporated herein by reference to the information contained in the section entitled “Ratification of Appointment of Independent Auditors – Fiscal 2017 and 2018 Audit Fee Summary” in the Proxy Statement.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following financial statements are filed as part of this report:
1 Financial Statements furnished are listed in the Table of Contents provided in response to Item 8.
2 Exhibits.

NUMBER	DESCRIPTION
3.1	Articles of Amendment of Amended and Restated Articles of Incorporation, effective November 16, 2009, Amended and Restated Articles of Incorporation, effective January 26, 1998, and Articles of Amendment, effective April 9, 2000, filed as Exhibit No. 3.1 to the Annual Report on Form 10-K for the year ended September 30, 2009, and hereby incorporated by reference.
3.2	Amended and Restated By-Laws of the Registrant, filed as Exhibit No. 3.1 to the Form 8-K filed on October 11, 2011, and hereby incorporated by reference.
3.3	Articles Supplementary to the Company Charter of the Registrant, as relates to Series A Preferred Stock, dated May 30, 2017, filed as Exhibit 5.03 to the 8-K filed on June 5, 2017, and hereby incorporated by reference.
3.4	Articles Supplementary to the Company Charter of the Registrant, as relates to Series A Preferred Stock, dated November 6, 2017, filed as Exhibit 3.1 to the Form 8-K filed on November 21, 2017, and hereby incorporated by reference.
3.5	Amended and Restated By-Laws of the Registrant, filed as Exhibit No. 3.1 to the Form 8-K filed on January 25, 2018, and hereby incorporated by reference.
3.6	Articles Supplementary to the Company Charter of the Registrant, as relates to Series A Preferred Stock, filed as Exhibit 3.1 to the Form 8-K filed on May 23, 2018, and hereby incorporated by reference.
10.1*	Amended and Restated Employment Agreement between Registrant and Gary Weis dated as of September 30, 2011, filed as Exhibit 10.1 to the Form 8-K filed on October 4, 2011, and hereby incorporated by reference.
10.2*	Registrant's 2008 Non-Employee Directors' Stock Option Plan, as amended, filed as Exhibit 3 to the Form 14A filed on January 26, 2017, and hereby incorporated by reference.
10.3*	Registrant's 2008 Employee Stock Purchase Plan, as amended, filed as Exhibit 1 to the Form 14A filed on January 26, 2017, and hereby incorporated by reference.
10.4*	Registrant's 2009 Stock Incentive Plan, as amended, filed as Exhibit 2 to the Form 14A filed on January 26, 2017, and hereby incorporated by reference.

10.5	Lease Agreement between Registrant, as tenant, and West Washington Associates, LLC as landlord, dated June 28, 2011, filed as Exhibit 10.1 to the Form 8-K filed on July 1, 2011, and hereby incorporated by reference.
10.6	Second Amended and Restated Loan and Security Agreement dated June 27, 2011 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.2 to the Form 8-K filed on July 1, 2011, and hereby incorporated by reference.
10.7	First Amendment to Second Amended and Restated Loan and Security Agreement dated May 31, 2013 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on June 3, 2013, and hereby incorporated by reference.
10.8	Second Amendment to Second Amended and Restated Loan and Security Agreement dated January 10, 2014 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on January 16, 2014, and hereby incorporated by reference.
10.9*	Employment Agreement dated March 21, 2014 between Sonic Foundry, Inc. and Kenneth A. Minor, filed as Exhibit 10.2 to the Form 8-K filed on March 26, 2014, and hereby incorporated by reference.
10.10*	Employment Agreement dated March 21, 2014 between Sonic Foundry, Inc. and Robert M. Lipps, filed as Exhibit 10.1 to the Form 8-K filed on March 26, 2014, and hereby incorporated by reference.

10.11	Third Amendment to Second Amended and Restated Loan and Security Agreement dated March 24, 2014 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on March 28, 2014, and hereby incorporated by reference.
10.12	Forms of Subscription Agreements, Lock-Up Agreements and Warrant Agreements dated December 22, 2014 among Sonic Foundry, Inc. and Mark Burish, and Sonic Foundry, Inc. and Andrew Burish, filed as Exhibits 10.1, 10.2, and 10.3 to the Form 8-K filed on December 30, 2014 and hereby incorporated by reference.
10.13	Fourth Amendment to Second Amended and Restated Loan and Security Agreement dated January 27, 2015 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on February 2, 2015, and hereby incorporated by reference.
10.14	Lease Agreement between Mediasite KK, as tenant, and Ollie Company as landlord, dated September 1, 2011, filed as Exhibit 10.23 to the form 10-Q filed on February 6, 2015, and hereby incorporated by reference.
10.15	Lease Agreement between Mediasite KK, as tenant, and Ollie Company as landlord, dated September 1, 2011, filed as Exhibit 10.24 to the form 10-Q filed on February 6, 2015, and hereby incorporated by reference.
10.16	Lease Agreement between Sonic Foundry International, as tenant, and Prinsen Geerligs as landlord, dated February 1, 2014, filed as Exhibit 10.25 to the form 10-Q on February 6, 2015, and hereby incorporated by reference.
10.17	Fifth Amendment to Second Amended and Restated Loan and Security Agreement, dated May 13, 2015 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.26 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
10.18	Loan and Security Agreement, dated May 13, 2015 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.27 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
10.19	Warrant, dated as of May 13, 2015, between Registrant and Partners for Growth IV, L.P., filed as Exhibit 10.28 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
10.20	Warrant, dated as of May 13, 2015, between Registrant and Silicon Valley Bank, filed as Exhibit 10.29 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
10.21	Warrant dated as of May 13, 2015, between Registrant and PFG Equity Investors, LLC, filed as Exhibit 10.30 to the form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
10.22	Intellectual Property Security Agreement, dated as of May 13, 2015, between Registrant and Partners for Growth IV, L.P., filed as Exhibit 10.31 to form 10-Q filed on May 14, 2015, and hereby incorporated by reference.
10.23	Sixth Amendment to Second Amended and Restated Loan and Security Agreement, dated October 5, 2015 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on October 9, 2015, and hereby incorporated by reference.

10.24	Modification No. 1 to Loan and Security Agreement, dated September 30, 2015 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit No. 10.2 to the Form 8-K filed on October 9, 2015, and hereby incorporated by reference.
10.25	Seventh Amendment to Second Amended and Restated Loan and Security Agreement, dated February 8, 2016 among Registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit No. 10.28 to the Form 10-Q filed on February 11, 2016, and hereby incorporated by reference.
10.26	Lease Agreement between Mediasite KK, as tenant, and Sumitomo Metal Mining Co., Ltd., as landlord, dated August 1, 2016, filed as Exhibit 10.1 to the Form 8-K filed on August 3, 2016, and hereby incorporated by reference.
10.27	Eighth Amendment to Second Amended and Restated Loan and Security Agreement, dated December 9, 2016 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit No. 10.1 to the Form 8-K filed on December 14, 2016, and hereby incorporated by reference.
10.28	Modification No. 2 to Loan and Security Agreement, dated February 8, 2017 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.28 to the Form 10-Q filed on February 9, 2017, and hereby incorporated by reference.
10.29	Ninth Amendment to Second Amended and Restated Loan and Security Agreement, dated March 22, 2017 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit No. 10.1 to the Form 8-K filed on March 28, 2017, and hereby incorporated by reference.
10.30	Waiver and Tenth Amendment to Second Amended and Restated Loan and Security Agreement, dated May 10, 2017 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.30 to the Form 10-Q filed on May 11, 2017, and hereby incorporated by reference.
10.31	Waiver and Modification No. 3 to Loan and Security Agreement, dated May 11, 2017 among Registrant Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.31 to the Form 10-Q filed on May 11, 2017, and hereby incorporated by reference.
10.32	Subscription Agreement between Registrant and Mark D. Burish, dated May 30, 2017, filed as Exhibit 3.02 to the 8-K filed on June 5, 2017, and hereby incorporated by reference.
10.33	Agreement Not to Convert between Registrant and Mark D. Burish, dated November 17, 2017, filed as Exhibit 10.1 to the Form 8-K filed on November 21, 2017, and hereby incorporated by reference.
10.34	Subscription Agreement between Registrant and Mark D. Burish, dated August 23, 2017, filed as Exhibit 10.1 to the 8-K filed on August 25, 2017, and hereby incorporated by reference.
10.35	Eleventh Amendment to Second Amended and Restated Loan and Security Agreement, dated December 22, 2017 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.1 to the Form 8-K filed on December 29, 2017, and hereby incorporated by reference.
10.36	Modification No. 4 to Loan and Security Agreement, dated December 28, 2017 among Registrant, Sonic Foundry, Inc. and Partners for Growth IV, L.P., filed as Exhibit 10.2 to the Form 8-K filed on December 29, 2017, and hereby incorporated by reference.
10.37	

	Subscription Agreement between Registrant and Mark D. Burish, dated January 19, 2018, filed as Exhibit 10.1 to the Form 8-K filed on January 25, 2018, and hereby incorporated by reference.
10.38	10.75% Convertible Secured Subordinated Promissory Note between Registrant and Mark D. Burish, filed as Exhibit 10.2 to the Form 8-K filed on January 25, 2018, and hereby incorporated by reference.
10.39	Subscription Agreement between Registrant and Andrew D. Burish, dated April 16, 2018, filed as Exhibit 10.1 to the Form 8-K filed on April 18, 2018, and hereby incorporated by reference.
10.40	Warrant, dated April 16, 2018, filed as Exhibit 10.2 to the Form 8-K filed on April 18, 2018, and hereby incorporated by reference.
10.41	Loan and Security Agreement, dated May 11, 2018 among Registrant, Sonic Foundry, Inc. and Partners for Growth V, L.P., filed as Exhibit 10.41 to the Form 10-Q filed on May 15, 2018, and hereby incorporated by reference.
10.42	Warrant, dated as of May 11, 2018, between Registrant and Partners for Growth V, L.P., filed as Exhibit 10.42 to the Form 10-Q filed on May 15, 2018, and hereby incorporated by reference.
10.43	Twelfth Amendment to Second Amended and Restated Loan and Security Agreement, dated May 11, 2018 among Registrant Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as Exhibit 10.43 to the Form 10-Q filed on May 15, 2018, and hereby incorporated by reference.
10.44	Promissory Note between Registrant and Mark D. Burish, dated January 4, 2019, filed as Exhibit 10.1 to the Form 8-K filed on January 8, 2019, and hereby incorporated by reference.
10.45	Promissory Note between Registrant and Mark D. Burish, dated January 31, 2019, effective upon receipt of funds on February 5, 2019, filed as Exhibit 10.1 to the Form 8-K filed on February 12, 2019, and hereby incorporated by reference.
10.46	Promissory Note between Registrant and Mark D. Burish, dated February 14, 2019, filed as Exhibit 10.1 to the Form 8-K filed on February 20, 2019, and hereby incorporated by reference.
10.47	Note Purchase Agreement between the Company and Mark Burish, dated February 28, 2019, filed as Exhibit 10.1 to the Form 8-K filed on March 6, 2019, and hereby incorporated by reference.
10.48	Warrant between the Company and Mark Burish, dated February 28, 2019, filed as Exhibit 10.2 to the Form 8-K filed on March 6, 2019, and hereby incorporated by reference.
10.49	Consent, Waiver & Modification to Loan and Security Agreement between Sonic Foundry, Inc. and Partners for Growth V, L.P., dated March 11, 2019.
21	List of Subsidiaries

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23.1	Consent of Baker Tilly Virchow Krause LLP, Independent Registered Public Accounting Firm
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer and Secretary
32	Section 906 Certification of Chief Executive Officer and Chief Financial Officer and Secretary
101	The following materials from the Sonic Foundry, Inc. Form 10-K for the year ended September 30, 2018 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Comprehensive Loss, (iv) the Consolidated Statements of Stockholder's Equity, (v) the Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements.

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

*Compensatory Plan or Arrangement

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SIGNATURES

Pursuant to the requirement of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Sonic Foundry, Inc.
(Registrant)

By: /s/ Gary R. Weis
Gary R. Weis
Chairman and Chief Executive Officer

Date: March 15, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Gary R. Weis	Chief Executive Officer and Director	March 15, 2019
/s/ Kenneth A. Minor	Chief Financial Officer and Secretary	March 15, 2019
/s/ Mark D. Burish	Chair and Director	March 15, 2019
/s/ Frederick H. Kopko, Jr.	Director	March 15, 2019
/s/ Brian T. Wiegand	Director	March 15, 2019
/s/ Nelson A. Murphy	Director	March 15, 2019
/s/ David F. Slayton	Director	March 15, 2019