AVID TECHNOLOGY INC
Form 10-Q
August 07, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

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

For the transition period from __________ to __________

Commission File Number: 0-21174

____

Avid Technology, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**04-2977748**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

Avid Technology Park, One Park West

Tewksbury, Massachusetts 01876

(Address of Principal Executive Offices, Including Zip Code)

(978) 640-6789

(Registrant s Telephone Number, Including Area Code)

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

Yes **x** No o

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

Large Accelerated Filer **x**	Accelerated Filer o
Non-accelerated Filer **o** (Do not check if smaller reporting company)	Smaller Reporting Company o

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

Yes o No **x**

The number of shares outstanding of the registrant s Common Stock as of August 1, 2008 was 37,062,055.

AVID TECHNOLOGY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008

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This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and Section 27A of the Securities Act of 1933, as amended. For this purpose, any statements contained herein regarding our strategy, future plans or operations, financial position, future revenues, projected costs, prospects and objectives of management, other than statements of historical facts, may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We cannot guarantee that we actually will achieve the plans, intentions or expectations expressed or implied in forward-looking statements. There are a number of factors that could cause actual events or results to differ materially from those indicated or implied by such forward-looking statements, many of which are beyond our control, including the factors discussed in Part I - Item 1A under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, and as referenced in Part II - Item 1A of this report. In addition, the forward-looking statements contained herein represent our estimates only as of the date of this filing and should not be relied upon as representing our estimates as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, whether to reflect actual results, changes in assumptions, changes in other factors affecting such forward-looking statements or otherwise.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AVID TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands except per share data, unaudited)

	Three Months Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Net revenues:				
Products	$189,115	$192,370	$357,291	$384,813
Services	33,748	32,956	63,838	59,411
Total net revenues	222,863	225,326	421,129	444,224
Cost of revenues:				
Products	92,628	92,991	177,701	185,703
Services	19,629	17,454	37,016	33,433
Amortization of intangible assets	2,270	4,761	5,524	9,233
Total cost of revenues	114,527	115,206	220,241	228,369
Gross profit	108,336	110,120	200,888	215,855
Operating expenses:				
Research and development	38,972	38,444	77,482	76,186
Marketing and selling	55,259	56,505	105,586	108,199
General and administrative	19,492	17,698	41,435	35,550
Amortization of intangible assets	3,323	3,431	6,710	6,863
Restructuring costs, net	937	1,517	2,000	1,775
Total operating expenses	117,983	117,595	233,213	228,573
Operating loss	(9,647)	(7,475)	(32,325)	(12,718)
Interest income	746	2,037	2,309	4,026
Interest expense	(143)	(98)	(279)	(222)
Other income (expense), net	14	84	68	114
Loss before income taxes	(9,030)	(5,452)	(30,227)	(8,800)
Provision for (benefit from) income taxes, net	1,355	547	1,306	(2,821)
Net loss	$(10,385)	$(5,999)	$(31,533)	$(5,979)
Net loss per common share basic and diluted	$(0.28)	$(0.15)	$(0.83)	$(0.15)
Weighted-average common shares outstanding basic and diluted	36,904	40,940	38,133	41,046

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

AVID TECHNOLOGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, unaudited)

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$129,437	$208,619
Marketable securities	9,025	15,841
Accounts receivable, net of allowances of $20,976 and $20,784 at June 30, 2008 and December 31, 2007, respectively	114,080	138,692
Inventories	120,728	117,324
Deferred tax assets, net	1,894	1,873
Prepaid expenses	12,670	9,967
Other current assets	26,935	24,948
Total current assets	414,769	517,264
Property and equipment, net	44,491	46,160
Intangible assets, net	59,193	71,427
Goodwill	360,521	360,584
Other assets	11,537	10,518
Total assets	$890,511	$1,005,953
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$36,358	$34,992
Accrued compensation and benefits	34,738	30,724
Accrued expenses and other current liabilities	45,133	49,319
Income taxes payable	13,271	13,869
Deferred revenues	79,186	79,771
Total current liabilities	208,686	208,675
Long-term liabilities	17,539	17,495
Total liabilities	226,225	226,170
Contingencies (Note 11)		
Stockholders equity:		
Common stock	423	423
Additional paid-in capital	973,482	968,339
Accumulated deficit	(196,123)	(155,722)
Treasury stock at cost, net of reissuances	(128,735)	(45,823)
Accumulated other comprehensive income	15,239	12,566
Total stockholders equity	664,286	779,783
Total liabilities and stockholders equity	$890,511	$1,005,953

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

AVID TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Six Months Ended June 30, 2008	2007
Cash flows from operating activities:		
Net loss	$(31,533)	$(5,979)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	23,352	27,167
Provision for doubtful accounts	941	405
Non-cash provision for restructuring	16	
Loss on disposal of fixed assets	17	15
Compensation expense from stock grants and options	6,473	8,103
Changes in deferred tax assets and liabilities	(376)	(2,208)
Changes in operating assets and liabilities:		
Accounts receivable	25,481	1,479
Inventories	(3,406)	4,186
Prepaid expenses and other current assets	(4,122)	(6,642)
Accounts payable	1,267	(2,095)
Accrued expenses, compensation and benefits and other liabilities	(2,937)	(3,846)
Income taxes payable	(1,203)	(3,243)
Deferred revenues	374	5,288
Net cash provided by operating activities	14,344	22,630
Cash flows from investing activities:		
Purchases of property and equipment	(8,543)	(14,709)
Payments for other long-term assets	(1,018)	(438)
Payments for business acquisitions		(529)
Purchases of marketable securities	(16,872)	(2,142)
Proceeds from sales of marketable securities	23,701	35,003
Net cash (used in) provided by investing activities	(2,732)	17,185
Cash flows from financing activities:		
Payments on capital lease obligations		(51)
Purchases of common stock for treasury	(93,187)	(23,687)
Proceeds from issuance of common stock under employee stock plans	1,205	4,245
Net cash used in financing activities	(91,982)	(19,493)
Effect of exchange rate changes on cash and cash equivalents	1,188	(1,673)
Net (decrease) increase in cash and cash equivalents	(79,182)	18,649
Cash and cash equivalents at beginning of period	208,619	96,279
Cash and cash equivalents at end of period	$129,437	$114,928

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

AVID TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. FINANCIAL INFORMATION

The accompanying condensed consolidated financial statements include the accounts of Avid Technology, Inc. and its wholly owned subsidiaries (collectively, Avid or the Company). These financial statements are unaudited. However, in the opinion of management, the condensed consolidated financial statements include all adjustments, consisting of only normal, recurring adjustments, necessary for their fair statement. Interim results are not necessarily indicative of results expected for a full year. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and footnotes necessary for a complete presentation of operations, financial position and cash flows of the Company in conformity with generally accepted accounting principles. The accompanying condensed consolidated balance sheet as of December 31, 2007 was derived from Avid s audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles. The Company filed audited consolidated financial statements for the year ended December 31, 2007 in its 2007 Annual Report on Form 10-K, which included all information and footnotes necessary for such presentation. The financial statements contained in this Form 10-Q should be read in conjunction with the audited consolidated financial statements in the Form 10-K.

The Company s preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. The most significant estimates reflected in these financial statements include accounts receivable and sales allowances, stock-based compensation, inventory valuation, income tax asset valuation allowances and purchase accounting. Actual results could differ from the Company s estimates.

2. NET INCOME (LOSS) PER COMMON SHARE

Basic and diluted net income (loss) per common share are as follows (in thousands, except per share data):

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2008	**2007**	**2008**	**2007**
Net loss	$(10,385)	$(5,999)	$(31,533)	$(5,979)
Weighted-average common shares outstanding basic and diluted	36,904	40,940	38,133	41,046
Net loss per common share basic and diluted	$(0.28)	$(0.15)	$(0.83)	$(0.15)

The following table sets forth (in thousands) potential common shares, on a weighted-average basis, that are considered anti-dilutive securities and are excluded from the diluted net loss per share calculations because the sum of the exercise price per share and the unrecognized compensation cost per share is greater than the average market price of the Company s common stock for the relevant period.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Options	3,005	2,942	2,769	2,805
Warrant	1,155	1,155	1,155	1,155
Non-vested restricted stock and restricted stock units	1,174	129	1,036	6
Anti-dilutive potential common shares	5,334	4,226	4,960	3,966

Certain stock options and restricted stock units granted to executive officers starting in the fourth quarter of 2007 include shares that vest based on performance and market conditions and as a result are considered contingently issuable. The following table sets forth (in thousands) potential common shares, on a weighted-average basis, that are related to such contingently-issuable stock options and restricted stock units and were excluded from the calculation of diluted net loss for the three and six months ended June 30, 2008.

	Three Months Ended	Six Months Ended
	June 30, 2008	June 30, 2008
Performance-based options	1,115	1,009
Performance-based restricted stock units	27	18
Potential common shares from performance-based grants	1,142	1,027

The following table sets forth (in thousands) common stock equivalents excluded from the calculation of diluted net loss per share because the effect would be anti-dilutive due to the net loss for the relevant period.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Options	148	527	169	576
Non-vested restricted stock and restricted stock units	4	50	4	31
Anti-dilutive common stock equivalents	152	577	173	607

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but its provisions apply to all other accounting pronouncements that require or permit fair value measurement. SFAS No. 157 is effective for the Company s fiscal year beginning January 1, 2008 and for interim periods within that year. In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2, *Effective Date of FASB Statement No. 157*, which delayed for one year the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). As required, the Company adopted SFAS No. 157 for its financial assets on January 1, 2008. Adoption did not have a material impact on the Company s financial position or results of operations. The Company has not yet determined the impact on its financial statements of the January 1, 2009 adoption of SFAS No. 157 as it pertains to non-financial assets and liabilities.

SFAS No. 157 establishes a fair value hierarchy that requires the use of observable market data, when available, and prioritizes the inputs to valuation techniques used to measure fair value in the following categories:

Level 1 Quoted unadjusted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all observable inputs and significant value drivers are observable in active markets.

Level 3 Model derived valuations in which one or more significant inputs or significant value drivers are unobservable, including assumptions developed by the Company.

The following table summarizes the Company s fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2008 (in thousands):

		Fair Value Measurements at Reporting Date Using		
	June 30, 2008	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Financial Assets:				
Available for sale securities	$56,855	$18,990	$37,865	$
Deferred compensation plan investments	807	807		
Financial Liabilities:				
Foreign currency forward contracts	48		48	
Deferred compensation plan	$807	$807	$	$

4. GOODWILL AND INTANGIBLE ASSETS

Goodwill

Changes in the carrying amount of the Company s goodwill consisted of the following (in thousands):

	Total
Goodwill balance at December 31, 2007	$360,584
Revised restructuring estimates	(345)
Deferred tax liability adjustments, net	282
Goodwill balance at June 30, 2008	$360,521

Amortizable Identifiable Intangible Assets

Amortizable identifiable intangible assets resulting from the Company s acquisitions consisted of the following (in thousands):

	June 30, 2008			December 31, 2007		
		Accumulated			Accumulated	
	Gross	Amortization	Net	Gross	Amortization	Net
Completed technologies and patents	$65,727	$(59,925)	$5,802	$65,727	$(54,099)	$11,628
Customer relationships	71,701	(29,875)	41,826	71,701	(25,205)	46,496
Trade names	21,316	(9,879)	11,437	21,316	(8,284)	13,032
Non-compete covenants				1,704	(1,637)	67
License agreements	560	(432)	128	560	(356)	204
	$159,304	$(100,111)	$59,193	$161,008	$(89,581)	$71,427

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Amortization expense related to all intangible assets in the aggregate was $5.6 million and $8.2 million, respectively, for the three-month periods ended June 30, 2008 and 2007, and $12.2 million and $16.1 million, respectively, for the six-month periods ended June 30, 2008 and 2007. The Company expects amortization of these intangible assets to be approximately $9 million for the remainder of 2008, $15 million in 2009, $12 million in 2010, $10 million in 2011, $5 million in 2012, $2 million in 2013 and $6 million thereafter.

5. ACCOUNTS RECEIVABLE

Accounts receivable, net of allowances, consist of the following (in thousands):

	June 30, 2008	December 31, 2007
Accounts receivable	$135,056	$159,476
Less:		
Allowance for doubtful accounts	(2,444)	(2,160)
Allowance for sales returns and rebates	(18,532)	(18,624)
	$114,080	$138,692

The accounts receivable balances as of June 30, 2008 and December 31, 2007 exclude approximately $23.9 million and $24.6 million, respectively, for large solution sales and certain distributor sales that were invoiced, but for which revenues had not been recognized and payments were not then due.

6. INVENTORIES

Inventories, net of related reserves, consist of the following (in thousands):

	June 30, 2008	December 31, 2007
Raw materials	$29,205	$ 31,316
Work in process	9,144	6,179
Finished goods	82,379	79,829
	$120,728	$ 117,324

As of June 30, 2008 and December 31, 2007, the finished goods inventory includes inventory at customer locations of $20.3 million and $22.8 million, respectively, associated with products shipped to customers for which revenues had not yet been recognized.

7. PROPERTY AND EQUIPMENT, NET

Property and equipment, net, consist of the following (in thousands):

	June 30, 2008	December 31, 2007
Computer and video equipment and software	$121,878	$116,413
Manufacturing tooling and testbeds	8,205	7,748
Office equipment	3,523	3,741
Furniture and fixtures	12,033	13,314
Leasehold improvements	31,145	30,762
	176,784	171,978
Less accumulated depreciation and amortization	(132,293)	(125,818)
	$44,491	$46,160

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8. LONG-TERM LIABILITIES

Long-term liabilities consist of the following (in thousands):

	June 30, 2008	December 31, 2007
Long-term deferred tax liabilities	$7,381	$7,430
Long-term deferred revenue	5,549	4,581
Long-term deferred rent	2,724	3,008
Long-term accrued restructuring	1,885	2,476
	$17,539	$17,495

9. ACCOUNTING FOR STOCK-BASED COMPENSATION

Stock Incentive Plan

At the Company s 2008 Annual Stockholder Meeting held on May 21, 2008, the Company s stockholders approved the Company s Amended and Restated 2005 Stock Incentive Plan (the Plan). Under the Plan, the Company is authorized to issue, subject to adjustment in the event of stock splits and other similar events, up to 8,000,000 shares of the Company s common stock plus:

an aggregate of 168,143 shares that remained available for issuance as of May 21, 2008 under the Company s 1993 Director Stock Option Plan, as amended; the Company s 1998 Stock Option Plan; the Company s Amended and Restated 1999 Stock Option Plan; and the Company s Midiman, Inc. 2002 Stock Option/Stock Issuance Plan (the Existing Plans); and

any shares subject to awards granted under the Existing Plans, which awards expire, terminate or are otherwise surrendered, canceled, forfeited or repurchased by the Company at their original issuance price pursuant to a contractual repurchase right; as of May 21, 2008, there were 1,519,437 shares subject to awards granted under the Existing Plans.

No further awards will be granted under the Existing Plans from and after May 21, 2008. Under the Plan, the Company may grant stock awards or options to purchase the Company s common stock to employees, officers, directors (subject to certain restrictions) and consultants, generally at the market price on the date of grant. The options become exercisable over various periods, typically four years for employees and one year for non-employee directors, and have a maximum term of seven years. Restricted stock and restricted stock unit awards typically vest over four years. As of June 30, 2008, 5,629,145 shares were available for issuance under the Plan, including 1,002,771 shares that may alternatively be issued as awards of restricted stock or restricted stock units.

The Company records stock-based compensation expense in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. The following table sets forth the key assumptions and fair value results for stock options with time-based vesting granted during the three- and six-month periods ended June 30, 2008 and 2007:

	Three Months Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Expected dividend yield	0.00%	0.00%	0.00%	0.00%
Risk-free interest rate	2.67%	4.85%	2.48%	4.80%
Expected volatility	40.9%	31.2%	39.4%	32.9%
Expected life (in years)	4.71	4.63	4.43	4.37
Weighted-average fair value of options granted	$8.67	$11.49	$8.42	$11.80

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In December 2007, the Company issued a stock option to purchase 625,000 shares of Avid common stock to the Company s new chief executive officer that has vesting based on market conditions or a combination of performance and market conditions. The compensation cost and derived service periods for this option were recorded based on a Monte Carlo valuation with an assumed volatility of 32.80% and a risk-free interest rate of 3.93%. The weighted-average fair value of this grant is $6.60 and the expected lives range from 3.25 to 4.98 years with a weighted average of 4.44 years.

During the three months ended March 31, 2008, the Company issued stock options to purchase 490,000 shares of Avid common stock to newly hired officers of the Company that have vesting based on market conditions or a combination of performance and market conditions. The compensation cost and derived service periods for these options were recorded based on a Monte Carlo valuation with a weighted-average volatility of 38.44% and a risk-free interest rate of 3.42%. The weighted-average fair value of these grants is $7.11 and the expected lives range from 2.81 to 4.97 years with a weighted average of 4.26 years.

Also during the three months ended March 31, 2008, the Company issued 27,200 restricted stock units to executives as part of the Company s annual grant program that have vesting based on market conditions or a combination of performance and market conditions. The compensation cost and derived service periods for these restricted stock units were estimated using the Monte Carlo valuation method using a volatility of 38.95% and a risk-free interest rate of 3.29%. For restricted stock units with vesting based on a combination of performance and market conditions, compensation costs were also estimated using the intrinsic value on the date of grant factored for probability. Compensation costs for each vesting tranche were recorded based on the higher estimate. The weighted-average fair value of these restricted stock units is $18.61 and the derived service periods range from 3.04 to 4.75 years with a weighted average of 4.17 years.

In accordance with SFAS 123(R), the Company estimates forfeiture rates at the time awards are made based on historical turnover rates and applies these rates in the calculation of estimated compensation cost. For all stock-based awards for the year ended December 31, 2006 and for most of the stock-based awards for the year ended December 31, 2007, the Company applied a 6.5% estimated forfeiture rate. In the fourth quarter of 2007, based on historical turnover rates, the Company segregated non-employee directors into a separate class and applied a 0% estimated forfeiture rate to the calculation of estimated compensation cost for this class. During the three months ended March 31, 2008, based on recent changes in the Company s stock-based compensation structure and executive management staff, the Company determined that the executive management staff should be segregated from the rest of its employees into a separate class for the calculation of stock-based compensation. Accordingly, based on the Company s historical turnover rates for these classes of employees and directors, for grants made during the first quarter of 2008, the Company applied annualized estimated forfeiture rates of 0% to non-employee director awards, 7% to executive management staff awards and 8.75% to awards to all other employees. Similarly, based on a review of updated historical turnover rates during the three months ended June 30, 2008, the Company determined that the annualized forfeiture rates for grants made in that quarter to the executive management staff should be increased to 8%. Accordingly, for grants made during the second quarter of 2008, the Company applied annualized estimated forfeiture rates of 0% to non-employee director awards, 8% to executive management staff awards and 8.75% to awards to all other employees.

During the first and second quarters of 2008, the Company also revised its estimated forfeiture rates for, and began applying the then current revised forfeiture rates to, all outstanding stock options and non-vested restricted stock awards, resulting in a revised estimate of compensation costs related to these stock-based grants. As a result of the application of the changes in forfeiture rates, the Company recorded in its results of operations cumulative adjustments that reduced previously recorded stock-based compensation expense of approximately $1.2 million during the first six months of 2008.

The following table summarizes changes in the Company s stock option plans during the six-month period ended June 30, 2008:

	Stock Options Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2007	3,825,180	$35.83		
Granted	1,009,430	$23.51		
Exercised	(48,253)	$14.31		
Forfeited or expired	(351,285)	$44.59		
Options outstanding at June 30, 2008	4,435,072	$32.57	6.53	$1,549
Options vested at June 30, 2008 or expected to vest	4,018,182	$33.29	6.41	$1,549
Options exercisable at June 30, 2008	2,074,125	$37.87	5.01	$1,549

The aggregate intrinsic value of stock options exercised during the six-month periods ended June 30, 2008 and 2007 was approximately $0.4 million and $3.5 million, respectively. Cash received from the exercise of stock options was $0.7 million and $3.7 million for the six-month periods ended June 30, 2008 and 2007, respectively. The Company did not realize any actual tax benefit from the tax deductions for stock option exercises during the six-month periods ended June 30, 2008 and 2007 due to the full valuation allowance on the Company s U.S. deferred tax assets.

The following tables summarize the changes in the Company s non-vested restricted stock units and non-vested restricted stock during the six-month period ended June 30, 2008:

	Non-Vested Restricted Stock Units Shares	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Non-vested at December 31, 2007	647,501	$35.39		
Granted	712,254	$23.50		
Vested	(171,585)	$35.46		
Forfeited	(66,325)	$32.24		
Non-vested at June 30, 2008	1,121,845	$28.13	1.90	$19,049

	Non-Vested Restricted Stock Shares	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Non-vested at December 31, 2007	106,463	$26.72		

Granted				
Vested	(2,155)	$47.01		
Forfeited				
Non-vested at June 30, 2008	104,308	$26.30	3.40	$1,771

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Employee Stock Purchase Plan

On February 27, 2008, the Company s board of directors approved the Company s Second Amended and Restated 1996 Employee Stock Purchase Plan (the ESPP). The amended plan became effective May 1, 2008, the first day of the next offering period under the plan, and offers shares for purchase at a price equal to 85% of the closing price on the applicable offering termination date. Shares issued under the ESPP are considered compensatory under SFAS 123(R). Accordingly, the Company is required to assign fair value to, and record compensation expense for, shares issued from the ESPP starting May 1, 2008. Prior to May 1, 2008, shares were authorized for issuance at a price equal to 95% of the closing price on the applicable offering termination date, and shares offered under this arrangement were considered noncompensatory under SFAS 123(R).

The following table sets forth the key assumptions and fair value results for shares issued under the ESPP starting May 1, 2008:

	Three Months Ended
	June 30, 2008
Expected dividend yield	0.00%
Risk-free interest rate	2.50%
Expected volatility	40.9%
Expected life (in years)	0.25
Weighted-average fair value of shares issued	$3.39

At the 2008 Annual Stockholder Meeting held on May 21, 2008, the Company s stockholders authorized an additional 800,000 shares for issuance under the ESPP. As of June 30, 2008, 1,027,076 shares remained available for issuance under the ESPP.

Stock-Based Compensation Expense

Stock-based compensation was included in the following captions in the Company s condensed consolidated statements of operations for the three- and six-month periods ended June 30, 2008 and 2007 (in thousands):

	Three Months Ended		**Six Months Ended**	
	June 30,		**June 30,**	
	2008	**2007**	**2008**	**2007**
Products cost of revenues	$ 171	$ 182	$ 303	$ 323
Services cost of revenues	166	251	264	448
Research and development expense	1,089	1,354	1,452	2,397
Marketing and selling expense	1,109	1,201	1,638	2,136
General and administrative expense	2,053	1,563	3,076	2,799
Total stock-based compensation expense	$4,588	$4,551	$6,733	$8,103

As of June 30, 2008, the Company had $55.5 million of unrecognized compensation cost before forfeitures related to non-vested stock-based compensation awards granted under its stock-based compensation plans. This cost will be recognized over the next five years.

10. STOCK REPURCHASES

A stock repurchase program was approved by the Company s board of directors and publicly announced on April 26, 2007. Under this program, the Company was authorized to repurchase up to $100 million of the Company s common stock through transactions on the open market, in block trades or otherwise. The stock repurchase program has no expiration date. On February 27, 2008, the Company announced its board of directors approval of a $100 million increase in the authorized funds for the repurchase of the Company s common stock, increasing the total authorized funds for stock repurchases under the program to $200 million. During 2007, the Company repurchased 809,236 shares of the Company s common stock for a total purchase price, including commissions, of $26.6 million, or $32.92 per share. During the three months ended March 31, 2008, the Company repurchased an additional 4,254,397 shares of the Company s common stock for a total purchase price, including commissions, of $93.2 million. The average price per share paid for the shares repurchased during the first quarter of 2008, including commissions, was $21.90. No shares were repurchased during the three months ended June 30, 2008, and, as of June 30, 2008, $80.3 million remained available for future stock repurchases under the program. This stock repurchase program is being funded using the Company s working capital.

At June 30, 2008 and December 31, 2007, treasury shares held by the Company totaled 5.3 million shares and 1.2 million shares, respectively.

11. CONTINGENCIES

Avid receives inquiries from time to time claiming possible patent infringement by the Company. If any infringement is determined to exist, the Company may seek licenses or settlements. In addition, as a normal incidence of the nature of the Company s business, various claims, charges and litigation have been asserted or commenced from time to time against the Company arising from or related to contractual or employee relations, intellectual property rights or product performance. Settlements related to any such claims are generally included in the general and administrative expenses caption in the Company s consolidated statements of operations. Management does not believe these claims will have a material adverse effect on the financial position or results of operations of the Company.

On May 24, 2007, David Engelke and Bryan Engelke filed a complaint against the Company s Pinnacle subsidiary in Pinellas County (Florida) Circuit Court, claiming that Pinnacle breached certain contracts among them and that the Engelkes are entitled to indemnification for damages (and attorneys fees) awarded against them in litigation with a third party. The complaint, which seeks damages of approximately $17.7 million, was served on September 4, 2007. On September 28, 2007, the Florida appellate court reversed the damages award for which the Engelkes seek indemnification and, on June 16, 2008, remanded the case for a new damages trial with instructions that would limit the potential award to a sum significantly lower than the amount demanded in the Engelkes complaint against Pinnacle. Because the Company cannot predict the outcome of this action at this time, no costs have been accrued for any loss contingency; however, the Company does not expect this matter to have a material effect on the Company s financial position or results of operations.

From time to time, the Company provides indemnification provisions in agreements with customers covering potential claims by third parties of intellectual property infringement. These agreements generally provide that the Company will indemnify customers for losses incurred in connection with an infringement claim brought by a third party with respect to the Company s products. These indemnification provisions generally offer perpetual coverage for infringement claims based upon the products covered by the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is theoretically unlimited; however, to date, the Company has not incurred material costs related to these indemnification provisions. As a result, the Company believes the estimated fair value of these indemnification provisions is minimal.

As permitted under Delaware law and pursuant to Avid s Third Amended and Restated Certificate of Incorporation, as amended, the Company is obligated to indemnify its current and former officers and directors for certain events that occur or occurred while the officer or director is or was serving in such capacity. The term of the indemnification period is for each respective officer s or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification obligations is unlimited; however, Avid has mitigated the exposure through the purchase of directors and officers insurance, which is intended to limit the risk and, in most cases, enable the Company to recover all or a portion of any future amounts paid. As a result of this insurance coverage, the Company believes the estimated fair value of these indemnification obligations is minimal.

The Company, through a third party, provides lease financing options to its customers, including end users and, on a limited basis, resellers. During the terms of these leases, which are generally three years, the Company remains liable for any unpaid principal balance upon default by the customer, but such liability is limited in the aggregate

based on a percentage of initial amounts funded or, in certain cases, amounts of unpaid balances. At June 30, 2008 and December 31, 2007, Avid s maximum recourse exposure totaled approximately $9.1 million and $8.8 million, respectively. The Company records revenues from these transactions upon the shipment of products, provided that all other revenue recognition criteria, including collectibility being reasonably assured, are met. Because the Company has been providing these financing options to its customers for many years, the Company has a substantial history of collecting under these arrangements without providing significant refunds or concessions to the end user, reseller or financing party. To date, the payment default rate has consistently been between 2% and 4% per year of the original funded amount. This low default rate results because the third-party leasing company diligently screens applicants and collects amounts due, and because Avid actively monitors its exposures under the financing program and participates in the approval process for any lessees outside of agreed-upon credit-worthiness metrics. The Company maintains a reserve for estimated losses under this recourse lease program based on the historical default rates applied to the funded amount outstanding at period end. At June 30, 2008 and December 31, 2007, the Company s accrual for estimated losses was $0.9 million and $0.8 million, respectively.

Avid provides warranties on externally sourced and internally developed hardware. For internally developed hardware and in cases where the warranty granted to customers for externally sourced hardware is greater than that provided by the manufacturer, the Company records an accrual for the related liability based on historical trends and actual material and labor costs. The warranty period for all of the Company s products is generally 90 days to one year, but can extend up to five years depending on the manufacturer s warranty or local law.

The following table sets forth activity for the Company s product warranty accrual (in thousands):

	Six Months Ended June 30, 2008	2007
Accrual balance at beginning of period	$5,803	$ 6,072
Accruals for product warranties	4,180	4,260
Cost of warranty claims	(3,800)	(4,338)
Accrual balance at end of period	$6,183	$ 5,994

12. COMPREHENSIVE LOSS

Total comprehensive loss, net of taxes, consists of net loss and the net changes in foreign currency translation adjustment and net unrealized gains and losses on available-for-sale securities. The following is a summary of the Company s comprehensive loss (in thousands):

	Three Months Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Net loss	$(10,385)	$(5,999)	$(31,533)	$(5,979)
Net changes in:				
Foreign currency translation adjustment	(510)	2,051	2,659	2,417
Unrealized gains on securities		16	14	27
Total comprehensive loss	$(10,895)	$(3,932)	$(28,860)	$(3,535)

13. SEGMENT INFORMATION

The Company has been organized into three strategic business units, Professional Video, Audio, and Consumer Video, each of which is a reportable segment. During the first quarter of 2008, the Company changed the way it reviews and manages its business by excluding certain corporate infrastructure costs and expenses, including finance, human resources, legal and some information technology expenses, when evaluating segment performance and measuring the profitability of each operating segment. Such expenses, which were previously allocated to the operating segments, are managed outside the segments and are not controllable at the segment level. The Company believes that excluding these costs provides a better measure of each segment s performance. The Company also continues to exclude certain other costs and expenses when evaluating segment performance and profitability, including the amortization and impairment of acquired intangible assets, the write-off of acquired in-process research and development, stock-based compensation expenses, restructuring expenses and legal settlements. The Company now reports a contribution margin for each business unit that excludes these costs and has revised the prior period segment disclosures to conform to the current presentation. The change to the current presentation did not affect the Company s consolidated operating results.

The following is a summary of the Company s revenues and contribution margin by reportable segment for the three- and six-month periods ended June 30, 2008 and 2007 and a reconciliation of segment contribution margin to total consolidated operating loss for each period (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2008	2007	June 30, 2008	2007
Revenues:				
Professional Video	$115,738	$120,318	$209,988	$232,989
Audio	75,315	76,763	148,554	155,686
Consumer Video	31,810	28,245	62,587	55,549
Total revenues	$222,863	$225,326	$421,129	$444,224
Contribution Margin:				
Professional Video	$10,563	$12,136	$9,243	$23,737
Audio	10,626	12,109	21,496	25,262
Consumer Video	21	1,967	530	2,535
Segment contribution margin	21,210	26,212	31,269	51,534
Less unallocated costs and expenses:				
Common costs and operating expenses	(19,739)	(18,402)	(42,627)	(37,253)
Amortization of acquisition-related intangible assets	(5,593)	(8,192)	(12,234)	(16,096)
Stock-based compensation	(4,588)	(4,551)	(6,733)	(8,103)
Restructuring costs, net	(937)	(1,517)	(2,000)	(1,775)
Legal settlements		(1,025)		(1,025)
Consolidated operating loss	$(9,647)	$(7,475)	$(32,325)	$(12,718)

In July 2008, the Company announced several changes to its previous business unit structure. The Company is taking actions necessary to transition to this new business structure in the second half of 2008. The new business unit structure will be used to evaluate segment performance and measure segment profitability beginning January 1, 2009.

14. RESTRUCTURING COSTS AND ACCRUALS

During the quarter ended March 31, 2008, the Company initiated restructuring plans within the Company s Professional Video business unit and corporate operations to eliminate duplicative business functions and improve operational efficiencies. During the quarter ended March 31, 2008, the Company recorded restructuring charges of $1.2 million under these plans related to employee termination costs for 20 employees, primarily in the marketing and selling teams and general and administrative teams. During the quarter ended June 30, 2008, the Company recorded restructuring charges of $1.0 million under these plans primarily related to employee termination costs for 26 employees, primarily in the research and development teams and marketing and selling teams. The Company expects to incur total expenses, representing cash expenditures, under these restructuring plans of $3 million to $4 million and anticipates that it will complete the actions under the plans by December 31, 2008.

During 2007, the Company implemented restructuring plans within the Professional Video and Consumer Video business units, as well as corporate operations, that resulted in restructuring charges of $12.2 million. In connection with these actions, the Company terminated the employment of approximately 125 employees, primarily from the research and development teams and marketing and selling teams. The purpose of these plans was to eliminate duplicative business functions, improve operational efficiencies and align business skills with future opportunities. The charges for the estimated costs for the employee terminations totaled $5.2 million. Actions under these restructuring plans also included the closure of facilities in Munich, Germany and Chicago, Illinois and portions of facilities in Tewksbury, Massachusetts; Montreal, Canada; and Mountain View, California, and the Company s exit from the transmission server product line. The costs for the facility closures totaled $2.6 million. As a result of exiting the transmission server product line, the Company recorded non-cash charges totaling $4.3 million in cost of revenues for the write-down of inventory. The Company also recorded a non-cash restructuring charge of $0.1 million related to the disposal of fixed assets. During the first six months of 2008, the Company revised its previous estimated liability for the 2007 restructuring plans and recorded a restructuring recovery of $0.1 million.

The Company recorded these charges in accordance with the guidance of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. These restructuring charges and accruals require significant estimates and assumptions, including sub-lease income assumptions. These estimates and assumptions are monitored on at least a quarterly basis for changes in circumstances and any corresponding adjustments to the accrual are recorded in the Company s statement of operations in the period when such changes are known.

In connection with the August 2005 Pinnacle acquisition and the January 2006 Medea acquisition, the Company recorded accruals of $14.4 million and $1.1 million, respectively, related to severance agreements and lease or other contract terminations in accordance with Emerging Issues Task Force (EITF) Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*. During the third quarter of 2007, the Company recorded a $0.7 million increase in the estimate for the Pinnacle restructuring and a corresponding restructuring charge in the Company s statement of operations. Similarly, in the first quarter of 2007, the Company recorded a $0.1 million increase in the estimate for the Medea restructuring and a corresponding restructuring charge. During the second quarter of 2008, the Company recorded a $0.1 million decrease in the estimate for the Medea restructuring and a corresponding decrease in goodwill.

The following table sets forth the activity in the restructuring costs and accruals for the six-month period ended June 30, 2008 (in thousands):

	Non-Acquisition-Related Restructuring Liabilities		**Acquisition-Related Restructuring Liabilities**		
	Employee-Related	**Facilities-Related**	**Employee-Related**	**Facilities-Related**	**Total**
Accrual balance at December 31, 2007	$1,186	$3,256	$2	$2,041	$6,485
New restructuring charges operating expenses	2,020	137			2,157
Revisions of estimated liabilities	(76)	(44)	(2)	(170)	(292)
Accretion		37		2	39
Cash payments for employee-related charges	(1,991)				(1,991)
Cash payments for facilities, net of sublease income		(1,112)		(488)	(1,600)
Foreign exchange impact on ending balance	5	6		(4)	7
Accrual balance at June 30, 2008	$1,144	$2,280	$	$1,381	$4,805

The employee-related accruals at June 30, 2008 represent severance and outplacement costs to former employees that will be paid within the next 12 months and are, therefore, included in the caption accrued expenses and other current liabilities in the condensed consolidated balance sheet at June 30, 2008.

The facilities-related accruals at June 30, 2008 represent estimated losses on subleases of space vacated as part of the Company s restructuring actions. The leases, and payments against the amounts accrued, will extend through 2011 unless the Company is able to negotiate earlier terminations. Of the total facilities-related accruals, $1.8 million is included in the caption accrued expenses and other current liabilities and $1.9 million is included in the caption long-term liabilities in the condensed consolidated balance sheet at June 30, 2008.

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15. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. SFAS No. 161 requires companies with derivative instruments to disclose information that should enable financial-statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities and how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. SFAS No 161 is effective for the Company s fiscal year beginning January 1, 2009. Adoption of SFAS No. 161 is not expected to have a material impact on the Company s financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) (SFAS 141(R)), *Business Combinations*. SFAS 141(R) makes significant changes to the accounting and reporting standards for business acquisitions. SFAS 141(R) establishes principles and requirements for an acquirer s financial statement recognition and measurement of the assets acquired; the liabilities assumed, including those arising from contractual contingencies; any contingent consideration; and any noncontrolling interest in the acquiree at the acquisition date. SFAS 141(R) amends SFAS No. 109, *Accounting for Income Taxes*, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable as a result of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. The statement also amends SFAS No. 142, *Goodwill and Other Intangible Assets*, to, among other things, provide guidance for the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use. SFAS 141(R) is effective for the Company s fiscal year beginning January 1, 2009 and may not be adopted early or applied retrospectively. The adoption of SFAS 141(R) will have an impact on the accounting for, and the effect will depend upon the nature of, business combinations occurring on or after the adoption date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires that a noncontrolling interest, or minority interest, be recognized as equity in the consolidated financial statements and that it be presented separately from the parent s equity. Also, the amounts of net income attributable to the parent and to the noncontrolling interest must be included in consolidated net income on the face of the income statement. SFAS No. 160 clarifies that changes in a parent s ownership interest in a subsidiary are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated, with such gain or loss measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 is effective for the Company s fiscal year beginning January 1, 2009 and requires retroactive adoption of the presentation and disclosure requirements for existing minority interests; all other requirements may only be applied prospectively. Adoption of SFAS No. 160 is not expected to have a material impact on the Company s financial position or results of operations.

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

EXECUTIVE OVERVIEW

Our Markets and Strategy

We develop, market, sell and support a wide range of software and hardware products for the production, management and distribution of digital media content. Our products empower users, from the home hobbyist to film studios and media-production companies, to realize their creative vision, whether they aspire to edit blockbuster feature films, write and record hit songs, or design animated characters for games or movies. Our technology also improves customer workflows by enabling collaboration, streamlining processes and securely managing digital assets and allows users to distribute media over multiple platforms, including airwaves, cable and the Internet.

We have been organized into business units that focus on products and services sold to the following markets: Professional Video, Audio and Consumer Video. These business units also reflect our reportable segments and collectively encompass seven brands: Avid Video, Digidesign, M-Audio, Pinnacle, Sibelius, Softimage and Sundance Digital. The following is an overview of the business units and the markets they serve.

Professional Video. This business unit offers innovative solutions including video- and film-editing systems, integrated storage, workflow and asset management tools, 3D and special-effects software, and a comprehensive range of services, from product support and training to consultancy and managed services. We market these solutions under the brand names Avid Video, Softimage and Sundance Digital to a broad range of professional users, broadcast and cable companies, corporations, governmental entities and educational institutions. Professional users include production and post-production companies that produce feature films, music videos, commercials, entertainment programs, documentaries, and industrial videos, as well as professional animators, video-game developers and film studios. Our broadcast and cable customers include national and international broadcasters, as well as network affiliates, local independent television stations, web news providers and local and regional cable operators.

Audio. Under the Digidesign, M-Audio and Sibelius brand names, this business unit offers solutions for audio creation, mixing, post-production, collaboration, distribution and scoring to a range of users from home studio novices to award-winning, multi-platinum recording artists. We also sell our solutions to professional music studios, project studios, film and television production and post-production facilities, television and radio broadcasters, new media production studios (for example, creators of DVD and web content), performance venues, corporations, governmental entities and educational institutions. Customers use our audio products and solutions for a wide variety of tasks in both studio and live environments, including recording, editing, mixing, processing, mastering, composing and performing.

Consumer Video. This business unit markets, under the Pinnacle brand name, video-editing and digital-lifestyle products to the home user who wants to create, edit, share, publish and view video content easily, creatively and effectively. This segment s two vertical markets consist of home video editing and TV-over-PC viewing. The home video-editing market includes novice and advanced home video editors, as well as corporations, governmental entities and educational institutions, who want to edit, enhance and preserve their videos and share those videos on DVD or over the Internet. The TV-over-PC viewing market includes virtually any consumer who wants to watch and record television programming on a personal computer.

In July 2008, we announced several changes to our previous business unit structure. We are taking actions necessary to transition to this new business structure in the second half of 2008. The new business unit structure will be used to evaluate segment performance and measure segment profitability beginning January 1, 2009.

We continue to focus on strategically enhancing our existing products and broadening our product offerings to satisfy customer demand for new technology across the spectrum of educational to consumer to professional markets. We also continue to position ourselves and deliver new products and services to benefit from a number of important industry trends, including the move to HD television production, the switch to all-digital broadcast production, the growth of home audio studios, the move to digital audio mixing and the growth of consumer video editing and consumption.

Financial Summary

Our revenues for the three months ended June 30, 2008 were $222.9 million, a decrease of 1% compared to the same period last year. By business unit, compared to the second quarter last year, Professional Video revenues decreased 4%, Audio revenues decreased 2% and Consumer Video revenues increased 13%. Our revenues for the six-months ended June 30, 2008 were $421.1 million, a decrease of 5% compared to the same period last year. By business unit, compared to the first half of last year, Professional Video revenues decreased 10%, Audio revenues decreased 5% and Consumer Video revenues increased 13%. The revenues of each business unit are discussed in further detail in the section titled Results of Operations below.

For both the three- and six-month periods ended June 30, 2008, compared to the same periods in 2007, decreases in our revenues and gross margins, coupled with increased operating expenses, resulted in an overall decline in operating income. The $4.6 million increase in operating expenses in the first six months of 2008, compared to the same period in 2007, included increased expenses of approximately $4.9 million related to investments in strategic consultants assisting management in the transformation of our business and management transition expenses. During the first quarter of 2008, we initiated restructuring plans within our Professional Video business unit and corporate operations and recorded restructuring charges of $2.2 million under these plans during the first six months of 2008.

During the first quarter of 2008, we used $93.2 million in cash to repurchase 4,254,397 shares of our common stock. No additional shares of our common stock were repurchased during the second quarter of 2008. At June 30, 2008, we had authorization from our board of directors for additional repurchases of up to $80.3 million. In the first six months of 2008, our operating activities provided cash flows totaling $14.3 million.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our management s discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. We make estimates and assumptions in the preparation of our consolidated financial statements that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. However, actual results may differ from these estimates.

We believe that our critical accounting policies are those related to revenue recognition and allowances for product returns and exchanges, stock-based compensation, allowances for bad debts and reserves for recourse under financing transactions, inventories, business combinations, goodwill and intangible assets, and income tax assets. We believe these policies are critical because they are important to the portrayal of our financial condition and results of operations, and they require us to make judgments and estimates about matters that are inherently uncertain. Additional information about our critical accounting policies may be found in our 2007 Annual Report on Form 10-K in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, under the heading Critical Accounting Policies and Estimates. During the three months ended March 31, 2008 and June 30, 2008, primarily due to the differing types of stock-based awards that are now being granted, we revised our estimates of future forfeitures used in the calculation of estimated compensation costs for these awards. As a result, we have revised our critical accounting policy for Stock-Based Compensation. The revised policy is provided below.

Stock-Based Compensation

On January 1, 2006, we adopted the provisions of, and started to account for stock-based compensation in accordance with, Statement of Financial Accounting Standards, or SFAS, No. 123 (revised 2004), or SFAS 123(R), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS

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123(R) requires employee stock-based compensation awards to be accounted for under the fair value method and eliminates the ability to account for these instruments under the intrinsic value method as prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. We adopted SFAS 123(R) using the modified prospective application method as permitted under SFAS 123(R). Under this method, we are required to record compensation cost, based on the fair value estimated in accordance with SFAS 123(R), for stock-based awards granted after the date of adoption over the requisite service periods for the individual awards, which generally equals the vesting period. We are also required to record compensation cost for the non-vested portion of previously granted stock-based awards outstanding at the date of adoption over the requisite service periods for the individual awards based on the fair value estimated in accordance with the original provisions of SFAS No. 123 adjusted for forfeitures as required by SFAS 123(R).

During 2008 and 2007, we granted both restricted stock units and stock options as part of our key performer stock-based compensation program, as well as stock options, restricted stock units and restricted stock to newly hired employees. The vesting of stock option grants may be based on time, performance or market conditions. In the future, we may grant stock awards, options, or other equity-based instruments allowed by our stock-based compensation plans, or a combination thereof, as part of our overall compensation strategy.

The fair values of restricted stock awards with time-based vesting, including restricted stock and restricted stock units, are generally based on the intrinsic values of the awards at the date of grant. As permitted under SFAS No. 123 and SFAS 123(R), we generally use the Black-Scholes option pricing model to estimate the fair value of stock option grants. The Black-Scholes model relies on a number of key assumptions to calculate estimated fair values. Our assumed dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. Since adoption of SFAS 123(R) on January 1, 2006, the expected stock-price volatility assumption used by us has been based on recent (six-month trailing) implied volatility calculations. These calculations are performed on exchange traded options of our common stock. We believe that using a forward-looking market-driven volatility assumption will result in the best estimate of expected volatility. The assumed risk-free interest rate is the U.S. Treasury security rate with a term equal to the expected life of the option. The assumed expected life is based on company-specific historical experience. With regard to the estimate of the expected life, we consider the exercise behavior of past grants and model the pattern of aggregate exercises.

In accordance with SFAS 123(R), we estimate forfeiture rates at the time awards are made based on historical turnover rates and apply these rates in the calculation of estimated compensation cost. For all stock-based awards for the year ended December 31, 2006 and for most stock-based awards for the year ended December 31, 2007, we applied a 6.5% estimated forfeiture rate. In the fourth quarter of 2007, based on historical turnover rates, we segregated our non-employee directors into a separate class and applied a 0% estimated forfeiture rate to the calculation of estimated compensation cost for this class. During the three months ended March 31, 2008, based on recent changes in our stock-based compensation structure and executive management staff, we determined that the executive management staff should be segregated from the rest of our employees into a separate class for the calculation of stock-based compensation. Accordingly, based on our historical turnover rates for these classes of employees and directors, for grants made during the first quarter of 2008, we applied annualized estimated forfeiture rates of 0% to non-employee director awards, 7% to executive management staff awards and 8.75% to awards to all other employees. Similarly, based on a review of updated historical turnover rates during the three months ended June 30, 2008, we determined that the annualized forfeiture rates for grants made in that quarter to the executive management staff should be increased to 8%. Accordingly, for grants made during the second quarter of 2008, we applied annualized estimated forfeiture rates of 0% to non-employee director awards, 8% to executive management staff awards and 8.75% to awards to all other employees

During the three-month periods ended March 31, 2008 and June 30, 2008, we also revised our estimated forfeiture rates for, and began applying the then current revised forfeiture rates to, all outstanding stock options and non-vested restricted stock awards, resulting in a revised estimate of compensation costs related to these stock-based grants. As a result of the application of the changes in forfeiture rates, we recorded in our results of operations cumulative adjustments that reduced previously recorded stock-based compensation expense of approximately $1.2 million during the first six months of 2008.

In December 2007, we granted a stock option to purchase 625,000 shares of our common stock to our new chief executive officer that has vesting based on market conditions or a combination of performance and market

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conditions. During the three months ended March 31, 2008, we issued stock options to purchase 490,000 shares of common stock to newly hired executive officers, as well as 27,200 restricted stock units to other executives, as part of our annual grant program, that also have vesting based on market conditions or a combination of performance and market conditions. The compensation costs and derived service periods for all grants with vesting based on market conditions or a combination of performance and market conditions were estimated using the Monte Carlo valuation method. For stock option grants with vesting based on a combination of performance and market conditions, the compensation costs were also estimated using the Black-Scholes valuation method. For restricted stock grants with vesting based on a combination of performance and market conditions, the compensation costs were also estimated using the intrinsic value on the date of grant factored for probability. Compensation costs for these stock option and restricted stock grants were recorded based on the higher estimate for each vesting tranche.

If factors change and we employ different assumptions for estimating stock-based compensation expense in future periods, or if we decide to use a different valuation model, the stock-based compensation expense we recognize in future periods may differ significantly from what we have recorded in the current period and could materially affect our operating income, net income and earnings per share. It may also result in a lack of comparability with other companies that use different models, methods and assumptions. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. These characteristics are not present in our option grants. Existing valuation models, including the Black-Scholes and Monte Carlo models, may not provide reliable measures of the fair values of our stock-based compensation. See Note 9 of the unaudited condensed consolidated financial statements in Item 1 of this report for further information regarding stock-based compensation.

RESULTS OF OPERATIONS

Net Revenues

Our net revenues are derived mainly from sales of computer-based digital, nonlinear, media-editing and finishing systems and related peripherals, including shared-storage systems, software licenses, and related professional services and software maintenance contracts.

	Three Months Ended June 30, 2008 and 2007 (dollars in thousands)					
	2008 Net Revenues	**% of Consolidated Net Revenues**	**2007 Net Revenues**	**% of Consolidated Net Revenues**	**Change**	**% Change in Revenues**
Professional Video:						
Product revenues	$ 82,761	37.1%	$ 87,838	39.0%	($5,077)	(5.8%)
Services revenues	32,977	14.8%	32,480	14.4%	497	1.5%
Total	115,738	51.9%	120,318	53.4%	(4,580)	(3.8%)
Audio:						
Product revenues	74,545	33.4%	76,287	33.9%	(1,742)	(2.3%)
Services revenues	770	0.4%	476	0.2%	294	61.8%
Total	75,315	33.8%	76,763	34.1%	(1,448)	(1.9%)
Consumer Video:						
Product revenues	31,810	14.3%	28,245	12.5%	3,565	12.6%
Total	31,810	14.3%	28,245	12.5%	3,565	12.6%
Total net revenues:	$222,863	100.0%	$225,326	100.0%	($2,463)	(1.1%)

Six Months Ended June 30, 2008 and 2007
(dollars in thousands)

	2008 Net Revenues	% of Consolidated Net Revenues	2007 Net Revenues	% of Consolidated Net Revenues	Change	% Change in Revenues
Professional Video:						
Product revenues	$147,679	35.1%	$174,469	39.3%	($26,790)	(15.4%)
Services revenues	62,309	14.8%	58,520	13.2%	3,789	6.5%
Total	209,988	49.9%	232,989	52.5%	(23,001)	(9.9%)
Audio:						
Product revenues	147,025	34.9%	154,795	34.8%	(7,770)	(5.0%)
Services revenues	1,529	0.4%	891	0.2%	638	71.6%
Total	148,554	35.3%	155,686	35.0%	(7,132)	(4.6%)
Consumer Video:						
Product revenues	62,587	14.8%	55,549	12.5%	7,038	12.7%
Total	62,587	14.8%	55,549	12.5%	7,038	12.7%
Total net revenues:	$421,129	100.0%	$444,224	100.0%	($23,095)	(5.2%)

The decreases in Professional Video product revenues for both the three- and six-month periods ended June 30, 2008, compared to the same periods in 2007, were primarily due to lower revenues from our video-editing products and, to a lesser extent, decreased revenues from large broadcast deals. We believe the decrease in video-editing revenues was the result of a slowdown in sales in early 2008 in anticipation of our new editor product set, which was released in June 2008, as well as price reductions announced in the first quarter of 2008 in response to competitive pressures. The effect of the price reductions was partially offset by higher unit volumes for these products. The decrease in revenues from large broadcast deals was due to the timing of customer acceptance and revenue recognition.

Professional Video services revenues are derived primarily from maintenance contracts, professional and installation services, and training. There was no significant change in services revenues for the three-month period ended June 30, 2008, compared to the same period in 2007. The increase in services revenues for the six-month period ended June 30, 2008, compared to the same period in 2007, was primarily due to increased revenues generated from maintenance contracts sold in connection with our products and, to a lesser extent, increased revenues from installation and training services. Maintenance revenues increased starting in the second quarter of 2007 due to an increase in new large deals that included maintenance contracts.

The decreases in Audio product revenues for the three- and six-month periods ended June 30, 2008, compared to the same periods in 2007, were primarily the result of decreased revenues from our entry-level Digidesign products, as well as a slowdown in sales of our Digidesign integrated mixing console products. The decreases in revenues from our entry-level Digidesign products were due to temporary delays in the release of products compatible with a new version of Apple s Mac OS X Leopard operating system, as well as increased competitive pressure. The products compatible with the new version of the Mac OS X Leopard operating system were released late in the second quarter of 2008. We believe the slowdown in sales of our Digidesign integrated mixing console products was due to unfavorable macroeconomic conditions.

The increases in Consumer Video product revenues for the three- and six-month periods ended June 30, 2008, compared to the same periods in 2007, were primarily the result of increased revenues, on increased volumes, from our TV-over-PC viewing products, as well as new revenues from our Pinnacle Video Transfer product introduced in the first quarter of 2008.

Net revenues derived through indirect channels were 68% for both the three-month periods ended June 30, 2008 and 2007, and 70% for both the six-month periods ended June 30, 2008 and 2007.

International sales accounted for 61% and 60% of our net revenues for the three- and six-month periods ended June 30, 2008, respectively, compared to 58% for both periods in 2007.

Gross Profit

Cost of revenues consists primarily of costs associated with:

- the procurement of components;
- the assembly, testing and distribution of finished products;
- warehousing;
- customer support costs related to maintenance contract revenues and other services; and
- royalties for third-party software and hardware included in our products.

Cost of revenues also includes amortization of technology, which represents the amortization of developed technology assets acquired in the August 2005 acquisition of Pinnacle and, to a lesser extent, other acquisitions we have made since August 2004. Amortization of technology is described further in the Amortization of Intangible Assets section below.

Gross margin fluctuates based on factors such as the mix of products and services sold, the cost and proportion of third-party hardware and software included in the products sold, the offering of product upgrades, price discounts and other sales promotion programs, the distribution channels through which products are sold, the timing of new product introductions and currency exchange rate fluctuations.

Three Months Ended June 30, 2008 and 2007
(dollars in thousands)
2008