



**BEACON
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RESEARCH**

Sonic Foundry, Inc.
NasdaqNM: SOFO

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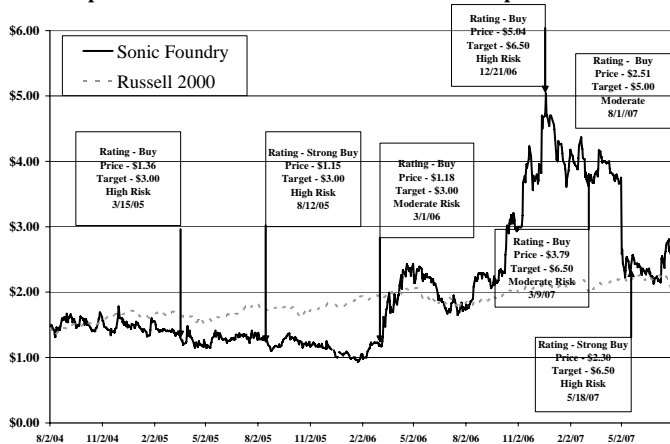
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5956 N.W. 213th Place, Portland, Oregon 97229

Price	\$2.46	Shares (mils)	35.5
P/E Ratio (ttm)	NA	Market Cap (mils)	\$89.1
P/S Ratio (ttm)	5.34 X	52 Week Range	\$5.15 - \$2.02
Sales/share (ttm)	\$0.47	Ave. Daily Vol.	228,603
Price/Book	4.92 X	Short Interest	174,502
Book Value	\$0.51	Gross Margin	73.9%
Cash/share	\$0.24	Oper. Margin	-35.4%
Quick Ratio	2.31	Insider Ownership	30.1%
Debt to cap ratio	6.17 %	Inst'l Ownership	17.6%

Disclosures 1,2,3,4

Price Target	\$5.00
Rating	Buy
Risk	Moderate



Sonic Foundry, Inc. (NasdaqNM: SOFO) is a technology leader providing solutions for the growing rich media (audio, video, and graphics) communications marketplace. The Company provides an elegant means for capturing and viewing rich media over the Internet. The Company has demonstrated its leadership position by a high level of repeat sales to existing customers and widespread acceptance among the largest higher education, corporate, and government institutions. Sonic Foundry has consistently improved its product, driven by a focus to meet the changing needs of its customers.

- Revenues of \$4.7 million in 3Q07, up 31% over 3Q06.
- Pipeline of approximately \$50 million, double last year.
- Company experiences strong sales to higher education.

Sonic Foundry met our expectations for the recent quarter, the first of two of its seasonally strongest quarters. The company continues to benefit by regular recognition of increasing levels of deferred revenue. We are reducing our 12-month price target to **\$5.00** per share and rating to **Buy**, and upgrading our risk assessment to **Moderate** considering strong financial performance anticipated for its strongest seasonal period and potential to exceed analyst expectations.

Earnings Per Share					
	Q1: Dec	Q2: Mar	Q3: Jun	Q4: Sep	Annual*
2008E	\$ (0.04)	\$ (0.04)	\$ (0.03)	\$ (0.01)	\$ (0.12)
2007A	\$ (0.04)	\$ (0.05)	\$ (0.04)	\$ (0.03)	\$ (0.16)
2006A	\$ (0.05)	\$ (0.03)	\$ (0.02)	\$ (0.01)	\$ (0.11)
2005A	\$ (0.05)	\$ (0.03)	\$ (0.03)	\$ (0.02)	\$ (0.13)

* numbers may not add up due to rounding

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Platform in Place to Support Growth

The education segment has proven itself to be the most immediate and reliable opportunity for Sonic Foundry. The Company's presentation recorders are ideally suited for ease of production and versatility in viewing rich media content. The introduction of advanced search technologies to efficiently ply ever increasing volumes of rich media content has positioned the company for additional revenue growth and expanding relationships. The Company recently completed the first of two of its seasonally strongest financial quarters tied to the education sales cycle. About one half of the Company's clients are in the education segment and a third identified as corporate.

The education segment continues to grow, up 61% from the previous year, and notably adding increasing numbers of law and business schools. Sonic Foundry is finding that educational institutions that have their own profit and loss accountability are much more likely to see the benefit of adding the Company's solutions. Sonic Foundry recently completed a survey of students and found that many would be willing to pay \$2,000 more in annual tuition for the enhanced benefit of having classroom presentations available on line. The survey also indicates evidence of increasing grades and overall student satisfaction. We suspect that in time the importance of online presentations may come to equal or exceed the importance of textbooks. In addition, this leads us to believe that Sonic Foundry's products are still in the very early phase of adoption. Sonic Foundry believes all classes may need to be captured, and with over 200,000 classrooms at \$20,000 per classroom, this would suggest a potential \$4 billion market opportunity. Interestingly, the Company is seeing increasing trends for its room based presentation recorders relative to sales of its slightly more expensive mobile units. Also, they note increasing attention by consultants and architects interested in designing-in rich media capabilities. All these factors confirm the company's products are well positioned for further growth.

Sonic Foundry is implementing new initiatives to increase penetration into the corporate segment. We anticipate that the Company's Mediasite Now! pilot program is an important tactic providing turnkey product and budgetary solutions. This should increase the opportunity to overcome IT hurdles in the sales cycle by providing pre-configured recorders including data center access and EX server capabilities. Also, a one year commitment by subscription bypasses burdensome capital expenditure processes. For these reasons, we anticipate the pilot program may become institutionalized, resulting in accelerated growth in the corporate segment for an increasing diversity of applications.

Sonic Foundry also reported progress in commercializing its multi-modal advanced search capabilities. We anticipate that advanced search may become the most significant barrier to entry for competitors. The ability to offer advanced search capabilities should also be important to help close larger transactions with institutions with growing libraries of rich media content.

Fiscal 3Q07 Financial Results

Sonic Foundry has reported the first of its two seasonally strongest quarters which are tied to the education segment. Financial results for 3Q07 largely met our expectations for the quarter. Considering the difficulties growing companies may experience introducing innovative products into new markets, we were pleased with the direction and consistency of growth leading toward higher revenues, margins, and profitability. We are impressed with the potential contribution of recognizing service revenues in future quarters. We are also impressed with the control of sales and marketing, and general and administrative expenses. A combination of these improving trends increases the opportunity for revenues or earnings to exceed market expectations in future quarters.

As reported, total revenues increased to \$4.7 million in 3Q07, up 31% over \$3.6 million in 3Q06, meeting our forecast of \$4.8 million for the quarter. Sonic Foundry reported revenues from sales of Mediasite presentation recorders of \$3.5 million in 3Q07, up from \$3.0 million in 3Q06, which was below our forecast of \$3.8 million. Revenue from services increased to \$1.1 million in 3Q07, up from \$663,000 in 3Q06, ahead of our estimate of \$1.0 million. The increase in services revenues, from recognition of higher levels of unearned income, partially offset our expectation for higher sales of presentation recorders in the quarter. We anticipate there is good potential for the trend of increasing service revenues to continue. This may provide support for higher revenues in seasonally weaker quarters and for positive revenue surprises in the next year. Other income was not significant in the quarter.

Company management noted an increase in total billings to \$5.9 million in 3Q07, up from \$4.3 million in 2Q07, and \$3.8 million in 3Q06. Billings for support, hosting, and training increased to \$2.2 million in 3Q07, up 136% from \$918,000 in 3Q06. It is important to note that support, hosting, and training billings increased to 34% of total billings in 3Q07 compared to 24% in 3Q06. Unearned revenue was \$3.1 million at the end of 3Q07, almost double \$1.7 million at the end of 3Q06. The Company's focus on service income, evidenced by consistent higher levels of unearned income, may support revenues in seasonally weaker quarters and resumption of a trend toward higher margins.

Gross profit was \$3.5 million in 3Q07, up from \$2.8 million in 3Q06, slightly below our forecast of \$3.7 million. As reported, gross margin 73.9% in 3Q07, down from was 76.7% in 2Q07, and below our estimate of 76.1%. Management reported that the reduction in margin was the result of higher levels of sales of recorders and a significant level of deferred revenues from services. As a result it is expected that service revenues will be recognized in later quarters and margins should resume the trend toward 80%.

Total operating expenses were \$5.1 million in 3Q07 as forecast, compared to \$3.4 million in 3Q06, and slightly above our forecast of \$4.9 million. Sonic Foundry reported selling and marketing expense of \$3.4 million in 3Q07, up from \$2.1 million in 3Q06, and close to our forecast of \$3.1 million. Management noted that the increase in marketing is the result of increased headcount and that this may decline relative to increasing revenues in future quarters. General and administrative expenses were \$952,000 in 3Q07, below our estimate of \$1.1 million, and down from \$1.1 million in 2Q07. Considering the increased product offering and focus on larger deal size, the control on overhead expense is notable. Product development expenses were \$837,000 in 3Q07, above our forecast of \$700,000, but consistent with the Company's past investment in developing its products and services. We see this as the reason for the Company to continue to make improvements important to maintain its leadership position.

Sonic Foundry reported a net loss of \$1.6 million in 3Q07, or a loss of \$0.04 per share, compared to a loss of \$583,000, or \$0.02 per share in 3Q06. We expected Sonic Foundry to have a net loss of \$1.2 million, or \$0.03 per share, in 3Q07. Interestingly, the Company reported a non-cash loss of \$1.22 million, or \$0.03 per share in 3Q07, meeting our earnings estimate on a GAAP basis. Cash balances were \$8.4 million at the end of 3Q07 compared to \$8.8 million at the end of 2Q07. Management previously reported that they have a net operating loss carry forward of approximately \$72 million, which we estimate could reduce future taxes by about \$27 million. The company remains substantially debt free.

Management Guidance

Sonic Foundry did not offer specific guidance for revenues and earnings for fiscal 2007 on its 3Q07 earnings conference call. Management did indicate that higher levels of service income should lead to higher margins in the high 70s and low 80s which seems reasonable. The rapid and regular increase in billings of service revenues supports this statement. They reported average deal size is \$33,100 and they are tracking over 1,600 opportunities. 200 of these opportunities are over \$50,000, and the dollar value of these 20 opportunities is over \$20 million. The Company continues to maintain a pipeline of \$50 million, significantly higher than sales on a quarterly or annual basis. Depending on the success rate on closing deals in the pipeline, size of deals closed, proportion of presentation recorder sales to service billings (complicating revenue recognition), reported financial results may experience significant volatility. Considering investors' attention to quarterly financial results at the expense of recognizing material progress in its business plan, management may be prudent to limit guidance until results become predictable. In practice, we are noting sustained trends leading to increased confidence in modeling near-term seasonal and year-over-year financial results.

August 1, 2007

Our Model

It would appear that the dominant theme in our model is a consistent and increasing level of unearned income, increasing service revenue and expanding margins. Presentation recorder sales are still likely to be significant but may decline in importance both financially and in relation to the focus on generating service revenue. We anticipate continued strong seasonal performance in 4Q07 to the education segment.

There is the possibility that total revenues may be supported by recognition of service revenues in seasonally weaker quarters. In addition, we anticipate that efforts to refocus attention on the corporate segment sensitive to the segment's reluctance for capital investment may also be rewarded in seasonally weaker quarters. The success of this strategy may provide good opportunity for both positive revenue and earnings surprises important to our investment thesis. Our model reflects this perspective, we forecast revenues of \$17.3 million and \$23.2 million in fiscal 2007 and 2008, respectively. In addition, we anticipate the Company should have a loss of \$0.17 per share and \$0.12 per share in fiscal 2007 and 2008, respectively.

Valuation and Conclusion

We continue to believe that Sonic Foundry provides the "Rolls Royce" of one-to-many rich media communication solutions for the Internet. This is based by our own experience producing and viewing presentations captured by their elegant presentation recorders. Sonic Foundry's presentation recorders have set the standard for long-distance education, and their sophisticated first-to-market advanced search technology is opening new vistas on retrieval of archived rich media content. In addition to developing this important ground breaking technology, the Company has successfully commercialized the technology and continues to make meaningful adjustments in response to the marketplace. We anticipate management will remain a disciplined approach in this regard, taking advantage of yet unrecognized opportunities as the potential market for communicating rich media expands.

We are reducing our rating to **Buy** from Strong Buy. Considering the Company performing as we expected, and selling off \$0.17 the day following the earnings release, it is not clear to us how the additional analyst coverage may impart the 52-week trading range. Our 12-month price target of **\$5.00** per share was based on a sales multiple of 8x and estimated sales of \$0.60 per share for the next four quarters. Our previous price target was \$6.50 per share. While our forecast of sales per share increased slightly, the reduction was primarily due to a reduced sales multiple which appears reasonable given the vaporization of momentum investors and profit taking. While our price target remains aggressive, we believe the risk profile for the Company has improved and anticipate potential for revenue or earnings surprises leading up to seasonally strong sales in the second half of fiscal 2008.

Risks

We have a high degree of confidence in Sonic Foundry as both a company and an investment. The Company continues to innovate proactively in anticipation of trends to meet customer requirements. We also have more confidence in the opportunity for increased consistency in financial performance with the potential for positive surprises. We continue to see some risk related to the focus on larger transactions but the core business appears to be robust and we are upgrading our risk assessment to **Moderate**.

Beacon Rock Research, LLC

August 1, 2007

Sonic Foundry, Inc.

September FYE

(#'s in 000's)

	1Q06A	2Q06A	3Q06A	4Q06A	1Q07A	2Q07A	3Q07A	4Q07E	2005A	2006A	2007E	2008E
	Dec.-05	Mar.-06	Jun.-06	Sept.-06	Dec.-06	Mar.-07	Jun.-07	Sept.-07				
Income Statement												
Revenues												
Mediasite revenues	\$1,346	\$2,288	\$2,967	\$3,301	\$2,586	\$2,898	\$3,544	\$3,950	\$6,928	\$9,902	\$12,978	\$16,150
Customer support fees	415	652	663	776	878	913	1,148	1,350	975	2,506	4,289	7,025
Other	111	13	17	15	9	10	10	10	439	156	39	40
Total revenues	1,872	2,953	3,647	4,092	3,473	3,821	4,702	5,310	8,342	12,564	17,306	23,215
Cost of goods sold	560	861	812	982	773	891	1,226	1,221	2,754	3,215	4,111	5,030
Gross profit	1,312	2,092	2,835	3,110	2,700	2,930	3,476	4,089	5,588	9,349	13,195	18,185
Operating expenses												
Selling and marketing expenses	1,718	1,750	2,101	2,061	2,504	3,043	3,353	3,400	5,277	7,630	12,300	15,100
General and administrative expenses	696	766	744	835	970	1,104	952	1,000	2,864	3,041	4,026	4,250
Product development expenses	534	544	593	567	675	806	837	840	1,803	2,238	3,158	3,460
Total operating expense	2,948	3,060	3,438	3,463	4,149	4,953	5,142	5,240	9,944	12,909	19,484	22,810
Operating income	(1,636)	(968)	(603)	(353)	(1,449)	(2,023)	(1,666)	(1,151)	(4,356)	(3,560)	(6,289)	(4,625)
Other income (expense)	24	21	20	12	20	111	77	65	187	77	273	175
Interest expense	0	0	0	0	0	0	0	0	0	0	0	0
Income (loss) before income taxes	(1,612)	(947)	(583)	(341)	(1,429)	(1,912)	(1,589)	(1,086)	(4,169)	(3,483)	(6,016)	(4,450)
Provision for income taxes	0	0	0	0	0	0	0	0	0	0	0	0
Net income	(1,612)	(947)	(583)	(341)	(1,429)	(1,912)	(1,589)	(1,086)	(4,169)	(3,483)	(6,016)	(4,450)
Earnings per share	\$ (0.05)	\$ (0.03)	\$ (0.02)	\$ (0.01)	\$ (0.04)	\$ (0.05)	\$ (0.04)	\$ (0.03)	\$ (0.14)	\$ (0.11)	\$ (0.17)	\$ (0.12)
Diluted shares	31,275	31,694	31,995	32,300	32,363	35,369	35,505	35,600	30,363	32,015	34,709	35,850
Percentage of Sales												
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	29.9%	29.2%	22.3%	24.0%	22.3%	23.3%	26.1%	23.0%	33.0%	25.6%	23.8%	21.7%
Gross profit	70.1%	70.8%	77.7%	76.0%	77.7%	76.7%	73.9%	77.0%	67.0%	74.4%	76.2%	78.3%
Selling and marketing expenses	91.8%	59.3%	57.6%	50.4%	72.1%	79.6%	71.3%	64.0%	63.3%	60.7%	71.1%	65.0%
General and administrative expenses	37.2%	25.9%	20.4%	20.4%	27.9%	28.9%	20.2%	18.8%	34.3%	24.2%	23.3%	18.3%
Product development expenses	28.5%	18.4%	16.3%	13.9%	19.4%	21.1%	17.8%	15.8%	21.6%	17.8%	18.2%	14.9%
Total operating expense	157.5%	103.6%	94.3%	84.6%	119.5%	129.6%	109.4%	98.7%	119.2%	102.7%	112.6%	98.3%
Operating income	-87.4%	-32.8%	-16.5%	-8.6%	-41.7%	-52.9%	-35.4%	-21.7%	-52.2%	-28.3%	-36.3%	-19.9%
Other income (expense)	1.3%	0.7%	0.5%	0.3%	0.6%	2.9%	1.6%	1.2%	2.2%	0.6%	1.6%	0.8%
Net income (continuing operations)	-86.1%	-32.1%	-16.0%	-8.3%	-41.1%	-50.0%	-33.8%	-20.5%	-50.0%	-27.7%	-34.8%	-19.2%
Sales/share (tm)	\$ 0.28	\$ 0.31	\$ 0.35	\$ 0.39	\$ 0.44	\$ 0.46	\$ 0.47	\$ 0.50	\$ 0.27	\$ 0.39	\$ 0.50	\$ 0.65

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Sonic Foundry, Inc.
September FYE
 (#'s in 000's)
BALANCE SHEET

ASSETS	2003	2004	2005	2006	4Q06	1Q07	2Q07	3Q07
Cash and equivalents - (000's)	\$12,623	\$7,583	\$4,271	\$2,751	\$2,751	\$12,054	\$8,841	\$8,354
Accounts receivable	508	1,345	2,232	3,442	3,442	3,396	4,570	5,679
Accounts receivable, other	139	18	0	0	0	0	0	0
Inventory	111	371	414	398	398	297	308	85
Other current assets	214	281	363	399	399	423	731	1,103
Assets of discontinued operations	0	0	0	0	0	0	0	0
Total current assets	13,595	9,598	7,280	6,990	6,990	16,170	14,450	15,221
Net property, plant, and equipment	588	745	1,007	2,294	2,294	2,301	2,254	2,339
Goodwill & intangibles	8,618	8,288	7,958	7,628	7,628	7,575	7,575	7,599
Deferred long-term asset charges	0	0	0	0	0	0	0	0
Other assets	0	0	0	0	0	0	0	0
Long-term assets of discontinued operations	0	0	0	0	0	0	0	0
Total assets	\$22,801	\$18,631	\$16,245	\$16,912	\$16,912	\$26,046	\$24,279	\$25,159
LIABILITIES AND SHAREHOLDERS' EQUITY								
Accounts payable	\$1,065	\$879	\$1,323	\$1,521	\$1,521	\$1,908	\$1,434	\$1,465
Accrued liabilities	1,263	686	780	1,225	1,225	868	819	1,115
Unearned revenues	194	473	957	2,005	2,005	1,931	2,244	3,122
Current portion of capital lease obligation	48	0	15	41	41	41	43	386
Convertible debt	0	0	0	0	0	0	0	0
Liabilities of discontinued operations	0	0	0	0	0	0	0	0
Current liabilities	2,570	2,038	3,075	4,792	4,792	4,748	4,540	6,088
Long-term debt	0	0	0	0	0	0	0	630
Deferred long-term liability charges	0	27	49	519	519	486	451	478
Other long term liabilities	0	0	0	0	0	0	0	0
Shareholders' equity	20,231	16,566	13,121	11,601	11,601	20,812	19,288	17,963
Total liabilities and shareholders' equity	\$22,801	\$18,631	\$16,245	\$16,912	\$16,912	\$26,046	\$24,279	\$25,159
Cash per share	\$0.44	\$0.26	\$0.14	\$0.09	\$0.09	\$0.37	\$0.25	\$0.24
Quick ratio	5.11	4.38	2.11	1.29	1.29	3.25	2.95	2.31
Current ratio	5.29	4.71	2.37	1.46	1.46	3.41	3.18	2.50
Debt to capitalization ratio	0.00%	0.16%	0.37%	4.47%	4.47%	2.34%	2.34%	6.17%
Book per share	\$0.70	\$0.56	\$0.43	\$0.36	\$0.36	\$0.64	\$0.55	\$0.51

DISCLOSURES:

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This report has been written in accordance with current SEC regulations and the Standards of Practice developed by the Chartered Financial Analyst Institute (CFAI). Our research has been conducted by employing analytical practices generally accepted as standard within the analytical industry. In this instance, a comparison of financial strength, a bottom-up earnings projection based on a recovery in the U.S. economy, and relative multiples, were employed. The target price was calculated on comparative EPS, sales and book value multiples, and our knowledge of small-cap markets when enjoying both a sector and a cyclical rebound. Our conclusions are, by the very nature of forecasting, speculative, but are also reasonable, supportable and consistent.

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EQUITY RECOMMENDATION SYSTEM:

Buy	Immediate purchase is recommended. The security expected to outperform the market over the next 12 to 18 months.
Hold	Holding the stock is recommended because the share price's appreciation potential is less than or equal to the market.
Sell	The stock has reached the target price objective and/or conditions have changed sufficiently to alter the outlook for the stock.

EQUITY RISK SYSTEM:

High	The security is more volatile than the market and/or the company is more leveraged than its peer group.
Moderate	The security has about the same volatility as the market and/or the company carries a level of leverage in line with its peer group.
Low	The security is less volatile than the market and/or the company is less leveraged than its peer group.

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