AVOCENT CORP
Form 10-Q
August 06, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 29, 2007 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: 000-30575

AVOCENT CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**91-2032368**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
4991 Corporate Drive **Huntsville, Alabama**	**35805**
(Address of Principal Executive Offices)	(Zip Code)

256-430-4000

(Registrant s Telephone Number, Including Area Code)

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

x Yes o No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Securities Exchange Acto.)

Large Accelerated filer x Accelerated Filer o Non- Accelerated filer o

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

As of August 1, 2007, the number of outstanding shares of the Registrant s Common Stock was 50,291,859.

AVOCENT CORPORATION

FORM 10-Q

June 29, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AVOCENT CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited, in thousands, except per share data)

	For the three months ended June 29, 2007	June 30, 2006	For the six months ended June 29, 2007	June 30, 2006
Net sales:				
Products and services	$ 125,407	$ 111,009	$ 238,983	$ 199,199
Licenses and royalties	24,818	6,996	44,393	13,318
Total net sales	150,225	118,005	283,376	212,517
Cost of sales:				
Products and services	51,778	46,595	100,872	85,150
Licenses and royalties	598		957	
Amortization of intangibles related to licenses and royalties	2,767		5,450	
Total cost of sales (including stock compensation of $301 and $480 for the three and six months ended June 29, 2007; $164 and $214 for the three and six months ended June 30, 2006)	55,143	46,595	107,279	85,150
Gross profit	95,082	71,410	176,097	127,367
Research and development expenses (including stock compensation of $1,391 and $2,506 for the three and six months ended June 29, 2007; $762 and $1,063 for the three and six months ended June 30, 2006)	21,189	14,321	42,070	27,530
Acquired in-process research and development expense				2,100
Selling, general and administrative expenses (including stock compensation of $3,411 and $5,779 for the three and six months ended June 29, 2007; $1,796 and $2,286 for the three and six months ended June 30, 2006)	52,442	32,718	101,102	56,102
Cyclades integration expenses		2,269		2,269
Amortization of intangible assets	7,581	4,901	16,543	7,252
Total operating expenses	81,212	54,209	159,715	95,253
Income from operations	13,870	17,201	16,382	32,114
Net investment income	904	2,114	1,783	5,205
Net realized investment gains (losses)		2		(53)
Interest expense	(2,268)	(137)	(4,502)	(146)
Other income (expense), net	15	(200)	(302)	(211)
Income before income taxes	12,521	18,980	13,361	36,909
Provision (benefit) for income taxes	(2,479)	5,399	(2,385)	10,395
Net income	$ 15,000	$ 13,581	$ 15,746	$ 26,514
Earnings per share:				
Basic	$ 0.30	$ 0.28	$ 0.31	$ 0.55
Diluted	$ 0.29	$ 0.28	$ 0.31	$ 0.54
Weighted average shares used in computing earnings per share:				
Basic	50,476	47,943	50,607	48,515
Diluted	51,158	48,709	51,457	49,336

See notes accompanying these condensed consolidated financial statements.

Avocent Corporation

Consolidated Balance Sheets

June 29, 2007 and December 31, 2006

(Unaudited, in thousands, except per share data)

	June 29, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 91,443	$ 81,301
Investments maturing within one year	17,668	25,864
Accounts receivable, less allowance for doubtful accounts of $2,201 and $2,449 at June 29, 2007 and December 31, 2006, respectively	110,329	126,471
Other receivables	11,148	13,365
Inventories	32,230	41,765
Other current assets	5,624	3,904
Deferred tax assets, net	9,266	7,355
Total current assets	277,708	300,025
Investments		987
Property and equipment, net	38,018	38,004
Goodwill	590,386	607,488
Other intangible assets, net	189,055	209,674
Other assets	2,787	2,676
Total assets	$ 1,097,954	$ 1,158,854
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 14,639	$ 16,260
Accrued wages and commissions	20,826	25,511
Accrued liabilities	25,822	29,754
Income taxes payable	13,729	17,364
Deferred revenue, current	47,485	44,453
Total current liabilities	122,501	133,342
Unsecured bank line of credit	115,000	150,000
Deferred tax liabilities, net	9,491	30,377
Deferred revenue, non-current	10,057	10,070
Other non-current liabilities	532	1,222
Total liabilities	257,581	325,011
Commitments and contingencies *(see Notes 10 and 11)*		
Stockholders equity:		
Preferred stock, par value $0.001 per share; 5,000 shares authorized; no shares issued and outstanding		
Common stock, par value $0.001 per share; 200,000 shares authorized; June 29, 2007 53,814 shares issued and 50,847 outstanding; December 31, 2006 53,382 shares issued and 50,642 outstanding;	54	53
Additional paid-in capital	1,195,888	1,185,114
Accumulated other comprehensive income	682	65
Accumulated deficit *(see Note 10)*	(248,902)	(261,971)
Treasury stock, at cost; June 29, 2007, 3,327 shares; December 31, 2006, 2,740 shares;	(107,349)	(89,418)
Total stockholders equity	840,373	833,843
Total liabilities and stockholders equity	$ 1,097,954	$ 1,158,854

See notes accompanying these condensed consolidated financial statements.

AVOCENT CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	For the six months ended June 29, 2007	June 30, 2006
Cash flows from operating activities:		
Net income	$ 15,746	$ 26,514
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,730	3,974
Amortization of intangible assets	22,208	7,252
Stock-based compensation	8,765	3,563
Acquired in-process research and development expenses		2,100
Amortization of premiums (discounts) on investments	(143)	100
Net loss on sales of investments		53
Net loss on disposition of fixed assets	222	
Excess tax benefit from stock-based compensation	(848)	(3,845)
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable, net	16,113	(387)
Inventories, net	9,559	(3,415)
Other assets	499	(3,765)
Accounts payable	(1,498)	(5,971)
Accrued wages and commissions	(4,685)	2,456
Accrued other liabilities and deferred revenue	(955)	5,180
Income taxes, current and deferred	(12,254)	(2,228)
Net cash provided by operating activities	57,459	31,581
Cash flows from investing activities:		
Purchase of other intangible assets	(3,425)	(2,699)
Purchase of Cyclades, net of cash received		(91,568)
Purchases of property and equipment	(4,868)	(3,157)
Purchases of investments	(50,681)	(128,420)
Maturities and proceeds from sales of investments	60,085	294,719
Net cash provided by investing activities	1,111	68,875
Cash flows from financing activities:		
Repayment of debt assumed in acquisition		(1,715)
Borrowings (repayments) under unsecured line of credit, net	(35,000)	12,005
Payment of financing costs		(2,005)
Proceeds from employee stock option exercises	3,533	20,587
Excess tax benefit from stock-based compensation	848	3,845
Purchases of treasury stock	(17,931)	(119,186)
Net cash used in financing activities	(48,550)	(86,469)
Effect of exchange rate changes on cash and cash equivalents	122	279
Net increase in cash and cash equivalents	10,142	14,266
Cash and cash equivalents at beginning of period	81,301	66,425
Cash and cash equivalents at end of period	$ 91,443	$ 80,691

See notes accompanying these condensed consolidated financial statements.

AVOCENT CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(Unaudited, in thousands, except per share data)

Note 1. Basis of Presentation

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

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes contained in our Annual Report on Form 10-K for the year ended December 31, 2006, which is on file with the Securities and Exchange Commission and is available at our website, www.avocent.com. The consolidated balance sheet presented in the accompanying condensed consolidated financial statements for December 31, 2006, was derived from the audited financial statements filed in our Form 10-K for the period ended December 31, 2006, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

We report our annual results based on years ending December 31. We report our quarterly results for the first three interim periods based on 13 week periods ending on Fridays and for the fourth interim period ending on December 31.

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

Note 2. Inventories

Inventories consisted of the following at:

	June 29, 2007	December 31, 2006
Raw materials	$ 2,655	$ 3,022
Work-in-process	1,632	1,411
Finished goods	27,943	37,332
Inventories	$ 32,230	$ 41,765

Inventories above have been reduced by reserves for excess and obsolete inventories of $7,058 and $5,578 as of June 29, 2007 and December 31, 2006, respectively.

Note 3. Equity and Treasury Stock

Stock option exercises and restricted stock unit (RSU) vesting Shares of our common stock issued as a result of option exercises totaled 50 shares during the quarter ended June 29, 2007 and 72 shares during the quarter ended June 30, 2006. Shares of our common stock issued as a result of option exercises totaled 186 shares during the six months ended June 29, 2007 and 987 shares during the six months ended June 30, 2006.

During the quarter June 29, 2007, a total of 19 restricted stock units vested. At the release of these shares, 7 shares were withheld for taxes and considered immediately retired, resulting in issuance of 12 shares, net of tax withholding. During the six months ended June 29, 2007, a total of 349 restricted stock units vested. At the release of these shares, 104 shares were withheld for taxes, resulting in issuance of 245 shares, net of tax withholding. There was no such vesting during the three and six months ended June 30, 2006. During the second quarter of 2007 our Compensation Committee approved the grant of 1,075 time-based and 399 performance-based restricted stock units to our officers, directors and other employees.

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(1) Stock repurchases We repurchased 100 shares of our common stock during the quarter ended June 29, 2007 at a cost totaling $2,493. We repurchased 587 shares of our common stock during the six months ended June 29, 2007 at a cost totaling $17,931. We repurchased 3,963 shares of our common stock during the quarter ended June 30, 2006 at a cost totaling $95,303. We repurchased 4,788 shares of our common stock during the six months ended June 30, 2006 at a cost totaling $122,255. We repurchased 122 shares of our common stock at a cost of $3,069 at the end of the second quarter of 2006. The transaction settled at the beginning of our third quarter of 2006.

These treasury shares were purchased on the open market through various brokers under the stock re-purchase plan approved by our Board of Directors. Our Board has approved a total of 12,000 shares for repurchase under the program. As of June 29, 2007 we may repurchase an additional 1,600 shares under this program.

Note 4. Accumulated Other Comprehensive Income (Loss)

We record unrealized gains and losses on our foreign currency translation adjustments, unrealized gains and losses on derivatives which are cash flow hedges, and unrealized holding gains or losses on our available-for-sale securities, net of tax, as as a separate component of stockholders equity as accumulated other comprehensive income (loss). Comprehensive income in the first six months of 2007 of $16,364 consists of $15,746 of net income, $190 of unrealized gains on investments (net of deferred income taxes) and $355 of unrealized gains on the cash flow hedge (net of deferred income taxes) and $73 of foreign currency translation adjustments. Comprehensive income in the first six months of 2006 of $26,926 consists of $26,514 of net income, $133 of unrealized gains on investments (net of deferred income taxes) and $279 of foreign currency translation adjustments. As of June 29, 2007 and December 31, 2006, total accumulated other comprehensive income was $682 and $65, respectively.

Note 5. Earnings Per Share

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the three months ended June 29, 2007			
Basic EPS			
Net income available to common stockholders	$ 15,000	50,476	$ 0.30
Effect of Dilutive Securities			
Stock options and unvested restricted stock awards		682	
Diluted EPS			
Net income available to common stockholders and assumed conversions	$ 15,000	51,158	$ 0.29
For the three months ended June 30, 2006			
Basic EPS			
Net income available to common stockholders	$ 13,581	47,943	$ 0.28
Effect of Dilutive Securities			
Stock options and unvested restricted stock awards		766	
Diluted EPS			
Net income available to common stockholders and assumed conversions	$ 13,581	48,709	$ 0.28
For the six months ended June 29, 2007			
Basic EPS			
Net income available to common stockholders	$ 15,746	50,607	$ 0.31
Effect of Dilutive Securities			
Stock options and unvested restricted stock awards		850	
Diluted EPS			
Net income available to common stockholders and assumed conversions	$ 15,746	51,457	$ 0.31
For the six months ended June 30, 2006			
Basic EPS			
Net income available to common stockholders	$ 26,514	48,515	$ 0.55
Effect of Dilutive Securities			
Stock options and unvested restricted stock awards		821	
Diluted EPS			

Net income available to common stockholders and assumed conversions	$	26,514	49,336	$	0.54

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Anti-dilutive options to purchase common stock outstanding were excluded from the calculations above. Anti-dilutive options totaled 2,203 and 2,207 for the three and six months ended June 29, 2007, respectively. Anti-dilutive options totaled 2,382 and 2,381 for the three and six months ended June 30, 2006, respectively.

Note 6. Segment Reporting

We evaluate the performance of our segments based on revenue and operating profit, which is calculated before corporate and unallocated costs, amortization of intangibles and other purchase accounting adjustments, acquired in-process research and development expense, and stock-based compensation costs. We do not track or use assets by segment as a measure of performance; therefore, we have not presented assets by segment. The following is a reconciliation of information for our reportable segments to our consolidated results:

	For the three months ended		**For the six months ended**	
	June 29, 2007	**June 30, 2006**	**June 29, 2007**	**June 30, 2006**
Net revenue:				
Management Systems	$ 114,964	111,823	$ 220,068	$ 202,321
LANDesk	27,563		51,417	
Other business units	6,035	5,251	10,259	8,272
Corporate and unallocated	2,158	931	2,908	1,924
Amortization of fair value adjustment to LANDesk deferred revenue	(495)		(1,276)	
Total net revenue	$ 150,225	$ 118,005	$ 283,376	$ 212,517

	For the three months ended		**For the six months ended**	
	June 29, 2007	**June 30, 2006**	**June 29, 2007**	**June 30, 2006**
Operating income (loss):				
Management Systems	$ 34,588	$ 30,009	$ 60,499	$ 55,792
LANDesk	1,117		84	
Other business units	(2,073)	(2,453)	(5,222)	(5,152)
Corporate and unallocated costs	(3,804)	(2,580)	(6,922)	(5,309)
Amortization of fair value adjustment to LANDesk deferred revenue	(495)		(1,276)	
Amortization of intangibles and other expenses	(10,360)	(5,053)	(22,017)	(7,554)
Stock-based compensation expense	(5,103)	(2,722)	(8,764)	(3,563)
Acquired in-process research and development expense				(2,100)
Total income from operations	$ 13,870	$ 17,201	$ 16,382	$ 32,114
Other income (expense)	(1,349)	1,779	(3,021)	4,795
Income before provision for income taxes	12,521	18,980	13,361	36,909

Revenue and operating income for our Management Systems Division includes the operating results of Cyclades from

the date of the acquisition on March 30, 2006. LANDesk revenue and operating income includes the operating results from the date of the acquisition on August 31, 2006.

Sales by product line for our Management Systems Division and LANDesk Division for the three months and six months ended June 29, 2007 and June 30, 2006 are as follows:

	For the three months ended		**For the six months ended**	
	June 29, 2007	**June 30, 2006**	**June 29, 2007**	**June 30, 2006**
Management Systems net revenue:				
KVM	$ 87,459	$ 83,496	$ 168,147	$ 161,471
Serial Management	12,752	13,817	24,038	14,810
Embedded software and solutions	7,897	8,828	15,474	14,961
Other	6,856	5,682	12,409	11,079
Total Management Systems net revenue:	$ 114,964	$ 111,823	$ 220,068	$ 202,321

	For the Three Months Ended June 29, 2007	**For the Six Months Ended June 29, 2007**
LANDesk Division net revenue:		
Licenses and royalties	$ 16,800	$ 30,171
Maintenance and services	10,763	21,246
Total LANDesk net revenue	$ 27,563	$ 51,417

We sell our products internationally to customers in several countries; however no foreign country accounted for more than 10% of sales in the second quarter or first six months of 2007 or 2006.

As of June 29, 2007, long-lived assets totaled $38,018, which includes $26,457 held in the United States and $11,561 held outside of the U.S. As of December 31, 2006, long-lived assets totaled $38,004, which includes $25,585 held in the United States and $12,419 held outside of the United States.

Note 7. Forward Contracts and Interest Rate Swap

We use forward contracts to reduce our foreign currency exposure related to the net cash flows from our international operations. The majority of these contracts are short-term contracts (three months or less) and are marked-to-market each quarter and included in trade payables, with the offsetting gain or loss included in other income (expense) in the accompanying consolidated statements of income. As of June 29, 2007, we had four open forward contracts with an approximate fair value of $(5). As of December 31, 2006, we had one open forward contract with an approximate fair value of zero.

In 2006, we entered into an interest rate swap agreement with an original notional amount of $125,000. The objective of the rate swap agreement is to provide a hedge against rising LIBOR interest rates that would have a negative effect on our cash flows due to changes in interest rates on the line of credit. The swap was effective on August 31, 2006 and terminates on December 31, 2008. The swap calls for us to make fixed rate payments of 5.42% over the term of the hedge and to receive floating rate payments based on LIBOR (matching the LIBOR rate in the line of credit above) from the counter-party. We anticipate that the hedge will be settled upon maturity and it is being accounted for as a cash flow hedge. The interest rate swap is recorded at fair value each reporting period with the changes in the fair value of the hedge that take place through the date of maturity recorded in accumulated other comprehensive income (OCI).

At June 29, 2007, we recorded an unrealized loss on the swap, net of tax, of $101 in accumulated OCI. There was no ineffectiveness in the year and we anticipate no reclassification of OCI into earnings in the next 12 months. The notional amount of the swap as of June 29, 2007 is $110,000.

Note 8. Goodwill and Other Intangible Assets

Other intangible assets subject to amortization were as follows:

	June 29, 2007 Gross Carrying Amounts	Accumulated Amortization	December 31, 2006 Gross Carrying Amounts	Accumulated Amortization
Developed technology	$ 69,740	$ 24,440	$ 68,720	$ 17,741
Internally developed software for resale	21,900	3,042	21,900	1,217
Patents and trademarks	36,012	10,109	35,520	7,753
Customer base and certifications	100,198	17,504	100,120	9,449
Maintenance contracts	9,600	1,600	9,600	640
Non-compete agreements	12,720	5,704	12,720	3,775
Other	4,228	2,944	4,228	2,559
	$ 254,398	$ 65,343	$ 252,808	$ 43,134

During the first quarter of 2007, we acquired an existing product line and related technology from a third party for approximately $1,020 in cash, which we recorded in intangible assets. The amounts are subject to future amortization over an estimated three year life. Additionally, the purchase agreement provides for certain potential incentive payments of approximately $600. These potential incentive costs will be recognized as expense over the periods for which the related services are provided.

Amortization expense for other intangible assets for the three months ended June 29, 2007 and June 30, 2006, was $10,348 and $4,901, respectively. Amortization expense for other intangible assets for the six months ended June 29, 2007 and June 30, 2006, was $21,993 and $7,252, respectively. The approximate estimated annual amortization for other intangibles is as follows:

Years ending December 31:	
2007, remaining	$ 22,170
2008	$ 42,097
2009	$ 37,507
2010	$ 34,499
2011	$ 26,034
Thereafter	$ 26,748

As a result of the merger of certain divisions there were reallocations of the carrying amount of goodwill among the divisions during the first quarter of 2007. Additionally, as a result of making certain tax elections during the second quarter of 2007, we adjusted the carrying amount of goodwill for the LANDesk division (*see Note 10*). A summary of changes in goodwill for the six months ended June 29, 2007, is as follows:

	Management Systems Division	LANDesk Division	Embedded Software and Solutions Divisions	Other Business Units	Total
Balance as of December 31, 2006	$ 316,430	$ 274,613	$ 11,862	$ 4,583	$ 607,488
Reallocation from segment changes	11,862		(11,862)		
Adjustments during the six months		(17,102)			(17,102)
Balance as of June 29, 2007	$ 328,292	$ 257,511	$	$ 4,583	$ 590,386

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Note 9. Product Warranties and Deferred Revenue

The activity within the liability for warranty returns for the six months ended June 29, 2007 is as follows:

	2007
Balance, January 1, 2007	$ 2,486
Accruals for product warranties issued during the period	2,480
Settlements made during the period	(2,913)
Balance, June 29, 2007	$ 2,053

Deferred revenue related to our extended warranty for hardware products program was $4,514 at June 29, 2007 and $4,545 at December 31, 2006. We recorded earned revenue from the amortization of deferred revenue related to extended warranties of $2,015 during the six months ended June 29, 2007. In addition, we recorded deferred revenue related to new extended warranties of $1,984 during the six months ended June 29, 2007.

We defer revenue for subscription, service and maintenance contracts until earned, which is generally over the term of the contract or when services are performed. As of June 29, 2007, deferred revenue was $57,542, of which approximately $51,540 related to LANDesk. As of December 31, 2006, deferred revenue was $53,514, of which approximately $47,858 related to LANDesk.

Note 10. Income taxes

During the second quarter of 2007, we made certain elections under the Internal Revenue Code Sec. 338(g) related to the LANDesk acquisition in August 2006. As a result of making these elections, the acquisition will now be treated for U.S. tax purposes as an asset acquisition where we step up the tax basis in assets and liabilities previously recognized in the purchase accounting. We previously accounted for this acquisition as a qualified stock purchase, with carryover tax basis in the assets and liabilities recorded. Our preliminary purchase price allocation was based upon the initial structure of the transaction and did not take into consideration the tax impacts should these elections be made within the required time period, including the tax impacts associated with the amount assigned to in-process R&D that was charged to expense at acquisition. During the second quarter of 2007, we reconsidered the measurement of deferred taxes related to this business combination to take into consideration the tax impacts of the elections made. As a result, we adjusted the deferred tax accounts with the offset reducing the amount of goodwill previously recognized from this transaction. In addition, we recognized a tax benefit of $6,500 during the quarter ended June 29, 2007 to take into consideration the tax impacts associated with the in-process R&D previously charged to expense on a gross basis at acquisition. We have indemnified former LANDesk shareholders for any personal tax consequences should this election create current tax obligations for these former shareholders.

As a result of these tax elections, the effective tax rate in the first six months of 2007 was approximately (17.8)%, compared to an effective tax rate of approximately 28.2% in the first six months of 2006. The provision for income taxes was a benefit of ($2,385) for the first six months of 2007, compared to income tax expense of $10,395 for the first six months of 2006.

We adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 on January 1, 2007. As a result of adopting this FASB Interpretation, we recorded an increase to reserves for uncertain tax positions of $2,900. This increase was recorded as an increase to the January 1, 2007 accumulated deficit balance. As of June 29, 2007 we had total reserves for uncertain tax positions related to gross unrecognized tax benefits of $11,717 of which $9,617, if recognized, would affect the effective tax rate. We recognize potential accrued interest and penalties related to unrecognized tax benefits from our global operations within income tax expense. As of June 29, 2007, we had accrued interest expense related to the unrecognized tax benefits of $2,728.

We conduct business globally, and as a result our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business we are subject to examinations by taxing authorities throughout the world including the U.S. With few exceptions, we are no longer subject to U.S. federal, state, and local, or non-U.S. income tax examinations before 2003.

We are currently under audit by the Internal Revenue Service for the 2004 and 2005 tax years. It is possible that the examination phase of the audit for those years will conclude in 2007, and it is possible a change in the unrecognized tax benefits may occur; however, quantification of an estimated range cannot be made at this time.

Note 11. Litigation

In March 2006, TFS Electronic Manufacturing Services, Inc. (TFS) filed a Third-Party Complaint and an Objection to Claim of Avocent Corporation with the United States Bankruptcy Court, District of Arizona. As a result of the complaint, an adversary proceeding has been commenced against us in the TFS bankruptcy case in an effort to disallow our claim in its entirety. TFS also seeks damages in an undetermined amount for our alleged breach of contract, negligence, negligent misrepresentations, breaches of warranty, unjust enrichment, disparagement of TFS business, and quantum merit. TFS is seeking recovery of actual damages, punitive damages, attorneys fees, pre- and post-judgment interest, costs, and the imposition of joint and several liability as to us and a named co-defendant, TopSearch Printed Circuits (HK), Ltd. (TopSearch). The matter has been consolidated with a separate matter between TFS and TopSearch pending in the United States District Court for the District of Arizona, for purposes of discovery through pre-trial. The court has ordered that early mediation be scheduled and a mediator has been assigned. Discovery is underway. We intend to vigorously defend our positions.

In January 2007, we filed a complaint for patent infringement in the United States District Court for the Western District of Washington against Aten Technology, Inc., Aten International Co., Ltd, Belkin Corporation, Rose Electronics and its general partners, and Trippe Manufacturing Company. The defendants have filed counterclaims alleging non-infringement, unenforceability, and invalidity, and discovery is currently underway. In May 2007, we entered into a Settlement and License Agreement with Trippe Manufacturing, and dismissed Trippe from the lawsuit.

In March 2007, KBM Enterprises, formerly a contract manufacturer for Avocent, filed a complaint against Avocent in the Circuit Court of Madison County, Alabama, seeking $9.5 million for costs allegedly incurred by KBM in its manufacturing efforts on behalf of Avocent. We have filed an answer and counterclaims against KBM and one of its principals, and we intend to vigorously defend our positions. Discovery is currently under way.

In April 2007, we filed a complaint for declaratory judgment against Aten International Co., Ltd. in the United States District Court for the Northern District of Alabama. We are seeking a declaratory judgment that two patents owned by Aten and asserted against Avocent are invalid and that certain of products alleged by Aten to infringe do not infringe these patents.

Note 12. Subsequent Events

During the period from June 30, 2007 through August 1, 2007, we purchased 200 additional shares of our common stock under our share repurchase program for a total cost of $5,822.

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

THE INFORMATION IN THIS ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS CONTAINS FORWARD-LOOKING STATEMENTS, INCLUDING, WITHOUT LIMITATION, STATEMENTS RELATING TO OUR FUTURE BUSINESS PROSPECTS AND ECONOMIC CONDITIONS IN GENERAL; STATEMENTS REGARDING OUR ABILITY TO PREDICT FUTURE SALES AND MANAGE INVENTORY LEVELS; STATEMENTS REGARDING PRICING PRESSURE; STATEMENTS REGARDING THE FLUCTUATION OF OUR REVENUE GROWTH IN RELATION TO ECONOMIC CONDITIONS AND IT CAPITAL SPENDING TRENDS; STATEMENTS REGARDING OUR PRODUCT PLATFORMS AND OUR ABILITY TO RESUME GROWTH IN OUR OVERALL BUSINESS; STATEMENTS REGARDING INCREASED SALES OF OUR DIGITAL PRODUCTS AND EMBEDDED SOLUTIONS AND THEIR ABILITY TO OFFSET PRICE DECLINES AND COMPETITIVE FACTORS; STATEMENTS ABOUT THE REPAYMENT OF OUR BANK LINE OF CREDIT; STATEMENTS REGARDING OUR REVENUE, GROSS MARGINS, OUR RESEARCH AND DEVELOPMENT EXPENSES, OUR SELLING, GENERAL AND ADMINISTRATIVE EXPENSES, AMORTIZATION EXPENSES, AND STOCK-BASED COMPENSATION EXPENSES IN THE SECOND HALF OF 2007; AND STATEMENTS REGARDING OUR LEGAL COSTS FOR PATENT AND OTHER LITIGATION MATTERS. THESE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN PART II, ITEM 1A RISK FACTORS.

Overview

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

For a more complete description of our products, technologies and markets, please refer to our Form 10-K, which was filed on March 1, 2007.

A substantial portion of our revenue is derived from sales to major server OEMs who purchase our switching systems on a private-label or branded basis for integration and sale with their own products, sales through our reseller and distributor network, and sales to a limited number of direct customers. Sales to our branded customers accounted for 65% of sales in the first six months of 2007 and 56% of sales in the first six months of 2006. Sales to our OEM customers accounted for 35% of sales in the first six months of 2007 and 44% of sales in the first six months of 2006. We do not have contracts with many of our branded customers, and in general, our OEM and branded business customers are obligated to purchase products from us only pursuant to binding purchase orders. The loss of, or material decline in orders from, these customers would have a material adverse effect on our business, financial condition, results of operations, and cash flows. Our top five customers include both OEM and branded customers, and accounted for 53% and 60% of sales in the first six months of 2007 and 2006, respectively.

We sell products to resellers, distributors, end-users, and OEMs in the United States, Canada, Europe, and Asia as well as in other foreign markets. Sales within the United States accounted for approximately 57% of sales in the first six months of 2007 and 56% of sales in the first six months of 2006. Sales outside of the United States accounted for 43% of sales in the first six months of 2007 and 44% of sales in the first six months of 2006. No foreign country accounted for more than 10% of sales in the first six months of 2007 or 2006.

With continued industry-wide initiatives to reduce all channel inventories and to shorten lead times, generally trends with our major customers are to reduce the number of weeks of forward-committed firm orders. This trend continues to affect our business with certain distributors, OEMs, and other server manufacturers, and we believe that it will continue to make our future sales more difficult to predict and inventory levels more difficult to manage.

We continue to experience significant price competition in the market for all of our products, and we expect that pricing pressures will continue in the future. In addition, general economic conditions are not predictable and we expect our revenue growth rate to fluctuate in relation to economic conditions and IT related spending trends.

Many of our executive officers and directors are vested in significant amounts of options to purchase shares of our common stock and restricted stock units (RSUs). These officers and directors have informed us that they have sold, and may continue to sell, shares of our common stock to provide liquidity and diversify their portfolios. During the second quarter of 2007 our Board of Directors granted both time-based and performance-based RSUs with two and three year vesting.

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Our largest division, the Management Systems Division comprised 78% of our consolidated net revenue in the first six months of 2007 and 95% in 2006. Our LANDesk Division contributed 18% of net revenue to the first six months of 2007. Our other divisions and unallocated revenue comprised the remaining 4% of our consolidated net revenue in 2007 and 5% of our consolidated net revenue in the first six months 2006. See Note 6 in the notes to the condensed consolidated financial statements contained in Part I, Item 1 of this document.

Results of Operations

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

	Three Months Ended				Six Months Ended			
	June 29, 2007		**June 30, 2006**		**June 29, 2007**		**June 30, 2006**	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	36.7		39.5		37.9		40.1	
Gross profit	63.3		60.5		62.1		59.9	
Operating expenses:								
Research and development expenses	14.1		12.1		14.8		13.0	
Acquired in-process research and development expenses							1.0	
Selling, general and administrative expenses	34.9		27.7		35.7		26.4	
Cyclades integration expenses			1.9				1.0	
Amortization of intangible assets	5.1		4.2		5.8		3.4	
Total operating expenses	54.1		45.9		56.3		44.8	
Income from operations	9.3		14.6		5.8		15.1	
Net investment income	0.6		1.8		0.6		2.4	
Net realized investment losses								
Interest expense	(1.5	)	(.01	)	(1.6	)		
Other income (expense), net			(0.2	)	(0.1	)	(0.1	)
Income before provision (benefit) for income taxes	8.3		16.1		4.7		17.4	
Provision (benefit) for income taxes	(1.7	)	4.6		(0.9	)	4.9	
Net income	10.0	%	11.5	%	5.6	%	12.5	%

Net sales. Net sales increased 27% to $150.2 million for the second quarter of 2007 from $118.0 million for the second quarter of 2006. The increase in sales resulted primarily from the contribution of $27.1 million in revenue from our LANDesk acquisition, completed on August 31, 2006. Branded sales increased 40% from $70.6 million in the second quarter of 2006 to $98.7 million in the second quarter of 2007. As a percentage of sales, branded revenue accounted for 66% of sales in the second quarter of 2007 and 60% of revenue in the second quarter of 2006. OEM sales grew 9% from $47.4 million in the second quarter of 2006 to $51.5 million in the second quarter of 2007. OEM sales were 34% of sales for the second quarter of 2007, compared to 40% of sales for the second quarter of 2006. Sales of our digital products were $70.4 million in the second quarter of 2007 compared to $69.7 million in the second quarter of 2006. Although revenue from sales of digital products increased in dollars, as a percentage of sales our digital products represented 47% of our revenue in the second quarter of 2007 compared to 59% of our revenue in the second quarter of 2006. This decline in the percentage of revenue generated by sales from our digital products is a result of the diversification of our business that the LANDesk acquisition provided.

Sales in the second quarter of 2007 increased 31% within the United States and 22% internationally compared to sales in the second quarter of 2006 primarily due to the additional revenue resulting from our acquisition of LANDesk. LANDesk s revenue comprised $14.9 million of revenue in the United States and $12.2 million of international revenue. Total sales within the United States were $88.3 million and $67.3 million in the second quarter of 2007 and 2006 respectively. International sales were $61.9 million and $50.7 million in the second quarter of 2007 and 2006, respectively. Sales within the United States were 59% of sales in the second quarter of 2007 and 57% of sales in the second quarter of 2006. International sales were 41% of sales in the second quarter of 2007 and 43% of sales in the second quarter of 2006.

Net sales increased 33% to $283.4 million for the first six months of 2007 from $212.5 million for the first six months of 2006. The increase is primarily a result of the added revenue from the acquisitions of Cyclades in the first quarter of 2006 and LANDesk in the third quarter of 2006. Sales within the United States increased by approximately 35% to $162.1 million in the first six months of 2007 compared to domestic sales of $119.7 million in the first six months of 2006. International sales increased approximately 31% to $121.3 million in the first six months of 2007 compared to international sales of $92.8 million in the first six months of 2006. Additionally, sales to our branded customers increased 55% to $183.8 million in the first six months of 2007 from $118.6

in the first six months of 2006, while sales to our OEM customers increased 6% to $99.6 million in the first six months of 2007 from $93.9 in the first six months of 2006.

From a divisional perspective, revenues from our Management Systems Division increased from $111.8 million in the second quarter of 2006 to $115.0 million in the second quarter of 2007, primarily due to the growth in our traditional KVM business. Our Management Systems Division is comprised of our traditional KVM products, our serial products, and our embedded software and solutions products. Revenue from the Management Systems Division accounted for 77% of our revenue in the second quarter of 2007 and 95% of our revenue in the second quarter of 2006. This decline in the Management System s percentage of revenue is a result of the diversification of our business, primarily as a result of the addition of LANDesk, which accounted for 18% of our revenue in the second quarter of 2007. Our serial management business includes revenue from Cyclades, acquired March 30, 2006. Sales by product line for our Management Systems Division for the three and six month periods ended June 29, 2007 and June 30, 2006 are as follows:

	For the three months ended		**For the six months ended**	
	June 29, 2007	**June 30, 2006**	**June 29, 2007**	**June 30, 2006**
Management Systems net revenue:				
KVM	$ 87,459	$ 83,496	$ 168,147	$ 161,471
Serial Management	12,752	13,817	24,038	14,810
Embedded software and solutions	7,897	8,828	15,474	14,961
Other	6,856	5,682	12,409	11,079
Total Management Systems net revenue:	$ 114,964	$ 111,823	$ 220,068	$ 202,321

The LANDesk Division contributed $27.6 million of net revenue during the second quarter of 2007, or 18% of our net revenue. LANDesk s revenue and bookings are comprised of both license-based revenue, primarily LANDesk Management Suite, and subscription-based revenue, primarily maintenance and LANDesk Security Suite, with the growth in bookings from the subscription-based revenue outpacing the growth in license-based revenue. This change in mix has an impact on the revenue we recognize because subscription revenue is deferred and amortized over the subscription term. Sales by product line for our LANDesk Division for the three and six months ended June 29, 2007 are provided below. As LANDesk was acquired in August 2006, there were no corresponding sales for the three and six month periods ended June 30, 2006.

	For the Three Months Ended June 29, 2007	**For the Six Months Ended June 29, 2007**
LANDesk Division net revenue:		
Licenses and royalties	$ 16,800	$ 30,171
Maintenance and services	10,763	21,246
Total LANDesk net revenue	$ 27,563	$ 51,417

We expect continued improvement and growth in our revenues and earnings during the second half of 2007. Based on information from industry analysts as well as our resellers and end customers, we expect IT capital spending will increase during this time period. Usually the second half of the year sees higher IT capital spending in general and higher revenue for us than in the first half of the year. We expect this seasonal trend will recur in 2007. We expect our revenue for the second half of 2007 will be within a range of $330 to $350 million.

Gross profit. Gross profit is affected by a variety of factors: including the ratio of sales among our distribution channels, as OEM sales typically have lower gross margins than our branded sales; absorption of fixed costs as sales levels fluctuate; product mix; raw material costs; labor costs; new product introductions by us and by our competitors; royalty revenue; sales levels of our software products, which tend to have higher gross margins than our hardware products; and our outsourcing of manufacturing and assembly services. Gross profit increased to $95.1 million, or 63.3% of sales, in the second quarter of 2007 compared to $71.4 million, or 60.5% of sales, in the second quarter of 2006 primarily due to the contribution from our LANDesk acquisition. The increase in gross profit was disproportionately higher than the 27% increase in revenue due to the impact of LANDesk software and maintenance revenue, which has a substantially higher gross profit than that experienced by the rest of Avocent. Gross profit from LANDesk software and maintenance contributed 1.6 points of the 2.8 point increase for the second quarter, excluding the $2.8 million of other intangible amortization resulting from the LANDesk acquisition included in cost of sales. The increase in gross profit from the LANDesk division was partially offset by the additional $2.8 million included in cost of sales from amortization of other intangible assets recorded as a result of the LANDesk acquisition related to internally developed software for resale. Gross profit increased from $127.4 million, or 59.9% of sales, in the first six months of 2006 compared to $176.1 million, or 62.1% of sales, in the first six months of 2007 for the same reasons as that of the increase for the quarter.

Based on our forecasted revenue range for the second half of 2007, we expect positive contributions from LANDesk, which we expect will have a positive affect on our gross margin. We expect the combination of these factors to offset price declines and competitive factors in the last half of 2007. Accordingly, we expect gross margins to be between 64.5% and 65.5% for the remainder of 2007.

Research and development expenses. Research and development expenses were $21.2 million, or 14.1% of sales, in the second quarter of 2007 compared to $14.3 million, or 12.1% of net sales, in the second quarter of 2006. The increase in the amount spent on research and development was primarily due to the additional costs from the LANDesk acquisition, including costs related to the integration of the Avocent and LANDesk software platforms. Our LANDesk division recorded $6.2 million of research and development expense for the second quarter of 2007.

Research and development expenses for the first six months of 2007 increased to $42.1 million from $27.5 million from the first six months of 2006 primarily due the additional costs from the Cyclades and LANDesk acquisitions. LANDesk recorded $11.7 million of research and development expenses in the first six months of 2007. Additionally, the amount of stock-based compensation expensed in the first six months of 2007, $2.5 million, was higher as compared to 2006, $1.1 million, primarily because our Board did not approve the 2006 grants until the second quarter of 2006, and accordingly, we did not begin expensing the related cost until the second quarter of 2006. As a percentage of net sales, year-to-date research and development expenses increased to 14.8% in the first half of 2007 from 13.0% in the first half of 2006.

We believe that the timely development of innovative products and enhancements to existing products is essential to maintaining our competitive position, and we will continue to make significant investments in research and development. We believe research and development expenses for the remainder of 2007 will be relatively consistent with the second quarter of 2007 and within the range of $21.0 million to $22.0 million each quarter.

Acquired in-process research and development expense. Acquisition related expenses in the first six months of 2006 were comprised solely of the non-recurring write-off of $2.1 million of in-process research and development expense related to the acquisition of Cyclades. There were no such charges in the second quarter of 2006 or the first six months of 2007.

Selling, general and administrative expenses. Selling, general and administrative expenses were $52.4 million, or 34.9% of net sales, for the second quarter of 2007 compared to $32.7 million, or 27.7% of net sales, for the second quarter of 2006. The increase in selling, general and administrative expenses was attributed to increased headcount and other costs attributable to the addition of LANDesk, which recorded $16.5 million of selling, general and administrative expenses in the second quarter of 2007. Selling, general and administrative expenses were $101.1 million, or 35.7% of net sales, for the first half of 2007 compared to $56.1 million, or 26.4% of net sales, for the first half of 2006. Again, the increase in selling, general and administrative expenses was attributed to increased headcount and other costs attributable to the addition of LANDesk, which recorded $32.6 million of selling, general and administrative expenses in the first six months of 2007.

We believe certain elements of selling, general and administrative expenses will be flat from the second quarter of 2007, with the exception of sales incentive compensation, which we expect to increase as a result of increased revenue as compared to the first half of 2007. As a result of these factors, including stock-based compensation expense, we expect selling, general and administrative expenses to be in the range of $53 to $56 million in each of the third and fourth quarters of 2007.

Amortization of intangible assets. Amortization of $7.6 million in the second quarter of 2007 included the amortization of the identifiable intangible assets created as a result of the acquisitions of OSA, Sonic Mobility, Cyclades, and LANDesk. Amortization of $4.9 million in the second quarter of 2006 included primarily the amortization of the identifiable intangible assets created as a result of the acquisitions of Equinox, 2C, Soronti, Crystal Link, OSA, Sonic Mobility and Cyclades. Amortization of $16.5 million in the first half of 2007 included the amortization of the identifiable intangible assets created as a result of the acquisitions of OSA, Sonic Mobility, Cyclades, and LANDesk. Amortization of $7.3 million in the first half of 2006 included primarily the amortization of the identifiable intangible assets created as a result of the acquisitions of Equinox, 2C, Soronti, Crystal Link, OSA, Sonic Mobility and Cyclades. The increase in amortization expense relates primarily to additional amortization expense related to the intangible assets recorded in the acquisitions of Cyclades and LANDesk. Amortization expense is expected to be approximately $8 million in each of the third and fourth quarters of 2007.

Stock-Based Compensation. We record compensation expense in each line of our condensed consolidated financial statements based on the department in which an employee works. Stock-based compensation increased from $2.7 million in the second quarter of 2006 to $5.1 million in the second quarter of 2007. The increase was due primarily to the addition of LANDesk employees who were granted retention awards in September 2006 and additional awards to directors, officers, and employees granted during the second quarter of 2007. Of the $5.1 million of stock-based compensation recorded in the second quarter of 2007, $301,000 was recorded in cost of sales, $1.4 million was recorded in research and development expense, and $3.4 million was recorded in selling, general and administrative expenses. Of the $2.7 million of stock-based compensation recorded in the second quarter of 2006,

$164,000 was recorded in cost of sales, $762,000 was recorded in research and development expense, and $1.8 million was recorded in selling, general and administrative expenses.

For the first six months of 2007, we recorded $8.8 million of stock-based compensation: $480,000 was recorded in cost of sales, $2.5 million was recorded in research and development expense, and $5.8 million was recorded in selling, general and administrative expenses. For the first six months of 2006, we recorded $3.6 million of stock-based compensation: $214,000 was recorded in cost of sales, $1.1 million was recorded in research and development expense, and $2.3 million was recorded in selling, general and administrative expenses.

We expect stock-based compensation expense to be in the range of $5.0 million to $6.0 million in each of the third and fourth quarters of 2007. We believe equity based compensation is an important part of our total compensation packages and is needed to attract and retain key employees.

Net investment income. Net investment income decreased to $904,000 in the second quarter of 2007 as compared to $2.1 million in the second quarter of 2006. The decrease in net investment income in the second quarter of 2007 was the result of lower cash and investments as a result of funding the cash component of approximately $200 million of the LANDesk acquisition in the third quarter of 2006, as well as funding the purchase of common stock under our stock repurchase program. Net investment income decreased to $1.8 in the first half of 2007 as compared to $5.2 million in the first half of 2006. The decrease in investment income in the first half of 2007 was also the result of lower cash and investments as a result of funding the purchase of Cyclades late in the first quarter of 2006 and the cash component of the LANDesk acquisition in the third quarter of 2006, purchases of common stock under our stock repurchase program, and repayments of our line of credit.

Net realized investment gains(losses). Net realized investment losses decreased from a $2,000 gain in the second quarter of 2006 to zero in second quarter of 2007. For the first six months, net losses improved from $53,000 in 2006 to zero in 2007.

Interest expense. Interest expense was $2.3 million and $4.5 million in the second quarter and first six months of 2007, respectively. Interest expense was $137,000 and $147,000 in the second quarter and first six months of 2006, respectively. Interest expense results from borrowings under our $250 million unsecured line of credit obtained in the second quarter of 2006, which we used to finance a portion of the LANDesk acquisition and share repurchases.

Other income (expense), net. Net other income improved from an expense of $200,000 in the second quarter of 2006 to income of $15,000 in the second quarter of 2007. Net other expense increased from an expense of $211,000 in the first half of 2006 to an expense of $302,000 in the first half of 2007.

Provision (benefit) for income taxes. The effective tax rate in the second quarter of 2007 was a benefit of approximately 19.8% compared to a provision of approximately 28.4% in the second quarter of 2006. The benefit for income taxes was $2.5 million for the second quarter of 2007, compared to a provision of $5.4 million in the second quarter of 2006. The effective tax rate in the first half of 2007 was a benefit of approximately 17.8% compared to a provision of approximately 28.2% in the first half of 2006. The benefit for income taxes was $2.4 million for the first half of 2007, compared to a provision of $10.4 million in the first half of 2006. As discussed in Note 10 to the consolidated financial statements, the decrease in the effective tax rate was primarily the result of making certain tax elections during the second quarter of 2007 related to the LANDesk acquisition and the resulting $6.5 million tax benefit for the previously expensed $18.6 million of in-process R&D. Deferred tax liabilities have been adjusted as a result of the tax elections related to the LANDesk acquisition. We adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 on January 1, 2007. As a result of adopting this FASB Interpretation, we recorded an increase to reserves for uncertain tax positions of $2.9 million. This increase was recorded as an increase to the January 1, 2007 accumulated deficit balance.

Net income. Net income for the second quarter of 2007 was $15.0 million compared to $13.6 million for the second quarter of 2006, as a result of the factors detailed in the above discussion. Net income, as a percentage of sales for the second quarter of 2007, was 10.0% compared to 11.5% for the second quarter of 2006. Net income for the first half of 2007 was $15.7 million compared to $26.5 million for the first half of 2006, as a result of the factors detailed in the above discussion. Net income, as a percentage of sales for the first half of 2007, was 5.6% compared to 12.5% for the first half of 2006.

Liquidity and Capital Resources

As of June 29, 2007, our principal sources of liquidity consisted of $109 million in cash, cash equivalents, and investments. We also have a $250 million unsecured five year revolving bank line of credit that is available for general corporate purposes. The line of credit currently bears an interest rate of LIBOR plus 70 basis points. We reduced the outstanding balance of our line of credit by $35.0 million during the second quarter of 2007, resulting in a balance of $115 million outstanding under the line of credit as of June 29,

2007. We classify the entire obligation as long-term as it carries a five-year term and has no required repayment schedule. We expect to repay the borrowings with future cash flows from operations or potential future capital raising activities.

Our operating activities generated cash of $57.5 million in the first six months of 2007, compared to approximately $31.6 million in the first six months of 2006. The improvement in cash flow in the first half of 2007 was primarily the result of increases in accounts receivable collections during the second quarter of 2007, a decline in inventory during the second quarter of 2007 and an increase in cash earnings. Our accounts receivable decreased $16.1 million from December 31, 2006 to June 29, 2007 as a result of the improved cash collections. In addition to the decline in our accounts receivable balance, our days sales outstanding (DSO) improved to 67 days from approximately 74 days at the end of the first quarter of 2007. DSO improvement is also a direct result of improved collections during the second quarter of 2007. Adding LANDesk customer balances to our accounts receivable, which tend to have longer payment terms than legacy Avocent balances, offset some of the improvement in our DSO. However, LANDesk DSO improved from approximately 108 days at the end of the first quarter of 2007 to 93 days at the end of the second quarter of 2007. Excluding our LANDesk Division, our DSO was approximately 61 days at the end of the second quarter of 2007 and was 67 days at the end of the first quarter of 2007.

Inventories decreased $9.6 million from December 31, 2006 to June 29, 2007. Our operations group worked to reduce our inventories in the first half of 2007, especially during the second quarter. As a result our inventory turns improved to 6.0 in the second quarter of 2007, compared to 4.6 for the first quarter of 2007. A decline in accrued compensation due to the payment of 2006 annual bonuses partially offset the decline in accounts receivable and inventories impact to cash flow from operations for the first half of 2007.

In the ordinary course of our business, we may at any point in time have a significant amount of contractual commitments not yet recognized in our financial statements. These commitments relate primarily to our need to schedule the purchase of inventories in advance of the related forecasted sales to customers. We have longer lead times for the products we purchase from suppliers based in Asia than those for our U.S. based and European suppliers. Our actual contractual commitments are typically limited to products needed for one to three months of forecasted sales. The liabilities for these inventory purchases along with the related inventory assets are typically recognized upon our receipt of the products. We also have at any point in time a variety of short term contractual commitments for services such as advertising, marketing, accounting, legal, and research and development activities. The liabilities for these services and the related expenses are typically recognized upon our receipt of the related services. As of June 29, 2007, we had approximately $27.9 million of such purchase commitments. None of our expected purchase commitments requires payment beyond the next year. During the second quarter of 2007, we recognized a tax benefit of approximately $6.5 million to take into consideration the tax impacts associated with the in-process R&D previously charged to expense on a gross basis at acquisition. We have indemnified former LANDesk shareholders for any personal tax consequences should this election create current tax obligations for these former shareholders.

We adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 on January 1, 2007. As a result of adopting this FASB Interpretation, we recorded an increase to reserves for uncertain tax positions of $2,900. This increase was recorded as an increase to the January 1, 2007 accumulated deficit balance. As of June 30, 2007 we had total reserves for uncertain tax positions related to gross unrecognized tax benefits of $11,717 of which $9,617, if recognized, would affect the effective tax rate. We recognize potential accrued interest and penalties related to unrecognized tax benefits from our global operations within income tax expense. As of June 30, 2007, we had accrued interest expense related to the unrecognized tax benefits of approximately $2,728. (*see Note 10 in the notes to the condensed consolidated financial statements in Part I, Item 1*).

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

We repurchased 587,000 shares of our common stock for a total cost of approximately $17.9 million during first half of 2007 under the stock repurchase program approved by our Board of Directors. During the first quarter of 2007, our Board approved the repurchase of up to an additional 2.0 million shares under our share repurchase program. As of June 29, 2007, we had the authority from our Board to repurchase an additional 1.6 million shares under this program.

Investments

Our investments consist of corporate bonds, municipal bonds, commercial paper, and mortgage backed securities guaranteed by U.S. government agencies. We classify our debt and equity securities as available-for-sale securities and report them at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders equity. We periodically review our investment portfolio for investments considered to have sustained an other-than-temporary decline in value.

Upon review of our investment portfolio as of June 29, 2007, no investments were considered to have sustained an other-than-temporary decline, and no charge was recorded in the first half of 2007.

Recently Issued Accounting Standards and Regulatory Standards

See above regarding adoption of FIN 48 during the first quarter of 2007.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our primary market risk is the potential loss arising from increases in interest rates, which could have an adverse impact on the fair value of our investment securities. Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing the return on our investment portfolio through the investment of available funds. We diversify our investment portfolio by investing in a variety of highly-rated investment-grade securities and through the use of different investment managers. Our investment securities portfolio is primarily invested in securities with maturities (or interest rate resets) of two years or less with at least an investment grade rating to minimize interest rate and credit risk as well as to provide for an immediate source of funds. Market risk, calculated as the potential change in fair value in our investment portfolio resulting from a hypothetical 10% change in interest rates, was not material at June 29, 2007. We generally hold investment securities until maturity.

We also face interest rate risk on our bank line of credit which currently bears interest at a variable rate of LIBOR plus 70 basis points. We have partially hedged this exposure to interest rate risk with an interest rate swap, which currently has a remaining notional amount of $110 million, through a well-established financial institution.

We also face foreign currency exchange rate risk to the extent that the value of certain foreign currencies relative to the U.S. dollar affects our financial results. Our international operations transact a portion of our business in currencies other than the U.S. dollar, predominantly the euro, and changes in exchange rates may positively or negatively affect our revenue, gross margins, operating expenses, and retained earnings since these transactions are reported by us in U.S. dollars. We occasionally purchase foreign currency forwards aimed at limiting the impact of currency fluctuations. These instruments provide only limited protection against currency exchange risks, and there can be no assurance that such an approach will be successful, especially if a significant and sudden decline occurs in the value of local currencies. As of June 29, 2007, we had four open forward contracts with an approximate fair value of $(5,000).

Item 4. Controls and Procedures.

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of June 29, 2007, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective.

(b) *Changes in internal control over financial reporting*. There were no changes in our internal controls over financial reporting during the quarter ended June 29, 2007 that materially affected or is reasonably likely to materially affect, our internal controls over financial reporting. We have begun to integrate LANDesk into our standard processes and controls and ERP system and we expect to complete the integration during 2007.

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Item 1. Legal Proceedings.

In March 2006, TFS Electronic Manufacturing Services, Inc. (TFS) filed a Third-Party Complaint and an Objection to Claim of Avocent Corporation with the United States Bankruptcy Court, District of Arizona. As a result of the complaint, an adversary proceeding has been commenced against us in the TFS bankruptcy case in an effort to disallow our claim in its entirety. TFS also seeks damages in an undetermined amount for our alleged breach of contract, negligence, negligent misrepresentations, breaches of warranty, unjust enrichment, disparagement of TFS business, and quantum merit. TFS is seeking recovery of actual damages, punitive damages, attorneys fees, pre- and post-judgment interest, costs, and the imposition of joint and several liability as to us and a named co-defendant, TopSearch Printed Circuits (HK), Ltd. (TopSearch). The matter has been consolidated with a separate matter between TFS and TopSearch pending in the United States District Court for the District of Arizona, for purposes of discovery through pre-trial. The court has ordered that early mediation be scheduled and a mediator has been assigned. Discovery is underway. We intend to vigorously defend our positions.

In January 2007, we filed a complaint for patent infringement in the United States District Court for the Western District of Washington against Aten Technology, Inc., Aten International Co., Ltd, Belkin Corporation, Rose Electronics and its general partners,

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and Trippe Manufacturing Company. The defendants have filed counterclaims alleging non-infringement, unenforceability, and invalidity, and discovery is currently underway. In May 2007, we entered into a Settlement and License Agreement with Trippe Manufacturing, and dismissed Trippe from the lawsuit.

In March 2007, KBM Enterprises, formerly a contract manufacturer for us, filed a complaint against us in the Circuit Court of Madison County, Alabama, seeking $9.5 million for costs allegedly incurred by KBM in its manufacturing efforts on our behalf. We have filed an answer and counterclaims against KBM and one of its principals, and we intend to vigorously defend our positions. Discovery is currently underway.

In April 2007, we filed a complaint for declaratory judgment against Aten International Co., Ltd. in the United States District Court for the Northern District of Alabama. We are seeking a declaratory judgment that two patents owned by Aten and asserted against Avocent are invalid and that certain of products alleged by Aten to infringe do not infringe these patents.

Item 1A. Risk Factors.

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

Our acquisition of LANDesk could disrupt our business, expose us to new risks, and adversely affect the results of our operations.

We acquired LANDesk Group Limited (LANDesk) in the third quarter of 2006. This acquisition represents a departure from our core products and technologies and our entry into a new market (systems management software products and services) in which we have very limited experience. The market for systems management products is highly competitive, and we expect competition in this market to continue and intensify. Many of LANDesk s competitors have substantially greater financial, customer support, technical and marketing resources, larger customer bases, longer operating histories, greater name recognition, and more established relationships in the industry than LANDesk has, and we may not have the resources or expertise to compete successfully with them in the future.

The LANDesk acquisition may divert the attention of management and other personnel from our core business operations, which may adversely affect our financial performance in one or more quarters. LANDesk presents us with new and different issues regarding revenue recognition, channel management, and collection of existing or new receivables, any of which could have a material adverse effect on our business, financial condition, and results of operations. We will need to expand and improve our internal systems, including our management information systems, to monitor these items. In particular, we have not yet completed our review and assessment of the internal systems and controls over the LANDesk financial reporting and information systems, and we will also need to expand our operating, administrative, and financial systems and controls to include the LANDesk operations. The acquisition and integration of LANDesk and its software products and services will require significant time, expense, and resources and subject us to the acquisition risks detailed below as we move into this new market. Any failure to successfully integrate and operate LANDesk could thus materially and adversely affect our result of operations, cash flows, and financial position.

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

A key component of our engineering and product development strategy and our future growth is the investment in or the acquisition of technologies and companies, including our acquisitions of Cyclades Corporation and LANDesk Group Limited (LANDesk) in 2006. We intend to continue to execute our strategy through the acquisition of technologies or companies or through investments in complementary companies, products, personnel, or technologies, and it is likely we will complete such acquisitions or investments in the future. These acquisitions and investments involve many risks, including the following:

- Difficulty integrating the acquired company s personnel, products, product roadmaps, technologies, systems, processes, and operations, including product delivery, order management, and information systems;

- Difficulty in conforming the acquired company s financial policies and practices to our policies and practices and in

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implementing and maintaining adequate internal systems and controls over the financial reporting and information systems of the acquired company;

- Diversion of management s attention and disruption of ongoing business;

- Difficulty in combining product and technology offerings and entering into new markets (such as software) or geographical areas in which we have no or limited direct experience and where our competitors may have stronger market positions;

- Loss of management, sales, technical, or other key personnel;

- Revenue from the acquired companies not meeting our expectation, and the potential loss of the acquired company s customers, distributors, resellers, suppliers, or other partners;

- Delays or difficulties and the attendant expense in evaluating, coordinating, and combining administrative, manufacturing, research and development and other operations, facilities, and relationships with third parties in accordance with local laws and other obligations while maintaining adequate standards, controls and procedures, including financial controls and controls over information systems;

- Difficulty in completing projects associated with acquired in-process research and development;

- Incurring amortization expense related to certain intangible assets and recording goodwill and non-amortizable assets that will be subject to impairment testing and possible impairment charges;

- Dilution of existing stockholders as a result of issuing equity securities, including the assumption of any stock options issued by the acquired company;

- Overpayment for any acquisition or investment or unanticipated costs or liabilities;

- Assumption of liabilities of the acquired company, including any potential intellectual property infringement claims or other litigation; and

- Incurring substantial write-offs, restructuring charges, and transactional expenses.

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

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

The markets for our products and technologies are highly fragmented, rapidly evolving, and intensely competitive, and we expect this competition to continue and increase. Aggressive competition from both hardware and software products and technologies could lengthen the customer evaluation process and result in price reductions and loss of sales, which would materially harm our business. Our business is becoming increasingly sensitive to the introduction of new products and technologies (such as virtualization), price changes, and marketing efforts by numerous and varied competitors. Accordingly, our future success will be highly dependent upon our timely completion and introduction of new products and technologies and features at competitive prices and performance levels that address the evolving needs of our customers. We continue to experience aggressive price competition and increased customer sensitivity to product prices, and pricing and margin pressures are likely to increase in the future. Because of this competition, we may have to continue to lower the prices of many of our products and technologies or offer greater functionality within our products to deliver greater value to customers to stay competitive, while at the same time trying to maintain or improve our revenue and gross margin. Because our business model is based on providing innovative and high quality products, we may spend a proportionately greater amount on research and development than some of our competitors. If we cannot proportionately decrease our cost structure on a timely basis in response to competitive price pressures, our gross margin and profitability could be adversely affected. In addition, if our pricing, functionality, and other factors are not sufficiently competitive, or if there is an adverse reaction to our product decisions, we may lose market share in certain areas, which could adversely affect our revenue and prospects.

We compete for sales of switching systems and extension products with companies such as Raritan Computer, Rose Electronics, Minicom Advanced Systems, Aten, Belkin, Lantronix, and Digital V6. These products also face competition from software providers (such as Microsoft, Computer Associates, Tivoli, Symantec, Novell, and BMC Software), who may be able to offer software products competitive with our hardware products at a much lower cost or even bundled for free, and from server manufacturers (including our OEM customers), who are able to offer their competitive technologies or products at the time of the server sale. These competitive software and hardware products address many of the problems our switching systems and technologies, extension products, and remote access products are designed to address.

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

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

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

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

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

The process of developing or acquiring new products and technologies and enhancing existing products and technologies is complex, costly, and uncertain, and any failure by us to anticipate customers changing needs and emerging technological trends accurately could significantly harm our market share and results of operations. We must make long-term investments, develop or obtain appropriate intellectual property, and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. After we develop a product, we must then accurately forecast volumes and configurations that meet customer requirements, manufacture appropriate hardware volumes quickly and at low cost and develop cost-effective software solutions, and train our sales force and resellers. Any delay in the development, production, marketing of, or training for new products or technologies could result in our not being among the first to market, which could further harm our competitive position.

Sales of switching, extension, and remote access products and technologies are characterized by rapid technological advances, frequent new product and technological introductions and enhancements, and significant price competition. If we do not keep pace with these changes, we will lose customers, and our business will be adversely affected. The introduction of products or technologies incorporating superior alternatives such as virtualization hardware and software, other switching software, the emergence of new

industry standards, or changes in pricing structure could render our existing products and technologies and those under development obsolete or unmarketable. New technologies offered by us or our competitors could compete with our existing products at a lower price, which could reduce our revenue.

Our hardware products combine components, such as printed circuit boards, connectors, semiconductors, memory, cable assemblies, power supplies and enclosures that are manufactured by other companies and are generally available to competitors and potential competitors. Our software products combine software or content from third parties, such as open source software or technology, drivers, security, or anti-virus information, which may also be generally available to our competitors and potential competitors. Our future success will depend in large part upon continued innovative application of commercially available components and third party software or technology, and continued enhancements to our proprietary hardware, software, firmware, and other technologies, the expansion and enhancement of existing products and technologies, and our development and introduction of new products and technologies that address changing customer needs on a cost-effective and timely basis. If we fail to respond on a timely basis to technological developments, changes in industry standards, customer requirements, competitive products, product localization, or software innovations, we will lose customers, and our business will be greatly harmed. Similar results could occur if we experience significant delays in the development or introduction of new products or technologies.

Due to our significant reliance on OEM relationships, our hardware development efforts may often be focused on developing new products, technologies, or enhancements for OEM customers. As a result, our OEM relationships may negatively affect our ability to develop new and enhanced products and technologies for our non-OEM customers. Moreover, these new products, technologies, or enhancements for OEM customers may not be available to, or readily marketable to, other customers without significant modification and delay. The expansion, termination, or significant disruption of our relationship with certain OEMs or other customers for whom we devote significant product development resources is likely to result in lost opportunities with respect to the development of products, technologies, or enhancements for our other customers.

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

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

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

We have, in the past, filed complaints for patent infringement against a number of companies, and we may initiate claims or litigation against other third parties for infringement of proprietary rights or to establish the validity of proprietary rights. Similarly, our competitors or other third parties may initiate claims or litigation against us alleging infringement of their proprietary rights or improper use of their intellectual property, and from time to time, third parties notify us that our products may infringe their intellectual property rights, which regardless of merit, requires our time and resources to evaluate and respond. Existing litigation, and any other litigation relating to intellectual property to which we become a party, is subject to numerous risks and uncertainties, including the risk of counterclaims or other litigation against us, and we may not be successful in any such litigation. Litigation is expensive, and the existing litigation or any other litigation by or against us could result in significant additional expense, divert the efforts of technical and management personnel, whether or not such litigation results in a favorable determination, harm our relationships with existing customers, and deter future customers from purchasing or licensing our products. In the event of an adverse result in any such litigation, we could be required to pay substantial damages, suspend or cease the development, manufacture, use, marketing, and sale of any infringing products, expend significant resources to redesign products or develop non-infringing technology, discontinue the use

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of certain processes, or obtain licenses to the infringing technology. There can be no assurance that we would be successful in such development or that such licenses would be available on reasonable terms, or at all, and any such development or license could require us to expend substantial time and other resources. In the event that any third party makes a successful claim against us, or our customers, and a license is not made available on commercially reasonable terms, our business, financial condition, and results of operations could be adversely affected. In addition, any dispute involving our intellectual property could result in our customers, distributors, or resellers becoming involved in the litigation, which could trigger indemnification obligations in certain of our sales, license, or service agreements.

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

We are likely to experience fluctuations in operating results.

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

- The volume, timing, pricing, and contractual terms of orders, particularly from OEMs, resellers, and other large customers, a significant portion of which tend to occur late in each quarter;
- The timing of shipments;
- The timing of new product introductions, new technologies, and enhancements by us and by our competitors, and the possibility that customers may defer purchases of our products in anticipation of these new products, new technologies, and enhancements;
- Changes in or our failure to accurately predict product or distribution and reseller channel mixes, including changes in the mix of software licenses in which revenue is recognized upfront as opposed to deferred over time and changes in the mix of revenue attributable to higher-margin products as opposed to lower-margin sales or services;
- Changes in demand for our products;
- Fluctuations or a decline in sales of servers due to changes in technology (such as virtualization), economic conditions, or capital spending levels;
- Changes in pricing policies or price reductions;
- Changes in renewal rates for software upgrade protection or maintenance;
- Competition from new products and technologies and price reductions by competitors;
- The availability and cost of supplies, components, or third party code or content on commercially reasonable terms;
- Compatibility or interoperability of our products with third party systems and applications;
- Sales and marketing expenses related to entering into new markets, introducing new products, new technologies, and retaining current OEM and other large customers;

- Fluctuations in foreign currency exchange rates and interest rates;

- The amount and timing of operating expenses and capital expenditures relating to the expansion of our business and operations; and

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• Costs associated with legal proceedings, including legal fees and any adverse judgments or settlements.

Our operating results will continue to be affected by seasonal trends, by general conditions in the IT market, and by general economic conditions. We have experienced, and we expect to continue to experience, some degree of seasonality due to customer buying cycles. We believe that the third and fourth quarters will generally have higher net sales levels due to customer budgeting and procurement cycles, which may depress net sales in other quarters. In addition, European sales are often weaker during the summer months. In the past, revenue in our fourth quarter of each year has typically been higher than revenue in prior quarters for the year, and we typically see a sequential decline in revenue from the fourth quarter of a year to the first quarter of the following year. While it is difficult to predict revenue in any quarter, we expect that this pattern will continue in the future. Many of the factors that create and affect seasonal trends are beyond our control.

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

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

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

Our gross margins are expected to vary and may decline.

Gross margins may vary or decline from period-to-period depending on a number of factors, including:

• The ratio of OEM sales to branded sales, since OEM sales typically have lower gross margins than branded sales;

• The ratio of sales through indirect channels to direct sales, since indirect sales typically have lower gross margins than direct sales;

• Product mix, because sales of some of our products and technologies will have lower gross margins than sales of other products or technologies (e.g. our software products tend to have higher gross margins);

• Raw materials, freight, and labor costs;

• Introduction of new products, services, and technologies by us and by our competitors; and

• The level of outsourcing of our manufacturing and assembly services for our hardware products.

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

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

A substantial portion of our sales is concentrated among a limited number of OEM customers. Sales to these

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OEMs represented approximately 40% of net sales in 2006, 48% of net sales in 2005, and 45% of net sales in 2004. Sales to Hewlett-Packard represented approximately 14% of our net sales in 2006, 20% of our net sales in 2005, and 23% of our net sales in 2004. Sales to Dell represent approximately 14% of net sales in 2006, 15% of our net sales in 2005, and 12% of our net sales in 2004.

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

Our OEM business is subject to many risks, including:

- Contract termination or reduced or delayed orders;

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

- Changes in the OEMs internal product life cycles including the delay of planned new product introductions and uncertainty over product end-of-life decisions;

- Adoption of competing products or technologies developed by third parties for the OEMs, acquisition or internal development of competing products or technologies by the OEMs, or changes in the OEMs marketing of competing products or reduced marketing of our products;

- Changes in corporate ownership, financial condition, business direction, sales compensation related to our products, or product mix by the OEMs: and

- Fluctuations or a decline in sales of servers due to changes in technology (such as virtualization), economic conditions, or capital spending levels.

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

The loss of one or more large OEM customers would materially harm our business. While we have contracts with some of our existing OEM customers, none of our OEM customers is obligated to purchase products from us except pursuant to binding purchase orders. Consequently, any OEM customer could cease doing business with us at any time. Our dependence upon a few OEMs also results in a significant concentration of credit risk, thus a substantial portion of our trade receivables outstanding from time to time may be concentrated among a limited number of customers. In addition, OEM customers have longer payment cycles that increase the likelihood of aged or problem accounts receivable.

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

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

A substantial portion of our sales consists of sales of our branded products to a limited number of resellers and distributors. Sales to resellers and distributors represented approximately 56% of net sales in 2006, 48% of net sales in 2005, and 52% of net sales in 2004. The loss of significant revenue opportunities with these resellers and distributors could negatively impact our results of operations. In addition, many of these customers also have or distribute competing products. If resellers and distributors elect to

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increase the marketing of competing products or reduced marketing of our products, our ability to grow our business will be negatively impacted and will impair one of our substantial revenue sources.

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

- Concentration of business in a limited number of resellers and distributors could result in significant damage to our business upon the termination of our reseller relationship;

- Termination of our reseller and distributor agreements or reduced or delayed orders;

- Difficulty in predicting sales to reseller and distributors who do not have long-term commitments to purchase from us, which requires us to maintain sufficient inventory levels to satisfy anticipated demand;

- Lack of visibility of end user customers and revenue recognition and channel inventory issues related to sales by resellers and distributors;

- Resellers and distributors electing to resale or increase their marketing of competing products or technologies or reduced marketing of our products; and

- Changes in corporate ownership, financial condition, business direction, sales compensation related to our products, or product mix by the resellers and distributors.

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

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

We will need to expand sales through distributors and resellers in order to develop our business and increase revenue.

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

- Difficulties in replacing any lost or terminated distributors or resellers;

- Existing or new distributors and resellers may not be able to effectively sell our current or future products or services;

- Potential distributors and resellers deciding not to enter into relationships with us because of our existing relationships with other distributors and resellers with which they compete;

- Our ability to provide proper training and technical support to our distributors and resellers;
- Distributors and resellers electing to place greater emphasis on products or services offered by our competitors; and

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- The lack of direct control over the business practices, marketing, sales and services offered by distributors and resellers;

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

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

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

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

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

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

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

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

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

For our software products, sales are final and we do not generally allow any returns. We provide a ninety day warranty on the media used to deliver the software, which is not applicable to electronic downloads, and we often provide a limited warranty (usually no more than ninety days) that our products will function in accordance with the user documentation.

In the future, we may, as a result of competitive pressures or customer demands, change our warranty policies or our warranty

terms to provide coverage that is greater in scope and duration than the coverage we currently offer. If we were to increase our warranty coverage, our risk of warranty claims, and therefore our warranty expense and reserves, would likely increase.

We must meet the increased demands on customer service operations or customer satisfaction and sales could suffer.

Continued growth of our sales is likely to be accompanied by increasing demands on customer service operations. As a result of our commitment to a high level of customer service, we will need to invest significant resources in the maintenance and improvement of our customer service resources. Any failure to maintain adequate customer service could cause customer dissatisfaction, result in reduced sales of products and, accordingly, materially adversely affect our business, financial condition, and results of operations.

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

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

- Difficulties in managing foreign distributors and resellers;
- Longer payment cycles and problems in collecting accounts receivable;
- The effects of seasonal customer demand;
- Changes in regulatory requirements;
- Difficulties in meeting the requirements of different international product regulations, including import and export requirements;
- Risks relating to the protection of our intellectual property rights;
- The impact on our marketing expenses and our research and development resources as we localize our product offerings to meet local user requirements such as language translations and hardware compatibility issues;
- Export restrictions, tariffs, and other trade barriers;
- Fluctuations in currency exchange rates; and
- Potentially adverse tax consequences and political instability.

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

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

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

- Ongoing instability or changes in a country s or region s economic or political conditions, including inflation, recession, interest rate fluctuations, and actual or anticipated military or political conflicts, particularly in areas where we have offices or other facilities;

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- Currency fluctuations, which could contribute to variations in sales of products and technologies and could also affect our reported results expressed in U.S. dollars;
- Longer accounts receivable cycles and financial instability among customers;
- Tax or trade regulations, tariffs, duties, and procedures and actions affecting production, pricing, and marketing of or payments for products;
- Local labor conditions and other regulations;
- Differing technology standards or customer requirements;
- Limited or unfavorable intellectual property protection in certain foreign countries including the loss of proprietary information due to piracy or misappropriation;
- Fluctuations in freight costs and disruptions at important geographic points of exit and entry;
- Natural or manmade disasters, such as earthquakes, tsunamis, hurricanes, typhoons, fires, power shortages, blackouts, or telecommunications failures;
- Medical epidemics, such as avian flu or Severe Acute Respiratory Syndrome (SARS);
- Seasonal reductions in business activity in certain foreign countries, such as the summer months in Europe;
- Compliance with a wide variety of complex laws, treaties, and regulations that increase the risks of doing business in certain foreign countries;
- Restrictions against repatriation of earnings from our international operations;
- Difficulties in staffing and managing international operations, including the difficulty in managing a geographically dispersed workforce;
- Possible non-compliance with our Code of Conduct or other corporate policies due to inconsistent laws, interpretations, and/or application of corporate standards in foreign countries;
- Increased financial accounting and reporting burdens and complexities; and
- The need to localize our products.

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

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

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

Currently, a majority of our international business is conducted in U.S. dollars. However, as we expand our international operations, it is likely that international business will increasingly be conducted in foreign currencies. In particular, the introduction of the euro has led many of our European customers to request or insist that our sales to them be denominated in euros instead of U.S. dollars and sales from our software operations are frequently conducted in foreign currencies. Fluctuations in the value of foreign

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currencies relative to the U.S. dollar have caused, and are expected to increasingly cause, currency transaction gains and losses. In addition, currency fluctuations could also affect our reported results expressed in U.S. dollars. While we attempt to hedge our foreign currency exposure, we cannot predict the effect of exchange rate fluctuations upon future quarterly and annual operating results, and we may experience currency losses in the future.

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

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

- Customers budgetary constraints, internal acceptance requirements, and procurement procedures;
- Concerns about the actions or announcements of our competitors and their products;
- Concerns about the future or performance of our company; and
- Changes in economic conditions generally and in the technology market specifically.

For large opportunities, especially for enterprise-wide sales, the sales cycle is often significantly longer than our average sales cycle. In addition, these large opportunities are more difficult to forecast, and if we do not correctly forecast the timing in a given period, the amount of revenue we recognize in a period could be lower than we expect, which could negatively affect our operating results for the then current period and future periods over which revenue would have been recognized. In addition, the terms and conditions of the legal agreements for these large opportunities are often based on our customers purchase agreements and may contain terms that are generally less favorable to us than our standard terms and conditions. As a result, revenue recognition may be delayed.

Our software revenue is dependent on sales to existing customers or the renewal of annual software upgrade protection or maintenance services by existing customers.

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

Maintenance revenue related to the licensing of our software products is a significant part of our current and future operating revenue. In general, maintenance fees increase with the increase in the use of our software. Accordingly, we receive higher maintenance fees with new license agreements and as existing customers install more of our software products on additional systems. Due to increased discounting for larger sales opportunities, maintenance fees on a per unit basis for such large deals can be lower than average. In addition, customers are generally provided reduced annual maintenance percentages for entering into long-term maintenance agreements. Declines in our license bookings, increases in long-term maintenance agreements, customers electing to migrate to competitive products or find alternatives to our products, and/or increased discounting could lead to reduced software maintenance revenue and reduced gross margins.

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

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

Our software products include third party content or code upon which we rely for the interoperability, integration,

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development, or updates of our products, and disruption of our access to such code or content could delay product releases, inhibit our compatibility with third party products, and harm our business.

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

- Owners or licensees of third party systems could adopt more restrictive policies or impose unfavorable terms and conditions for access to their products making it more difficult for us to make our products compatible with their products and resulting in higher research and development costs for us for the enhancement or modification of our existing products and the development of new products;

- Functionality provided by third party code or content in our products may become obsolete, defective, or incompatible with future versions of our products, may not be adequately maintained or updated, and we may be unable to find viable alternatives or develop our own proprietary solution;

- Quality, warranty, and support terms vary dramatically when licensing third party code and content, and we have limited ability to control quality issues with third party code and content and we must depend on our own research and development personnel to evaluate and select third party code that we believe is of the most value to our customers; and

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

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

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

Our software products are generally large and intricate programs. As a result, our current software products, updates, upgrades or future products may contain errors, failures, or bugs, some of which may not become known until after the product has been released by us for use by customers. While we routinely test our products for such errors and identify and correct bugs through our customer support group, these problems are inevitable. Any significant errors may result in, among other things, loss of, or delay in, the market acceptance or our products, lost revenue and sales of our products, reallocation of, or increases in, development and customer support resources, impairment to our reputation, loss of future renewal or maintenance revenue, and increased service and warranty costs. Errors could also result in significant delays in the release of updates, upgrades, or new products while such errors are corrected. Moreover, because our products primarily support other systems and applications, any software errors or bugs in these other systems or applications may affect the performance of our software, and it may be difficult or impossible to determine where the errors reside. As a result, product errors, failures, or bugs could result in significant harm to our business and have a material adverse effect on our results of operations.

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

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

Open source software is software that is made widely available by its authors or other third parties and is often licensed on

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an as is for a nominal fee or, in some cases, at no charge. We have incorporated some open source software into our products, allowing us to enhance certain solutions without incurring substantial additional research and development costs. While we have not experienced any material problems as a result of our use of open source software, use of open source software entails significant risks including:

- Open source software or technology becoming competitive with our proprietary technology, which could cause sales of our products to decline or force us to reduce the fees we charge for our products, which could have a material adverse impact on our revenue and operating margins;

- Requiring that we make available the source code for any modifications or derivative works we make to or from the open source software, and that we license or contribute such modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use;

- Our proprietary software could be combined with open source software in such a way that we would be required to release the source code of our proprietary software; and

- The lack of any warranty, maintenance, or support for most open source software or technology.

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

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

We are greatly dependent on the ability to retain key management, sales, and technical personnel, and our future success is highly dependent upon the personal efforts of our management, sales, and technical personnel and other key employees. The loss of services of key personnel, including those who recently joined us a result of the Cyclades and LANDesk acquisitions, could have a material adverse effect on our business, financial condition, and results of operations. We have attempted to mitigate these risks by offering key Cyclades and LANDesk employees retention bonuses (payable only if they continue employment with us for specified periods) and equity awards, but there is the risk that we could nevertheless lose key management, sales, and technical employees.

We have historically used stock options and are currently using restricted stock units as a key component in our executive and employee compensation programs in order to align employees interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. Many of our employee stock options are fully vested. This could affect our ability to retain present employees. In addition, we are now required to record a charge to earnings for employee stock option grants and other equity incentives. Moreover, applicable stock exchange listing standards relating to obtaining stockholder approval of equity compensation plans could make it more difficult or expensive for us to grant options to employees in the future. As a result, we may incur increased compensation costs, change our equity compensation strategy, or find it difficult to attract, retain, and motivate employees, any of which could materially adversely affect our business.

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

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

For the last several years, we have experienced rapid revenue and customer growth and expansion in the number of employees, product offerings, customers, operating locations, and suppliers. In addition, we have acquired a number of companies in the same time period. This growth and these acquisitions have resulted in increased responsibilities and placed significant strain on our managerial, operational, and financial resources and resulted in new and increased responsibilities for management personnel. There can be no assurance that our management, personnel, systems, procedures, and controls are, or will be, adequate to support our existing and future operations or that we will continue to grow. If we fail to recruit and retain sufficient and qualified managerial, operational, or financial personnel or to implement or maintain internal systems that enable us to effectively manage our growing business and operations worldwide, our financial results in any given period may be adversely affected and our business and financial condition could be materially harmed.

Our ability to effectively manage during changing economic conditions will require us to continue to implement and improve our operational, financial, and information systems and internal controls and will likely require additional management personnel. In addition, we believe that we must continue to develop greater engineering, financial, marketing, sales, and customer service capabilities in order to develop new products and technologies, secure new customers, and effectively serve the evolving needs of present and future customers. We may not be successful in strengthening these capabilities. Without adequate management, engineering, financial, product development, marketing, sales, and customer service capabilities, our ability to effectively manage during changing economic conditions, expand and enhance our product lines, further penetrate existing markets, and develop new markets will be significantly limited. If we are unable to effectively manage during changing economic conditions, our business, financial condition, and results of operations could be materially adversely affected.

Because our business and operating results depend to a significant extent on the general conditions in the server market, any adverse change in the server market due to adverse economic conditions, declining capital spending levels, or other factors could have a material adverse effect on our business, financial condition, and results of operations. In addition, we continue to see industry-wide initiatives by OEMs and by distributors and resellers of our hardware products to reduce their inventories and to shorten their lead times, thereby reducing early commitments to firm orders by our major OEM and our distributor and reseller customers.

Our line of credit could adversely affect us and our operations.

In the second quarter of 2006, we obtained a $250,000,000 unsecured, five-year, revolving, bank line of credit, and we used borrowings under this line of credit to fund a portion of the LANDesk acquisition and the purchase of our shares under our stock repurchase program. Interest expense on borrowings and additional future borrowings under the line of credit could adversely affect our future net income, margins, expenses, and financial conditions by:

- Requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, which would reduce the availability of our cash flow to fund internal growth through working capital and capital expenditures and for other general corporate purposes;

- Increasing our vulnerability to economic downturns in our industry;

- Increasing our vulnerability to interest rate increases to the extent any of our variable rate debt is not hedged;

- Placing us at a competitive disadvantage compared to our competitors that have less debt in relation to cash flow;

- Limiting our flexibility in planning for or reacting to changes in our business and our industry;

- Limiting, among other things, our ability to borrow additional funds, refinance the line of credit, or obtain other financing capacity; and

- Subjecting us to a risk of noncompliance with financial and other restrictive covenants in our indebtedness.

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

Our ability to comply with these provisions of our line of credit may be affected by changes in the economic or business conditions or other events beyond our control. If we do not comply with these covenants and restrictions, we could be in default under our line of credit, and our debt, together with accrued interest, could then be declared immediately due and payable. There can be no assurance that we will be able to obtain sufficient funds to enable us to repay or refinance our debt obligations on commercially reasonable terms or at all. We also face interest rate risk on our bank line of credit which currently bears interest at a variable rate of LIBOR plus 70 basis points. We have partially hedged this exposure to interest rate risk with an interest rate swap, which has a remaining notional amount of $110 million, through a well established financial institution.

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

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

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

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we implement and maintain adequate internal systems and effective internal controls over financial reporting and information systems. We have not yet completed our review and assessment of the internal systems and controls over the LANDesk financial reporting and information systems, and we have until December 31, 2007 to do so. The absence of such controls could have a material adverse effect on our business, financial condition, and results of operations. In addition, correction of any significant deficiencies or material weaknesses (as defined under PCAOB guidelines) could require additional remedial measures including hiring additional personnel which could be costly and time-consuming. If a significant deficiency or material weakness exists as of a future period year-end (including a material weakness identified prior to year-end for which there is an insufficient period of time to evaluate and confirm the effectiveness of the corrections or related new procedures), our management and our auditors will be unable to report favorably as to the effectiveness of our control over financial reporting or information systems. This could result in a loss of investor confidence in the accuracy and completeness of our financial reports and our management, which could result in a decline of our stock price, damage to our business reputation, and potential litigation.

Changes in accounting standards or the interpretation of accounting standards, including changes related to revenue recognition, could cause significant impact on our revenue or earnings.

Based on our interpretation of current accounting standards, we believe we have properly reported our current sales and license revenue. New accounting standards or regulations, changes to current accounting standards, or different interpretations of existing accounting standards in the future could result in corresponding changes in our revenue recognition or other accounting policies that could have a material adverse effect on our financial condition and operating results.

Unforeseen environmental costs could negatively affect our future earnings.

Some of our operations use substances regulated under various federal, state, and international laws governing the environment, including those governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes, and the cleanup of contaminated sites. Many of our products are subject to various federal, state, and international laws governing chemical substances in products, including those regulating the manufacture and distribution of chemical substances and those restricting the presence of certain substances in electronics products. We could incur substantial costs, including cleanup costs, fines, civil or criminal sanctions, third party property damage, or personal injury claims if we were to violate or become liable under environmental laws or if our products become non-compliant with environmental laws. We also face increasing complexity in our product design and procurement operations as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead and certain other substances that will apply to specified electronics products put on the market in the European Union as of July 1, 2006 (Restriction of Hazardous Substances Directive) and similar legislation currently proposed in China and other countries. The ultimate costs under environmental laws and the timing of these costs are difficult to predict, and liability under some environmental laws relating to contaminated sites can be imposed retroactively and on a joint and several basis.

We could also face significant costs and liabilities in connection with product take-back legislation. The European Union has finalized the Waste Electrical and Electronic Equipment Directive (WEEE), which makes producers of electrical goods, including computers and peripherals, financially responsible for specified collection, recycling, treatment, and disposal of past and future covered products. This deadline to enact and implement the directive by individual European Union governments generally was August 13, 2004, although extensions were granted to some countries (such legislation, together with the directive, the WEEE Legislation), and producers are financially responsible under the WEEE Legislation beginning in August 2005. Similar legislation has been or may be enacted in other geographies, including in the United States and Japan, the cumulative impact of which could be significant for us. We have incurred some costs and will continue to incur costs under the WEEE legislation but the amount and timing of these costs are difficult to predict.

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

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

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

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

In 2004, our Board of Directors approved a stock repurchase program whereby we may purchase shares of our common stock. Our Board has approved a total of 12.0 million shares to be repurchased under this program, including 2.0 million additional shares approved by our Board in February 2007. The plan has no expiration date. Details of purchases made during the first six months of 2007 are as follows:

Period:	**Total Number of Shares Purchased During the Period**	**Average Price Paid Per Share for Period Presented**		**Total Cumulative Number of Shares Purchased as Part of Publicly Announced Plan**	**Maximum Number of Shares Remaining to Purchase Under the Plan**
January 1, 2007 January 26, 2007		$		9,813,733	186,267
January 27, 2007 February 23, 2007	186,267	$	35.03	10,000,000	2,000,000
February 24, 2007 March 30, 2007	300,000	$	29.71	10,300,000	1,700,000
Quarter ended March 30, 2007	486,267	$	31.75		
March 31, 2007 April 27, 2007	100,000	$	24.93	10,400,000	1,600,000
April 28, 2007 May 25, 2007		$		10,400,000	1,600,000
May 26, 2007 June 29, 2007		$		10,400,000	1,600,000
Quarter ended June 29, 2007	100,000	$	24.93		
Six months ended June 29, 2007	586,267	$	30.58		

Approximately 104,000 shares were withheld as payment for employee payroll withholding taxes at the release of vested restricted stock units in the first six months of 2007 (*see note 3 to the financial statements*). The 104,000 shares were considered as treasury shares; however, these treasury shares were considered immediately retired and are not considered in the table above.

Item 6. Exhibits.

(a) Exhibits

31.1 Sarbanes-Oxley Act of 2002 Section 302(a) Certification of the Chief Executive Officer

31.2 Sarbanes-Oxley Act of 2002 Section 302(a) Certification of the Chief Financial Officer

32.1 Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

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SIGNATURE

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

AVOCENT CORPORATION
(Registrant)

Date: August 6, 2007

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