

AVOCENT CORP  
Form 10-Q  
November 04, 2009  
[Table of Contents](#)

# U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

(Mark One)

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended September 30, 2009 or**

- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from            to**

**Commission file number: 000-30575**

## **AVOCENT CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**91-2032368**

(I.R.S. Employer Identification Number)

**4991 Corporate Drive  
Huntsville, Alabama**

(Address of Principal Executive Offices)

**35805**

(Zip Code)

**256-430-4000**

(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, as amended, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

## Edgar Filing: AVOCENT CORP - Form 10-Q

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act): Yes  No

As of October 30, 2009, the number of outstanding shares of the Registrant's Common Stock was 44,591,979.

---

Table of Contents

AVOCENT CORPORATION

FORM 10-Q

September 30, 2009

INDEX

	<b>Page(s)</b>
<u>Part I</u>	
<u>Financial Information</u>	
<u>Item 1.</u>	
<u>Financial Statements (unaudited)</u>	
<u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2009 and September 26, 2008</u>	3
<u>Consolidated Balance Sheets at September 30, 2009 and December 31, 2008</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Three and Nine Months Ended September 30, 2009 and September 26, 2008</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6-18
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19-30
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures about Market Risks</u>	30
<u>Item 4.</u>	
<u>Controls and Procedures</u>	31
<u>Part II</u>	
<u>Other Information</u>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	31
<u>Item 1A.</u>	
<u>Risk Factors</u>	32
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	48
<u>Item 6.</u>	
<u>Exhibits</u>	49
<u>Signature</u>	50

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****AVOCENT CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited, in thousands, except per share data)

	For the three months ended		For the nine months ended	
	September 30, 2009	September 26, 2008	September 30, 2009	September 26, 2008
Net sales:				
Products	\$ 93,564	\$ 131,693	\$ 263,828	\$ 354,861
Licenses and royalties	24,948	30,873	71,185	80,688
Services	19,043	20,482	57,235	48,080
Total net sales	137,555	183,048	392,248	483,629
Cost of sales:				
Products	43,648	58,355	120,499	154,685
Licenses and royalties	308	566	1,243	1,935
Services	4,822	5,862	14,406	12,186
Amortization of intangibles related to licenses and royalties	4,133	4,218	12,823	9,753
Total cost of sales (including stock compensation of \$552 and \$1,014 for the three and nine months ended Sept. 30, 2009; \$298 and \$797 for the three and nine months ended Sept. 26, 2008)	52,911	69,001	148,971	178,559
Gross profit	84,644	114,047	243,277	305,070
Research and development expenses (including stock compensation of \$869 and \$2,727 for the three and nine months ended Sept. 30, 2009; \$1,523 and \$3,878 for the three and nine months ended Sept. 26, 2008)	19,548	24,398	61,077	72,126
Acquired in-process research and development expenses		700		700
Selling, general and administrative expenses (including stock compensation of \$5,194 and \$10,992 for the three and nine months ended Sept. 30, 2009; \$3,986 and \$9,288 for the three and nine months ended Sept. 26, 2008)	52,182	60,266	149,521	172,830
Restructuring, integration and retirement expenses (including stock compensation of (\$142) and (\$138) for the three and nine months ended Sept. 30, 2009; \$480 and \$2,999 for the three and nine months ended Sept. 26, 2008)	2,884	5,926	9,709	13,627
Amortization of intangible assets	7,780	8,971	25,843	24,123

Edgar Filing: AVOCENT CORP - Form 10-Q

Impairment of goodwill			80,000		
Total operating expenses	82,394	100,261	326,150	283,406	
Income (loss) from operations	2,250	13,786	(82,873)	21,664	
Net investment income	105	295	390	1,863	
Interest expense	(1,845)	(2,268)	(6,079)	(5,915)	
Other income, net	1,888	2,362	724	2,722	
Income (loss) before provision (benefit) for income taxes	2,398	14,175	(87,838)	20,334	
Provision (benefit) for income taxes	(4,652)	3,214	(31,617)	5,199	
Net income (loss)	\$ 7,050	\$ 10,961	\$ (56,221)	\$ 15,135	
Earnings (loss) per share:	\$ 0.16	\$ 0.24	\$ (1.27)	\$ 0.33	
Basic	\$ 0.16	\$ 0.24	\$ (1.27)	\$ 0.33	
Diluted					
Weighted average shares used in computing earnings (loss) per share:					
Basic	44,341	44,792	44,383	45,241	
Diluted	44,801	45,467	44,383	45,868	

See notes accompanying these condensed consolidated financial statements.

Table of Contents

## Avocent Corporation

## Consolidated Balance Sheets

(Unaudited, in thousands, except per share data)

	September 30, 2009	December 31, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 110,103	\$ 126,858
Accounts receivable, less allowance for doubtful accounts of \$3,562 and \$4,548 at September 30, 2009 and December 31, 2008, respectively	99,536	122,133
Other receivables	7,752	12,281
Inventories	24,236	31,516
Other current assets	7,871	5,209
Deferred tax assets, net	7,544	6,885
Total current assets	257,042	304,882
Property and equipment, net	35,266	38,197
Goodwill	535,529	616,326
Other intangible assets, net	142,088	180,276
Deferred tax asset, non-current	46,198	10,873
Other assets	5,705	3,616
Total assets	\$ 1,021,828	\$ 1,154,170
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 13,504	\$ 17,494
Accrued wages and commissions	23,206	30,966
Accrued liabilities	29,484	42,027
Income taxes payable	15,035	11,678
Deferred revenue, current	65,678	66,248
Total current liabilities	146,907	168,413
Unsecured bank credit facility	125,000	170,000
Deferred revenue, non-current	7,134	9,572
Other non-current liabilities	3,480	4,028
Total liabilities	282,521	352,013
Commitments and contingencies ( <i>see Note 13</i> )		
Stockholders' equity:		
Preferred stock, par value \$0.001 per share; 5,000 shares authorized; no shares issued and outstanding		
Common stock, par value \$0.001 per share; 200,000 shares authorized; September 30, 2009 55,307 shares issued and 44,280 outstanding; December 31, 2008 54,533 shares issued and 44,706 outstanding;	55	55
Additional paid-in capital	1,237,480	1,230,840
Accumulated other comprehensive income (loss)	599	(1,606)
Accumulated deficit	(249,468)	(193,247)
Treasury stock, at cost; September 30, 2009, 11,027 shares; December 31, 2008, 9,827 shares;	(249,359)	(233,885)
Total stockholders' equity	739,307	802,157

Edgar Filing: AVOCENT CORP - Form 10-Q

Total liabilities and stockholders' equity	\$	1,021,828	\$	1,154,170
--	----	-----------	----	-----------

See notes accompanying these condensed consolidated financial statements.



Table of Contents

## AVOCENT CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	For the nine months ended	
	September 30, 2009	September 26, 2008
Cash flows from operating activities:		
Net income (loss)	\$ (56,221)	\$ 15,135
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	6,113	7,027
Amortization of intangible assets	39,002	34,416
Stock-based compensation	14,586	16,957
Acquired in-process research and development expense		700
Net loss on disposition of fixed assets	238	548
Impairment of goodwill	80,000	
Tax adjustments from stock-based compensation	3,216	(85)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable, net	24,670	(8,214)
Inventories	7,356	4,521
Other assets	239	(3,127)
Accounts payable	(6,632)	(4,252)
Accrued wages and commissions	(7,760)	4,170
Accrued other liabilities and deferred revenue	(17,306)	3,532
Income taxes, current and deferred	(36,061)	(5,167)
Net cash provided by operating activities	51,440	66,161
Cash flows from investing activities:		
Purchase of Ergo, net of cash received		(28,443)
Purchase of Touchpaper, net of cash received		(47,113)
Purchase of other intangible assets	(727)	(674)
Additional consideration paid for LANDesk and Touchpaper	(4,077)	
Purchases of property and equipment	(3,823)	(6,773)
Proceeds from sale of property and equipment	622	
Maturities and proceeds from sales of investments		5,942
Net cash used in investing activities	(8,005)	(77,061)
Cash flows from financing activities:		
Borrowings under term loan		90,000
Payments under unsecured line of credit, net	(45,000)	(5,000)
Proceeds from employee stock plans	1,509	1,484
Tax adjustments from stock-based compensation	(3,216)	85
Purchases of treasury stock	(15,474)	(64,449)
Net cash (used in) provided by financing activities	(62,181)	22,120
Effect of exchange rate changes on cash and cash equivalents	1,991	(1,502)
Net increase (decrease) in cash and cash equivalents	(16,755)	9,718
Cash and cash equivalents at beginning of period	126,858	105,183
Cash and cash equivalents at end of period	\$ 110,103	\$ 114,901

Edgar Filing: AVOCENT CORP - Form 10-Q

See notes accompanying these condensed consolidated financial statements.

Table of Contents

**AVOCENT CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED**

(Unaudited, in thousands, except share data)

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with United States generally accepted accounting principles and reflect all adjustments consisting of normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results for the periods shown. The results of operations for these periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes contained in our Annual Report on Form 10-K for the year ended December 31, 2008, which is on file with the Securities and Exchange Commission and is available at our website, [www.avocent.com](http://www.avocent.com). The consolidated balance sheet presented in the accompanying condensed consolidated financial statements for December 31, 2008, was derived from the audited financial statements filed in our 10-K for the period ended December 31, 2008, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

We report our annual results based on years ending December 31. Prior to 2009, we reported our quarterly results for the first three interim periods based on 13 week periods ending on Fridays and for the fourth interim period ending on December 31. Beginning January 1, 2009, we began reporting our quarterly periods based on the calendar month end to better align our quarter ends with those of our customers and others within our industry.

Certain reclassifications have been made to the prior year's condensed consolidated financial statements in order to conform to the 2009 presentation. These reclassifications had no effect on previously reported net income, net cash provided by operating activities, net cash provided by investing activities nor total stockholders' equity.

Our financial statements are consolidated and include the accounts of Avocent Corporation and our wholly owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

Note 2. Inventories

Edgar Filing: AVOCENT CORP - Form 10-Q

Inventories consisted of the following at:

	September 30, 2009		December 31, 2008	
Raw materials	\$	2,135	\$	525
Work-in-process		787		308
Finished goods		21,314		30,683
Inventories	\$	24,236	\$	31,516

Inventories above have been reduced by reserves for excess and obsolete inventories of \$4,645 and \$6,401 as of September 30, 2009 and December 31, 2008, respectively.

Note 3. Equity and Treasury Stock

We issued common stock as a result of stock option exercise activity during the three and nine months ended September 30, 2009 and September 26, 2008 as follows:

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Stock option exercises	24,000	73,000	49,000	138,000

Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

We issued common stock as a result of restricted stock unit (RSU) vesting activity during the three and nine months ended September 30, 2009 and September 26, 2008 as follows:

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Net RSUs issued				
RSU s vested	87,000	28,000	926,000	617,000
Shares withheld for tax	(27,000)	(4,000)	(274,000)	(179,000)
Net RSUs issued	60,000	24,000	652,000	438,000

Share repurchase activity during the three and nine months ended September 30, 2009 and September 26, 2008 was as follows:

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Shares repurchased	200,000		1,200,000	4,000,000

We issued common stock as a result of employee stock purchase plan (ESPP) activity during the three and nine months ended September 30, 2009 and September 26, 2008 as follows:

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
ESPP activity			73,000	

RSUs granted During the first nine months of 2009, our Compensation Committee approved the grant of 1,656,000 restricted stock units to our employees, officers and directors. Of these grants, 1,071,000 were time-based and 585,000 were based on market and performance conditions. During the first nine months of 2008, our Compensation Committee approved the grant of 1,551,000 restricted stock units to our employees, officers and directors. Of these grants, 963,000 were time-based and 588,000 were based on market and performance conditions.

Note 4. Accumulated Other Comprehensive Income (Loss)

## Edgar Filing: AVOCENT CORP - Form 10-Q

We record our foreign currency translation adjustments and unrealized gains and losses on cash flow hedges, net of tax, within accumulated other comprehensive income (loss). This comprehensive income (loss) is included as a separate component of stockholders' equity with year to date balances for the nine months ended September 30, 2009 and September 26, 2008 as follows:

	For the nine months ended	
	September 30,	
	2009	September 26, 2008
Comprehensive income (loss)		
Net income (loss)	\$ (56,221)	\$ 15,135
Unrealized gains on cash flow hedge	471	430
Foreign currency translation adjustment	1,734	(1,871)
Total comprehensive income (loss)	\$ (54,016)	\$ 13,694

As of September 30, 2009 and December 31, 2008, total accumulated other comprehensive income (loss) was \$599 and \$(1,606), respectively.

Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

Note 5. Earnings (Loss) Per Share (share data in thousands)

	Income (Loss) (Numerator)	Shares (Denominator)	Per-Share Amount
<b><u>For the three months ended September 30, 2009</u></b>			
<b>Basic EPS</b>			
Net income available to common stockholders	\$ 7,050	44,341	\$ 0.16
<b>Effect of Dilutive Securities</b>			
Stock options and unvested RSUs		460	
<b>Diluted EPS</b>			
Net income available to common stockholders and assumed conversions	\$ 7,050	44,801	\$ 0.16
<b><u>For the three months ended September 26, 2008</u></b>			
<b>Basic EPS</b>			
Net income available to common stockholders	\$ 10,961	44,792	\$ 0.24
<b>Effect of Dilutive Securities</b>			
Stock options and unvested restricted stock awards		675	
<b>Diluted EPS</b>			
Net income available to common stockholders and assumed conversions	\$ 10,961	45,467	\$ 0.24
<b><u>For the nine months ended September 30, 2009</u></b>			
<b>Basic EPS</b>			
Net loss available to common stockholders	\$ (56,221)	44,383	\$ (1.27)
<b>Effect of Dilutive Securities</b>			
Stock options and unvested RSUs			
<b>Diluted EPS</b>			
Net loss available to common stockholders and assumed conversions	\$ (56,221)	44,383	\$ (1.27)
<b><u>For the nine months ended September 26, 2008</u></b>			
<b>Basic EPS</b>			
Net income available to common stockholders	\$ 15,135	45,241	\$ 0.33
<b>Effect of Dilutive Securities</b>			
Stock options and unvested restricted stock awards		627	
<b>Diluted EPS</b>			
Net income available to common stockholders and assumed conversions	\$ 15,135	45,868	\$ 0.33

Anti-dilutive options to purchase common stock outstanding were excluded from the calculations above. Anti-dilutive options and anti-dilutive RSUs totaled 3,160 and 4,884 for the three and nine months ended September 30, 2009, respectively. Anti-dilutive options and anti-dilutive RSUs totaled 3,871 and 4,074 for the three and nine months ended September 26, 2008, respectively.

Note 6. Segment Reporting

In the third quarter of 2008, we began the process of dissolving our Connectivity and Control business unit and merging its products into our remaining business units. We divided this business unit into its three product lines: the Equinox branded serial business, the Broadcast business and the Pro Audio Visual business. We folded the broadcast product line into Management Systems in the third quarter of 2008. We folded the Serial product line and the Pro Audio Visual product line into Management Systems during third quarter of 2009. As a result of these actions, all revenues and costs associated with our Connectivity and Control business are included within Management Systems in the tables below. Additionally, historical segment results for Management Systems have been changed to reflect these changes and the Connectivity and Control business unit has now been effectively dissolved.



Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

We evaluate the performance of our segments based on revenue and operating profit, which are calculated before corporate and unallocated costs, amortization and impairment of intangibles, acquired in-process research and development expense, restructuring, integration and retirement expenses and stock compensation costs. We do not track nor use assets by segment as a measure of performance, therefore, we have not presented assets by segment. The following is a presentation of information for our two reportable segments, Management Systems and LANDesk and for Corporate and unallocated:

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Net revenue:				
Management Systems	\$ 100,322	\$ 140,983	\$ 282,289	\$ 378,995
LANDesk	36,459	41,559	107,625	102,594
Corporate and unallocated	774	506	2,334	2,040
Total net revenue	\$ 137,555	\$ 183,048	\$ 392,248	\$ 483,629

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Operating income (loss):				
Management Systems	\$ 23,924	\$ 38,634	\$ 57,477	\$ 93,351
LANDesk	4,931	7,620	17,152	12,161
Corporate and unallocated costs	(5,194)	(6,844)	(14,394)	(21,515)
Acquired research and development expense		(700)		(700)
Amortization of intangibles and other expenses	(11,913)	(13,191)	(38,666)	(34,043)
Impairment of goodwill			(80,000)	
Restructuring, integration and retirement expenses	(3,025)	(5,446)	(9,847)	(10,628)
Stock-based compensation expense	(6,473)	(6,287)	(14,595)	(16,962)
Total income (loss) from operations	\$ 2,250	\$ 13,786	\$ (82,873)	\$ 21,664

Sales by product line for Management Systems and LANDesk for the three and nine months ended September 30, 2009 and September 26, 2008 are as follows:

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Management Systems net revenue:				
KVM	\$ 67,314	\$ 97,101	\$ 191,706	\$ 271,379
Serial management	7,706	13,517	22,327	39,572

Edgar Filing: AVOCENT CORP - Form 10-Q

Embedded software and solutions	7,493	10,229	19,731	26,981
Other	17,809	20,136	48,525	41,063
Total Management Systems net revenue	\$ 100,322	\$ 140,983	\$ 282,289	\$ 378,995

Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
LANDesk net revenue:				
Licenses and royalties	\$ 18,069	\$ 22,092	\$ 52,790	\$ 57,919
Maintenance and services	18,390	19,467	54,835	44,675
Total LANDesk net revenue	\$ 36,459	\$ 41,559	\$ 107,625	\$ 102,594

We sell our products internationally to customers in several countries; however no foreign country accounted for more than 10% of sales in the first nine months of 2009 or 2008.

Following is a presentation of long-lived assets as of September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008
Long-lived assets:		
United States	\$ 26,951	\$ 28,176
International	8,315	10,021
Total	\$ 35,266	\$ 38,197

**Note 7.** Forward Contracts, Interest Rate Swaps and Credit Facility

We use forward contracts to reduce our foreign currency exposure related to the net cash flows from our international operations. The majority of these contracts are short-term contracts (three months or less) and are marked-to-market each quarter and included in trade payables, with the offsetting gain or loss included in other income (expense) in the accompanying consolidated statements of income. As of September 30, 2009, we had five open forward contracts with an approximate fair value of \$(22). As of December 31, 2008, we had four open forward contracts with an approximate fair value of \$26.

There was \$125,000 outstanding under our credit facility, which includes both our line of credit and term loan, as of September 30, 2009. The line of credit and term loan contain affirmative and negative covenants, including limitations on our ability to (i) make distributions, investments, and other payments unless we satisfy certain financial tests or other criteria, (ii) incur additional indebtedness, (iii) restructure our subsidiaries, and (iv) make acquisitions and capital expenditures. The financial tests include an interest coverage ratio and a total leverage ratio. We are in compliance with these covenants and related tests as of September 30, 2009. Failure to comply with these covenants could result in an event of default which, if not cured or waived, could have a material adverse effect on us. We pay a commitment fee on the unused portion of the line of credit based on the results of a leverage ratio computation. As of September 30, 2009, the commitment fee rate is 20 basis points per quarter. The fair value of our unsecured bank credit facility approximates its carrying value at September 30, 2009.

## Edgar Filing: AVOCENT CORP - Form 10-Q

As of September 30, 2009, we have two interest rate swaps, which are recorded on our balance sheet. On May 1, 2008, we entered into an interest rate swap agreement with a notional amount of \$80,000. The remaining notional amount of this interest rate swap was \$20,000 as of September 30, 2009. The swap was effective on May 1, 2008 and terminates on December 31, 2009. The swap calls for us to make fixed rate payments of 3.05% over the term of the hedge and to receive floating rate payments based on LIBOR (matching the LIBOR rate in the line of credit above) from the counter-party. On November 6, 2008 we entered into an additional interest rate swap agreement with a notional amount of \$90,000. The notional amount of this interest rate swap will remain at \$90,000 until the termination on June 16, 2011 unless otherwise terminated by us at an earlier date. The swap was effective on December 31, 2008. The swap calls for us to make fixed rate payments of 2.75% over the term of the hedge and to receive floating rate payments based on LIBOR (matching the LIBOR rate in the term loan above) from the counter-party.

The objective of the interest rate swap agreements is to provide a hedge against LIBOR interest rate changes that could have an effect on our cash flows and borrowing costs. As of September 30, 2009, we anticipate these hedges will be settled upon maturity and they are accounted for as cash flow hedges. The interest rate swaps are recorded at fair value each reporting period with the changes in the fair value of the hedges that take place through the date of maturity recorded in accumulated other comprehensive income (loss).

Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

These interest rate swaps qualify as derivative instruments and are designated as cash flow hedges. We do not expect any material amounts to be reclassified into earnings, as a result of interest rate swap ineffectiveness, within the next twelve months. The cash flow hedges were in a liability position as of September 30, 2009 and were included in other non-current liabilities in the consolidated balance sheet, as follows:

	September 30, 2009	
Cash flow hedges:		
Interest rate swaps	\$	2,727

For the nine months ended September 30, 2009, the activity related to our interest rate swaps designated as cash flow hedges is included in our condensed consolidated financial statements as follows:

	September 30, 2009		
	Effective Portion Included in OCI, Net of Tax	Effective Portion in AOCI, Reclassified into Earnings	Ineffectiveness, Excluded from Hedge Effectiveness
Cash flow hedges:			
Interest rate swaps	\$ 471	\$	\$

**Note 8.** Goodwill and Other Intangible Assets

Other intangible assets subject to amortization were as follows:

	September 30, 2009		December 31, 2008	
	Gross Carrying Amounts	Accumulated Amortization	Gross Carrying Amounts	Accumulated Amortization
Developed technology	\$ 84,437	\$ 43,896	\$ 86,285	\$ 31,401
Internally developed software for resale	21,900	11,254	21,900	8,517
Patents and trademarks	31,941	14,173	31,236	10,915
Customer base	110,900	48,103	116,121	39,388
Maintenance contracts	17,600	7,920	17,600	5,280
Non-compete agreements	7,225	6,569	11,325	8,690

Edgar Filing: AVOCENT CORP - Form 10-Q

\$	274,003	\$	131,915	\$	284,467	\$	104,191
----	---------	----	---------	----	---------	----	---------

For the three months ended September 30, 2009 and September 26, 2008, amortization expense for other intangible assets was \$11,995 and \$13,383, respectively. For the nine months ended September 30, 2009 and September 26, 2008, amortization expense for other intangible assets was \$39,002 and \$34,416, respectively. The approximate estimated annual amortization for other intangibles is as follows:

Years ending December 31:	
2009, remainder	\$ 11,727
2010	\$ 46,504
2011	\$ 38,170
2012	\$ 29,052
2013	\$ 16,036
Thereafter	\$ 599

Table of Contents

AVOCENT CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

**We evaluate the carrying value of goodwill for potential impairment annually during the fourth quarter of each year, and on an interim basis if an event occurs or circumstances change that indicate a potential detrimental impact to the fair value of a reporting unit compared to its carrying value may have occurred.** Our fourth quarter 2008 impairment test concluded that there had been no impairment of goodwill, however, there were certain factors noted during the 2008 testing that required continued monitoring, especially related to any potential future decline in our market capitalization. During the first quarter of 2009, we concluded that interim impairment testing was required due to the continued deterioration in the global economic environment, the resulting decrease in our market capitalization to less than the book value of our shareholders' equity, and declining market valuations for many other companies in our peer group. In preparation for this interim testing, we revised our five year forecast, used as a base element of this testing, in light of the continuing global recession.

**As of September 30, 2009 we have three reporting units: Management Systems (MS), LANDesk and AESS, which is combined with MS for segment reporting purposes.** We perform our goodwill impairment test in two steps. Step one compares the fair value of each reporting unit to its carrying amount. If step one indicates that an impairment potentially exists, the second step is performed to measure the amount of impairment, if any. Goodwill impairment exists when the estimated fair value of goodwill is less than its carrying value.

**For purposes of the interim step one analysis prepared as of March 1, 2009, the fair values of our reporting units were determined through the use of a combination of a discounted cash flow analysis, utilizing the income approach, and the guideline public company method, utilizing a market approach. The result of each valuation was weighted in determining each of the reporting unit's fair value.** Under the market approach, the fair value of each reporting unit is determined based upon comparisons to public companies engaged in similar businesses. Under the income approach, the fair value of each reporting unit was based on the present value of estimated future cash flows. The income approach is dependent on a number of significant management assumptions including estimated demand in each geographic market and the discount rate. The discount rate is commensurate with the risk inherent in the projected cash flows and reflects an assumed rate of return required by an investor in the current economic conditions. Based on our assessment of the market conditions, the weighting applied to the market approach for the March 1, 2009 valuation was decreased from 50% to 40% and the weighting for the income approach was increased from 50% to 60%, as compared to the assumptions as of October 1, 2008, the date used for our most recent prior impairment testing. We believe that this change was appropriate as it reflects our longer term view, including our revised cash flow projections based on current expectations, while continuing to reflect the impact of declining equity values in this highly volatile equity market impacting our stock price and the stock price of many of our peers.

**The results of our step one test as of March 1, 2009 indicated that the fair value of each of our reporting units had declined from 2008, but, with the exception of LANDesk, the estimated fair values exceeded their carrying value. We estimated the fair value of Management Systems to be \$184 million higher, or approximately 35%, than its carrying value of \$520 million. Our remaining reporting units at the time were not material to our financial statements, however we estimated the combined fair value of these reporting units to be \$49 million higher, or well over double, their combined carrying value of \$20 million.**

**As a result of our step one testing, we then performed step two testing for potential goodwill impairment on the LANDesk business unit. This testing focuses on the identifiable tangible and intangible assets associated with a particular business unit and estimates the fair market value a potential acquirer would assign them. Any residual amount is considered to be applicable to goodwill and is compared**

to the current carrying value of the related goodwill. Any unfavorable variance is considered as the impairment amount. Our step two testing resulted in an \$80,000 impairment charge during our three months ended March 31, 2009 and is reflected in the following table.



Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

The changes in the carrying amount of goodwill (see note 11) for the nine months ended September 30, 2009, are as follows:

	Management Systems	LANDesk	Corporate and Other	Total
Balance as of January 1, 2009	\$ 335,096	\$ 278,709	\$ 2,521	\$ 616,326
Impairment loss related to LANDesk		(80,000)		(80,000)
Reallocation from segment changes	2,521		(2,521)	
Other adjustments	27	(824)		(797)
<b>Balance as of September 30, 2009</b>				
Goodwill	337,644	277,885		615,529
Accumulated impairment losses		(80,000)		(80,000)
	\$ 337,644	\$ 197,885	\$	\$ 535,529

**Note 9. Product Warranties and Deferred Revenue**

The activity within the liability for warranty returns for the nine months ended September 30, 2009 was as follows:

Balance as of January 1, 2009	\$	2,245
Accruals for product warranties issued during the period		5,247
Settlements and adjustments to estimates made during the period		(5,797)
Balance as of September 30, 2009	\$	1,695

We include an accrued liability for the extended warranty program in our balance sheet within deferred revenue. The activity within deferred revenue for our extended warranty program for the nine months ended September 30, 2009 was as follows:

Balance as of January 1, 2009	\$	5,151
-------------------------------	----	-------

Edgar Filing: AVOCENT CORP - Form 10-Q

New extended warranty contracts		3,423
Earned revenue from amortization of deferred revenue		(3,100)
Balance as of September 30, 2009	\$	5,474

We defer revenue for subscription, service and maintenance and upgrade protection contracts until earned, which is generally over the term of the contract or when services are performed. As of September 30, 2009, deferred revenue was \$72,812. As of December 31, 2008, deferred revenue was \$75,820.

Table of Contents

**AVOCENT CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED**

(Unaudited, in thousands, except share data)

Note 10. Income Taxes

The effective tax rate in the third quarter of 2009 was (193.2)% compared to an effective tax rate of 22.7% for the third quarter of 2008. The benefit for income taxes was \$4,652 for the third quarter of 2009, compared to a provision of \$3,214 for the third quarter of 2008. The effective tax rate for the first nine months of 2009 was (36)% compared to an effective tax rate of 25.6% for the first nine months of 2008. The benefit for income taxes was \$31,617 for the first nine months of 2009, compared to a provision of \$5,199 for the first nine months of 2008. The change in the effective tax rate was primarily attributable to the change in the amount and mix of our pretax book income within taxable jurisdictions and the tax benefit recognized to record a deferred tax asset associated with the goodwill impairment charge (*see note 8*).

We have considered guidance within Accounting Standards Codification (ASC) 740, the income taxes topic within the FASB ASC, which limits the amount of benefit that can be reflected in a year-to-date interim loss period to an amount equal to the anticipated benefit that would be derived from the anticipated cumulative loss for the entire reporting year. Our loss through September 30, 2009 exceeds the anticipated loss for the year and the tax benefit recognized through September 30, 2009 has been limited to the amount that would be recognized based on the anticipated full year loss. As of September 30, 2009, we have limited our benefit by \$722.

As of September 30, 2009, we had total reserves for uncertain tax positions related to gross unrecognized tax benefits of \$5,897, of which \$4,553, if recognized, would affect the effective tax rate. We recognize potential accrued interest and penalties related to unrecognized tax benefits from our global operations within income tax expense. We recorded \$203 of such expenses in the first nine months of 2009. As of September 30, 2009, we had accrued interest payable related to the unrecognized tax benefits of \$1,050.

We conduct business globally, and as a result, our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, we are subject to examinations by taxing authorities in the U.S. and throughout the world. With few exceptions, we are no longer subject to U.S. federal, state, local, or non-U.S. income tax examinations for periods ending before 2005.

The Internal Revenue Service (IRS) commenced an examination in 2006 of our U.S. income tax returns for 2004 and 2005. During the first quarter of 2008, we reached a settlement with the IRS concerning those periods. A payment for additional tax, including interest was made of \$6,600 during the first quarter of 2008. This payment did not result in a material change to our financial position. The IRS is currently examining our 2006 and 2007 income tax returns. As of September 30, 2009, we have proposed certain voluntary adjustments pursuant to the 2006 and 2007 income tax examinations. These did not have a material impact on our financial statements.

Note 11. Fair Value Measurements

## Edgar Filing: AVOCENT CORP - Form 10-Q

In September 2006, the FASB issued a new statement regarding fair value measurement disclosures. The guidance was effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. We adopted the guidance as of January 1, 2008, with the exception of the application of the statement to nonfinancial assets and nonfinancial liabilities, which include those measured at fair value in goodwill impairment testing, indefinite lived intangible assets measured at fair value for impairment testing, and those initially measured at fair value in a business combination. We adopted the provisions of the guidance that pertain to nonfinancial assets and nonfinancial liabilities as of January 1, 2009.

The fair value guidance established a valuation hierarchy for disclosure of inputs to the valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified contractual term, a level 2 input must be observable for substantially the full term of the asset or liability. Level 3 inputs are unobservable inputs based on our own estimates on assumptions market participants would use in pricing the assets or liabilities (including assumptions about risk), used to measure assets and liabilities at fair value. An asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

The following table provides the financial assets and liabilities carried at fair value measured on a recurring basis as of September 30, 2009:

	Total Carrying Value	Fair value measurements		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Money market funds	\$ 42	\$ 42	\$	\$
Derivative liabilities	\$ 2,727	\$	\$ 2,727	\$

The fair market value of our money market funds is measured at fair value using quoted prices in active markets. These fair value measurements are classified within Level 1 of the valuation hierarchy.

The fair market value of over-the-counter derivatives is measured at fair value using expected cash flows over the life of the trade. The fair value measurement is prepared using the closing mid-market rate/price environment on September 30, 2009, using proprietary models, available market data and reasonable assumptions and includes a consideration of credit risk. These fair value measurements are classified within Level 2 of the valuation hierarchy.

The following table provides the indefinite lived intangible assets and liabilities carried at fair value, measured on a non-recurring basis during the nine months ended September 30, 2009:

	Total Carrying Value	Fair value measurements			Total Gains (Losses)
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
LANDesk goodwill	\$ 197,885	\$	\$	\$ 197,885	\$ (80,000)

Our impairment testing prepared on March 1, 2009 for LANDesk goodwill indicated that its implied fair value was less than its pre-adjusted carrying value of \$277,885. The fair value of LANDesk goodwill was determined through the combination of a discounted cash flow analysis, utilizing the income approach and a guideline public company method, utilizing a market approach (*see note 8*).

Note 12. Restructuring, Integration and Retirement

During 2008 we began a series of restructuring actions which continued into the third quarter of 2009. Also in 2008, we began the integration of our Ergo and Touchpaper acquisitions, each acquired in the third quarter of 2008. The restructuring and integration actions were designed to enhance competitiveness, improve efficiency, and reduce our overall cost structure. The restructuring and integration costs, along with costs associated with our former CEO's retirement incurred in the first quarter of 2008, have been separately identified as Restructuring, integration and retirement expenses within our operating expenses. Restructuring and integration expenses include severance charges incurred for certain workforce reductions and the costs associated with the relocation of certain functions from our Shannon, Ireland, Redmond, Washington and Shanghai, China facilities to Huntsville, Alabama.

We recorded \$2,884 and \$5,926 of such costs for the three months ended September 30, 2009 and September 26, 2008, respectively. We recorded \$9,709 and \$13,627 of such costs for the nine months ended September 30, 2009 and September 26, 2008, respectively. These costs include severance and other charges settled in cash, stock compensation adjustments and integration costs related to the Ergo and Touchpaper acquisitions. The costs in the first quarter of 2008 also include costs settled in cash related to the retirement of our former CEO. The following table provides the amounts attributable to each element within our restructuring, integration and retirement expenses:

Table of Contents

## AVOCENT CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except share data)

	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Severance and other charges settled in cash	\$ 2,929	\$ 4,510	\$ 7,130	\$ 8,280
Integration	97	936	2,717	936
Stock compensation	(142)	480	(138)	2,999
Retirement				1,412
Total	\$ 2,884	\$ 5,926	\$ 9,709	\$ 13,627

As of September 30, 2009, we had accrued approximately \$2,391 related to severance costs, which were included in accrued wages and commissions in our consolidated balance sheet. All costs associated with our restructuring and integration program were carried at the corporate level and none of these costs were allocated to specific business units. A rollforward of the liability for severance charges associated with our restructuring programs is as follows:

Balance as of January 1, 2009	\$ 3,585
Accruals for severance costs	6,620
Adjustments to accrual	(384)
Settlements made during the period	(7,430)
Balance as of September 30, 2009	\$ 2,391

We expect to record additional restructuring and integration expenses of approximately \$900 related to these actions after the third quarter of 2009. We expect the remaining accruals and any additional costs to be paid by the end of the fourth quarter 2009.

## Note 13. Legal Matters

In January 2007, we filed a complaint for patent infringement in the United States District Court for the Western District of Washington against Aten Technology, Inc., Aten International Co., Ltd, Belkin Corporation, Rose Electronics and its general partners, and Trippe Manufacturing Company. The defendants filed counterclaims alleging non-infringement, unenforceability, and invalidity. In May 2007, we entered into a Settlement and License Agreement with Trippe Manufacturing, and dismissed Trippe from the lawsuit. In October 2007, the District Court stayed the action pending a re-examination of our patents by the Patent and Trademark Office. The PTO has now confirmed the patentability of the patents and terminated the reexaminations. We have asked the District Court to restart the litigation. In July 2009, Rose filed new reexamination requests with the PTO against two of the three patents at issue in the litigation.

## Edgar Filing: AVOCENT CORP - Form 10-Q

In January 2008, Avocent Redmond Corp. filed a complaint for unauthorized use of patented inventions against the United States government in the United States Court of Federal Claims. The complaint alleges that the United States government accepted products manufactured and sold by Rose Electronics that are covered by patents held by Avocent Redmond. The United States has answered, Rose Electronics has intervened, and a trial has been scheduled for June 2010.

In March 2007, KBM Enterprises, formerly a contract manufacturer for Avocent, filed a complaint against Avocent in the Circuit Court of Madison County, Alabama, seeking \$9,500 for costs allegedly incurred by KBM in its manufacturing efforts on behalf of Avocent. We have filed an answer and counterclaims against KBM and one of its principals. Discovery is currently underway.

In November 2007, Gemini IP, LLC filed a complaint for patent infringement in the United States District Court for the Eastern District of Texas, Sherman Division, against Avocent Corporation and our subsidiary LANDesk Software, Inc. The complaint alleges infringement of a Gemini patent through the sales of a LANDesk product. The complaint seeks injunctive relief, damages, attorneys' fees, and costs. Avocent Corporation was dismissed from the lawsuit in January 2008. In April 2008, the District Court stayed the action pending a review of the Gemini Patent by the Patent and Trademark Office.



Table of Contents

**AVOCENT CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED**

(Unaudited, in thousands, except share data)

On October 20, 2009, a purported class action complaint was filed in the Court of Chancery of the State of Delaware against us, all of our current directors, Emerson Electric, Inc. ( Emerson ) and Globe Acquisition Corp. ( Globe ). Among other things, the complaint alleges that (i) our Board of Directors breached the fiduciary duties owed to our stockholders in connection with the approval of our proposed acquisition by Emerson (the Merger ), (ii) our Board of Directors breached fiduciary duties owed to our stockholders by disseminating inadequate and materially misleading information in connection with the filing of our Schedule 14D-9 Solicitation/Recommendation Statement on October 15, 2009, and (iii) we, Emerson, and Globe aided and abetted our Board of Directors in such breaches. The complaint seeks class certification, certain forms of equitable relief, including enjoining the consummation of the Merger, and unspecified damages. A hearing on the plaintiff's motion for a preliminary injunction has been scheduled for November 6, 2009. The parties have commenced discovery.

Also on October 20, 2009, a second purported class action complaint was filed in the Circuit Court of Madison County, Alabama, against us, all of our current directors, and Emerson. Among other things, the complaint alleges that (i) our Board of Directors breached fiduciary duties owed to our stockholders in connection with the approval of the Merger, (ii) we and our Board of Directors breached fiduciary duties owed to our stockholders by disseminating inadequate and materially misleading information in connection with our filing of the Schedule 14D-9 Solicitation/Recommendation Statement on October 15, 2009 and (iii) Emerson aided and abetted us and our Board of Directors in such breaches. The complaint seeks class certification, unspecified damages, and such other relief as the court may find just and proper. On October 22, 2009, plaintiff filed a motion for temporary restraining order and expedited discovery that seeks an order by the court that would temporarily restrain the consummation of the Merger until a hearing on a forthcoming motion for a preliminary injunction may be held. On October 26, 2009, the defendants filed a motion to dismiss, a motion to stay, and an opposition to the plaintiff's motion for a temporary restraining order and expedited discovery. Also on October 26, 2009, the court held a hearing at which it did not rule on any of the pending motions.

We intend to vigorously defend each of these matters, but the outcome of any claim, litigation, or proceeding is always inherently uncertain. Based on the facts and circumstances currently known to us, we believe that resolution of the foregoing matters will not materially affect our operations, financial condition, or cash flows.

**Note 14. Recently Issued Accounting Pronouncements**

In December 2007, the FASB issued new guidance that establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The new business combination guidance is to be applied prospectively to business combinations for which the acquisition date is on or after an entity's fiscal year that begins after December 15, 2008. Since we have significant acquired deferred tax assets for which full valuation allowances were recorded at the acquisition date, this guidance could materially affect the results of operations if changes in the valuation allowances occur after adoption of the standard. We will assess the impact of this guidance on future acquisitions, however the application will result in a significant change in accounting for any such future acquisitions.

## Edgar Filing: AVOCENT CORP - Form 10-Q

In March 2008, the FASB issued new guidance that requires companies with derivative instruments to disclose information that would enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. The new requirements apply to derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under the guidance. This guidance was effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We adopted the new guidance on January 1, 2009 and it did not have a material impact on our financial statements.

In April 2008, the FASB issued guidance which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of an intangible asset. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. We adopted this guidance on January 1, 2009 and it did not have a material impact on our financial statements.

Table of Contents

**AVOCENT CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED**

(Unaudited, in thousands, except share data)

In April, 2009, the FASB issued new guidance which provides methodology for determining whether a market is inactive and a transaction is distressed in order to apply the existing fair value measurement guidance. In addition, the new guidance requires enhanced disclosures regarding financial assets and liabilities that are recorded at fair value. This guidance is effective for interim and annual reporting periods ending after June 15, 2009. We adopted the guidance on June 15, 2009 and it did not have a material impact on our financial statements.

**In April 2009, the FASB issued new guidance which requires disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. This guidance is effective for interim periods ending after June 15, 2009. We adopted this guidance in the second quarter of 2009, and have provided the disclosures required.**

In June 2009, the FASB issued new guidance which incorporates the subsequent events guidance contained in the auditing standards literature into authoritative accounting literature. It also requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. This guidance is effective for all interim and annual periods ending after June 15, 2009. We adopted the guidance upon its issuance and it had no material impact on our financial statements. See Note 15 - Subsequent Events for this new disclosure.

In June 2009, the FASB issued new guidance to improve financial reporting by companies involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The new guidance is effective for fiscal years beginning after November 15, 2009. We are currently evaluating the impact that the adoption of this guidance will have on our financial statements.

On July 1, 2009, the FASB issued the FASB Accounting Standards Codification (the Codification). The Codification became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. The Codification eliminates the previous US GAAP hierarchy and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The Codification was effective for interim and annual periods ending after September 15, 2009. We adopted this during the third quarter of 2009.

In October 2009, the FASB issued amended revenue recognition guidance for arrangements with multiple deliverables. The new guidance eliminates the residual method of revenue recognition and requires the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence (VSOE), vendor objective evidence (VOE) or third-party evidence (TPE) is unavailable. This guidance is effective for all new or materially modified arrangements entered into on or after January 1, 2011 with earlier application permitted as of the beginning of a fiscal year. Full retrospective application of the new guidance is optional. We are currently assessing our implementation of this new guidance, but do not expect a material impact on our financial statements.

**Note 15. Subsequent Events**

## Edgar Filing: AVOCENT CORP - Form 10-Q

We have evaluated subsequent events for recognition or disclosure through November 4, 2009, which was the date we filed this Form 10-Q with the SEC.

On October 6, 2009, we announced an agreement whereby Emerson Electric Co. will acquire all the outstanding shares of Avocent. The Avocent Board of Directors unanimously endorsed the terms of an all-cash tender offer of \$25 per share, or approximately \$1,100,000. The purchase is expected to close around January 1, 2010, pending customary regulatory approvals and acceptance of the offer by Avocent stockholders holding a majority of Avocent shares. For additional information see our current reports on Form 8-K and Schedules 14D-9 filed with the U.S. Securities and Exchange Commission in October, 2009.

Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*THE INFORMATION IN THIS ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS AND IN OTHER PARTS OF THIS FORM 10-Q CONTAINS FORWARD-LOOKING STATEMENTS, INCLUDING, WITHOUT LIMITATION, STATEMENTS RELATING TO OUR FUTURE BUSINESS PROSPECTS AND ECONOMIC CONDITIONS IN GENERAL; STATEMENTS REGARDING OUR ABILITY TO PREDICT FUTURE SALES AND MANAGE INVENTORY LEVELS; STATEMENTS REGARDING PRICING PRESSURE; STATEMENTS REGARDING THE FLUCTUATION OF OUR REVENUE GROWTH IN RELATION TO ECONOMIC CONDITIONS AND IT RELATED SPENDING TRENDS; STATEMENTS REGARDING OUR PRODUCT PLATFORMS AND OUR ABILITY TO RESUME GROWTH IN OUR OVERALL BUSINESS; STATEMENTS REGARDING INCREASED SALES OF OUR DIGITAL PRODUCTS AND EMBEDDED SOLUTIONS AND THEIR ABILITY TO OFFSET PRICE DECLINES AND COMPETITIVE FACTORS; STATEMENTS REGARDING OUR ANTICIPATED FUTURE GROSS MARGINS, RESEARCH AND DEVELOPMENT EXPENSES, AND SELLING, GENERAL AND ADMINISTRATIVE EXPENSES; AND STATEMENTS REGARDING THE OUTCOME OF, AND OUR LEGAL COSTS FOR, PATENT AND OTHER LEGAL CLAIMS, LITIGATION, AND PROCEEDINGS. THESE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN PART II, ITEM 1A RISK FACTORS.*

**Overview**

Avocent Corporation designs, manufactures, licenses, and sells software and hardware products and technologies that provide connectivity and centralized management of information technology (IT) infrastructure. We (meaning Avocent and its wholly-owned subsidiaries) provide connectivity and systems management, endpoint security, and service management products and technologies that centralize control of servers, desktop computers, serial devices, wireless devices, mobile devices, and network appliances, thus increasing the efficiency of IT resources. Server manufacturers resell private-labeled Avocent KVM (keyboard, video, and mouse) switches, LCD trays, and embedded software and hardware technology in their systems, and companies large and small depend on our software and hardware products and technologies for managing their growing IT infrastructure.

For a more complete description of our products, technologies and markets please refer to our Form 10-K filed on February 27, 2009.

Most of our revenue is derived from sales to a limited number of OEMs (who purchase our products on a private-label or branded basis for integration and sale with their own products), sales through our reseller and distributor network, and sales to a limited number of direct customers. Sales to our branded customers accounted for 71% of sales in the first nine months of 2009 and 67% of sales in the first nine months of 2008. Sales to our OEM customers accounted for 29% of sales in the first nine months of 2009 and 33% of sales in the first nine months of 2008. We do not have contracts with many of our branded customers, and in general, our OEM and branded business customers are obligated to purchase products from us only pursuant to binding purchase orders. Although we are not substantially dependent on any one OEM customer, the loss of, or material decline in orders from, these customers would have a material adverse effect on our business, financial condition, results of operations, and cash flows. Our top five customers include both OEM and branded customers, and accounted for 48% of sales in the first nine months of both 2009 and 2008.

We sell products to resellers, distributors, end-users, and OEMs in the United States, Canada, Europe, and Asia as well as in other foreign markets. Sales within the United States accounted for approximately 51% and 53% of first nine months sales in 2009 and 2008, respectively.

## Edgar Filing: AVOCENT CORP - Form 10-Q

No other country accounted for more than 10% of sales in the first nine months of 2009 or 2008.

With continued industry-wide initiatives to reduce all channel inventories and to shorten lead times, trends with our major customers are, generally, to reduce the number of weeks of forward-committed firm orders. This trend continues to affect our business with certain distributors, OEMs, and other server manufacturers, and we believe that it will continue to make our future sales more difficult to predict and inventory levels more difficult to manage. We monitor inventories of our products owned by our major distribution partners and we strive to maintain a level of inventory in our own facilities to service these customers, and monitor these levels to minimize potential exposure of having excessive inventory on hand. A change in the amount of inventory held by a customer in any one period could adversely affect our revenues through reduced orders in that or a subsequent period which could have a material impact on our business, financial condition, results of operations, and cash flows.

We experience significant price competition in the market for most of our products, and we expect that pricing pressures will continue in the future. In addition, our business and operating results depend to a significant extent on economic conditions in general and on IT spending in particular, and we expect our revenue growth rate to fluctuate in relation to economic conditions and IT related spending trends. Any adverse change in IT spending due to adverse economic conditions, declining capital spending levels, or other factors could have a material adverse effect on our business, financial condition, and results of operations. World-wide efforts to cut capital spending, general economic uncertainty, and a weakening global economy could have a material adverse effect on us. For example, in recent periods global credit and other financial markets have suffered substantial stress, volatility, illiquidity, and

Table of Contents

disruption. This financial crisis and the current global recession could have an impact on our business in a variety of ways, including insolvency of key suppliers resulting in product delays, inability of customers to obtain credit to finance purchases of our products and customer insolvencies. As we evaluate anticipated impacts from the global economic uncertainties, we periodically adjust our spending and related headcount to mitigate the overall impact on our financial results of any anticipated negative changes. We continually monitor the financial health of our key suppliers and customers by constant reviews of our accounts receivable aging and open purchase orders to ensure our customers are paying in a timely fashion and our suppliers are meeting our needs so that we can service our customers.

Many of our executive officers and directors are vested in significant amounts of options to purchase shares of our common stock and RSUs. These officers and directors have informed us that they have sold, and may sell additional, shares of our common stock to provide liquidity and diversify their portfolios. During the first nine months of 2009 and 2008, our Board of Directors granted both time-based and market and performance condition-based restricted stock units (RSUs) with two and three year vesting.

During the first nine months of 2009, we had the following three business units: Management Systems, which includes our branded and OEM KVM, embedded software, serial console, power control, LCD tray, and management appliance businesses; LANDesk, which includes systems, security, and service management solutions for desktops, servers, and mobile devices across the enterprise; and Connectivity and Control, which focuses on our audio-visual products, but was folded into Management Systems in the third quarter of 2009 (see further discussion below).

We believe our business units allow us to focus on new technology and growth opportunities and to add product and shareholder value in the future. We believe this structure enhances customer service, speeds delivery of products to market and better focuses our research, development, and marketing resources. In the third quarter of 2008, we began the process of dissolving the Connectivity and Control business unit and merging its products into our Management Systems business units. We divided this business unit into its three product lines: the Equinox branded serial business, the Broadcast business and the Pro Audio Visual business. We folded the broadcast product line into Management Systems in the third quarter of 2008. We folded the serial product line and the Pro Audio Visual product line into Managements Systems during the third quarter of 2009. As a result of these actions, all revenues and costs associated with our Connectivity and Control business are included within Management Systems in the relevant tables in this quarterly report. Additionally, historical segment results for Management Systems have been changed to reflect these changes and the Connectivity and Control business unit has now been effectively dissolved.

**Our largest business unit, Management Systems, comprised 72% of our consolidated net revenue in the first nine months of 2009 and 77% in 2008. LANDesk contributed 27% of net revenue in the first nine months of 2009 and 21% in 2008. Our Corporate and unallocated revenue comprised the remaining percentage of our consolidated net revenue in 2009 and 2008. See Note 6 in the notes to the condensed consolidated financial statements contained in Part I, Item 1 of this document.**

**Results of Operations**

The following table sets forth, for the periods indicated, selected statement of income data expressed as a percentage of net sales:

Three months ended		Nine months ended	
Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008

Edgar Filing: AVOCENT CORP - Form 10-Q

Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	38.5	37.7	38.0	36.9
Gross profit	61.5	62.3	62.0	63.1
Operating expenses:				
Research and development expenses	14.2	13.3	15.6	14.9
Acquired research and development expenses		0.4		0.1
Selling, general and administrative expenses	37.9	32.9	38.1	35.7
Restructuring, integration and retirement expenses	2.1	3.2	2.5	2.8
Amortization of intangible assets	5.7	4.9	6.6	5.0
Impairment of goodwill			20.4	
Total operating expenses	59.9	54.7	83.2	58.5
Income (loss) from operations	1.6	7.6	(21.2)	4.6
Net investment income	0.1	0.2	0.1	0.4
Interest expense	(1.3)	(1.2)	(1.5)	(1.2)
Other income (expense), net	1.3	1.2	0.2	0.6
Income (loss) before provision (benefit) for income taxes	1.7	7.8	(22.4)	4.4
Provision (benefit) for income taxes	(3.4)	1.8	(8.1)	1.1
Net income (loss)	5.1%	6.0%	(14.3)%	3.3%



## Edgar Filing: AVOCENT CORP - Form 10-Q

### Table of Contents

*Net sales.* Our net sales consist of sales of keyboard, video, and mouse (KVM) console switching systems, digital connectivity products and technologies, software licenses and subscriptions, support and maintenance services, serial connectivity devices, wireless extension products, IPMI, extension, remote access and management products and technologies, and royalties from licensing our intellectual property.

(dollars presented in 000 s)	For the three months ended				For the nine months ended			
	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales
Net revenue, customer distribution								
Branded	\$ 100,410	73%	\$ 124,613	68%	\$ 276,863	71%	\$ 325,147	67%
OEM	37,145	27%	58,435	32%	115,385	29%	158,482	33%
Total net revenue	\$ 137,555	100%	\$ 183,048	100%	\$ 392,248	100%	\$ 483,629	100%

We experienced a 25% decline in sales during the third quarter of 2009 compared to the third quarter of 2008. The decline in sales was evident in both our branded sales, which were down 19%, and our OEM sales, which were down 36%. Branded sales in North America were down 17%, while EMEA declined 24% and Asia declined 20%. OEM sales declined 26% in North America, 42% in EMEA and 44% in Asia in the third quarter of 2009 as compared to the same period of 2008. As detailed below, the sales decline was evident in both our Management Systems and LANDesk business units. We attribute the weakness we experienced in sales this quarter primarily to decreased data center purchasing activity, especially lower server purchases, as customers continue to reduce technology spending due to the ongoing global economic recession. Additionally, foreign exchange rates contributed to our revenue decline for the third quarter of 2009 compared to the third quarter of 2008. If we had experienced the same foreign exchange rates in the third quarter of 2009 as the third quarter a year ago, our revenues would have been approximately \$1.5 million higher. Net sales decreased 19% for the first nine months of 2009 compared to the first nine months of 2008 for the same reasons as described for the third quarter of 2009.

(dollars presented in 000 s)	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Net revenue:				
Management Systems	\$ 100,322	\$ 140,983	\$ 282,289	\$ 378,995
LANDesk	36,459	41,559	107,625	102,594
Corporate and unallocated	774	506	2,334	2,040
Total net revenue	\$ 137,555	\$ 183,048	\$ 392,248	\$ 483,629

Our Management Systems business unit is comprised of our traditional KVM products, serial products, and embedded software and solutions products. Management Systems sales decreased approximately 29% in the third quarter 2009 compared to the third quarter of 2008, primarily due to the decline in data center and server purchasing activity as a result of the continuing global recession. The decline in revenue was experienced across all major Management Systems product lines. Our KVM products sales were down 31% in the third quarter of 2009 from the third quarter of 2008, primarily as a result of the slower OEM and branded sales across all major geographic regions as customers reduced their data center investments due to the ongoing global economic recession. Sales by product line for Management Systems for the three and nine months ended September 30, 2009 and September 26, 2008 were as follows:

(dollars presented in 000 s)	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
Management Systems net revenue:				
KVM	\$ 67,314	\$ 97,101	\$ 191,706	\$ 271,379
Serial Management	7,706	13,517	22,327	39,572

Edgar Filing: AVOCENT CORP - Form 10-Q

Embedded software and solutions		7,493		10,229		19,731		26,981
Other		17,809		20,136		48,525		41,063
Total Management Systems net revenue	\$	100,322	\$	140,983	\$	282,289	\$	378,995

LANDesk revenue is comprised of license-based revenue, primarily from the LANDesk Management Suite product, and subscription-based revenue, primarily from the LANDesk Security Suite products and from maintenance and support agreements related to LANDesk Management Suite (LDMS). Compared to the third quarter of 2008, LANDesk revenues decreased 12% during the third quarter of 2009, primarily as a result of the weakened demand stemming from the ongoing global economic recession. The weakness in license and royalty revenue noted below for the third quarter of 2009 was attributable primarily to a \$2.5 million combined decline in our LDMS and Service Desk products. The decline in our maintenance and services revenue noted below for the third quarter of 2009 was attributable primarily to a \$2.2 million decline in our professional services. Sales by product line for LANDesk for the three and nine months ended September 30, 2009 and September 26, 2008 were as follows:

Edgar Filing: AVOCENT CORP - Form 10-Q

Table of Contents

(dollars presented in 000 s)	For the three months ended		For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008	Sept. 30, 2009	Sept. 26, 2008
LANDesk net revenue:				
Licenses and royalties	\$ 18,069	\$ 22,092	\$ 52,790	\$ 57,919
Maintenance and services	18,390	19,467	54,835	44,675
Total LANDesk net revenue	\$ 36,459	\$ 41,559	\$ 107,625	\$ 102,594

International sales declined by 29% in the third quarter of 2009 from the third quarter of 2008, while sales within the United States declined approximately 21% over the same period. As mentioned previously, the global recession negatively affected both our U.S. and international revenue in the third quarter of 2009.

(dollars presented in 000 s)	For the three months ended				For the nine months ended			
	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales
Net revenue, geographic region								
United States	\$ 74,899	54%	\$ 94,850	52%	\$ 201,493	51%	\$ 256,217	53%
International	62,656	46%	88,198	48%	190,755	49%	227,412	47%
Total net revenue	\$ 137,555	100%	\$ 183,048	100%	\$ 392,248	100%	\$ 483,629	100%

*Gross profit.* Gross profit is affected by a variety of factors, including the ratio of sales among our distribution channels, as OEM sales typically have lower gross margins than our branded sales; absorption of fixed costs as sales levels fluctuate; product mix and component costs; labor costs; new product introductions by us and by our competitors; increasing sales of our software products which tend to have higher gross margins; and our outsourcing of manufacturing and assembly services. Gross profits and margins as a percentage of sales for the three and nine months ended September 30, 2009 and September 26, 2008 were as follows:

(dollars presented in 000 s)	For the three months ended				For the nine months ended			
	September 30, 2009	Gross Margin	September 26, 2008	Gross Margin	September 30, 2009	Gross Margin	September 26, 2008	Gross Margin
Management Systems	\$ 57,206	57.0%	\$ 82,876	58.8%	\$ 162,682	57.6%	\$ 225,242	59.4%
LANDesk	31,236	85.7%	35,088	84.4%	91,915	85.4%	88,281	86.0%
Corporate, other and unallocated	887		599		2,517		2,097	
Stock-based compensation	(552)		(298)		(1,014)		(797)	
Intangible amortization								
LANDesk software	(4,133)		(4,218)		(12,823)		(9,753)	
Gross profit and margin	\$ 84,644	61.5%	\$ 114,047	62.3%	\$ 243,277	62.0%	\$ 305,070	63.1%

The decline in gross margin and gross profit in the third quarter and nine months ended September 30, 2009 resulted from lower sales volume. Although we have made significant improvements in our gross margin and profit through cost savings realized from our supply chain realignment program, these improvements were not enough to offset the impact of the lower sales volume experienced in the third quarter of 2009.

Edgar Filing: AVOCENT CORP - Form 10-Q

Operating expenses.

(dollars presented in 000 s)	For the three months ended				For the nine months ended			
	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales
Research and development expenses	\$ 19,548	14.2%	\$ 24,398	13.3%	\$ 61,077	15.6%	\$ 72,126	14.9%
Acquired research and development expenses			700	0.4%			700	0.1%
Selling, general and administrative expenses	52,182	37.9%	60,266	32.9%	149,521	38.1%	172,830	35.7%
Restructuring, integration and retirement expenses	2,884	2.1%	5,926	3.2%	9,709	2.5%	13,627	2.8%
Amortization of intangible assets	7,780	5.7%	8,971	4.9%	25,843	6.6%	24,123	5.0%
Impairment of goodwill					80,000	20.4%		
	\$ 82,394	59.9%	\$ 100,261	54.7%	\$ 326,150	83.2%	\$ 283,406	58.5%

Table of Contents

**Research and development expenses.** Research and development expenses include compensation for engineers, support personnel, outside contracted services, and materials costs, all of which are expensed as incurred. R&D decreased 20% in the third quarter of 2009 from the third quarter of 2008. The decrease in R&D expense is primarily attributable to the effect of our re-alignment, restructuring and cost-cutting efforts which began at the end of the second quarter of 2008. Salaries and wages decreased approximately \$1.8 million and contracted services declined \$1.3 million from the third quarter of 2008 to the third quarter of 2009 as a result of these activities. R&D decreased 15% from the first nine months of 2008 compared to the first nine months of 2009 for similar reasons as that experienced in the third quarter of 2009. We continue to invest in targeted integrated R&D projects that leverage technology from both Management Systems and LANDesk. We believe that the timely development of innovative products and enhancements to existing products is essential to maintaining our competitive position, and we will continue to make significant investments in research and development.

**Selling, general and administrative expenses.** Selling, general and administrative expenses include personnel, materials, services and other related costs for administration, finance, information systems, human resources, sales and marketing and general management, rent, utilities, legal and accounting expenses, bad debts, advertising, promotional material, trade show expenses, and related travel costs. Selling, general and administrative expenses decreased 13% in the third quarter of 2009 from the third quarter of 2008. The decrease in selling, general and administrative expenses was attributed to the effect of our cost-cutting efforts which began at the end of the second quarter of 2008 and lower sales commissions incurred as a result of lower sales volume on a comparative basis. The results of our cost cutting measures were evident in reduced salaries, trade show and travel costs and reduced contracted services. Salaries decreased approximately \$3.0 million, while trade show expenses and travel-related expenses decreased approximately \$1.5 million in the third quarter of 2009 compared to the same period in 2008. Additionally, contracted services decreased \$1.4 million in the third quarter of 2009 compared to the same period in 2008. SG&A expenses decreased 14% in the first nine months of 2009 from the first nine months of 2008 for similar reasons as that experienced in the third quarter of 2009.

**Restructuring, integration and retirement expenses.** Restructuring, integration and retirement expenses of \$2.9 million for the third quarter of 2009 and \$5.9 million in for the third quarter of 2008 relate to severance charges incurred for workforce reductions in connection with our realignment of resources, integration of marketing functions, and integration of our 2008 acquisitions into our operations. Restructuring, integration and retirement expenses of \$9.7 million for the first nine months of 2009 and \$13.6 million for the first nine months of 2008 were comprised of charges similar to those incurred during the third quarter of 2009. In addition to the third quarter charges, restructuring and retirement charges for the first nine months of 2008 includes the retirement costs for our former CEO of \$2.2 million.

**Amortization of intangible assets.** Amortization was \$7.8 million and \$9.0 million for the three months ended September 30, 2009 and September 26, 2008, respectively. Amortization was \$25.8 million and \$24.1 million for the nine months ended September 30, 2009 and September 26, 2008, respectively. The increase in amortization for the nine months ended 2009 was due to the amortization of intangible assets related to our acquisitions of Touchpaper and Ergo, completed early in the third quarter of 2008.

**Impairment of goodwill.** The \$80.0 million impairment of goodwill relates entirely to the write-off of a portion of goodwill associated with the LANDesk business unit in the first quarter of 2009. We performed an impairment review during the first quarter of 2009 as a result of the continued decline in our stock price and those of comparable companies. The resulting impairment analysis determined that the goodwill associated with LANDesk was impaired by \$80.0 million. No other business unit was determined to have an impairment at the time of the impairment analysis. (See updates to critical accounting policies elsewhere in Part I, Item 2 of this filing). There could be additional impairment in the future depending on any worsening of the recessionary environment and the resulting impact on our business, our stock price, and market valuations of companies in our peer group.

**Stock-based Compensation.** We allocate stock-based compensation expense based on the functional area in which an employee works. Stock compensation expenses for the periods ending September 30, 2009 and September 26, 2008 were as follows:

Edgar Filing: AVOCENT CORP - Form 10-Q

(dollars presented in 000 s)	For the three months ended				For the nine months ended			
	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales	Sept. 30, 2009	% of Sales	Sept. 26, 2008	% of Sales
Cost of sales	\$ 552		\$ 298		\$ 1,014		\$ 797	
Research and development expense	869		1,523		2,727		3,878	
Selling, general and administrative expense	5,194		3,986		10,992		9,288	
Restructuring and retirement expense	(142)		480		(138)		2,999	
	\$ 6,473	4.7%	\$ 6,287	3.4%	\$ 14,595	3.7%	\$ 16,962	3.5%

Table of Contents

Stock-based compensation expense decreased approximately 3% in the third quarter 2009 from the third quarter 2008. Stock-based compensation expense decreased almost 14% in the first nine months of 2009 from the first nine months of 2008. Our Compensation Committee approved the grant of time-based and market condition-based restricted stock units to our officers and other employees in the first quarter of 2008 while such grants for 2009 were made at the end of the second quarter of 2009 (following shareholder approval of amendments to our equity plan in June 2009). This delay further reduced stock-based compensation expense in the first nine months of 2009 compared to the similar period in 2008. Additionally, we recorded almost \$3.0 million of expense as a result of modifying certain equity awards as part of our restructuring efforts in the first nine months of 2008. However, we recorded \$138,000 of income as a result of modifying such equity awards in the first nine months of 2009. We expect to continue to incur stock-based compensation expense in future periods.

*Net investment income.* Net investment income decreased to \$105,000 in the third quarter of 2009 as compared to \$295,000 in the third quarter of 2008. Net investment income decreased to \$390,000 in the first nine months of 2009 as compared to \$1.9 million in the first nine months of 2008.

*Interest expense.* Interest expense decreased to \$1.8 million in the third quarter 2009, compared to \$2.3 million in the third quarter of 2008. The decrease primarily resulted from lower borrowings outstanding for the third quarter of 2009 compared to the same period in 2008. Interest expense increased slightly to \$6.1 million in the first nine months of 2009, compared to \$5.9 million in the first nine months of 2008. This slight increase was driven by the higher borrowings outstanding for most of the first nine months of 2009 compared to 2008.

*Other income, net.* Net other income decreased to \$1.9 million in the third quarter of 2009 from \$2.4 million in the third quarter of 2008. Net other income declined to \$724,000 in the first nine months of 2009 from \$2.7 million in the first nine months of 2008. The decrease in other income for the first nine months of 2009 is primarily the result of decreased net foreign currency transaction gains of approximately \$2.6 million over the comparative period in 2008, primarily as a result of changes in the both the euro and British pound and the impact of movement of foreign currency denominated cash and other assets into U.S. dollar denominated balances, causing a realization of certain foreign exchange gains and losses.

*Provision for income taxes.* The effective tax rate for the third quarter of 2009 was (193.2)% compared to an effective tax rate of 22.7% for the third quarter of 2008. The benefit for income taxes was \$4.7 million for the third quarter of 2009, compared to a provision of \$3.2 million for the third quarter of 2008. The effective tax rate for the first nine months of 2009 was (36.0)% compared to 25.6% for the first nine months of 2008. The benefit for income taxes was \$31.6 million for the first nine months of 2009, compared to a provision of \$5.2 million for the first nine months of 2008. The change in the effective tax rate was primarily attributable to the change in the amount and mix of our pretax book income within taxable jurisdictions and a tax benefit recognized to record a deferred tax asset associated with a goodwill impairment charge recorded in the first quarter of 2009. Further, we have considered guidance within ASC 740, the income taxes topic within the FASB ASC, which limits the amount of benefit that can be reflected in a year-to-date interim loss period to an amount equal to the anticipated benefit that would be derived from the anticipated cumulative loss for the entire reporting year. Our loss through September 30, 2009 exceeds the anticipated loss for the year and the tax benefit recognized through September 30, 2009 has been limited to the amount that would be recognized based on the anticipated full year loss. Accordingly, as of September 30, 2009, we have limited our benefit by \$722,000. As of September 30, 2009, we had total reserves for uncertain tax positions related to gross unrecognized tax benefits of \$5.9 million, of which \$4.6 million if recognized would affect the effective tax rate.

*Net income (loss).* Net income for the third quarter of 2009 was \$7.1 million compared to net income \$11.0 million for the third quarter of 2008, as a result of the factors detailed in the above discussion. Net income, as a percentage of sales for the third quarter of 2009 was 5.1%, compared to 6.0% for the third quarter of 2008. Net loss for the first nine months of 2009 was \$(56.2) million compared to net income of \$15.1 million for the first nine months of 2008, as a result of the factors detailed in the above discussion. Net income (loss), as a percentage of sales for the first nine months of 2009 was (14.3)%, compared to 3.3% for the first nine months of 2008.

**Liquidity and Capital Resources**

As of September 30, 2009, our principal sources of liquidity consisted of \$110 million in cash and cash equivalents and \$215 million available from our \$340 million credit facility that is available for general corporate purposes. The balance of the entire facility is due in June 2011. The term loan and line of credit have similar variable interest rates.

The line of credit and term loan contain affirmative and negative covenants, including limitations on our ability to (i) make distributions, investments, and other payments unless we satisfy certain financial tests or other criteria, (ii) incur additional indebtedness, (iii) restructure our subsidiaries, and (iv) make acquisitions and capital expenditures. The financial tests include an interest coverage ratio and a total leverage ratio. We are currently in compliance with these covenants and related tests as of September 30, 2009. All of these restrictions could affect our ability to operate our business and may limit our ability to take advantage of potential business opportunities as they arise. Failure to comply with these covenants could result in an event of default which, if not cured or waived, could have a material adverse effect on us.



## Edgar Filing: AVOCENT CORP - Form 10-Q

### Table of Contents

The line of credit and term loan currently bear an interest rate of LIBOR plus 150 basis points. There was \$125 million outstanding under the credit facility as of September 30, 2009. We classify these obligations as long-term as they mature in June 2011. As of September 30, 2009, we expect to repay the borrowings through future cash flows from operations. A summary of our cash flows is as follows:

	For the nine months ended	
	Sept. 30, 2009	Sept. 26, 2008
Total cash provided by (used in):		
Operating activities	\$ 51,440	\$ 66,161
Investing activities	(8,005)	(77,061)
Financing activities	(62,181)	22,120
Effect of exchange rate changes on cash	1,991	(1,502)
Increase (decrease) in cash and cash equivalents	\$ (16,755)	\$ 9,718

The decline in cash flow from operations in the first nine months of 2009 was primarily the result of lower net income as well as decreases in accounts payable, accrued wages and commissions and accrued other liabilities. These changes were offset somewhat by increased collections of accounts receivable and a decrease in inventory. Accrued wages and commissions were lower at September 30, 2009, due to lower accrued commissions at the end of the period as a result of lower sales during the period. Additionally, our accounts payable declined as a result of reduced inventory purchases as we reacted to our significantly lower sales volume. The reduced inventory purchases also resulted in significantly lower inventory on-hand at September 30, 2009 compared to December 31, 2008.

Our days sales outstanding (DSO) increased to 66 days at the end of the third quarter 2009 compared to 63 days at the end of the third quarter of 2008. DSO increased primarily as a result of the weakened economy driving slightly longer payment trends with some of our customers in the third quarter of 2009 compared to the third quarter of 2008. Inventories decreased \$7.4 million from December 31, 2008 to September 30, 2009, and when combined with the lower sales volume, resulted in a decrease in inventory turns from 8.6 at the end of the third quarter of 2008 compared to 7.1 at the end of the third quarter 2009. Our inventory turns improved from 4.1 at the end of the second quarter of 2009, primarily as a result of our lower inventory levels.

Our investing activities used \$8.0 million of cash flow in the first nine months of 2009, primarily to pay an additional \$4.1 million of consideration previously accrued for LANDesk and Touchpaper. Our investing activities used \$77.1 million of cash flow in the first nine months of 2008, primarily to fund the Touchpaper and Ergo acquisitions completed in July 2008.

Our financing activities used cash to repay \$45 million of borrowings from our line of credit and to repurchase 1.2 million shares of our common stock during the first nine months of 2009 at a cost totaling over \$15 million. Our financing activities used the cash provided by operations and investing activities, as well as additional borrowings, to repurchase approximately 4 million shares of our common stock during the first nine months of 2008 at a cost totaling \$64 million. These treasury shares were purchased through various brokers under the stock repurchase program approved by our Board of Directors. As of September 30, 2009 we have approximately 900,000 shares available for purchase under the program.

We may use a portion of our cash and cash equivalents or our line of credit for strategic acquisitions of technologies and companies that we believe will enhance and complement our existing technologies and help increase our sales.

## Edgar Filing: AVOCENT CORP - Form 10-Q

In fiscal July 2008, in January 2009, and again in July 2009 we announced a series of actions designed to enhance competitiveness, improve our efficiency, and reduce our cost structure. We initiated workforce reduction and consolidation actions designed to intensify our focus on our growth areas and improve our operating efficiency. The restructuring included actions to increase our organizational efficiency, reduce certain research and development investments in lower growth product areas, integrate our marketing functions, and shift support for our Asian operations from Shannon, Ireland, to our recently-established regional hub in Singapore. We also relocated certain functions from Redmond, Washington to Huntsville, Alabama.

On October 6, 2009, we announced an agreement whereby Emerson Electric Co. will acquire all the outstanding shares of Avocent. The Avocent Board of Directors unanimously endorsed the terms of an all-cash tender offer of \$25 per share, or approximately \$1.1 billion. The purchase is expected to close around January 1, 2010, pending customary regulatory approvals and acceptance of the offer by Avocent stockholders holding a majority of Avocent shares. For additional information see our current reports on Form 8-K and Schedules 14D-9 filed with the U.S. Securities and Exchange Commission in October, 2009.

Table of Contents**Off-Balance Sheet Arrangements and Contractual Obligations**

In the ordinary course of our business, we may at any point in time have a significant amount of contractual commitments not yet recognized in our financial statements. These commitments relate primarily to our need to schedule the purchase of inventories in advance of the related forecasted sales to customers. We have longer lead times for the products we purchase from suppliers based in Asia than we have for the products we purchase from our U.S. and European based suppliers. Our actual contractual commitments are typically limited to products needed for one to three months of forecasted sales. The liabilities for these inventory purchases, along with the related inventory assets, are typically recognized upon our receipt of the products. We also have, at any point in time, a variety of short term contractual commitments for services such as advertising, marketing, accounting, legal, and research and development activities. The liabilities for these services and the related expenses are typically recognized upon our receipt of the related services. In our 2008 Form 10-K, we disclosed our contractual obligations in the section entitled Off-Balance Sheet Arrangements and Contractual Obligations in Part II Item 7. At September 30, 2009, there have been no material changes to contractual obligations outside the ordinary course of business. We reduced our debt balance \$45 million to \$125 million at September 30, 2009, down from \$170 million at December 31, 2008.

Other than operating leases for offices and warehouse space, we do not engage in off-balance sheet financing arrangements or have any variable-interest entities that would require consolidation within our financial results. As of September 30, 2009 we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

**Non-GAAP Operational Measures**

To supplement our consolidated financial statements presented in accordance with GAAP, we present investors with certain non-GAAP operational measures which we use internally to manage our business, including gross profit, operating expenses, and the resulting operating income, income before taxes, operational net income, and operational earnings per share, all of which primarily exclude the effects of amortization related to purchase accounting adjustments, goodwill impairment expense, stock-based compensation, and restructuring, integration and retirement expenses. Specifically, we use the following non-GAAP measures:

Non-GAAP Operational Measures (dollars presented in 000 s)	Three months ended		Nine months ended	
	September 30, 2009	September 26, 2008	September 30, 2009	September 26, 2008
Operational gross profit	\$ 89,328	\$ 118,564	\$ 257,114	\$ 315,620
Operational operating income	\$ 23,661	\$ 39,410	\$ 60,235	\$ 83,997
Operational net income	\$ 20,134	\$ 30,441	\$ 45,401	\$ 63,289
Operational diluted earnings per share	\$ 0.45	\$ 0.67	\$ 1.01	\$ 1.38

- The non-GAAP gross profit operational measure consists of net sales, less cost of sales, excluding the impact of stock-based compensation and amortization related to purchase accounting adjustments as they relate to cost of sales.

- The non-GAAP operating expense operational measure consists of GAAP operating expenses, excluding the impact of stock-based compensation, restructuring, integration and retirement expenses, goodwill impairment expense and amortization related to purchase accounting adjustments as they relate to the particular operating expense.

## Edgar Filing: AVOCENT CORP - Form 10-Q

- The non-GAAP operating income operational measure consists of GAAP operating income, adjusted for the non-GAAP operational measures described above.
- The non-GAAP net income operational measure consists of GAAP net income, adjusted by the non-GAAP operational measures described above and the tax effects of these non-GAAP operational measures plus the income tax benefit realized from deducting the amortization of LANDesk goodwill for tax purposes (which is not amortized under GAAP).
- The non-GAAP earnings per share operational measure is calculated by dividing the non-GAAP net income operational measure described above by GAAP weighted average basic and diluted shares outstanding.

Edgar Filing: AVOCENT CORP - Form 10-Q

Table of Contents

We provide the following reconciliations between GAAP and our operational measures:

	GAAP Financial Measures	Stock-based Compensation	Purchase Accounting Adjustments	Restructuring and Retirement Expenses	Non-GAAP Operational Measures
<b>For the three months ended September 30, 2009</b>					
Operational gross profit	\$ 84,644	552	4,132		\$ 89,328
Operational operating income	\$ 2,250	6,473	11,913	3,025	\$ 23,661
Operational net income	\$ 7,050	5,474	5,007	2,602	\$ 20,134
Operational diluted earnings per share	\$ 0.16	0.12	0.11	0.06	\$ 0.45
<b>For the three months ended September 26, 2008</b>					
Operational gross profit	\$ 114,047	298	4,219		\$ 118,564
Operational operating income	\$ 13,786	6,287	13,891	5,446	\$ 39,410
Operational net income	\$ 10,961	4,802	10,518	4,160	\$ 30,441
Operational diluted earnings per share	\$ 0.24	0.11	0.23	0.09	\$ 0.67
<b>For the nine months ended September 30, 2009</b>					
Operational gross profit	\$ 243,277	1,014	12,823		\$ 257,114
Operational operating income	\$ (82,873)	14,595	118,666	9,847	\$ 60,235
Operational net income	\$ (56,221)	11,989	81,483	8,150	\$ 45,401
Operational diluted earnings per share	\$ (1.27)	0.27	1.83	0.18	\$ 1.01
<b>For the nine months ended September 26, 2008</b>					
Operational gross profit	\$ 305,070	797	9,753		\$ 315,620
Operational operating income	\$ 21,664	16,962	34,743	10,628	\$ 83,997
Operational net income	\$ 15,135	12,978	27,044	8,132	\$ 63,289
Operational diluted earnings per share	\$ 0.33	0.28	0.59	0.18	\$ 1.38

We believe that excluding amortization associated with purchase accounting adjustments and the goodwill impairment expense, as well as the tax impact of certain purchase accounting elections for prior acquisitions, provides meaningful supplemental information and an alternative presentation useful to investors understanding our core operating results and trends between periods. Not only are these depreciation, amortization and tax impact adjustments based on amounts assigned in purchase accounting, that may have little bearing on present or future replacement costs, but they also are based on management's estimates of remaining useful lives.

Similarly, we believe that excluding stock-based compensation and restructuring, integration and retirement expenses provides meaningful supplemental information and an alternative presentation useful to investors understanding of our core operating results and trends, especially when comparing those results on a consistent basis to results for previous periods and anticipated results for future periods.

## Edgar Filing: AVOCENT CORP - Form 10-Q

We also believe that, in excluding stock-based compensation and restructuring, integration and retirement expenses, goodwill impairment expense and amortization associated with purchase accounting adjustments (together with the related tax effects), our non-GAAP financial measures provide investors with transparency into the information and basis used by management and our Board of Directors to measure and forecast our results of operations, to compare on a consistent basis our results of operations for the current period to that of prior periods, to compare our results of operations on a more consistent basis against that of other companies in making financial and operating decisions, and to establish targets for management incentive compensation.

Table of Contents

These non-GAAP operational measures have historically been used as key performance metrics by our senior management as they evaluate both the performance of the consolidated financial results as well as those of individual business segments. These non-GAAP operational measures are reviewed individually as well as in total in measuring our performance against internal and external expectations for the period and the expectations for such key non-GAAP operational measures are the basis for any financial guidance provided by management for future periods. We believe that the use of each of these non-GAAP financial measures provides enhanced consistency and comparability with our past financial reports, and also facilitates comparisons with other companies in our industry, many of which use similar non-GAAP financial measures to supplement their GAAP results. We provide this information to investors to enable them to perform additional analyses of past, present and future operating performance, compare us to other companies, and evaluate our ongoing financial operations.

We believe that each of these operational measures is useful to investors in their assessment of our operating performance and the valuation of our company. Operational net sales, gross profit, operating income, operational net income, and operational earnings per share are significant measures used by management for:

- Reporting our financial results and forecasts to our Board of Directors;
- Evaluating the operating performance of our company;
- Managing and comparing performance internally across our businesses and externally against our peers; and
- Establishing internal operating targets.

These non-GAAP operational measures, including operational net sales, operational gross profit, operational operating income, operational net income, and operational earnings per share are used by us as broad measures of financial performance that encompass our operating performance, cash, capital structure, investment management, and income tax planning effectiveness. These operational measures are not calculated in accordance with GAAP, and should be considered supplemental to, and not as a substitute for, or superior to, financial measures calculated in accordance with GAAP. These operational measures have limitations in that they do not reflect all of the costs associated with the operations of our business as determined in accordance with GAAP. In addition, these operational measures may not be comparable to non-GAAP financial measures reported by other companies. As a result, one should not consider these measures in isolation or as a substitute for analysis of our results as reported under GAAP. We compensate for these limitations by analyzing current and future results on a GAAP basis as well as a non-GAAP basis, prominently disclosing GAAP results and providing reconciliations from GAAP results to non-GAAP operational measures. We expect to continue to incur expenses similar to the non-GAAP adjustments described above, and the exclusion or inclusion of these items from our non-GAAP financial measures should not be construed as an inference that these costs are unusual or infrequent. One of the limitations in relying on our non-GAAP financial measures is that the non-GAAP gross profit, operating income, net income, and earnings per share operational measures are limited in that they do not include the impact of stock-based compensation expense or specific costs and benefits associated with certain purchase accounting adjustments or, restructuring, integration and retirement expenses.

We compensate for these limitations by prominently disclosing the reported GAAP results and providing investors with reconciliations from GAAP to the non-GAAP measures in the financial tables above.

**Recently Issued Accounting Standards and Regulatory Standards**

In December 2007, the FASB issued new guidance that establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The new business combination guidance is to be applied prospectively to business combinations for which the acquisition date is on or after an entity's fiscal year that begins after December 15, 2008. Since we have significant acquired deferred tax assets for which full valuation allowances were recorded at the acquisition date, this guidance could materially affect the results of operations if changes in the valuation allowances occur after adoption of the standard. We will assess the impact of this guidance on future acquisitions, however the application will result in a significant change in accounting for any such future acquisitions.

In March 2008, the FASB issued new guidance which requires companies with derivative instruments to disclose information that would enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. The new requirements apply to derivative



Table of Contents

instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under the guidance. This guidance was effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We adopted the new guidance on January 1, 2009 and it did not have a material impact on our financial statements.

In April 2008, the FASB issued guidance which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of an intangible asset. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. We adopted this guidance on January 1, 2009 and it did not have a material impact on our financial statements.

In April, 2009, the FASB issued new guidance which provides methodology for determining whether a market is inactive and a transaction is distressed in order to apply the existing fair value measurement guidance. In addition, the new guidance requires enhanced disclosures regarding financial assets and liabilities that are recorded at fair value. This guidance is effective for interim and annual reporting periods ending after June 15, 2009. We adopted the guidance on June 15, 2009 and it did not have a material impact on our financial statements.

**In April 2009, the FASB which requires disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. This guidance is effective for interim periods ending after June 15, 2009. We adopted this guidance in the second quarter of 2009, and have provided the disclosures required.**

In June 2009, the FASB issued new guidance which incorporates the subsequent events guidance contained in the auditing standards literature into authoritative accounting literature. It also requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. This guidance is effective for all interim and annual periods ending after June 15, 2009. We adopted the guidance upon its issuance and it had no material impact on our financial statements. See Note 15 - Subsequent Events for this new disclosure.

In June 2009, the FASB issued new guidance to improve financial reporting by companies involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The new guidance is effective for fiscal years beginning after November 15, 2009. We are currently evaluating the impact that the adoption of this guidance will have on our financial statements.

On July 1, 2009, the FASB issued the FASB Accounting Standards Codification (the Codification). The Codification became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. The Codification eliminates the previous US GAAP hierarchy and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The Codification was effective for interim and annual periods ending after September 15, 2009. We adopted this during the third quarter of 2009.

In October 2009, the FASB issued amended revenue recognition guidance for arrangements with multiple deliverables. The new guidance eliminates the residual method of revenue recognition and requires the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence (VSOE), vendor objective evidence (VOE) or third-party evidence (TPE) is unavailable. This guidance is effective for all new or materially modified arrangements entered into on or after January 1, 2011 with earlier application permitted as of the beginning of a fiscal year. Full retrospective application of the new guidance is optional. We are currently

assessing our implementation of this new guidance, but do not expect a material impact on our financial statements.

**Updates to Critical Accounting Estimates**

- As discussed in Notes 7 and 14 to the Condensed Consolidated Financial Statements, we have adopted recently issued guidance for derivatives and hedging as of January 1, 2009. This guidance requires certain disclosures surrounding derivatives and hedges. We have interest rate swaps that qualify as derivative instruments and are classified as cash flow hedges.

- As discussed below and in Note 11 to the Condensed Consolidated Financial Statements, we have adopted recently issued guidance for fair value measurement as of January 1, 2009 as it applies to the application of the statement to nonfinancial assets and nonfinancial liabilities. During the first quarter of 2009 we measured our goodwill at fair value based upon Level 3 inputs, as defined under the guidance. We determine the fair value of our reporting units through a discounted cash flow analysis, utilizing the income approach, and a guideline public company method, utilizing a market approach, and weight the results of each valuation in determining the fair value of the reporting units.

**Table of Contents**

- The \$80.0 million adjustment to LANDesk goodwill was the result of an impairment charge recorded during the three months ended March 31, 2009. We evaluate the carrying value of goodwill for potential impairment annually during the fourth quarter of each year, and on an interim basis if an event occurs or circumstances change that indicate a potential detrimental impact to the fair value of a reporting unit compared to its carrying value may have occurred. Our fourth quarter 2008 impairment test concluded that there had been no impairment of goodwill, however, there were certain factors noted during the 2008 testing that required continued monitoring, especially related to any potential future decline in our market capitalization. During the first quarter of 2009, we concluded that interim impairment testing was required due to the continued deterioration in the global economic environment, the resulting decrease in our market capitalization to less than the book value of our shareholders' equity, and declining market valuations for many other companies in our peer group. In preparation for this interim testing, we revised our five year forecast, used as a base element of this testing, in light of the continuing global recession.

**As of September 30, 2009 we had three reporting units: Management Systems (MS), LANDesk and AESS, which is combined with MS for segment reporting purposes.** We perform our goodwill impairment test in two steps. Step one compares the fair value of each reporting unit (operating segment) to its carrying amount. If step one indicates that an impairment potentially exists, the second step testing is performed to measure the amount of impairment, if any. Goodwill impairment exists when the estimated fair value of goodwill is less than its carrying value.

**For purposes of the interim step one analysis prepared as of March 1, 2009, the fair values of our reporting units were determined through the use of a combination of a discounted cash flow analysis, utilizing the income approach, and the guideline public company method, utilizing a market approach. The result of each valuation was weighted in determining each reporting units fair value.** Under the market approach, the fair value of each reporting unit is determined based upon comparisons to public companies engaged in similar businesses. Under the income approach, the fair value of each reporting unit was based on the present value of estimated future cash flows. The income approach is dependent on a number of significant management assumptions including estimated demand in each geographic market and the discount rate. The discount rate is commensurate with the risk inherent in the projected cash flows and reflects the estimated rate of return required by an investor in the current economic conditions. Based on our assessment of the market conditions, the weighting applied to the market approach for the March 1, 2009 valuation was decreased from 50% to 40% and the weighting for the income approach was increased from 50% to 60%, as compared to the assumptions as of October 1, 2008. This change was considered appropriate as it reflects our longer term view, including our revised cash flow projections based on current expectations, while continuing to reflect the impact of declining equity values in this highly volatile equity market impacting our stock price and the stock price of many of our peers.

**The results of our step one test as of March 1, 2009 indicated that the fair value of each of our reporting units had declined from 2008, however, with the exception of LANDesk, the estimated fair values exceeded their carrying value. We estimated the fair value of Management Systems to be \$184 million higher, or approximately 35%, than its carrying value of \$520 million. Our remaining reporting units at the time were not material to our financial statements, however we estimated the combined fair value of these reporting units to be \$49 million higher, or approximately 250%, their combined carrying value of \$20 million.**

**Other than these changes, there have been no significant changes in our critical accounting estimates during the first nine months of 2009.**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

## Edgar Filing: AVOCENT CORP - Form 10-Q

Our primary market risk is the interest rate risk on our credit facility, which currently bears interest at a variable rate of LIBOR plus 150 basis points. We have partially hedged this exposure to interest rate risk with interest rate swaps, which have a remaining aggregate notional amount of \$110 million, with Regions Bank and SunTrust Bank.

We also face foreign currency exchange rate risk to the extent that the value of certain foreign currencies relative to the U.S. dollar affects our financial results. Our international operations transact a significant portion of our business in currencies other than the U.S. dollar, predominantly the euro and British pound, and changes in exchange rates may positively or negatively affect our revenue, gross margins, operating expenses, and retained earnings since these transactions are reported by us in U.S. dollars. We occasionally purchase foreign currency forwards aimed at limiting the impact of currency fluctuations. These instruments provide only limited protection against currency exchange risks, and there can be no assurance that such an approach will be successful, especially if a significant and sudden decline occurs in the value of local currencies. As of September 30, 2009, we had five open forward contracts with an approximate fair value of \$(22,300).

Table of Contents

**Item 4. Controls and Procedures.**

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of September 30, 2009, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective.

(b) *Changes in internal control over financial reporting.* There were no changes in our internal controls over financial reporting during the quarter ended September 30, 2009 that materially affected or are reasonably likely to materially affect, our internal controls over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

In January 2007, we filed a complaint for patent infringement in the United States District Court for the Western District of Washington against Aten Technology, Inc., Aten International Co., Ltd, Belkin Corporation, Rose Electronics and its general partners, and Trippe Manufacturing Company. The defendants filed counterclaims alleging non-infringement, unenforceability, and invalidity. In May 2007, we entered into a Settlement and License Agreement with Trippe Manufacturing, and dismissed Trippe from the lawsuit. In October 2007, the District Court stayed the action pending a re-examination of our patents by the Patent and Trademark Office. The PTO has now confirmed the patentability of the patents and terminated the reexaminations. We have asked the District Court to restart the litigation. In July 2009, Rose filed new reexamination requests with the PTO against two of the three patents at issue in the litigation.

In January 2008, Avocent Redmond Corp. filed a complaint for unauthorized use of patented inventions against the United States government in the United States Court of Federal Claims. The complaint alleges that the United States government accepted products manufactured and sold by Rose Electronics that are covered by patents held by Avocent Redmond. The United States has answered, Rose Electronics has intervened, and a trial has been scheduled for June 2010.

In March 2007, KBM Enterprises, formerly a contract manufacturer for Avocent, filed a complaint against Avocent in the Circuit Court of Madison County, Alabama, seeking \$9,500 for costs allegedly incurred by KBM in its manufacturing efforts on behalf of Avocent. We have filed an answer and counterclaims against KBM and one of its principals. Discovery is currently underway.

In November 2007, Gemini IP, LLC filed a complaint for patent infringement in the United States District Court for the Eastern District of Texas, Sherman Division, against Avocent Corporation and our subsidiary LANDesk Software, Inc. The complaint alleges infringement of a Gemini patent through the sales of a LANDesk product. The complaint seeks injunctive relief, damages, attorneys' fees, and costs. Avocent Corporation was dismissed from the lawsuit in January 2008. In April 2008, the District Court stayed the action pending a review of the Gemini Patent by the Patent and Trademark Office.

On October 20, 2009, a purported class action complaint was filed in the Court of Chancery of the State of Delaware against us, all of our current directors, Emerson Electric, Inc. (Emerson) and Globe Acquisition Corp. (Globe). Among other things, the complaint alleges that (i) our Board of Directors breached the fiduciary duties owed to our stockholders in connection with the approval of our proposed acquisition by Emerson (the Merger), (ii) our Board of Directors breached fiduciary duties owed to our stockholders by disseminating inadequate and materially misleading information in connection with the filing of our Schedule 14D-9 Solicitation/Recommendation Statement on October 15, 2009 and (iii) we, Emerson, and Globe aided and abetted our Board of Directors in such breaches. The complaint seeks class certification, certain forms of equitable relief, including enjoining the consummation of the Merger, and unspecified damages. A hearing on the plaintiff's motion for a preliminary injunction has been scheduled for November 6, 2009. The parties have commenced discovery.

Also on October 20, 2009, a second purported class action complaint was filed in the Circuit Court of Madison County, Alabama, against us, all of our current directors, and Emerson. Among other things, the complaint alleges that (i) our Board of Directors breached fiduciary duties owed to our stockholders in connection with the approval of the Merger, (ii) we and our Board of Directors breached fiduciary duties owed to our stockholders by disseminating inadequate and materially misleading information in connection with our filing of the Schedule 14D-9 Solicitation/Recommendation Statement on October 15, 2009, and (iii) Emerson aided and abetted us and our Board of Directors in such breaches. The complaint seeks class certification, unspecified damages, and such other relief as the court may find just and proper. On October 22, 2009, plaintiff filed a motion for temporary restraining order and expedited discovery that seeks an order by the court that would temporarily restrain the consummation of the Merger until a hearing on a forthcoming motion for a preliminary injunction may be held. On October 26, 2009, the defendants filed a motion to dismiss, a motion to stay, and an opposition to the plaintiff's motion for a temporary restraining order and expedited discovery. Also on October 26, 2009, the court held a hearing at which it did not rule on any of the pending motions.





Table of Contents

**Item 1A. Risk Factors.**

*THIS QUARTERLY REPORT CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES THAT COULD CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE DISCUSSED IN THIS QUARTERLY REPORT. THESE RISKS AND UNCERTAINTIES INCLUDE THE FOLLOWING:*

**The announcement and pendency of our agreement to be acquired by Emerson could adversely affect our business, financial results and operations.**

On October 6, 2009, we announced that we had entered into the Agreement and Plan of Merger with Emerson Electric Co. pursuant to which a wholly-owned subsidiary of Emerson commenced a cash tender offer on October 15, 2009, to acquire all of our issued and outstanding shares of common stock, at a price of \$25.00 per share, net to the holder thereof in cash. After the consummation of the tender offer, and subject to the satisfaction or waiver of certain conditions set forth in the merger agreement, Emerson's subsidiary will merge with and into us, and we will become a wholly-owned subsidiary of Emerson.

The announcement and pendency of the tender offer and the merger could cause disruptions in and create uncertainty surrounding our business, including affecting our relationships with our customers, vendors, and employees, which could have an adverse effect on our business, financial results, and operations. In particular, we could lose important personnel as a result of the departure of employees who decide to pursue other opportunities in light of the proposed merger. We could potentially lose customers or suppliers, or customer orders could be delayed or decreased. The sales cycles for our products may lengthen due to the uncertainty related to the proposed merger. In addition, we have diverted, and will continue to divert, significant management resources in an effort to complete the merger, which could adversely affect our business and results of operations. We are also experiencing increased competition from certain of our competitors, who are targeting our customers as a result of the uncertainty associated with our proposed acquisition by Emerson.

We are subject to prohibitions contained in the merger agreement on soliciting, initiating, knowingly facilitating, or knowingly encouraging alternative acquisition proposals. If violated, these restrictions could potentially result in the termination of the merger agreement by Emerson. We are also subject to restrictions contained in the merger agreement on the conduct of our business prior to the completion of the merger. These restrictions could result in our inability to respond effectively to competitive pressures, industry developments, and future opportunities or may otherwise harm our business, financial results, and operations.

**The failure to complete the tender offer and/or the merger could adversely affect our business and the market price of our common stock and could result in substantial termination and reimbursement costs.**

There is no assurance that the tender offer and the merger with Emerson or any other transaction will occur. Consummation of the tender offer is subject to various conditions, including a minimum condition for the valid tender of outstanding shares, the expiration or termination of applicable waiting periods under the HSR Act and other applicable waiting periods, clearances, consents, or approvals of governmental authorities, and certain other conditions. The closing of the merger is subject to certain closing conditions specified in the merger agreement, including, if required, approval of the merger by a majority of our stockholders.

If the proposed tender offer and/or merger, or a similar transaction, are not completed, the share price of our common stock may change to the extent that the current market price of our common stock reflects an assumption that a transaction will be completed. We will have incurred significant costs, including the diversion of management resources, for which we will have received little or no benefit. In addition, under circumstances defined in the merger agreement, we may be required to pay Emerson a termination fee of \$35 million and/or reimburse Emerson for up to \$7.5 million in transaction expenses. Furthermore, a failed transaction may result in negative publicity and a negative impression of us in the investment community.

**Certain of our directors and executive officers have interests in the merger that may be different from, or in addition to, the interests of our stockholders.**

Our executive officers negotiated the terms of the merger agreement under the direction of the Board. The Board unanimously adopted, approved, and declared advisable the merger agreement and the transactions contemplated by the merger agreement, declared it in the best interest of our stockholders for us to enter into the merger agreement and consummate the transactions contemplated by the merger agreement, declared the terms of the tender offer and the merger fair to our stockholders and recommended that our stockholders tender their shares into the offer and, if required, vote in favor of adoption of the merger agreement. These directors and executive officers may have interests in the merger that are different from, or in addition to, or may be deemed to conflict with those of our stockholders. These interests may include the continued employment of certain of our executive officers by the combined company and the indemnification of former directors and officers by the combined company. With respect to these directors and executive officers, these interests also include the treatment in the merger of employment agreements, severance policies, change of control arrangements, performance shares, restricted stock units, stock options, and other rights held by these directors and executive officers.

Table of Contents

**Difficulties encountered during challenging and changing economic conditions could adversely affect our results of operations.**

Our business and operating results depend to a significant extent on economic conditions in general and on IT spending and the server market in particular, and we expect our revenue growth rate to fluctuate in relation to economic conditions and IT-related spending trends. Any adverse change in IT spending or in the server market due to adverse economic conditions, declining capital spending levels, or other factors could have a material adverse effect on our business, financial condition, and results of operations. World-wide efforts to cut capital spending, general economic uncertainty, and a weakening global economy could have a material adverse effect on us. The current financial crisis could have an impact on our business in a variety of ways, including insolvency of key suppliers resulting in product delays, inability of customers to obtain credit to finance purchases of our products, bank failure or governmental takeover of financial institutions, and customer insolvencies. In addition, we continue to see industry-wide initiatives by OEMs and by distributors and resellers of our hardware products to reduce their inventories and to shorten their lead times, thereby reducing early commitments to firm orders by our major OEM and distributor and reseller customers. If we are unable to effectively manage during the current challenging and changing economic conditions, our business, financial condition, and results of operations could be materially adversely affected.

**We have acquired, and expect to continue to acquire, technologies and companies and these acquisitions could disrupt our business or expose us to other risks.**

A key component of our engineering and product development strategy and our future growth is the investment in or the acquisition of technologies and companies. We intend to continue to execute our strategy through the acquisition of technologies or companies or through investments in complementary companies, products, personnel, or technologies, and it is likely we will complete such acquisitions or investments in the future. These acquisitions and investments involve many risks and factors outside our control, including the following:

- Difficulty integrating the acquired company's personnel, distribution channels, products, product roadmaps, technologies, systems, processes, and operations, including product development, product delivery, order management, and information systems;
- Difficulty in conforming the acquired company's financial policies and practices to our policies and practices and in implementing and maintaining adequate internal systems and controls over the financial reporting and information systems of the acquired company;
- Diversion of management's attention and disruption of our current business and the challenges associated with managing the resulting larger company following any acquisition;
- Difficulty in combining product and technology offerings and entering into new markets or geographical areas in which we have no or limited direct experience and where our competitors may have stronger market positions;

## Edgar Filing: AVOCENT CORP - Form 10-Q

- Loss (at either Avocent or in the acquired company) of management, sales, technical, or other key personnel or the loss of customers, distributors, resellers, vendors, or other business relationships as a result of the acquisition;
- Revenue or deferred revenue from the acquired company not meeting our expectation, and the potential loss of the acquired company's customers, distributors, resellers, suppliers, or other partners;
- Delays or difficulties and the attendant expense in evaluating, coordinating, and combining administrative, manufacturing, research and development, operations, facilities, and relationships with third parties in accordance with local laws and other obligations while maintaining adequate standards, controls and procedures, including financial controls and controls over information systems;
- Difficulty in completing projects associated with acquired in-process research and development;
- Incurring amortization expense related to certain intangible assets and recording goodwill and non-amortizable assets that will be subject to impairment testing and possible impairment charges;

Table of Contents

- Dilution of existing stockholders as a result of issuing equity securities, including the assumption of any stock options or other equity issued by the acquired company;
- Overpayment for any acquisition or investment or unanticipated costs or liabilities;
- Assumption of liabilities of the acquired company, including any potential intellectual property infringement or other litigation claims, the liabilities and obligations under the acquired company's existing agreements, and any unrecorded tax obligations; and
- Incurring substantial write-offs, restructuring charges, interest expense, amortization, and transactional expenses.

Our integration plans and indemnification and escrow agreements might fail to adequately mitigate these risks and factors, and our failure to manage these risks and challenges could materially harm our business, financial condition, and results of operations. Further, if we do not successfully address these challenges in a timely manner, we may not fully realize all of the anticipated benefits or synergies on which the value of a transaction was based. Future transactions could cause our financial results to differ materially from expectations of market analysts or investors for any given quarter.

**We recorded an impairment charge in the first quarter of 2009, and our impairment testing may require us to take an additional impairment charge in the future.**

As required by generally accepted accounting principles, we have performed an annual impairment test of goodwill in each of the fourth quarter of 2008, 2007, and 2006. Our testing in the fourth quarter of each year concluded that there had been no impairment of goodwill and that no adjustments were required.

Our fourth quarter 2008 impairment test concluded that there had been no impairment of goodwill and that no adjustments were required. While our testing in 2008 indicated there was no goodwill impairment for any of our reporting units, there were certain factors we noted during the 2008 testing that would require continued monitoring, especially related to any potential decline in our market capitalization. During the first quarter of 2009 our market capitalization declined to less than the book value of our shareholders' equity. In addition, market valuations for many companies in our peer group declined significantly during the quarter. As a result, we determined goodwill impairment testing should be performed during the first quarter of 2009. We revisited our five-year forecast in light of the continuing global recession. Based on that trend, we revised our five-year forecast, and we recorded an impairment charge for LANDesk goodwill of \$80.0 million during the three months ended March 31, 2009.

As a result of the continued uncertainty in the stock market and due to the current recessionary environment and the resulting impact on our business, we are monitoring our stock price, control premium, and other conditions in relation to potential additional goodwill impairment testing. There is a risk that there may be an additional impairment in the future requiring an adjustment to the carrying value of goodwill and other intangible assets, and we may be required to take an additional impairment charge. If so, any charge could have material adverse effect on

our financial position and the results of our operations.

**Intense competition from new and existing competitors or consolidation in the industry could impair our ability to grow our business, to sustain our profitability, and to sell our products and technologies.**

The markets for our products and technologies are highly fragmented, rapidly evolving, and intensely competitive, and we expect these characteristics to continue and increase. Aggressive competition from both hardware and software products and technologies could lengthen the customer evaluation process and result in price reductions and loss of sales, which would materially harm our business. Our business is highly sensitive to the introduction of new products and technologies (such as virtualization), price changes, and marketing efforts by numerous and varied competitors. Accordingly, our future success will be highly dependent upon our timely completion and introduction of new products, technologies, and features at competitive prices and performance levels that address changing industry trends and the evolving needs of our customers. We continue to experience aggressive price competition and increased customer sensitivity to product prices, and pricing and margin pressures are likely to increase in the future. Because of this competition, we may have to continue to lower the prices of many of our products and technologies or offer greater functionality within our products without increasing prices to deliver greater value to customers to stay competitive, while at the same time trying to maintain or improve our revenue and gross margin. Because our business model is based on providing innovative and high quality products, we may spend a proportionately greater amount on research and development than some of our competitors. If we cannot proportionately decrease our cost structure on a timely basis in response to competitive price pressures and the loss of revenue, our gross and operating margins and profitability could be adversely affected. In addition, if our pricing, functionality, and other factors are not sufficiently competitive, or if there is an adverse reaction to our product decisions, we may lose market share in certain areas, which could adversely affect our revenue and prospects.

Table of Contents

We compete for sales of switching systems and extension products with companies such as Raritan Computer, Rose Electronics, Minicom Advanced Systems, Aten International, Belkin, Digi International, and Lantronix. These products also face competition from software providers (such as Microsoft, Computer Associates, Tivoli, Symantec, Novell, AMI, and BMC Software), who may be able to offer software products competitive with our hardware products at a much lower cost or even bundled for free with their other products, and from server manufacturers (including our OEM customers), who are able to offer their competitive technologies or products at the time of the server sale. These competitive software and hardware products address many of the problems our switching systems and technologies, extension products, and remote access products are designed to address.

We compete for sales of our systems management and security products with companies such as Microsoft, Computer Associates, BMC Software, Novell, and Symantec, many of whom have greater financial, technical, and marketing resources, a larger customer base, a longer operating history, greater name recognition, and more established relationships in the industry than we do, and may offer their own or third-party competitive software products at a lower cost or bundled for free with their other products. Microsoft, in particular, has delivered competitive products and announced its intention to continue to develop competitive software, and if it is successful in delivering software products that are competitive with our products, our ability to grow our software business may be limited.

Our current and potential competitors may be able to respond more quickly to new or emerging technologies or products and to changes in customer requirements or to devote greater resources to the research, development, promotion, sale, and support of their products and technologies than we do. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties that expand or enhance the ability of their products and technologies to address the needs of our current and prospective customers. Some of these competitors can also bundle hardware, software, and services together, and offer a more complete set of products and services than we are able to offer. We may not be able to compete successfully against current and future competitors and competitive pressure may materially harm our business, financial condition, operating results, and cash flows, or impair our ability to achieve our desired results.

Certain of our customers, such as Dell, Hewlett-Packard, IBM, Microsoft, and Symantec presently offer competitive hardware and/or software products and technologies that address many of the problems our products and technologies address. These customers could decide to manufacture or enhance their own switching, IPMI, or other embedded technologies, or systems management, security, and service desk products, or offer products or technologies supplied by competitors. Companies with hardware manufacturing experience or network management products, many of which are substantially larger than we are and have significantly more financial resources than we do, also offer products or technologies that compete with us. Established companies with hardware manufacturing or network management experience (such as Intel, Cisco, or EMC) could also offer new products, new technologies (such as virtualization), or new solutions that compete with, or reduce the demand for, our products and technologies.

There has been consolidation in the markets in which we compete, which we believe will continue and could lead to increased price competition and other forms of competition as companies attempt to maintain or extend their market positions in the rapidly changing IT industry. In addition, we may face competition in the future from large established companies or from emerging companies that have not previously entered the market or that do not currently have products that directly compete with our products. This could lead to more variability in our operating results for a variety of reasons including the lengthening of the customer evaluation process and/or the loss of business to these competitors, which may adversely affect our business, financial condition, and results of operations.

**Our gross margins are expected to vary and may decline.**

## Edgar Filing: AVOCENT CORP - Form 10-Q

Gross margins may vary or decline from period-to-period and may be adversely affected by a number of factors, including:

- The ratio of OEM sales to branded sales, since OEM sales typically have lower gross margins than branded sales;
- The ratio of sales through indirect channels to direct sales, since indirect sales typically have lower gross margins than direct sales;
- The ratio of sales in established markets to sales in new markets with different pricing and cost structures;
- Sales of lower margin products or other changes in our product mix, because sales of some of our products and technologies will have lower gross margins than sales of other products or technologies (e.g. our software products tend to have higher gross margins);
- Increased price competition;



Table of Contents

- Changes in product costs and sales discounts;
- Changes in raw materials, freight, regulatory, certification, import or export expenses, tariffs, and labor costs;
- Introduction of new products, services, business models, and technologies by us and by our competitors;
- The level of and costs for third-party technology and code used in our software products; and
- The level of and costs for outsourcing of our manufacturing and assembly services for our hardware products and the impact this can have on our inventory valuation of older products.

We expect that our gross margins may vary and may decline in the future primarily due to the factors listed above and to increased competition and the introduction of new products and technologies that may affect product prices and demand for our products.

**We have limited protection of proprietary rights and face risks of third-party infringements.**

Our future success depends in part upon our ability to develop and protect proprietary rights in our products and technologies. We seek to protect our intellectual property rights by invoking the benefits of the patent, trademark, copyright, trade secret, and unfair competition laws of the United States and other countries and the protections provided by confidentiality and nondisclosure agreements and other legal agreements. These laws and practices, however, afford only limited protection. There can be no assurance that the steps we have taken to protect our intellectual property rights, or that the steps we take in the future, will be adequate to prevent or detect misappropriation of our intellectual property or technologies or that our competitors will not independently develop proprietary or other technologies that are substantially equivalent or superior to our products or technologies. In addition, our proprietary information may be misused or improperly disclosed by third parties entrusted with this information. There also can be no assurance that our proprietary rights will not be challenged, invalidated, or avoided.

The U.S. Patent and Trademark Office has issued several patents to us for various aspects of our products. We have various corresponding patent applications pending under the provisions of the Patent Cooperation Treaty, which permits the filing of corresponding foreign patent applications in numerous foreign countries within a limited time period. We also have other United States and foreign patent applications pending. There can be no assurance that any additional patents will be issued from any of those pending applications or that any patents will be issued in any additional countries where our products can be sold. Claims allowed in our patents or in any pending patent applications may not be of sufficient scope or strength for, or provide meaningful protection or any commercial advantage to us or such claims may not be upheld if challenged. Also, competitors may develop their own intellectual property or technologies, obtain their own patents, or challenge the validity of, or be able to design around, our patents. The laws of certain foreign countries in which our products are or may be developed, manufactured, or sold (particularly certain countries in Asia) may not protect our products or intellectual property rights to the same extent as do the laws of the United States and thus increase the likelihood of piracy of our technologies and products.

We may initiate claims or litigation against other third parties for infringement of proprietary rights or to establish the validity of proprietary rights. Similarly, our competitors or other third parties may initiate claims or litigation against us alleging infringement of their proprietary rights or improper use of their intellectual property, and from time to time, third parties notify us that our products may infringe their intellectual property rights, which regardless of merit, requires our time and resources to evaluate and respond. Existing litigation, and any other litigation relating to intellectual property to which we become a party, is subject to numerous risks and uncertainties, including the risk of counterclaims or other litigation against us, and we may not be successful in any such litigation. Dealing with adverse claims and litigation is very expensive, and the existing litigation or any other litigation by or against us could result in significant additional expense, divert the efforts of technical and management personnel, whether or not such litigation results in a favorable determination, harm our relationships with existing customers, and deter future customers from purchasing or licensing our products. In the event of an adverse result in any such litigation, we could be required to pay substantial damages, suspend or cease the development, manufacture, use, marketing, and sale of any infringing products, expend significant resources to redesign products or develop non-infringing technology, discontinue the use of certain processes, or obtain licenses to the infringing technology. There can be no assurance that we would be successful in such development or that such licenses would be available on reasonable terms, or at all, and any such development or license could require us to expend substantial time and other resources. In the event that any third party makes a successful claim against us, or our customers, and a license is not made available on commercially reasonable terms, our business, financial condition, and results of operations could be adversely affected. In addition, any dispute involving our intellectual property could result in our customers, distributors, or resellers becoming involved in the litigation, which could trigger indemnification obligations in certain of our sales, license, or service agreements.

Table of Contents

The IT industry is characterized by vigorous pursuit and protection of intellectual property rights or positions, which has resulted in significant and often protracted and expensive litigation. We have in the past been, and we may from time to time in the future be, a party in litigation or other proceedings alleging infringement of intellectual property rights owned by third parties. If necessary or desirable, we may seek licenses under such intellectual property rights. However, licenses may not be offered on terms acceptable to us, or at all. The failure to obtain a license from a third party for technology used by us could cause us to incur substantial liabilities and to suspend or cease the manufacture of products requiring such technology. In addition, current or future competitors could obtain patents or other intellectual property rights that may prevent us from developing or selling our products. The result of these litigation matters is difficult to predict and an unfavorable resolution could affect our operating results, business, or financial condition. The resolution of litigation may have a negative impact on our operating results or financial condition.

**Our recent restructuring may disrupt our operations and adversely affect our operating and financial results.**

In fiscal July 2008, in January 2009, and again in July 2009, we announced a series of actions designed to enhance competitiveness, improve our efficiency, and reduce our cost structure. We initiated workforce reduction and consolidation actions designed to intensify our focus on our growth areas and improve our operating efficiency. The restructuring includes actions to increase our organizational efficiency, reduce certain research and development investments in lower growth product areas, integrate our marketing functions, and shift support for our Asian operations from Shannon, Ireland, to our recently-established regional hub in Singapore. We are also relocating certain functions from Redmond, Washington to Huntsville, Alabama. The impact of these organizational improvements will result in a decrease of approximately 330 positions or approximately 15% of our global workforce. In fiscal July 2008, we also announced that, as part of our continued focus on core markets, we intended to sell the portion of our entrepreneurial Connectivity and Control business unit dedicated to our Professional Audio Video and our Equinox serial products. In of the third quarter of 2009, we dissolved the remaining portions of our Connectivity and Control business and absorbed the Professional Audio Video products and serial products into Management Systems. The dissolution of this unit resulted in a net decrease of approximately 20 additional positions. The restructuring activities could create uncertainty and confusion among our employees, customers, and suppliers. In addition, the restructuring activities might not result in the cost savings or efficiencies we anticipate and may result in temporary operational inefficiencies. As a result, these restructuring activities could have a material adverse effect on our business, financial condition, and results of operations. The factors described above also could disrupt our product development, manufacturing, and sales, which would affect our financial results.

**We are likely to experience fluctuations in operating results.**

We have in the past experienced substantial fluctuations in revenue, bookings, and operating results, on a quarterly and an annual basis, and we expect these fluctuations will continue in the future. Our operating results will be affected by a number of factors, including, but not limited to:

- The volume, timing, pricing, and contractual terms of orders, particularly from OEMs, resellers, and other large customers, a significant portion of which tend to occur late in each quarter;
- The timing of shipments;

## Edgar Filing: AVOCENT CORP - Form 10-Q

- The unpredictable nature of the sales cycle for software products and the timing and completion of delivery of software products and any related services;
- The timing of new product introductions, new technologies, and enhancements by us and by our competitors, and the possibility that customers may defer purchases of our products in anticipation of these new products, new technologies, and enhancements;
- Changes in or our failure to accurately predict product or distribution and reseller channel mixes, including changes in the mix of software licenses in which revenue is recognized upfront as opposed to subscription licenses that are deferred over time and changes in the mix of revenue attributable to higher-margin products as opposed to lower-margin sales or services;
- Changes in demand for our products and services;
- Changes in pricing policies, price reductions, and channel programs;
- Changes in laws, regulations, or other government requirements;
- Changes in renewal rates for software upgrade protection or maintenance;

Table of Contents

- Competition from new products, technologies, business models, and price reductions by competitors;
- The availability and cost of supplies, components, or third-party code or content on commercially reasonable terms;
- Compatibility or interoperability of our products with third-party systems and applications;
- Sales and marketing expenses related to entering into new markets, introducing new products, new technologies, and retaining current OEMs, resellers, and other large customers;
- Fluctuations in sales of servers and personal computers due to changes in technology (such as virtualization), economic conditions, or capital spending levels;
- The amount and timing of operating expenses and capital expenditures relating to the expansion of our business and operations; and
- Costs associated with legal proceedings, including legal fees and any adverse judgments or settlements.

Our operating results will continue to be affected by seasonal trends, by general conditions in the IT market, and by general economic conditions. Depending on the severity and longevity of the current economic crisis, we may see fluctuations in our operating results. In addition, we have experienced, and we expect to continue to experience, seasonality due to customer buying cycles and delays in customer orders during unfavorable economic periods. We believe that the third and fourth quarters will generally have higher net sales levels due to customer budgeting and procurement cycles, which may depress net sales in other quarters. In addition, European sales are often weaker during the summer months. In the past, we have typically seen a sequential decline in revenue from the fourth quarter of a year to the first quarter of the following year, and while it is difficult to predict revenue in any quarter, we expect that this pattern will continue in the future. Many of the factors that create and affect seasonal trends are beyond our control.

Our quarterly sales have also reflected a pattern in which a disproportionate percentage of each quarter's total sales occur toward the end of the quarter, and this trend has become more pronounced in recent periods. Our increased focus on the software market continues this trend with a greater proportion of our software revenue coming from software license and subscriptions booked in the last weeks or days of each quarter. This uneven sales pattern makes prediction of revenue, earnings, and working capital for each financial period difficult, increases the risk of unanticipated variations in quarterly results and financial condition, and places pressure on our hardware inventory management and logistics systems. If predicted demand for hardware is substantially greater than orders, there will be excess inventory. Alternatively, if hardware orders substantially exceed predicted demand, we may not be able to fulfill all of the orders received in the last few weeks of each quarter. Other developments late in a quarter, such as a systems failure, component pricing movements, actions or announcements from our competitors, global logistics disruptions, or large sales opportunities not being completed when predicted, could adversely impact inventory levels and results of

## Edgar Filing: AVOCENT CORP - Form 10-Q

operations in a manner that is disproportionate to the number of days in the quarter affected. In addition, accounting requirements associated with satisfying the various elements necessary to recognize software revenue may result in significant fluctuations in our quarterly results.

In order to remain competitive and provide our increasingly sophisticated customers with more options, we have made and expect to continue to make new products and new software purchasing and licensing options available to our customers. These new products and options may result in an increase in contracts where software revenue is deferred or cash is received over time as opposed to recognition of revenue or payment at or about the time of the purchase or license.

We believe that quarter-to-quarter comparisons of our historical financial results are not meaningful indicators of our future operating results, and you should not rely on them as an indication of our future performance. If our quarterly operating results fail to meet the expectations of equity research analysts, the price of our common stock could be negatively affected.

**A large portion of our business consists of sales to a limited number of resellers and distributors that are not obligated to continue doing business with us, and these sales vary considerably from quarter to quarter.**

A large portion of our sales consists of sales of our branded products to a limited number of resellers and distributors. Sales to resellers and distributors represented approximately 60% of net sales in 2008, 61% of net sales in 2007, and 56% of net sales in 2006. The loss of significant revenue opportunities with these resellers and distributors could negatively impact our results of operations. In addition, many of these customers also have or distribute competing products. If resellers and distributors elect to increase the marketing of competing products or reduced marketing of our products, our ability to grow our business will be negatively impacted and will impair one of our substantial revenue sources.

Table of Contents

Our reseller and distributor business is subject to many risks, including:

- Concentration of business in a limited number of resellers and distributors could result in significant damage to our business upon the termination of a reseller relationship;
- Termination of reseller and distributor agreements or reduced or delayed orders;
- Difficulty in predicting sales to resellers and distributors who do not have long-term commitments to purchase from us, which requires us to maintain sufficient inventory levels to satisfy anticipated demand;
- Lack of visibility of end user customers and revenue recognition and channel inventory issues related to sales by resellers and distributors;
- Resellers and distributors electing to resell or increase their marketing of competing products or technologies or reduced marketing of our products; and
- Changes in corporate ownership, financial condition, credit worthiness, payment patterns, business direction, sales compensation related to our products, or product mix by the resellers and distributors.

Any of these risks could have a material adverse effect on our business, financial condition, and results of operations. We have experienced, and expect to continue to experience, pricing pressures and significant variability in orders from our resellers and distributors, which may in the future have a material adverse effect on our quarterly sales and operating results.

The loss of one or more large resellers or distributors could materially harm our business. While we have reseller and distributor agreements, none of our resellers or distributors are obligated to purchase products from us. Consequently, any reseller or distributor could cease doing business with us at any time. Our dependence upon a few resellers and distributors could result in a significant concentration of credit risk, thus a substantial portion of our trade receivables outstanding from time to time may be concentrated among a limited number of customers. In addition, the inability to accurately forecast the timing and volume of orders for sales of branded products to resellers and distributors during any given quarter could adversely affect operating results for such quarter and, potentially, for future periods. If we underestimate sales, we will not be able to fill orders on a timely basis. This could cause customer dissatisfaction and loss of future business. If we overestimate sales, we will experience increased costs from inventory storage, waste, and obsolescence.

**We will need to expand our sales distribution channels in order to develop our business and increase revenue.**

We expect to rely increasingly on distributors and resellers, VARs, and systems integrators for the distribution and sale of our branded hardware and software products. Our strategy contemplates the expansion of our distributor and reseller networks both domestically and internationally, particularly in Asia, and an increase in the number of customers licensing our products through these expanded channels. Our future success will depend in part on our ability to attract, train, and motivate new distributors and resellers and expand our sales distribution channels. We may not be successful in expanding our distributor and reseller relationships. We will be required to invest significant additional resources in order to expand these relationships, and the cost of this investment may exceed the margins generated from this investment. Conducting business through indirect sales channels presents a number of risks, including:

- Difficulties in replacing any lost or terminated distributors or resellers;
  
- Existing or new distributors and resellers may not be able to effectively sell our current or future products or services;
  
- Potential distributors and resellers deciding not to enter into relationships with us because of our existing relationships with other distributors and resellers with which they compete;
  
- Our ability to provide proper training and technical support to our distributors and resellers;
  
- The possibility of damage or impairment to our market position, brands or trademarks as a result of the actions of our distributors and resellers;
  
- Distributors and resellers electing to place greater emphasis on products or services offered by our competitors; and
  
- The lack of direct control over the business practices, marketing, sales and services offered by distributors and resellers.



Table of Contents

As we expand our distribution and reseller channels, we will also need to expand our sales organization and invest substantial resources toward this expansion. We may experience difficulty in recruiting, training, and retaining qualified sales personnel, and any failure to obtain, train, and keep qualified personnel could limit our ability to sell products.

In addition, distributors and resellers of our hardware products often have rights of return, and in the future, these returns from our existing or any new distributors and resellers may have a material adverse effect on our business, financial condition, and results of operations. Our agreements with our current distributors and resellers are generally nonexclusive and may be terminated on short notice by either party without cause, and any new distributor or reseller agreements are likely to contain similar provisions. Distributors and resellers are not obligated to purchase products from us and frequently offer products from several different companies, including competitors' products, and distributors and resellers may give higher priority to the sale of our competitors' products. A reduction in sales efforts or efficiency by our distributors or resellers could lead to a reduction in our sales and could materially adversely affect our business, financial condition, and results of operations.

**A large portion of our business consists of sales to a limited number of OEM customers that are not obligated to continue doing business with us, and these sales vary considerably from quarter to quarter.**

A large portion of our sales is concentrated among a limited number of OEM customers. Aggregate sales to these OEMs represented approximately 33% of our net sales in 2008, 35% of net sales in 2007, and 40% of net sales in 2006. The following table identifies our customers that exceeded 10% of our net sales for the years 2008, 2007, and 2006:

	Percentage of Net Sales for the Year Ended		
	December 31, 2008	December 31, 2007	December 31, 2006
Dell	11%	13%	14%
Hewlett-Packard	<10%	12%	14%
Ingram Micro	13%	<10%	<10%
Tech Data	<10%	11%	12%

We have experienced, and we expect to continue to experience, period-to-period variability in sales to these OEM customers. Any cancellation, rescheduling, or reduction of orders by OEM customers in the future could materially adversely affect our operating results. Although our OEM customers typically place orders for products up to several months prior to scheduled shipment dates, these orders are subject to cancellation.

Our OEM business is subject to many risks, including:

- Contract termination or reduced or delayed orders;
- Short order cycles and difficulty in predicting sales because our OEM customers do not have long-term commitments to purchase from us;

- Changes in the OEMs' internal product life cycles including the delay of planned new product introductions and uncertainty over product end-of-life decisions;
- Adoption of competing products or technologies developed by third parties for the OEMs, acquisition or internal development of competing products or technologies by the OEMs, or changes in the OEMs' marketing of competing products or reduced marketing of our products; and
- Changes in corporate ownership, financial condition, credit worthiness, payment patterns, business direction, sales compensation related to our products, or product mix by the OEMs.

Any of these risks could have a material adverse effect on our business, financial condition, and results of operations. We have experienced, and expect to continue to experience, pricing pressures and significant variability in orders from our OEM customers, which may in the future have a material adverse effect on our quarterly sales and operating results.

Although we are not substantially dependent on any one OEM customer, the loss of one or more large OEM customers would materially harm our business. While we have agreements with some of our OEM customers, these agreements are generally cancellable at the will of the OEM (generally subject to notice provisions), and none of our OEM customers is obligated to purchase products from us except pursuant to binding purchase orders or licensing agreements. Consequently, any OEM customer could cease doing business with us at any time. Our volume of sales from just a few OEMs also results in a significant concentration of credit risk, thus a large portion of our trade receivables outstanding from time to time may be concentrated among a limited number of customers. In addition, OEM customers have longer payment cycles that increase the likelihood of aged or problem accounts receivable.

Table of Contents

We use multiple warehouses for many of our OEM customers to fulfill their hardware orders under a just-in-time inventory management system, which requires us to maintain sufficient inventory levels of our hardware products at each of these warehouses to satisfy anticipated demand from our OEM customers, and we generally recognize revenue only when these OEM customers take possession of our hardware products. We are required to plan production, order components, and undertake our manufacturing activities prior to the time that these orders become firm or the products are accepted. In addition, our OEM customers have requested, and are likely to continue to request from time to time, that we delay shipment dates or cancel orders for hardware products that are subject to firm orders. As a result, at any time we may be holding a significant amount of OEM-branded hardware products in inventory, and our sales to OEMs for future quarters are difficult to predict. The inability to accurately predict the timing and volume of hardware orders for our OEM customers during any given quarter could adversely affect operating results for that quarter and, potentially, for future quarters. If we underestimate sales, we may not be able to fill orders on a timely basis. This could cause customer dissatisfaction and loss of future business. If we overestimate sales, we may experience increased costs from inventory storage, waste, and obsolescence.

**Our failure to respond to rapid technological change or to introduce successful new products and technologies may result in reduced revenue or revenue growth.**

The process of developing or acquiring new products, software, and technologies and enhancing existing products, software, and technologies is complex, costly, and uncertain, and any failure by us to anticipate customers' changing needs and emerging technological trends accurately could significantly harm our market share and results of operations. Our products and technologies are characterized by rapid technological advances, frequent new product and technological introductions and enhancements, and significant price competition. If we do not keep pace with these changes, we will lose customers, and our business will be adversely affected. The introduction of products or technologies incorporating superior alternatives such as switching software, the emergence of new industry standards such as virtualization, or changes in pricing structure could render our existing products and technologies and those we have under development obsolete or unmarketable. New technologies offered by us or our competitors could compete with our existing products at a lower price, which could reduce our revenue.

Our future success will depend in large part upon continued innovative application of commercially available components and software or technologies, continued enhancements to our proprietary hardware, software, firmware, and other technologies, the expansion and enhancement of existing products and technologies, and our development and introduction of new products and technologies that address changing industry trends (including virtualization) and customer needs on a cost-effective and timely basis. If we fail to respond on a timely basis to technological developments, changes in industry standards, customer requirements, competitive products, product localization, or software innovations, we will lose customers, and our business will be greatly harmed. Similar results could occur if we experience significant delays in the development or introduction of new products or technologies.

**We are dependent upon third-party suppliers and outsourced manufacturing for our hardware products. Disruption of our access to these supplies and services, or problems with the quality of supplies or services, could prevent us from filling customer orders and harm our business.**

The principal components of our hardware products are electronic components, power supplies, semiconductors, memory, cable assemblies, line filters, enclosures, and printed circuit boards, all of which are purchased from outside vendors. We generally buy components under purchase orders and generally do not have long-term agreements with our suppliers. Also, we generally do not maintain large inventories of components. Any termination of, or significant disruption of, our relationships with the suppliers of our product components may prevent us from filling customer orders in a timely manner which could result in customer dissatisfaction and lost sales.

## Edgar Filing: AVOCENT CORP - Form 10-Q

We have occasionally experienced, and we may in the future experience, shortages or delays in delivery of components. Although alternate suppliers are available for most of the components and services needed to produce our products, the number of suppliers of some components is limited, and qualifying a replacement supplier and receiving components from alternate suppliers could take several months.

We have limited ability to control quality issues (particularly with respect to faulty components manufactured by third parties), and we depend upon suppliers to deliver components that are free from defects, competitive in functionality and cost, and in compliance with specifications and delivery schedules. Disruption in supply, a significant increase in the cost of one or more components, failure of a third-party supplier to remain competitive in functionality or price, or the failure of a supplier to comply with any of our procurement needs could delay or interrupt our ability to manufacture and deliver our products to customers on a timely basis, thereby delaying our revenue recognition and adversely affecting our business, financial condition, and results of operations.

Table of Contents

We rely on third-party manufacturers for subassembly of products and for final assembly, quality assurance, and testing of many of our products. These outsourcing arrangements and any future outsourcing arrangements involve numerous risks, including the economic and financial viability of these manufacturers, reduced control over product quality, delivery schedules, manufacturing yields, and costs. Moreover, although arrangements with such manufacturers may contain provisions for warranty obligations on the part of such manufacturers, we are primarily responsible to our customers for warranty obligations.

**Our hardware products are subject to warranty claims and returns. Increased warranty claims or returns could harm our business.**

We typically offer a 30-day unconditional money-back guarantee on our appliance products sold in North America. We also offer warranties for parts and service on our hardware products, ranging from one to three years (and, in the case of some of our Equinox branded products, five years). Although our historical return experience has not been significant, our returns may increase in the future. An increase in returns would have an adverse effect on our sales and could negatively affect our financial results.

For our software products, sales are final and we do not generally allow any returns. We provide a 90-day limited warranty on the media used to deliver the software, which is not applicable to electronic downloads, and we generally provide a 90-day limited warranty (except where a longer period is required by law) that our products will function in accordance with the user documentation.

In the future, we may, as a result of competitive pressures, requirements in certain geographies, or customer demands, change our warranty policies or our warranty terms to provide coverage that is greater in scope and duration than the coverage we currently offer. If we were to increase our warranty coverage, our risk of warranty claims, and therefore our warranty expense and reserves, would likely increase.

**If we are unable to successfully develop our international distribution and reseller networks and international sales efforts, results of operations may suffer.**

We are working to develop, integrate, and expand our international distribution and reseller networks in an effort to increase international sales and availability of our products. We may not be successful in developing or expanding the international distribution and reseller network or in marketing and selling products in foreign markets, particularly Asia. If the revenue generated by our international sales is not adequate to recover the expense of establishing, expanding, and maintaining an international distribution and reseller network, our business, financial condition, and results of operations could be materially adversely affected. If international sales become a more significant component of net sales, our business could become more vulnerable to the risks inherent in doing business on an international level, including:

- Difficulties in managing foreign distributors and resellers;
- Longer payment cycles and problems in collecting accounts receivable;

## Edgar Filing: AVOCENT CORP - Form 10-Q

- The effects of seasonal customer demand;
- Differing license terms and conditions to meet local requirements;
- Changes in regulatory requirements;
- Difficulties in meeting the requirements of different international product regulations, including import and export requirements, tariffs, and other trade barriers;
- Risks relating to the protection of our intellectual property rights;
- The impact on our marketing expenses and our research and development resources as we localize our product offerings to meet local user requirements such as language translations and hardware compatibility issues;
- Fluctuations in currency exchange rates; and
- Potentially adverse tax consequences and political instability.

The existence or occurrence of any one or more of these factors could have a material adverse effect on our business, financial condition, and results of operations.

Table of Contents

**Due to the international nature of our business, political or economic changes or other factors could harm our future revenue, increase our costs and expenses, and impair our financial condition.**

We are a global company with sales, manufacturing, and research and development efforts around the world. Sales outside the United States generate approximately half of our revenue, over half of our manufacturing takes place outside the United States, and we have research and development centers in several locations outside the United States. Accordingly, our business, operating results, future revenue, gross margin, expenses, and financial condition could suffer due to a variety of international factors, including:

- Ongoing instability or changes in a country's or region's economic or political conditions, including inflation, recession, interest rate fluctuations, and actual or anticipated military or political conflicts, particularly in areas where we have offices or other facilities;
- Currency fluctuations, which could contribute to variations in sales of products and technologies and could also affect our reported results expressed in U.S. dollars;
- Longer accounts receivable cycles and financial instability among customers;
- Tax or trade regulations, tariffs, duties, and procedures and actions affecting production, pricing, and marketing of or payments for products;
- Local labor conditions and other regulations;
- Differing technology standards or customer requirements;
- Limited or unfavorable intellectual property protection in certain foreign countries including the loss of proprietary information due to piracy or misappropriation;
- Fluctuations in freight costs and disruptions at important geographic points of exit and entry;
- Natural or manmade disasters, such as earthquakes, tsunamis, flooding, hurricanes, typhoons, fires, power shortages, blackouts, telecommunications failures, terrorism, or computer viruses;

## Edgar Filing: AVOCENT CORP - Form 10-Q

- Medical epidemics;
- Seasonal reductions in business activity in certain foreign countries, such as the summer months in Europe;
- Compliance with a wide variety of complex laws, treaties, and regulations that increase the risks of doing business in certain foreign countries;
- Restrictions against repatriation of earnings from our international operations;
- Difficulties in staffing and managing international operations, including the difficulty in managing a geographically dispersed workforce;
- Possible non-compliance with our Code of Conduct or other corporate policies due to inconsistent laws, interpretations, and/or application of corporate standards in foreign countries;
- Increased financial accounting and reporting burdens and complexities; and
- The need to localize our products.

The factors described above also could disrupt our product development and manufacturing, key suppliers, and OEMs and resellers located outside of the United States. For example, we rely on manufacturers in Asia and Europe for the assembly and manufacture of many of our hardware products, and we conduct substantial software development and testing operations in China and Taiwan. Accordingly, we are directly affected by economic, political, and military conditions in the regions where we have operations, including China and Taiwan. In particular, any interruption or curtailment of trade between China and its present trading partners could materially adversely affect our product development, product releases, support, business, operating results, and financial condition.



Table of Contents

Continued or increased international political instability, evidenced by the threat or occurrence of terrorist attacks, enhanced national security measures in the United States or other countries, sustained military action or other conflicts, or strained international relations may impair our ability to do business, increase our costs and adversely affect our stock price. Increased international instability may negatively impact our ability to obtain adequate insurance at reasonable rates or require us to take extra security precautions for our domestic and international operations.

**Fluctuations in the value of foreign currencies could result in currency exchange losses.**

Currently, a majority of our international business is conducted in U.S. dollars. As we expand our international operations, however, it is likely that international business will increasingly be conducted in foreign currencies. Fluctuations in the value of foreign currencies relative to the U.S. dollar have caused, and are expected to increasingly cause, currency transaction gains and losses. In addition, currency fluctuations could also affect foreign denominated investment values and reported results expressed in U.S. dollars. While we attempt to hedge some foreign currency exposure, we cannot effectively hedge all exposures, nor predict the effect of exchange rate fluctuations upon future operating results, and we may experience currency losses in the future.

**The sales cycle for our software products is unpredictable, making it difficult to forecast operating results for any given period.**

The sales cycle for our software products is typically ninety to one hundred eighty days or longer. This sales cycle is subject to a number of significant risks over which we have little or no control, including:

- Customers' budgetary constraints, fluctuations, or uncertainty, internal acceptance requirements, and procurement procedures;
- The actions or announcements of our competitors and their products;
- Customer concerns about the future or performance of our company; and
- Changes in economic conditions generally, in the technology market specifically, and in a customer's particular industry.

Moreover, our software license revenue is heavily weighted toward the end of each quarter, with as much as ninety percent of LANDesk's license revenue recorded in the third month of a quarter, making it difficult to forecast operating results for any quarter or give accurate guidance. For large opportunities, especially for enterprise-wide sales, the sales cycle is often significantly longer than our average sales cycle. In addition, these large opportunities are more difficult to forecast, and if we do not correctly forecast the timing in a given period, the amount of revenue we recognize in a period could be higher or lower than we expect, which could significantly affect our operating results for the then current period.

and future periods over which revenue would have been recognized. The terms and conditions of the legal agreements for these large opportunities are often based on our customers' purchase agreements and may contain terms that are generally less favorable to us than our standard terms and conditions. As a result, revenue recognition may be delayed or otherwise negatively affected, and if we fail to meet expectations, the price of our common stock could be negatively affected.

**A significant percentage of our software revenue is dependent on sales to existing customers or the renewal of annual software upgrade protection or maintenance services by existing customers.**

Our LANDesk business unit has historically derived, and plans to continue to derive, a significant portion of our total software revenue from existing customers who purchase additional products or annual maintenance or upgrade protection. As we introduce new software products, our current customers may not require or desire the functionality of our new products and may choose not to license these new products or renew their agreements for maintenance or upgrade protection. If our current customers do not purchase additional products, increase the numbers of our products already in use, or renew annual software upgrade protection or maintenance services, our ability to increase or maintain revenue levels could be limited to only new customers.

Maintenance revenue related to the licensing of our software products is a significant part of our current and future operating revenue. In general, maintenance fees increase with increased use of our software because we receive higher maintenance fees when we enter into new license agreements with new customers and when existing customers license our products for use on additional systems. Due to increased discounting for larger sales opportunities, maintenance fees on a per unit basis for such large deals can be

Table of Contents

lower than average. In addition, customers are generally provided annual maintenance discounts for entering into long-term maintenance agreements. Declines in our license bookings, increases in long-term maintenance agreements, customers electing to migrate to competitive products or other alternatives to our products, and/or increased discounting could lead to reduced software maintenance revenue and reduced gross margins.

**Our software products are designed with interoperability or compatibility with many third-party platforms, systems, and applications, the absence of which may harm our business.**

Our software products are designed for use with specific third-party platforms, systems, and applications. We believe the breadth of our integration with such platforms, systems, and applications is a significant competitive advantage. Any significant change in these third-party products could result in the loss of interoperability or compatibility with our products, making our products less attractive, increasing our research and development costs in order to modify our products, license new solutions, or develop new products, and potentially harming our future revenue. Our failure to anticipate, manage and adapt to these risks could result in significant delays in our product releases, changes in our product roadmaps, loss of current customers for whom the lost compatibility is an issue, and damage to our operating results.

**Our software products include licensed third-party content or code upon which we rely for the interoperability, integration, development, or updates of our products, and disruption of our access to such code or content could delay product releases, inhibit our compatibility with third-party products, and harm our business.**

The principal components of our software products are proprietary code and content. We do, however, rely on some licensed third-party code, content, or other intellectual property, and we expect to use such third-party code, content, or intellectual property in future products. Although we believe that there are usually adequate alternative sources for the third-party technology licensed to us, any significant interruption in the availability of these third-party software products on commercially acceptable terms or any defects in these products could delay development of future products or enhancement of our future products and harm our revenue. Use of such third-party code, content, or other intellectual property presents risks such as:

- Owners or licensees of third-party systems could adopt more restrictive policies or impose unfavorable or unacceptable terms and conditions for access to their products making it more difficult for us to make our products compatible with their products and resulting in higher research and development costs for us for the enhancement or modification of our existing products and the development of new products;
- Functionality provided by third-party code, content, or other intellectual property in our products may become obsolete, defective, or incompatible with future versions of our products, may not be adequately maintained or updated, and we may be unable to find viable alternatives or develop our own proprietary solution;
- Quality, warranty, and support terms vary dramatically when licensing third-party code, content, or other intellectual property and we have limited ability to control quality issues with third-party code, content, or other intellectual property and we must depend on our own research and development personnel to evaluate and select third-party code, content, or other intellectual property that we believe is of the most value to our customers; and

- Technical difficulties in integrating our products and third-party code, content, or other intellectual property to create a combined solution, and the risk that customers will not perceive the need for such integrated solutions.

Any significant termination of a third-party license, change in third-party license provisions, increase in the cost of such third-party code, content or other intellectual property, failure of a code, content or other intellectual property provider to remain competitive in functionality, or defect in or a quality issue could delay or interrupt our ability to develop and deliver software products to customers on a timely basis. This could delay our revenue recognition and adversely affect our business, financial condition, and results of operations and possibly expose us to claims under license agreements with our customers and possibly increased litigation fees and expenses. Our failure to anticipate, manage, and adapt to these risks could result in significant delays in our products releases, changes in our product roadmaps, and damage to our operating results.

**Software errors or bugs, and possible product liability claims related to such errors or bugs, could result in increased costs, damage to our reputation, and loss of market share.**

Our software products are generally large and intricate programs. As a result, our current software products, updates, upgrades, or future products may contain errors, failures, or bugs, some of which may not become known until after the product has been released by us for use by customers. While we routinely test our products for such errors and identify and correct bugs through our customer support group, these problems are inevitable. Any significant errors may result in, among other things, loss of, or delay

Table of Contents

in, the market acceptance of our products, lost revenue and sales of our products, reallocation of, or increases in, development and customer support resources, impairment to our reputation, loss of future renewal or maintenance revenue, and increased service and warranty costs. Errors could also result in significant delays in the release of updates, upgrades, or new products while such errors are corrected. Moreover, because our products primarily support other systems and applications, any software errors or bugs in these other systems or applications may affect the performance of our software, and it may be difficult or impossible to determine where the errors reside. As a result, product errors, failures, or bugs could result in significant harm to our business and have a material adverse effect on our results of operations.

We may be subject to legal actions or claims for damages related to product errors which could, whether or not successful, increase costs and distract our management and our development and support teams and could harm our business, result in unexpected expenses and damage our reputation. Our license agreements with our customers typically contain provisions designed to limit exposure to potential product liability claims, and, to the extent permitted by governing law, our standard agreements in many jurisdictions also provide that we will not be liable for indirect or consequential damages caused by the failure of our products. In certain jurisdictions, however, warranty and limitation of liability provisions are not effective.

**Use of free or open source software or technology in our products or in the development of our products may reduce our ability to control the quality and support for products and may result in damage to our operating results.**

Free or open source software is software that is made widely available by its authors or other third parties and is often licensed on an as is basis for a nominal fee or, in some cases, at no charge. We have incorporated some free and open source software into our products, allowing us to enhance certain solutions without incurring substantial additional research and development costs. In addition, we may use free or open source tools in the development of our products. While we have not experienced any material problems as a result of our use of free or open source software, use of free or open source software entails significant risks including:

- Free or open source software or technology becoming competitive with our proprietary technology, which could cause sales of our products to decline or force us to reduce the fees we charge for our products, which could have a material adverse impact on our revenue and operating margins;
- Requiring that we make available the source code for any modifications or derivative works we make to or from the free or open source software, and that we license or contribute such modifications or derivative works under the terms of a particular free or open source license or other license granting third parties certain rights of further use;
- Our proprietary software could be combined with open source software in such a way that we would be required to release the source code of our proprietary software; and
- The lack of any warranty, maintenance, or support for most open source software or technology.

## Edgar Filing: AVOCENT CORP - Form 10-Q

We have established processes to help minimize these risks to the extent within our control, including a review process for screening requests from our development organizations for the use of free or open source, but we cannot be sure that all free or open source software, technology, or tools are submitted for approval prior to use in our products or in the development of our products or that all use is in compliance with our corporate policies. These risks, if not eliminated, could negatively affect our ability to sell and license our products and could materially impact our business.

**Executive officers and other key personnel may depart, which could adversely affect our results of operations and harm our ability to grow the business.**

We are greatly dependent on the ability to retain key management, sales, and technical personnel, and our future success is highly dependent upon the personal efforts of our management, sales, and technical personnel and other key employees. Our Executive Vice President in charge of our Management Systems business unit departed in February 2009 and our Executive Vice President in charge of marketing departed in March 2009. Their loss or the loss of services of other key personnel could have a material adverse effect on our business, financial condition, and results of operations. We have attempted to mitigate these risks by offering key employees retention bonuses (payable only if they continue employment with us for specified periods) and equity awards that vest over time, but there is the risk that we could nevertheless lose key management, sales, and technical employees.

We have historically used stock options and are currently using an Employee Stock Purchase Plan and restricted stock units, including time-based, performance-based, and market conditioned-based shares, as a key component in our executive and employee compensation programs in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. Many of our employee stock options are fully vested, but most of these outstanding and

Table of Contents

vested options are currently underwater. This could affect our ability to retain present employees. In addition, we are now required to record a charge to earnings for employee stock option grants and other equity incentives. Moreover, applicable stock exchange listing standards relating to obtaining stockholder approval of equity compensation plans could make it more difficult or expensive for us to make equity awards to employees in the future. As a result, we may incur increased compensation costs, change our equity compensation strategy, or find it difficult to attract, retain, and motivate employees, any of which could materially adversely affect our business.

As we expand our international operations, we will be required to recruit and retain experienced management, sales and technical personnel in our international offices, and we expect that the identification, recruitment, training and retention of such personnel will require significant management time and effort and resources. Competition for employees with the skills required, particularly management, engineering and other technical personnel, is intense, and there can be no assurance that we will be able to attract and retain highly skilled employees in sufficient numbers to sustain our current business or to support future growth. We may need to pay recruiting or agency fees and offer additional compensation or incentives to attract and retain these and other employees, resulting in an increase to our operating expenses.

In addition, for the last several years, we have acquired several companies and these acquisitions have resulted in increased responsibilities and placed significant strain on our managerial, operational, and financial resources and resulted in new and increased responsibilities for management personnel. There can be no assurance that our management, personnel, systems, procedures, and controls are, or will be, adequate to support our existing and future operations or that we will continue to grow. If we fail to recruit and retain sufficient and qualified managerial, operational, or financial personnel or to implement or maintain internal systems that enable us to effectively manage our growing business and operations worldwide, our financial results in any given period may be adversely affected and our business and financial condition could be materially harmed.

**Terms and availability of credit could adversely affect us and our operations.**

In the second quarter of 2006, we obtained a \$250 million unsecured, five-year, revolving, bank line of credit, and we used borrowings under this line of credit to fund a portion of the LANDesk acquisition and the purchase of our shares under our recently-expanded stock repurchase program. In July 2008, we amended the line of credit and borrowed an additional \$90 million under a three-year term note. We may increase this bank debt or seek other bank debt in the future. The balance outstanding on our debt agreements was \$125 million as of September 30, 2009. Interest expense on borrowings under the term loan and additional future borrowings under the line of credit could adversely affect our future net income, margins, expenses, and financial conditions by:

- Requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, which would reduce the availability of our cash flow to fund internal growth through working capital and capital expenditures and for other general corporate purposes;
  
- Increasing our vulnerability to economic downturns in our industry;
  
- Increasing our vulnerability to interest rate increases to the extent any of our variable rate debt is not hedged;

## Edgar Filing: AVOCENT CORP - Form 10-Q

- Placing us at a competitive disadvantage compared to our competitors that have less debt in relation to cash flow;
- Limiting our flexibility in planning for or reacting to changes in our business and our industry;
- Limiting, among other things, our ability to borrow additional funds, refinance the line of credit, or obtain other financing capacity; and
- Subjecting us to a risk of noncompliance with financial and other restrictive covenants in our indebtedness.

The line of credit and term loan contain affirmative and negative covenants, including limitations on our ability to (i) make distributions, investments, and other payments unless we satisfy certain financial tests or other criteria, (ii) incur additional indebtedness, (iii) restructure our subsidiaries, and (iv) make acquisitions and capital expenditures. All of these restrictions could affect our ability to operate our business and may limit our ability to take advantage of potential business opportunities as they arise. The failure to comply with these covenants could result in an event of default which, if not cured or waived, could have a material adverse effect on us.



Table of Contents

Our ability to comply with these provisions of our line of credit and term loan may be affected by changes in the economic or business conditions or other events beyond our control. If we do not comply with these covenants and restrictions, we could be in default under our line of credit and/or the term loan, and our debt, together with accrued interest, could then be declared immediately due and payable. There can be no assurance that we will be able to obtain sufficient funds to enable us to repay or refinance our debt obligations on commercially reasonable terms or at all. We also face interest rate risk on our bank line of credit and term loan which currently bears interest at a variable rate of LIBOR plus 150 basis points. We have hedged this exposure to interest rate risk with interest rate swaps, which have a remaining aggregate notional amount of \$110 million, with Regions Bank and SunTrust Bank.

**Unanticipated changes in our tax rates or exposure to additional income tax liabilities could affect our profitability.**

We are subject to income taxes in both the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in different jurisdictions. Our effective tax rates could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, in the valuation of deferred tax assets and liabilities, in tax laws and treaties, or by material audit assessments, which could affect our profitability. In addition, the amount of income taxes we pay is subject to audit in various jurisdictions, and a material assessment by a governing tax authority could affect our profitability.

**Failure to maintain adequate internal systems and effective internal controls over our financial reporting and information systems could result in our management and auditors being unable to certify the effectiveness of our internal controls over financial reporting and information systems, which could harm our business reputation and cause our stock price to decline.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we implement and maintain adequate internal systems and effective internal controls over financial reporting and information systems. The absence of such controls could have a material adverse effect on our business, financial condition, and results of operations. In addition, correction of any significant deficiencies or material weaknesses (as defined under PCAOB guidelines) could require additional remedial measures including hiring additional personnel, which could be costly and time-consuming. If a significant deficiency or material weakness exists at any year-end (including a material weakness identified prior to year-end for which there is an insufficient period of time to evaluate and confirm the effectiveness of the corrections or related new procedures), our management and our auditors will be unable to report favorably as to the effectiveness of our control over financial reporting or information systems. This could result in a loss of investor confidence in the accuracy and completeness of our financial reports and our management, which could result in a decline of our stock price, damage to our business reputation, and potential litigation.

**Provisions in our charter documents and in Delaware law may discourage potential acquisition bids for us and may prevent changes in management that stockholders may favor.**

Provisions in our charter documents could discourage potential acquisition proposals and could delay or prevent a change in control transaction that stockholders may favor. These provisions could have the effect of discouraging others from making tender offers for shares, and as a result, these provisions may prevent the market price of our common stock from reflecting the effects of actual or rumored takeover attempts and may prevent stockholders from reselling their shares at or above the price at which they purchased their shares. These provisions may also prevent changes in management that stockholders may favor. Our charter documents do not permit stockholders to act by written consent, limit the ability of stockholders to call a stockholders meeting, and provide for a classified Board of Directors, which means stockholders can only elect, or remove, a limited number of directors in any given year. Furthermore, our Board of Directors has the authority to issue up to five million shares of preferred stock in one or more series. The Board of Directors can fix the price, rights, preferences, privileges, and restrictions of such preferred stock without any further vote or action by our stockholders. The issuance of shares of preferred stock may delay or prevent a change

in control transaction without further action by our stockholders.

In addition, Delaware law may inhibit potential acquisition bids for us. Delaware law prevents certain Delaware corporations, including Avocent, from engaging, under certain circumstances, in a business combination with any interested stockholder for three years following the date that such stockholder became an interested stockholder.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

In the fourth quarter of 2004 our Board of Directors approved a stock repurchase program whereby we may, from time to time, purchase our common stock in the open market, in privately negotiated transactions or otherwise, at prices that we deem appropriate. Since the program's initial approval through September 30, 2009, our Board has authorized a total of 19 million shares to be repurchased. The plan has no expiration date. Details of purchases under the plan during the nine months ended September 30, 2009 are as follows:

Table of Contents

Period:	Total Number of Shares Purchased During the Period	Average Price Paid Per Share for Period Presented	Total Cumulative Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares Remaining to Purchase Under the Plan
January 1, 2009 - January 31, 2009	50,000	\$ 14.60	16,950,000	2,050,000
February 1, 2009 - February 28, 2009	675,000	\$ 12.51	17,625,000	1,375,000
March 1, 2009 - March 31, 2009	275,000	\$ 11.26	17,900,000	1,100,000
Quarter ended March 31, 2009	1,000,000	\$ 12.27		
Quarter ended June 30, 2009			17,900,000	1,100,000
July 1, 2009 - July 31, 2009	100,000	\$ 15.91	18,000,000	1,000,000
August 1, 2009 - August 31, 2009	50,000	\$ 15.63	18,050,000	950,000
September 1, 2009 - September 30, 2009	50,000	\$ 16.59	18,100,000	900,000
Quarter ended September 30, 2009	200,000	\$ 16.01		
Nine months ended September 30, 2009	1,200,000	\$ 12.89		

Approximately 274,000 shares were withheld as payment for employee payroll withholding taxes at the release of vested restricted stock units in the first nine months of 2009 (see Note 3 to our condensed consolidated financial statements contained in Part I, Item 1 of this quarterly report). The 274,000 shares were considered to be treasury shares; however, these treasury shares were immediately retired and are not considered in the table above.

**Item 6. Exhibits.**

## (a) Exhibits

- 2.1 Agreement and Plan of Merger among Avocent Corporation, Emerson Electric Co., and Globe Acquisition Corporation dated as of October 5, 2009 (incorporated by reference to Exhibit 2.1 to the Company's report on Form 8-K filed with the SEC on October 7, 2009)
- 31.1 Sarbanes-Oxley Act of 2002 Section 302(a) Certification of the Chief Executive Officer
- 31.2 Sarbanes-Oxley Act of 2002 Section 302(a) Certification of the Chief Financial Officer
- 32.1 Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

ITEMS 3, 4 AND 5 ARE NOT APPLICABLE AND HAVE BEEN OMITTED.



**SIGNATURE**

SIGNATURE

Edgar Filing: AVOCENT CORP - Form 10-Q

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

AVOCENT CORPORATION  
(Registrant)

Date: November 4, 2009

/s/ Edward H. Blankenship  
Edward H. Blankenship  
Senior Vice President of Finance, Chief Financial  
Officer, and Assistant Secretary (Principal Financial Officer)