FORGENT NETWORKS INC
Form 10-Q
December 15, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 31, 2006

OR

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

For the transition period from to

Commission file number: 0-20008

FORGENT NETWORKS, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware (State of other jurisdiction of incorporation or organization)	**74-2415696** (I.R.S. Employer Identification No.)
108 Wild Basin Road **Austin, Texas** (Address of Principal Executive Offices)	**78746** (Zip Code)

(512) 437-2700
(Registrant s Telephone Number, including Area Code)

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

Yes x No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

Yes o No x

At December 11, 2006, the registrant had outstanding 25,433,043 shares of its Common Stock, $0.01 par value.

INDEX TO FINANCIAL STATEMENTS

FORGENT NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except per share data)

	OCTOBER 31, 2006 (UNAUDITED)	JULY 31, 2006
ASSETS		
Current Assets:		
Cash and equivalents, including restricted cash of $454 and $543 at October 31, 2006 and July 31, 2006, respectively	$ 15,038	$ 16,206
Accounts receivable, net of allowance for doubtful accounts of $9 and $13 at October 31, 2006 and July 31, 2006, respectively	6,091	714
Prepaid expenses and other current assets	299	274
Total Current Assets	**21,428**	**17,194**
Property and equipment, net	584	788
Intangible assets, net		4
Other assets	3	3
	$ 22,015	**$ 17,989**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 4,752	$ 3,631
Accrued compensation and benefits	768	547
Other accrued liabilities	798	907
Notes payable, current position	282	313
Deferred revenue	765	683
Total Current Liabilities	**7,365**	**6,081**
Long-Term Liabilities:		
Deferred revenue	9	11
Other long-term obligations	1,640	1,777
Total Long-Term Liabilities	**1,649**	**1,788**
Stockholders Equity:		
Preferred stock, $.01 par value; 10,000 shares authorized; none issued or outstanding		
Common stock, $.01 par value; 40,000 shares authorized; 27,208 and 27,163 shares issued; 25,418 and 25,373 shares outstanding at October 31, 2006 and July 31, 2006, respectively	272	271
Treasury stock at cost, 1,790 shares at October 31, 2006 and July 31, 2006	(4,815)	(4,815)
Additional paid-in capital	265,535	265,406
Accumulated deficit	(248,005)	(250,754)
Accumulated other comprehensive income	14	12
Total Stockholders Equity	**13,001**	**10,120**
	$ 22,015	**$ 17,989**

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

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FORGENT NETWORKS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

	FOR THE THREE MONTHS ENDED OCTOBER 31, 2006 (UNAUDITED)	2005
REVENUES:		
Intellectual property licensing	$ 8,134	$ 2,916
Software & services	962	731
Total Revenues	**9,096**	**3,647**
COST OF SALES:		
Intellectual property licensing	3,540	2,087
Software & services	310	194
Total Cost of Sales	**3,850**	**2,281**
GROSS MARGIN	5,246	1,366
OPERATING EXPENSES:		
Selling, general and administrative	2,500	2,683
Research and development	116	131
Amortization of intangible assets	4	10
Total Operating Expenses	**2,620**	**2,824**
INCOME (LOSS) FROM OPERATIONS	**2,626**	**(1,458)**
OTHER INCOME AND (EXPENSES):		
Interest income	155	98
Other	(32)	(17)
Total Other Income and (Expenses)	**123**	**81**
INCOME (LOSS) FROM OPERATIONS, BEFORE INCOME TAXES	**2,749**	**(1,377)**
Provision for income taxes		(5)
NET INCOME (LOSS)	**2,749**	**(1,382)**
BASIC AND DILUTED INCOME (LOSS) PER SHARE:		
Net income (loss) per share - basic and diluted	$ 0.11	$ (0.05)
WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic	25,381	25,178
Diluted	25,522	25,178

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

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FORGENT NETWORKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

	FOR THE THREE MONTHS ENDED OCTOBER 31, 2006 (UNAUDITED)	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Income (loss) from operations	$ 2,749	$ (1,382)
Adjustments to reconcile net income (loss) to net cash used in operations:		
Depreciation and amortization	239	329
Amortization of leasehold advance and lease impairment	(106)	(140)
Provision for doubtful accounts	1	3
Share-based compensation	128	81
Foreign currency translation gain	5	2
Gain on sale/disposal of fixed assets		(6)
Changes in operating assets and liabilities:		
Accounts receivable	(5,392)	(258)
Prepaid expenses and other current assets	(87)	(95)
Accounts payable	1,170	1,379
Accrued expenses and other long-term obligations	140	(38)
Deferred revenue	94	92
Net cash used in operating activities	**(1,059)**	**(33)**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net sales of short-term investments		100
Net purchases of property and equipment	(32)	(12)
Net cash (used in) provided by investing activities	**(32)**	**88**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of stock	2	4
Proceeds from notes payable		95
Payments on notes payable and capital leases	(89)	(95)
Net cash (used in) provided by financing activities	**(87)**	**4**
Effect of translation exchange rates	10	
Net (decrease) increase in cash and equivalents	(1,168)	59
Cash and equivalents at beginning of period	16,206	15,861
Cash and equivalents at end of period	**$ 15,038**	**$ 15,920**

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

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FORGENT NETWORKS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1 - GENERAL AND BASIS OF FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and accordingly, do not include all information and footnotes required under U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, these interim financial statements contain all adjustments, consisting of normal, recurring adjustments, necessary for a fair presentation of the financial position of Forgent Networks, Inc. (Forgent or the Company) as of October 31, 2006 and July 31, 2006, and the results of operations and cash flows for the three months ended October 31, 2006 and 2005. These consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto filed with the Securities and Exchange Commission in the Company s annual report on Form 10-K/A for the fiscal year ended July 31, 2006. The results for the interim periods are not necessarily indicative of results for a full fiscal year.

NOTE 2 - INTELLECTUAL PROPERTY LEGAL CONTRACTS

In October 2005, Forgent terminated Godwin Gruber, LLP (Godwin) and engaged Susman Godfrey, LLP (Susman) to serve as lead counsel in the 672 Litigation. Forgent agreed to pay Susman 33% of all net proceeds received from licensing and litigation once Forgent received $6,000 in gross recoveries received on or after October 27, 2004. Additionally, Forgent agreed to pay Susman a fixed monthly fee of $116 for time incurred. As a result of the Resolution Agreement entered into with Jenkens & Gilchrist (Jenkens) in December 2004, the Company s liability to Jenkens is 10% of future gross licensing and litigation proceeds related to the 672 patent.

In April 2006, Forgent engaged Hagans Burdine Montgomery Rustay & Winchester (Hagans) and Bracewell & Giuliani, L.L.P. (Bracewell) to provide legal services related to the litigation of the Company s U.S. Patent No. 6,285,746 (the 746 Litigation). Hagans and Bracewell replaced Godwin. Hagans is the lead counsel on the 746 Litigation. See Note 8, Subsequent Events, for information regarding an amendment to the agreement with Hagans and Bracewell. In May 2005, the Company engaged The Roth Law Firm, P.C. (Roth) to serve as local counsel in Marshall, Texas. Forgent agreed to pay Roth 10% of all litigation proceeds related to the 746 Litigation.

Legal expenses for the contingency fees and legal counsel s time incurred are recorded as part of cost of sales from Forgent s intellectual property licensing business on the Consolidated Statements of Operations. Cost of sales for the intellectual property licensing business for the three months ended October 31, 2006 and 2005 were $3,540 and $2,087, respectively. Other legal expenses incurred related to the Patent Licensing Program are recorded as part of operating expenses on the Consolidated Statements of Operations. Other related legal expenses for the three months ended October 31, 2006 and 2005 were $264 and $420, respectively.

NOTE 3 - COMPREHENSIVE INCOME (LOSS)

In accordance with the disclosure requirements of Statement of Financial Accounting Standard No. 130, *Reporting Comprehensive Income,* the Company s comprehensive income (loss) is comprised of net income (loss), foreign currency translation adjustments and unrealized gains and losses on short-term investments held as available-for-sale securities. Comprehensive income for the three months ended October 31, 2006 was $2,751 and comprehensive loss for the three months ended October 31, 2005 was $1,378.

NOTE 4 - RECENT ACCOUNTING PRONOUNCEMENTS

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

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

In May 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections* , which replaces Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes* and Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements.* Statement No. 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle. The standard also requires that a change in depreciation or amortization method for long-lived non-financial assets be accounted for prospectively as a change in estimate, and correction of errors in previously issued financial statements should be termed a restatement. Statement No. 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Thus, Forgent adopted this standard for accounting changes and corrections of errors made in fiscal year 2007, effective August 1, 2006. The adoption did not have any impact to the Company s consolidated financial statements.

NOTE 5 SHARE BASED COMPENSATION

On August 1, 2006 the Company s Board of Directors approved the repricing of all employee stock options with an exercise price greater than $0.385 (the average of the high and low for August 1, 2006). The new exercise price is $0.385. The Board of Directors determined that the repricing was the most cost effective way to motivate employees with options that had exercise prices greater than the current fair market value. The repricing resulted in a charge of $88 based on the incremental fair value of the new options versus the fair value of the old options for the three months ended October 31, 2006. Previously, on September 14, 2005 the Company s Board of Directors approved the repricing of all employee stock options with an exercise price greater than $1.42 (the average of the high and low for September 14, 2005). The new exercise price was $1.42. The repricing resulted in a charge of $65 based on the incremental fair value of the new options versus the fair value of the old options for the three months ended October 31, 2005.

The Company issued 45 and 3 shares of common stock related to exercises of stock options granted from its Stock Option and Stock Purchase Plans for the three months ended October 31, 2006 and 2005, respectively.

NOTE 6 - SEGMENT INFORMATION

Currently, the Company operates in two distinct segments: intellectual property licensing and software and services. During the three months ended October 31, 2006, Forgent s intellectual property licensing business focused on generating licensing revenues relating to the Company s technologies embodied in U.S. Patent No. 4,698,672 and its foreign counterparts, as well as in U.S. Patent No. 6,285,746. At the end of the first fiscal quarter of 2007, the Company settled with the remaining defendants in the 672 Litigation and does not anticipate generating additional licensing revenues from non-defendants going forward. Forgent s software and services business provides customers with scheduling and asset management software as well as software maintenance and support, installation and training services. In order to evaluate the intellectual property and software segments as stand-alone businesses, the Company records all unallocated corporate operating expenses in the Corporate segment.

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

The table below presents segment information about revenue from unaffiliated customers, gross margins and operating income (loss) for the three months ended October 31, 2006 and 2005:

	Intellectual Property Licensing	Software & Services	Corporate	Total
For the Three Month Period Ending October 31, 2006				
Revenues from unaffiliated customers	$ 8,134	$ 962	$	$ 9,096
Gross margin	4,594	652		5,246
Operating income (loss)	3,800	(289)	(885)	2,626
For the Three Month Period Ending October 31, 2005				
Revenues from unaffiliated customers	$ 2,916	$ 731	$	$ 3,647
Gross margin	829	537		1,366
Operating income (loss)	73	(364)	(1,167)	(1,458)

NOTE 7 CONTINGENCIES

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

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

Forgent and its wholly-owned subsidiary, Compression Labs, Incorporated (CLI), were in legal proceedings with multiple companies for infringement of the 672 patent. Prior to the first quarter of 2007, Forgent had settled with 15 defendants. On October 25, 2006, Forgent signed a Patent License and Settlement Agreement with the remaining defendants. Under this agreement, Forgent granted the defendants a patent license and the defendants agreed to pay Forgent $8.0 million. Additionally, all parties agreed to release all claims against each other and Forgent has no future obligations related to this settlement.

On November 16, 2005, the Public Patent Foundation filed a petition with the United States Patent and Trademark Office (the USPTO) to re-examine the 672 patent. In January 2006, the USPTO granted the petition and subsequently issued its first office action on May 25, 2006. This first action, which is not the final conclusion of the re-examination, confirmed 27 of the 46 claims in the 672 patent. Forgent responded to this first office action. The re-examination process is an extended process and Forgent is working directly with the USPTO to vigorously defend all of the claims, including those that were not initially upheld in the first office action. The USPTO has not issued any additional office actions.

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

Forgent is currently in litigation proceedings with multiple companies in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of its 746 patent. In September 2006, Forgent and the defendants participated in a court-ordered mediation, which did not result in any settlements or licenses. On November 9, 2006, Forgent and the defendants in the 746 Litigation appeared before the Court and presented arguments relating to claims construction, a motion for summary judgment and a motion to stay the litigation. On November 20, 2006, the Court denied the motion to stay the litigation. The Court did not rule on the motion for summary judgment and the Company is currently awaiting the Court s ruling on the claims construction.

On October 2, 2006, the USPTO granted Motorola Inc. s petition and ordered an *inter partes* re-examination of the 746 patent. On October 30, 2006, the USPTO issued its first office action related to this re-examination. This first action, which is not the final conclusion of the re-examination, denied the five claims in the 746 patent. Forgent has 60 days to respond to the USPTO and anticipates working directly with the USPTO to vigorously defend all of the claims of the 746 patent. If the Company is unsuccessful in defending its patent s

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Litigation of United States Patent No. 6,285,746 claims with the USPTO examiner, Forgent could pursue the appeal process within the USPTO and within the federal court system, if necessary. Any negative results from the re-examination would reduce the Company s ability to negotiate settlements with defendants and licenses with potential licensees, which could materially and adversely affect Forgent s licensing revenues. The ultimate rejection of significant claims could have material and adverse consequences for Forgent.

Forgent continues to monitor the progress of the 746 Litigation and the USPTO s re-examinations of its 746 and 672 patents. The Company will vigorously defend the validity of its patents, as well as pursue any entities that violated its patents. Resolution of some or all of these matters could materially affect the Company s business, future results of operations, financial position or cash flows in a particular period.

NOTE 8 SUBSEQUENT EVENTS

In November 2006, Forgent sold certain patents associated with videoconferencing and related fields and technology, together with related goodwill, rights and documentation, to Tandberg Telecom AS (Tandberg) for $3,150. Upon closing, Forgent received $2,900 of the purchase price, all of which was recorded as a gain. The remaining balance of $250 will be held in escrow for two years for indemnity claims. Following this sale, Forgent maintains approximately 10 patents and patent applications, including the 746 Patent, which Forgent is asserting in the U.S. District Court for the Eastern District of Texas.

On December 1, 2006, Forgent signed an amendment to the Legal Services Fee Agreement with Hagans, Burdine, Montgomery, Rustay & Winchester, P.C. and Bracewell & Giuliani, L.L.P. This amendment increased the contingency fee payable to Hagans and Bracewell from 30% (15% to each law firm) of all license and litigation proceeds related to the 746 patent, net of expenses, to 37.5% (20% to Hagans and 17.5% to Bracewell). Additionally, effective September 1, 2006, all related expenses, including consultant fees, travel expenses, document production expenses, etc. will be allocated as follows: 25% to Forgent, 50% to Hagans, and 25% to Bracewell, until total expenses reach $2,500. Prior to the amendment, Forgent was liable for all related expenses. Although the Company does not believe it will reach the $2,500 threshold, Forgent will be liable for all subsequent expenses if this threshold is exceeded.

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

The following review of Forgent s financial position as of October 31, 2006 and July 31, 2006 and for the three months ended October 31, 2006 and 2005 should be read in conjunction with the Company s 2006 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission. Forgent s internet website address is http://www.forgent.com. The Company s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the investor relations page of the Company s internet website free of charge as soon as reasonably practicable after they are electronically filed, or furnished to, the Securities and Exchange Commission. Forgent s internet website and the information contained therein or connected thereto are not intended to be incorporated into this Quarterly Report on Form 10-Q.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

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

RESULTS OF OPERATIONS

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

	FOR THE THREE MONTHS ENDED OCTOBER 31,			
	2006		**2005**	
Intellectual property licensing revenues	89	%	80	%
Software and services revenues	11		20	
Gross margin	58		37	
Selling, general and administrative	28		73	
Research and development	1		4	
Total operating expenses	29		77	
Other income, net	1		2	
Net income (loss)	30	%	(38	)%

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THREE MONTHS ENDED OCTOBER 31, 2006 AND 2005

Revenues

Revenues for the three months ended October 31, 2006 were $9.1 million, an increase of $5.5 million, or 149%, from the $3.6 million reported for the three months ended October 31, 2005. Consolidated revenues represent the combined revenues of the Company and its subsidiaries, including royalties and settlements received from licensing the Company s intellectual property as well as sales of Forgent s NetSimplicity software, installation and training and software maintenance services.

Intellectual Property Licensing Business

Intellectual property licensing revenues for the three months ended October 31, 2006 were $8.1 million, an increase of $5.2 million, or 179%, from the $2.9 million reported for the three months ended October 31, 2005. Intellectual property licensing revenues as a percentage of total revenues were 89% and 80% for the three months ended October 31, 2006 and 2005, respectively. Forgent s licensing revenues relate primarily to one-time intellectual property license agreements with companies for Forgent s data compression technology embodied in U.S. Patent No. 4,698,672 (the 672 patent) and its foreign counterparts. Additionally, the 672 patent is included in a group of Moving Picture Experts Group (MPEG) patents that garners royalties. Forgent s licensing revenues include royalties received from this MPEG-2 consortium. The Company is also seeking to license its U.S. Patent No. 6,285,746 (the 746 patent), which relates to technology for storing and retrieving multimedia data in a manner that allows playback during recording. However, no licensing revenues have been achieved as of October 31, 2006.

During the past nineteen consecutive quarters, Forgent has achieved approximately $121.6 million in aggregate revenues generated from multiple companies in Asia, Europe and the United States. These one-time license agreements generated approximately 98% and 95% of the intellectual property segment s licensing revenues for the three months ended October 31, 2006 and 2005, respectively. The Company does not anticipate any additional licensing revenue from companies that have previously signed license agreements. The 672 patent, which has generated all of the intellectual property licensing revenues to date, expired in October 2006 in the United States and its foreign counterparts will expire in September 2007. Upon expiration of the 672 patent s foreign counterparts, Forgent will cease receiving any royalties from the MPEG-2 consortium.

Forgent was in legal proceedings with multiple companies in the United States District Court for the Northern District of California regarding the infringement of its 672 patent (the 672 Litigation). Prior to the first quarter of 2007, Forgent had settled with 15 of the defendants. On October 25, 2006, Forgent signed a Patent License and Settlement Agreement with the remaining defendants. Under this agreement, Forgent granted the defendants a patent license and the defendants agreed to pay Forgent $8.0 million. Additionally, all parties agreed to release all claims against each other and Forgent has no future obligations related to this settlement. This settlement accounts for the increase in licensing revenues during the three months ended October 31, 2006, as compared to the three months ended October 31, 2005. Going forward, the Company believes its ability to garner additional licensing revenues from non-defendants related to the 672 patent is substantially concluded.

Forgent is also currently in legal proceedings with several companies in the United States District Court for the Eastern District of Texas, Tyler Division, for the infringement of its 746 patent (the 746 Litigation). In September 2006, Forgent and the defendants participated in a court-ordered mediation, which did not result in any settlements or licenses. On November 9, 2006, Forgent and the defendants in the 746 Litigation appeared before the Court and presented arguments relating to claims construction, a motion for summary judgment and a motion to stay the litigation. On November 20, 2006, the Court denied the motion to stay the litigation. The Court did not rule on the motion for summary judgment and the Company is currently awaiting the Court s ruling on the claims construction. At any time during the litigation process, Forgent will consider any reasonable settlements with the defendants, if the settlement amount provides an appropriate value.

On October 2, 2006, the USPTO granted Motorola Inc. s petition and ordered an *inter partes* re-examination of the 746 patent. On October 30, 2006, the USPTO issued its first office action related to this re-examination. This first action, which is not the final conclusion of the re-examination, denied the five claims in the 746 patent. Forgent has 60 days to respond to the USPTO and anticipates working directly with the USPTO to vigorously defend all of the claims of the 746 patent. If the Company is unsuccessful in defending its patents

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NOTE 8 SUBSEQUENT EVENTS

claims with the USPTO examiner, Forgent could pursue the appeal process within the USPTO and within the federal court system, if necessary. Any negative results from the re-examination would reduce the Company s ability to negotiate settlements with defendants and licenses with potential licensees, which could materially and adversely affect Forgent s licensing revenues. The ultimate rejection of significant claims could have material and adverse consequences for Forgent.

The trial date for the 746 Litigation is set for May 14, 2007. Prior to the trial date, any negative results from the claims construction hearing, summary judgment motion, or the USPTO s re-examination could significantly and adversely affect the Company s ability to proceed with the litigation and/or negotiate license agreements related to the 746 patent. Thus, there can be no assurance that the Company will be able to continue to effectively license its technology to other companies. Additionally, there are no guarantees that the Company can protect its intellectual property rights in its current litigation or prevent the unauthorized use of its technology in the future. However, management expects to generate licensing revenues related to the 746 patent.

Software and Services Business

Software and services revenues for the three months ended October 31, 2006 were $0.9 million, an increase of $0.2 million, or 32%, from the $0.7 million reported for the three months ended October 31, 2005. Software and services revenues as a percentage of total revenues were 11% and 20% for the three months ended October 31, 2006 and 2005, respectively. Revenues from this line of business include sales of Forgent s NetSimplicity scheduling and asset management software, which includes Meeting Room Manager (MRM), Visual Asset Manager (VAM) and Resource Scheduler. Also included in this segment s revenues are software maintenance and professional services, such as add-on software customization, installation and training.

During the first fiscal quarter of 2007, as compared to the first fiscal quarter of 2006, software revenues increased by 26% due to increased MRM sales resulting from the release of Version 7.0 in June 2006 and increased VAM sales resulting from the employment of a sales representative dedicated solely to selling VAM. Continued pursuit of maintenance renewals, as well as the increase in software sales, led to additional sales of maintenance and support contracts and increased maintenance revenues by 38% during the three months ended October 31, 2006. Towards the end of fiscal year 2006, Forgent partnered with several vendors which enabled the Company to resell hardware to complement its MRM and VAM software products. Hardware sales during the three months ended October 31, 2006 led to a 33% increase in revenues as Forgent did not have any hardware sales during the three months ended October 31, 2005. Increases in software revenues, maintenance revenues and hardware revenues accounted for 97% of the $0.2 million increase in the software segment s revenues during the first fiscal quarter of 2007. Forgent will continue to target North American and international companies in the education, governmental, healthcare and legal sectors, which generated approximately 49% of its software revenues during the three months ended October 31, 2006.

Gross Margin

Gross margins for the three months ended October 31, 2006 were $5.3 million, an increase of $3.9 million, or 284%, from the $1.4 million reported for the three months ended October 31, 2005. Gross margins as a percentage of total revenues were 58% and 37% for the three months ended October 31, 2006 and 2005, respectively.

The $3.9 million increase in gross margin, as well as the related increase in gross margin as a percentage of total revenues, for the three months ended October 31, 2006, is due primarily to the $3.8 million increase in gross margin resulting from licensing revenues generated during first fiscal quarter of 2007. To date, all of the Company s licensing revenue has been generated by the 672 patent. Because the 672 Litigation is concluded, the U.S. 672 patent expired in October 2006 and its foreign counterparts will expire in September 2007, licensing revenues will decline unless alternative sources of revenue are found. If licensing revenues decline, total gross margins will be adversely affected.

Intellectual Property Licensing Business

Intellectual property gross margins for the three months ended October 31, 2006 were $4.5 million, an increase of $3.7 million, or 454%, from the $0.8 million reported for the three months ended October 31, 2005.

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Intellectual property gross margins as a percentage of total revenues were 56% and 28% for the three months ended October 31, 2006 and 2005, respectively.

The cost of sales from the intellectual property licensing business relates to the legal fees incurred in successfully achieving signed license agreements as well as legal expenses incurred from legal counsel s time in connection with licensing and litigating the Company s patents. In October 2005, Forgent terminated Godwin Gruber, LLP (Godwin), and engaged Susman Godfrey, LLP (Susman) to lead its Patent Licensing Program. Under the amended agreement with Godwin, Forgent agreed to pay Godwin a fixed monthly fee of $0.2 million for time incurred. Under the agreement with Susman, Forgent agreed to pay Susman 33% of all net proceeds received from licensing and litigation once Forgent reached $6.0 million in gross recoveries received on or after October 27, 2004, and a fixed monthly fee of $0.1 million for time incurred. Since the Company achieved $6.0 million in gross recoveries during the second fiscal quarter of 2006, Forgent s contingency fee to Jenkens & Gilchrist (Jenkens) was reduced from 50% of the gross licensing revenues received related to the 672 patent to 10%. As a result of the change in legal counsel and the reduction in contingency fees to Jenkens, Forgent s gross margins from the intellectual property licensing business increased to 56% for the three months ended October 31, 2006, as compared to 28% for the three months ended October 31, 2005.

In April 2006, Forgent engaged Hagans and Bracewell to provide legal services related to the 746 Litigation. On December 1, 2006, Forgent signed an amendment to the original agreement, which increased the contingency fee payable to Hagans and Bracewell from 30% (15% to each law firm) of all license and litigation proceeds, net of expenses, to 37.5% (20% to Hagans and 17.5% to Bracewell). In May 2005, the Company engaged The Roth Law Firm, P.C. (Roth) to serve as local counsel in Marshall, Texas. Forgent agreed to pay Roth 10% of all litigation proceeds related to the 746 Litigation. Under these legal services agreements, Forgent does not pay any legal expenses for time incurred. Therefore, management anticipates achieving 52.5% gross margin on any licensing revenues related to future license agreements associated with the 746 patent.

Software and Services Business

Software and services gross margins for the three months ended October 31, 2006 were $0.6 million, an increase of $0.1 million, or 21%, from the $0.5 million reported for the three months ended October 31, 2005. Software and services gross margins as a percentage of total revenues were 68% and 73% for the three months ended October 31, 2006 and 2005, respectively.

The cost of sales associated with the software segment is relatively fixed and results primarily from the amortization of the Company s purchased software development costs and compensation expenses. During the three months ended October 31, 2006, cost of sales from the software segment increased by $0.1 million, approximately 80% of which related to changes in amortization expenses, compensation expenses and hardware expenses. As of July 31, 2006, the Company had formalized a group dedicated to providing maintenance and support. The compensation expenses and related expenses for this group were classified as cost of sales during the three months ended October 31, 2006. Since the group did not exist during the three months ended October 31, 2005, no related expenses were recorded during the first fiscal quarter of 2006. The increase in compensation and related expenses was offset by a decrease in amortization expenses since the purchased software development costs were fully amortized during the first fiscal quarter of 2007. Additionally, the hardware sales during the three months ended October 31, 2006 also increased cost of sales. Although the increase in software and services revenues led to a $0.1 million increase in total gross margin for the software segment, the additional compensation expenses and the lower margins generated by the hardware sales resulted in a 68% gross margin from the software segment during the first fiscal quarter of 2007, as compared to 73% during the first fiscal quarter of 2006. Since the purchased software development costs were fully amortized and since Forgent expects to generate more business from its software segment, management expects gross margins from the software segment to improve during the next fiscal quarter, in terms of total dollars and percentage of revenues.

Selling, General and Administrative

Selling, general and administrative expenses for the three months ended October 31, 2006 were $2.5 million, a decrease of $0.2 million or 7%, from the $2.7 million reported for the three months ended October 31, 2005. Selling, general and administrative (SG&A) expenses as a percentage of revenues were 28% and 74% for the three months ended October 31, 2006 and 2005, respectively.

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The $0.2 million decrease in SG&A expenses during the three months ended October 31, 2006 is due to the decrease in legal expenses from Forgent s intellectual property licensing segment. Legal expenses recorded as part of SG&A expenses, as opposed to legal expenses recorded as part of cost of sales, relate primarily to consultants fees, document production expenses and travel expenses. During the first fiscal quarter of 2007, legal expenses related to the 672 Litigation decreased by approximately $0.4 million, as compared to the first fiscal quarter of 2006. The 672 Litigation was resolved on October 25, 2006 when Forgent signed a settlement agreement with the remaining defendants. The decrease in legal expenses related to the 672 Litigation was offset by an increase of approximately $0.2 million in legal expenses related to the 746 Litigation.

As Forgent continues to pursue licensing and litigating the 746 patent, significant legal fees and consulting expenses will continue to be incurred and may increase. However, management believes the Company has the necessary financial resources to support all of its current and upcoming licensing and litigation efforts. Due to uncertainties inherent with litigation, management is unable to accurately predict the ultimate outcome and thus, there can be no assurances that the Company will be able to recover these costs. Forgent will continue, however, to evaluate and reduce any unnecessary SG&A expenses that do not directly support the generation of revenues for the Company. In future periods, management expects its SG&A expenses to fluctuate as legal fees and consulting expenses are incurred during the various litigation milestones.

Research and Development

Research and development expenses for the three months ended October 31, 2006 were $116 thousand, a decrease of $15 thousand, or 121%, from the $131 thousand reported for the three months ended October 31, 2005. Research and development (R&D) expenses as a percentage of revenues were 1% and 4% for the three months ended October 31, 2006 and 2005, respectively.

During the three months ended October 31, 2006, Forgent continued developing its MRM product and released versions 7.1 and 7.2, which included minor enhancement updates requested by the Company s enterprise customers. The Company also continued to develop VAM and will release version 5.6 in December 2006. VAM 5.6 also included minor enhancement updates. Forgent is currently working on MRM 7.5 and VAM 6.0 and expects to release these new versions during the third fiscal quarter of 2007. Management will attempt to maintain R&D expenses at reasonable levels in terms of percentage of revenue and anticipates R&D expenses to remain relatively flat during the next fiscal quarter.

Net Income (Loss)

Forgent generated a net income of $2.7 million, or $0.11 per share, during the three months ended October 31, 2006, compared to a net loss of $1.4 million, or $0.05 per share, during the three months ended October 31, 2005. Net income (loss) as a percentage of total revenues were 30% and (38%) for the three months ended October 31, 2006 and 2005, respectively. The $4.1 million increase in the Company s net income is primarily attributable to the $3.9 million increase in gross margin, which is mainly associated with the 672 settlement in the current period.

LIQUIDITY AND CAPITAL RESOURCES

	FOR THE THREE MONTHS ENDED OCTOBER 31, 2006 (in thousands)	2005
Working capital	$ 14,063	$ 12,479
Cash, cash equivalents and short-term investments	15,038	17,309
Cash used in operating activities	(1,059)	(33)
Cash (used in) provided by investing activities	(32)	88
Cash (used in) provided by financing activities	(87)	4

Cash used in operating activities was $1.1 million for the three months ended October 31, 2006 due primarily to a $5.4 million increase in accounts receivable, which was offset by the $2.8 million in net income and a $1.2 million increase in accounts payable. Cash used in operating activities was $33 thousand for the three months

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ended October 31, 2005 due primarily to $1.4 million in net loss, which was offset by a $1.4 million increase in accounts payable. During the three months ended October 31, 2006, Forgent collected $2.8 million in accounts receivable from its intellectual property licensing business. Management plans to continue utilizing these cash receipts for its Patent Licensing Program, especially due to anticipated expenditures related to the 746 Litigation, and to support the growth of its software operations. Forgent s average days sales outstanding was 60 for the first fiscal quarter of 2007, an increase from 15 days for the fourth fiscal quarter of 2006. This increase was due to $5.2 million in outstanding receivables from the intellectual property licensing program as of October 31, 2006. Subsequently, approximately $3.8 million of these receivables were collected as of December 12, 2006. The remaining outstanding receivables are due from international companies and are anticipated to be received fully during the second fiscal quarter. Additionally, Forgent s ability to collect its accounts receivables from the software segment timely is evidenced by the fact that only 5% of the Company s trade receivables were aged out past 60 days as of October 31, 2006.

Cash used in investing activities was $32 thousand for the three months ended October 31, 2006 due to purchases of fixed assets. Cash provided by investing activities was $0.1 million for the three months ended October 31, 2005 due largely to $0.1 million in net sales/maturities of short-term investments. Forgent manages its investments portfolio in order to fulfill corporate liquidity requirements and maximize investment returns while preserving the quality of the portfolio. During the first fiscal quarter, Forgent s investments were maintained in short-term investments that were classified as cash equivalents. The Company s current operations are not capital intensive and Forgent purchased minimal fixed assets during the three months ended October 31, 2006. Management does not anticipate any significant purchases of fixed assets during the remaining fiscal quarters of 2007.

The Company leases office space and equipment under non-cancelable operating leases that expire at various dates through 2013. Certain leases obligate Forgent to pay property taxes, maintenance and insurance and include escalation clauses. The total amount of base rentals over the term of the Company s leases is charged to expense on a straight-line basis, with the amount of the rental expense in excess of the lease payments recorded as a deferred rent liability. Additionally, the Company used the proceeds from its loans with Silicon Valley Bank to purchase equipment and fund operations. As of October 31, 2006, Forgent had an additional $0.5 million available in notes payable from Silicon Valley Bank. Additional notes payable obtained from Silicon Valley Bank would bear interest at prime plus 0.75% and require monthly installments over a three year term. Forgent may periodically make other commitments and thus become subject to other contractual obligations. Forgent s future minimum lease payments under all operating leases and payments on its notes payable as of October 31, 2006 are as follows:

	Payments Due By Period (in thousands)				
	Total	**Less than 1 year**	**1 - 3 years**	**3- 5 years**	**More than 5 years**
Operating lease obligations	$ 21,849	$ 3,502	$ 6,938	$ 6,797	$ 4,612
Notes payable obligations	486	305	181		
Total	**$ 22,335**	**$ 3,807**	**$ 7,119**	**$ 6,797**	**$ 4,612**

Approximately 98% of the Company s operating lease obligations relates to its corporate office location at Wild Basin in Austin, Texas. As of October 31, 2006, Forgent had $5.6 million in future minimum lease payments receivable under non-cancelable sublease arrangements. Additionally, Forgent had a $1.0 million liability related to impairment charges for the economic value of the lost sublease rental income related to its Austin property. In November 2006, the Company fully paid off its outstanding notes payables.

Cash used in financing activities was $87 thousand for the three months ended October 31, 2006 due primarily to $0.1 million in notes payable payments. Cash provided by financing activities was $4 thousand for the three months ended October 31, 2005 due to $0.1 million in proceeds received from the issuance of a note payable, which was offset by $0.1 million in notes payable payments and $4 thousand in proceeds received from the issuance of stock. Forgent s stock repurchase program allows the Company to purchase up to three million shares of the Company s common stock. No shares were repurchased during the three months ended October 31, 2006 or 2005.

As of October 31, 2006, Forgent had repurchased 1,790,401 shares for approximately $4.8 million and had the approval to repurchase approximately 1.2 million additional shares. Management will periodically assess repurchasing additional shares during fiscal year 2007, depending on the Company s cash position, market conditions and other factors.

As of October 31, 2006, Forgent s principal sources of liquidity consisted of $15.0 million of cash and cash equivalents and its ability to generate cash from its intellectual property licensing segment. Management currently plans to utilize its cash balances as necessary to focus on the litigation efforts, continue licensing its intellectual property and fund its software operations. Forgent s ability to generate cash from its intellectual property licensing business is subject to certain risks as discussed under Risk Factors. There remain risks and uncertainties as to the timing of the receipts of license fees due, in part, to the inherent nature of a patent licensing program. Therefore, there is no assurance that the Company will be able to limit its cash consumption and preserve its cash balances, and it is possible that the Company s business demands may lead to cash utilization at levels greater than recently experienced due to the litigation, increased legal expense levels and other factors. Management believes that the Company has sufficient capital and liquidity to pursue its licensing and litigation efforts and to fund its current operations. However, due to uncertainties related to the timing and costs of these efforts, Forgent may need to raise additional capital in the future. Yet, there is no assurance that the Company will be able to raise additional capital if and when it is needed.

CRITICAL ACCOUNTING POLICY

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

Management believes the following represents Forgent s critical accounting policy:

Revenue Recognition

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

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

Software and service revenue consists of software license and service fees. Revenue from the software element is earned through the licensing or right to use the Company s software and from the sale of specific software products. Service fee income is earned through the sale of maintenance and technical support, training and installation. Forgent sells multiple elements within a single sale. The Company allocates the total fee to the various

elements based on the relative fair values of the elements specific to the Company. The Company determines the fair value of each element in the arrangement based on vendor-specific objective evidence (VSOE) of fair value. VSOE of fair value for the software, maintenance, and training and installation services are based on the prices charged for the software, maintenance and services when sold separately. Revenue allocated to maintenance and technical support is recognized ratably over the maintenance term (typically one year). Revenue allocated to installation and training is recognized upon completion of these services. The Company s training and installation services are not essential to the functionality of its products as such services can be provided by a third party or the customers themselves.

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Management established and is responsible for maintaining internal control over the Company s financial reporting. Under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer, management of the Company has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15 under the Securities Exchange Act of 1934) as of a date within 90 days prior to the filing date of this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the date of the evaluation, the Company s disclosure controls and procedures are effective in timely alerting them to the material information relating to the Company required to be included in its periodic filings with the Securities and Exchange Commission. No changes were made in the Company s internal controls over financial reporting during the quarter ended October 31, 2006, that have materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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

Between April 2004 and November 2004, Forgent s wholly-owned subsidiary, Compression Labs, Incorporated (CLI), initiated litigation against multiple companies for infringement of the 672 patent in the United States District Court for the Eastern District of Texas, Marshall Division, seeking royalties from sales of infringing products and monetary damages, among other relief sought. The defendants included Agfa Corporation; Apple Computer, Incorporated; AudioVox Corporation; AudioVox Electronics Corporation; Axis Communications, Incorporated; BancTec, Inc.; Canon USA; Dell Incorporated; Eastman Kodak Company; Fuji Photo Film Co. U.S.A.; Fujitsu Computer Products of America; Gateway, Inc.; Hewlett-Packard Company; International Business Machines Corp.; JASC Software; JVC Americas Corporation; Macromedia, Inc.; Matsushita Electric Corporation of America; Mitsubishi Digital Electronics American, Incorporated; Oce North America, Incorporated; PalmOne, Inc.;

ITEM 4. CONTROLS AND PROCEDURES

Ricoh Corporation; Riverdeep, Incorporated (d.b.a. Broderbund); Savin Corporation; ScanSoft, Inc.; Thomson S.A.; TiVo Inc.; Toshiba Corporation; Xerox Corporation; Yahoo! Inc.; Acer America Corporation; Adobe Systems Incorporated; BenQ America Corporation; Color Dreams, Inc. (d/b/a StarDot Technologies); Concord Camera Corporation; Creative Labs, Incorporated; Creo, Inc.; Creo Americas, Inc.; Google Inc.; Kyocera Wireless Corporation; Onkyo Corporation; Panasonic Communications Corporation of America; Panasonic Mobile Communications Development Corporation of USA; Sun Microsystems Inc.; Veo Inc.; and Microsoft Corporation.

Prior to the first quarter of 2007, Forgent settled with defendants Adobe Systems, Inc.; Apple Computer, Incorporated; AudioVox Corporation; Axis Communications, Incorporated; BenQ America Corporation; Color Dreams, Inc.; JASC Software; Google Inc.; Macromedia, Inc.; ScanSoft, Inc.; Oce North America, Incorporated; Onkyo Corporation; Riverdeep, Incorporated; Xerox Corporation and Yahoo! Inc. On October 25, 2006, Forgent signed a Patent License and Settlement Agreement with the remaining defendants. Under this agreement, Forgent granted the defendants a patent license and the defendants agreed to pay Forgent $8.0 million. Additionally, all parties agreed to release all claims against each other and Forgent has no future obligations related to this settlement.

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

In July 2005, Forgent initiated litigation against 15 companies for infringement of the United States Patent No. 6,285,746 in the United States District Court for the Eastern District of Texas, Marshall Division, seeking injunctive relief against sales of infringing products and monetary damages, among other relief sought. The defendants include Cable One, Inc., a subsidiary of the Washington Post Company; Charter Communications, Inc.; Comcast Corporation; Cox Communications, Inc., a subsidiary of Cox Enterprises, Inc.; EchoStar Communications Corporation; The DIRECTV Group, Inc.; Time Warner Inc.; Scientific-Atlanta Inc.; Motorola Inc.; Diego, Inc.; and their respective subsidiaries. Forgent has since dismissed six defendants from the lawsuit since they had no operational role with respect to infringement: Cox Communications, Inc.; DIRECTV Group, Inc.; DIRECTV Enterprises, LLC; DIRECTV Operations, LLC; EchoStar Communications Corporation; and EchoStar DBS Corporation. No settlements accompanied these dismissals and there have been no other settlements to date in this litigation. The 746 litigation has since been moved to the United States District Court for the Eastern District of Texas, Tyler Division.

On October 2, 2006, the USPTO granted Motorola Inc. s petition and ordered an *inter partes* re-examination of the 746 patent. On October 30, 2006, the USPTO issued its first office action related to this re-examination. This first action, which is not the final conclusion of the re-examination, denied the five claims in the 746 patent. Forgent has 60 days to respond to the USPTO and anticipates working directly with the USPTO to vigorously defend all of the claims of the 746 patent.

On July 18, 2006 the defendants in the 746 Litigation filed a motion for summary judgment against Forgent, asserting that the 746 patent claims are invalid based on alleged indefiniteness in the patent s claims. On September 11, 2006, Forgent and the defendants participated in a court-ordered mediation, which did not result in any settlements or licenses. On September 29, 2006, Motorola, Inc. filed a motion to stay the 746 Litigation pending the re-examination of 746 patent by the USPTO.

On November 9, 2006, Forgent and the defendants in the 746 Litigation appeared before the Court and presented arguments relating to claims construction, the motion for summary judgment and the motion to stay the litigation. On November 20, 2006, the Court denied Motorola Inc. s motion to stay the litigation. The Court did not rule on the motion for summary judgment and the Company is currently awaiting the Court s ruling on the claims construction. The trial date for the 746 Litigation is set for May 14, 2007.

ITEM 1A. RISK FACTORS

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

INTELLECTUAL PROPERTY LICENSING BUSINESS

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

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

The 672 patent expired in the U.S. and revenues will decline if Forgent is unable to replace this revenue stream.

To date, all of the Company s intellectual property licensing revenue has been derived from the 672 patent. The U.S. 672 patent expired in October 2006 and its foreign counterparts will expire in September 2007. Upon expiration of the 672 patent s foreign counterparts, Forgent will cease receiving any royalties from the MPEG-2 consortium. Therefore, revenues from this patent are finite and, if such revenues are not replaced, net income and the market price of Forgent s common stock will decline following the expiration of the 672 patent.

Forgent s 672 patent is currently being re-examined by the United States Patent and Trademark Office and the Federal Trade Commission is conducting a non-public inquiry into the Company s Patent Licensing Program. Any negative results from the re-examination or the inquiry could reduce the Company s ability to proceed with its licensing process.

The United States Patent and Trademark Office s (USPTO) is currently re-examining the 672 patent and the Federal Trade Commission s (FTC) is conducting a non-public inquiry associated with the Company s Patent Licensing Program. This re-examination and inquiry can cause Forgent to incur significant legal expenses to defend its 672 patent. Additionally, if the FTC proceeds with its inquiry and thereafter determines that the Company acted improperly, further proceedings before the FTC could ensue, which could result in a challenge to the Company s licensing process.

Negative results from the United States Patent and Trademark Office s re-examination of the 746 patent may negatively affect the Company s ability to generate licensing revenues.

See Part II, Item 1 Legal Proceedings for information regarding the USPTO s first office action issued related to the 746 patent. The USPTO s re-examination can cause Forgent to incur significant legal expenses to defend its 746 patent. Since the USPTO denied the claims of the 746 patent, the Company s licensing abilities may be negatively affected. Although Forgent has not recognized any licensing revenues from the 746 patent to date, any successful challenge to the licensing process would reduce the Company s ability to negotiate settlements with defendants in the 746 Litigation and new licenses with other companies.

Forgent may not prevail in its 746 Litigation proceedings, which could cause the Company to incur significant legal expenditures without any related earnings.

The Company has initiated the 746 Litigation against several companies for the infringement of its 746 patent. As with any litigation, the outcome is uncertain, and although the Company intends to vigorously pursue its claims, there are no guarantees that the Company can protect its intellectual property rights in its current litigation or prevent the unauthorized use of its technology in the future. The litigation will be lengthy and costly. Additionally, unintended consequences of the Company s litigations may adversely affect the Company s business, including, without limitation, that the Company may have to devote significant time and financial resources to pursuing the litigation, that the Company may become subject to counterclaims or lawsuits and that the expenses of pursuing the litigation could increase based upon new developments. These, and other factors not currently known to or deemed material by management, could have a material and adverse impact on the Company s business, prospects, liquidity and results of operations.

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

Forgent s litigation involves intensive legal due diligence and negotiations. In the past, the Company changed its legal counsel, which cost the Company in terms of time and money. The Company may still encounter a number of risks associated with its current legal counsel, including but not limited to (1) turnover of individual

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attorneys working on the Company s Patent Licensing Program; (2) availability of key attorneys working on the program; (3) financial and other resources available to legal counsel; and (4) the financial strength of legal counsel. These risks may cause delays in Forgent s ability to proceed with its litigation, which could require significant additional legal expenditures and could result in declining revenues and earnings for the Company.

SOFTWARE & SERVICES BUSINESS

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

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

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

The future success of the Company s software segment is dependent in significant part on its ability to generate demand for its NetSimplicity software products and services. To this end, Forgent s marketing and sales operations must increase market awareness of its products to generate increased revenue. All sales new hires will require training and may take time to achieve full productivity. Forgent cannot be certain that its new hires will become as productive as necessary or that it will be able to hire enough qualified individuals or retain existing employees in the future. The Company cannot be certain that it will be successful in its efforts to market and sell its products, and if it is not successful in building greater market awareness and generating increased sales, future software revenues may decline.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

OTHER

Forgent s stock may be de-listed from NASDAQ, which may adversely affect the Company s ability to raise capital and stockholders ability to sell their shares.

On August 11, 2006, Forgent received a **NASDAQ** deficiency letter indicating that for 30 consecutive days, the per-share price of the Company s common stock closed below the minimum $1.00 per-share requirement and therefore, its common stock is subject to potential delisting from the **NASDAQ** Global Market pursuant to Rule 4450(a)(5). The Company was provided 180 calendar days, or until February 7, 2007, to regain compliance by maintaining a bid price of at least $1.00 for 10 consecutive trading days. If the Company cannot achieve compliance with the minimum per-share price requirement by February 7, 2007, NASDAQ will provide written notification that the Company s securities will be de-listed.

The Company may pursue trading on the NASDAQ Capital Market. If NASDAQ approves, Forgent would be provided an additional 180 calendar days to regain compliance with the minimum $1.00 per-share requirement while trading on the NASDAQ Capital Market. If NASDAQ does not approve the Company to trade on the Capital Market and the Company cannot achieve compliance by any other means, Forgent s common stock will be de-listed from NASDAQ.

If Forgent s common stock is de-listed from NASDAQ, the market liquidity of Company s common stock will be significantly limited, which would reduce stockholders ability to sell their Forgent securities in the secondary market. Additionally, any such de-listing would harm Forgent s ability to raise capital through alternative financing sources on acceptable terms, if at all, and may result in the loss of confidence in the Company s financial stability by suppliers, customers and employees. Forgent cannot give investors in its common stock any assurance that the Company will be able to regain and maintain compliance with the $1.00 per-share minimum price requirement for continued listing on NASDAQ or that its stock will not be de-listed by NASDAQ.

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

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

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

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

As part of Forgent s business strategy, Forgent may acquire additional businesses, products and technologies that could complement or expand its ongoing business. However, Forgent may be unable to identify suitable acquisitions or investment candidates. Even if Forgent identifies suitable candidates, there are no assurances that the Company will be able to make the acquisitions or investments on favorable terms. Negotiations of potential acquisitions could divert management time and resources and the Company may incorrectly judge the value or worth of an acquired business, product or technology. Additionally, Forgent may incur significant debt or be required to issue equity securities to pay for such future acquisitions or investments.

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

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

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

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

Although Forgent generated net income for the three months ended October 31, 2006, the Company incurred losses during the prior fiscal quarters. As of October 31, 2006, Forgent had an accumulated deficit of $248.0 million and Forgent may continue to incur additional losses in the future. Continued losses may cause existing and new customers to question the Company s viability and be reluctant to purchase from the Company. If Forgent is unable to increase its sales due to such concerns, revenues will decline, which would further adversely affect the Company s operating results. Therefore, there are no assurances that the Company can achieve or generate sufficient revenues to achieve profitability.

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

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

- timing of intellectual property license agreements and related recording of licensing revenues;
- results of the claims construction and summary judgment hearings for the 746 Litigation;
- resolution of the USPTO s re-examination of the 672 patent and the 746 patent;
- resolution of the FTC s non-public investigation;
- timing and costs related to the Company s patent litigation;
- market demand for NetSimplicity s software products and services;
- timing of customers budget cycles;
- timing of customer orders and deployment of NetSimplicity s software products and services;
- the mix of software license and services revenue;
- timing of introducing new products and services or enhancements to existing products and services;
- new product releases or pricing policies by Forgent s competitors;
- seasonal fluctuations in capital spending;
- changes in the rapidly evolving market for web-based applications;
- management s ability to manage operating costs, a large portion of which are relatively fixed in advance of any particular quarter;
- timing and costs related to possible acquisitions of businesses, products or technologies;

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

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

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

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

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

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

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

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

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibits:

3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company s quarterly report on Form 10-Q for the three months ended October 31, 2004).
3.2	Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Company s quarterly report on Form 10-Q for the three months ended October 31, 2004).
4.1	Specimen Certificate for the Common Stock (incorporated by reference to Exhibit 4.1 to the Company s Registration Statement on Form S-1, File No. 33-45876, as amended).
4.2	Rights Agreement, dated as of December 19, 2005 between Forgent Networks, Inc. and American Stock Transfer & Trust Company, which includes the form of Series A Preferred Stock, $.01 par

	value, the form of Rights Certificate, and the Summary of Rights (incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K dated December 19, 2005).
10.35*	Patent License and Settlement Agreement, effective October 25, 2006, by and among Forgent Networks, Inc., ACER, Incorporated, Agfa-Gevaert N.V., BancTec, Inc., Canon Inc., Concord Camera Corp., Creative Technology, Ltd., Dell Inc., Eastman Kodak Company and Creo, Inc., FUJIFILM Holdings Corporation, Fujitsu Limited, Gateway, Inc., Hewlett Packard Company, International Business Machines Corporation, Kyocera Corporation, Matsushita Electric Industrial Co., Ltd., Microsoft Corporation, Mitsubishi Electric Corporation, Palm, Inc., Ricoh Company, Ltd., Sun Microsystems, Inc., Thomson, Inc., TiVo Inc., and Toshiba Corporation (incorporated by reference to Exhibit 10.35 of the Company s annual report on Form 10-K for the year ended July 31, 2006).
10.36*	Second Asset Purchase Agreement, effective November 21, 2002, between Forgent Networks, Inc. and Tandberg Telecom AS.
10.37*	Amended Legal Services Fee Agreement, effective September 1, 2006, by and among Forgent Networks, Inc., Hagans, Burdine, Montgomery, Rustay & Winchester, P.C. and Bracewell & Giuliani, L.L.P.
10.38*	Forgent Networks, Inc. Incentive Bonus Plan
31.1*	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith

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SIGNATURES

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

	FORGENT NETWORKS, INC.	
December 15, 2006	By:	/s/ RICHARD N. SNYDER Richard N. Snyder Chief Executive Officer
December 15, 2006	By:	/s/ JAY C. PETERSON Jay C. Peterson Chief Financial Officer

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