SONIC FOUNDRY INC
Form DEF 14A
January 29, 2007

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of

the Securities Exchange Act of 1934

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement
¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to Rule 14a-12

SONIC FOUNDRY, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

SONIC FOUNDRY, INC.

222 West Washington Avenue

Madison, Wisconsin 53703

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held March 15, 2007

The Annual Meeting of Stockholders of **SONIC FOUNDRY, INC**., a Maryland corporation (Sonic) will be held at the Monona Terrace Community and Convention Center, One John Nolen Drive, Madison, Wisconsin 53703 on March 15, 2007 at 9:00 a.m. local time, for the following purposes:

1. To elect one director to hold office for a term of five years, and until his successor is duly elected and qualified.

2. To ratify the appointment of Grant Thornton LLP as our independent auditors for the fiscal year ending September 30, 2007.

3. To transact such other business as may properly come before the meeting or any adjournments thereof.

All the above matters are more fully described in the accompanying Proxy Statement.

Only holders of record of Common Stock at the close of business on January 19, 2007 are entitled to notice of, and to vote at, this meeting or any adjournment or adjournments thereof.

Please complete and return the enclosed proxy in the envelope provided or follow the instructions on the proxy card to authorize a proxy by telephone or over the Internet, **whether or not** you intend to be present at the meeting in person.

By Order of the Board of Directors,

Kenneth A. Minor
Secretary

Madison, Wisconsin

January 26, 2007

If you cannot personally attend the meeting, it is earnestly requested that you promptly indicate your vote on the issues included on the enclosed proxy and date, sign and mail it in the enclosed self-addressed envelope, which requires no postage if mailed in the United States or, follow the instructions on the proxy card to authorize a proxy by telephone or over the Internet. Doing so will save us the expense of further mailings. If you sign and return your proxy card without marking choices, your shares will be voted in accordance with the recommendations of the Board of Directors.

SONIC FOUNDRY, INC.

222 W. Washington Avenue

Madison, Wisconsin 53703

January 26, 2007

PROXY STATEMENT

The Board of Directors of Sonic Foundry, Inc., a Maryland corporation (Sonic), hereby solicits the enclosed proxy. Unless instructed to the contrary on the proxy, it is the intention of the persons named in the proxy to vote the proxies:

FOR the election of Rimas P. Buinevicius as Director for term expiring in 2012; and

FOR the ratification of the appointment of Grant Thornton LLP as independent auditors of Sonic for the fiscal year ending September 30, 2007.

In the event that the nominee for director becomes unavailable to serve, which management does not anticipate, the persons named in the proxy reserve full discretion to vote for any other person who may be nominated. Proxies may also be authorized by telephone or over the Internet by following the instructions on the proxy card. Any stockholder giving a proxy may revoke the same at any time prior to the voting of such proxy. This Proxy Statement and the accompanying proxy are being mailed on or about February 9, 2007.

Each stockholder will be entitled to one vote for each share of Common Stock standing in his or her name on our books at the close of business on January 19, 2007 (the Record Date). Only holders of issued and outstanding shares of Sonic s common stock as of the close of business on the Record Date are entitled to notice of and to vote at the Annual Meeting, including any adjournment or postponement thereof. On that date, we had outstanding and entitled to vote 35,279,304 shares of Common Stock, held by approximately 10,200 shareholders, of which approximately 9,700 were held in street name.

QUORUM; VOTES REQUIRED

Votes cast by proxy or in person at the Annual Meeting will be tabulated by the inspector of elections appointed for the Annual Meeting and will determine whether or not a quorum is present. Where, as to any matter submitted to the stockholders for a vote, proxies are marked as abstentions (or stockholders appear in person but abstain from voting), such abstentions will be treated as shares that are present and entitled to vote for purposes of determining the presence of a quorum but as unvoted for purposes of determining the approval of any matter submitted to the stockholders for a vote. If a broker indicates on the proxy that it does not have discretionary authority as to certain shares to vote on a particular matter and has not received instructions from the beneficial owner, which is known as a broker non-vote, those shares will not be considered as present and entitled to vote with respect to that matter; however, such shares will be considered present for purposes of a quorum. A majority of the shares of Common Stock issued, outstanding and entitled to vote at the Annual Meeting, present in person or represented by proxy, shall constitute a quorum at the Annual Meeting.

The election of the Directors requires a plurality of the votes present and entitled to vote. The approval of each other proposal requires the affirmative vote of the holders of a majority of the votes cast at the Annual Meeting.

DATE, TIME AND PLACE OF ANNUAL MEETING

The Annual Meeting will be held on March 15, 2007 at 9:00 a.m. (Central time) at the Monona Terrace Community and Convention Center, One John Nolen Drive, Madison, Wisconsin 53703.

PROPOSAL ONE: ELECTION OF DIRECTOR

Our Amended and Restated Articles of Incorporation and Bylaws provide that the Board of Directors shall be divided into five classes, with each class having a five-year term. Directors are assigned to each class in accordance with a resolution or resolutions adopted by the Board of Directors, each class consisting, as nearly as possible, of one-fifth the total number of directors. Vacancies on the Board of Directors resulting from death, resignation, disqualification, removal or other causes may be filled by either the affirmative vote of the holders of a majority of the then-outstanding shares or by the affirmative vote of a majority of the remaining directors then in office, even if less than a quorum of the Board of the Directors. Newly created directorships resulting from any increase in the number of directors may, unless the Board of Directors determines otherwise, be filled only by the affirmative vote of the directors then in office, even if less than a quorum of the Board of Directors. A director elected by the Board of Directors to fill a vacancy (including a vacancy created by an increase in the number of directors) shall serve for the remainder of the full term of the class of directors in which the vacancy occurred and until such director s successor is elected and qualified.

Our Amended and Restated Articles of Incorporation provide that the number of directors, which shall constitute the whole Board of Directors, shall be fixed exclusively by one or more resolutions adopted from time to time by the Board of Directors. Our currently authorized number of directors is seven. The seat on the Board of Directors, currently held by Rimas P. Buinevicius., is designated a Class IV Board seat, with a term expiring as of the Annual Meeting. Mr. Buinevicius will stand for re-election at this Annual Meeting.

Mr. Buinevicius is currently a Board member of Sonic who was previously elected by the stockholders. If elected at the Annual Meeting, Mr. Buinevicius would serve until the 2012 Annual Meeting and until his successor is elected and qualified or until his earlier death, resignation or removal.

Nominee for Director for a Five-Year term expiring on the 2012 Annual Meeting

Rimas P. Buinevicius

Mr. Buinevicius, age 44, has been our Chairman of the Board since October 1997 and Chief Executive Officer since January 1997. In addition to his organizational duties, Mr. Buinevicius is a recognized figure in the rich media industry focused on the convergence of technology, digital media and entertainment. Mr. Buinevicius joined Sonic in 1994 as General Manager and Director of Marketing. Prior to joining Sonic, Mr. Buinevicius spent the majority of his professional career in the fields of biomedical and industrial control research and development. Mr. Buinevicius earned an M.B.A. degree from the University of Chicago; a Master s degree in Electrical Engineering from the University of Wisconsin, Madison; and a Bachelor s degree in Electrical Engineering from the Illinois Institute of Technology, Chicago. Mr. Buinevicius is a recipient of Ernst and Young s Entrepreneur of the Year award.

The election of a Director requires the approval of a plurality of the votes cast by holders of the shares of Sonic s common stock. Any shares not voted, whether by broker non-vote or otherwise, will have no impact on the outcome of the election.

The Board of Directors unanimously recommends a vote FOR the election of Mr. Buinevicius as Class IV Director.

DIRECTORS CONTINUING IN OFFICE

Monty R. Schmidt **Term Expires in 2008**

Mr. Schmidt, age 42, has been our Chief Technology Officer since July 2003 and served as President from March 1994 to July 2003 and as a Director since February 1994. Throughout his tenure at Sonic Foundry, Mr. Schmidt has spearheaded a variety of engineering and strategic initiatives that have helped grow Sonic from the one person startup he founded in 1991. In addition to acting as an industry liaison, Mr. Schmidt is responsible for managing and facilitating technology development and utilization. Prior to joining Sonic, Mr. Schmidt served in software and hardware engineering capacities for companies in the medical and food service equipment industries. Mr. Schmidt has a B.S. degree in Electrical Engineering from the University of Wisconsin, Madison.

Gary R. Weis **Term Expires in 2008**

Mr. Weis, age 59, has been a Director of Sonic since February 2004 and was President, Chief Executive Officer and a Director of Cometa Networks, a wireless broadband Internet access company from March 2003 to April 2004. From May 1999 to February 2003 he was Senior Vice President of Global Services at AT&T where he was responsible for one of the world s largest data and IP networks, serving more than 30,000 businesses and providing Internet access to more than one million individuals worldwide. While at AT&T, Mr. Weis also was CEO of Concert, a joint venture between AT&T and British Telecom. Previously, from January 1995 to May 1999 he was General Manager of IBM Global Services, Network Services. Mr. Weis served as a Director from March 2001 to February 2003 of AT&T Latin America, a facilities-based provider of telecom services in Brazil, Argentina, Chile, Peru and Columbia. Mr. Weis earned BS and MS degrees in Applied Mathematics and Computer Science at the University of Illinois, Chicago.

David C. Kleinman **Term Expires in 2009**

Mr. Kleinman, age 71, has been a Director of Sonic since December 1997 and has taught at the Graduate School of Business at the University of Chicago since 1971, where he is now Adjunct Professor of Strategic Management. Mr. Kleinman has been a Director (trustee) of the Acorn Funds since 1972 (of which he is also Chair of the Audit Committee, Chair of the Committee on Investment Performance and a member of the Compliance Committee); a Director since 1984 of North Lime Holdings and its predecessor, Irex Corporation, a contractor and distributor of insulation materials (where he is Lead Director of the Board of Directors); and a Director since 1993 of Plymouth Tube Company, a manufacturer of metal tubing and metal extrusions (where he serves on the Audit Committee). From 1999 to 2006, he was a member of the Advisory Board of DSC Logistics, a logistics management and warehousing firm. From May 1997 to February 2004, Mr. Kleinman served as a Director of AT&T Latin America and predecessor companies, a facilities-based provider of telecom services in Brazil, Argentina, Chile, Peru and Columbia (where he was chair of the Audit Committee and a member of the Compensation Committee). From 1994 to 2005, he was a director of Wisconsin Paper and Products Company, a jobber of paper and paper products. From 1964 to 1971, Mr. Kleinman was a member of the finance staff of the Ford Motor Company.

Paul S. Peercy **Term Expires in 2009**

Mr. Peercy, age 66, has been a Director of Sonic since February 2004. Since September 1999, Mr. Peercy has served as dean of the University of Wisconsin-Madison College of Engineering. Since 2001 Mr. Peercy has been a member of the National Academy of Engineering. In 2000, then-Wisconsin Governor Tommy Thompson named Mr. Peercy to the Wisconsin Technology and Entrepreneurship Council. From August 1995 to September 1999, Mr. Peercy served as president of SEMI/SEMATECH, an Austin, Texas-based non-profit consortium of more than 160 of the nation s suppliers to the semiconductor industry. Prior to that position he was director of Microelectronics and Photonics at Sandia National Laboratories in Albuquerque, New Mexico. He is the author or co-author of more than 175 technical papers and the recipient of two patents. Mr. Peercy received a BA degree in Physics from Berea College and MS and PhD degrees in Physics from the University of Wisconsin - Madison.

Arnold B. Pollard **Term Expires in 2010**

Mr. Pollard, age 64, has been a Director of Sonic since December 1997. From 1993 until January 2002, he was the President and Chief Executive Officer of Chief Executive Group, which published Chief Executive magazine. For over 25 years, he has been President of Decision Associates, a management consulting firm specializing in organizational strategy and structure. Mr. Pollard has served as a Director of Firebrand Financial

Group, an investment banking, brokerage, and asset management firm, since 1996, as a Director and a member of the compensation committee of Delta Financial Corporation, a public company engaged in the business of home mortgage lending, since 2005 as a Director of Sentigen Holding Corp, a public company engaged in the biotechnology industry and since 1996 as a Director of the International Management Education Foundation, a non-profit educational organization. He also serves on the advisory board of PeopleTrends. From 1989 to 1991, Mr. Pollard served as Chairman and Chief Executive Officer of Biopool International, a biodiagnostic public company focusing on blood related testing; and previously served on the boards of Lillian Vernon Corp. and DEBE Systems Corp. From 1970 to 1973, Mr. Pollard served as adjunct professor at the Columbia Graduate School of Business. Mr. Pollard graduated from Cornell University (Tau Beta Pi), and holds a doctorate in Engineering-Economics Systems from Stanford University.

Frederick H. Kopko, Jr. **Term Expires in 2011**

Mr. Kopko, age 51, has been our Secretary from April 1997 to February 2001 and has been a Director since December 1995. Mr. Kopko is a partner of the law firm of McBreen & Kopko, Chicago, Illinois, and has been a partner of that firm since January 1990. He has been a Director of Mercury Air Group, Inc. since 1992. Mr. Kopko received a B.A. degree in economics from the University of Connecticut, a J.D. degree from the University of Notre Dame Law School, and an M.B.A. degree from the University of Chicago.

MEETINGS AND COMMITTEES OF DIRECTORS

The Board of Directors met five times during the fiscal year ended September 30, 2006 (Fiscal 2006). The Board of Directors has reviewed the independence of each director under the listing standards of the National Association of Securities Dealers. Based upon its review, the Board has determined that, of the seven directors who, if elected, will serve on the Board after the annual stockholders meeting, Messrs. Kleinman, Peercy, Weis and Pollard are independent as defined under Nasdaq listing standards.

The Board of Directors has four standing committees, the Audit Committee, the Executive Compensation Committee, the Nominating Committee and the Strategy Committee.

Sonic has a standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Messrs. Kleinman (chair), Weis and Peercy serve on the Audit Committee. Sonic s Board of Directors has determined that all members of Sonic s Audit Committee are independent as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act and as defined under Nasdaq listing standards. The Audit Committee provides assistance to the Board in fulfilling its oversight responsibility including: (i) internal and external financial reporting, (ii) risks and controls related to financial reporting, and (iii) the internal and external audit process. The Audit Committee is also responsible for recommending to the Board the selection of our independent public accountants and for reviewing all related party transactions. The Audit Committee met four times in Fiscal 2006. A copy of the charter of the Audit Committee is available on Sonic s website.

Sonic s Board of Directors has determined that, due to his affiliation with the Graduate School of Business at the University of Chicago, and due to his serving as a director on numerous company boards, along with his other academic and business credentials, Mr. Kleinman has the requisite experience and applicable background to meet Nasdaq standards requiring financial sophistication of at least one member of the audit committee. Sonic s Board of Directors has also determined that neither Mr. Kleinman nor any other member of the Audit Committee is an audit committee financial expert as defined by applicable SEC regulations.

The Executive Compensation Committee consists of Messrs. Kleinman (chair), Weis and Peercy. Mr. Weis was appointed by the Board in January 2007 to replace Mr. Pollard. The Board of Directors has determined that all of the members are independent as defined under Nasdaq listing standards. The Executive Compensation Committee makes recommendations to the Board with respect to salaries of employees, the amount and allocation of any incentive bonuses among the employees, and the amount and terms of stock options to be granted to executive officers. The Executive Compensation Committee met three times in Fiscal 2006. A copy of the charter of the Executive Compensation Committee is available on Sonic s website.

The Nominating Committee consists of Messrs. Pollard (chair) and Kleinman. The Board of Directors has determined that all of the members are independent as defined under Nasdaq listing standards. The purpose of the Nominating Committee is to evaluate and recommend candidates for election as directors, make recommendations concerning the size and composition of the Board of Directors, develop specific criteria for director independence, and assess the effectiveness of the Board of Directors. Our Board of Directors has adopted a charter for the Nominating Committee, which is available on Sonic s website. The Nominating Committee will review all candidates in the same manner regardless of the source of the recommendation. Shareholder recommendations of candidates for Board membership will be considered when submitted with sufficient detail including the candidate s name, principal occupation during the past 5 years, listing of directorships, a statement that such nominee has consented to the submission of the nomination, amount of common stock of Sonic held by the nominee and qualification addressed to Corporate Secretary, Sonic Foundry, Inc., 222 W. Washington Ave., Madison, WI 53703

The Strategy Committee consists of Messrs. Pollard (chair) and Buinevicius. The Strategy Committee meets regularly with senior management, an outside advisory council and other industry experts in order to develop and refine Sonic s business strategy. The Strategy Committee met in person five times and held numerous informal and telephonic meetings in fiscal 2006.

Each member of the Board attended at least 75% of the aggregate of the meetings of the Board and of the Committees on which he served and held during the period for which he was a Board or Committee member, respectively. Directors are expected to attend the Annual Meeting of Stockholders, and all directors attended the 2006 Annual Meeting.

DIRECTORS COMPENSATION

Our directors, who are not also our full-time employees, receive a fee of $1,500 for attendance at each meeting of the Board of Directors and $850 per committee meeting attended, other than the chair of our Audit committee, Mr. Kleinman, who receives $2,000 per Audit Committee meeting attended. In addition, the chair of our strategy committee receives compensation of $5,000 per month totaling $60,000 in 2006 for his role in managing the activities of the strategy committee. The cash compensation paid to the five non- employee directors combined in Fiscal 2006 was $117,400. When traveling from out-of-town, the members of the Board of Directors are also eligible for reimbursement for their travel expenses incurred in connection with attendance at Board meetings and Board Committee meetings. Directors who are also employees do not receive any compensation for their participation in Board or Board Committee meetings.

Pursuant to the Non-Employee Directors Stock Option Plan, we grant to each non-employee director who is reelected or who is continuing as a member of the Board of Directors at each annual stockholders meeting a stock option to purchase 20,000 shares of Common Stock. Further, the chair of our Audit Committee receives an additional stock option grant to purchase 5,000 shares of Common Stock per year pursuant to Sonic s Non Qualified Stock Option Plan. The exercise price of each stock option is equal to the market price of Common Stock on the date the stock option is granted. Stock options issued under the Non-Employee Directors Stock Option Plan generally will vest fully on the first anniversary of the date of grant and expire after ten years. An aggregate of 900,000 shares are reserved for issuance under the Non-Employee Directors Stock Option Plan. In addition, Mr. Pollard was granted an option to purchase 76,000 shares of Common Stock under Sonic s Non Qualified Stock Option Plan and cash compensation of $30,000 in February 2005 and was granted an option to purchase 94,000 shares of Common Stock under Sonic s Non Qualified

Stock Option Plan in December 2005 and cash compensation of $55,000 in January 2006 for accrued fiscal 2005 business advisory services. In calendar year 2006, Mr. Pollard received an additional $55,000 cash compensation for such services and, in January 2007, was awarded an option to purchase 20,085 shares of Common Stock under Sonic s Non Qualified Stock Option Plan.

If any change is made in the stock subject to the Non-Employee Directors Stock Option Plan, or subject to any option granted thereunder, the Non-Employee Directors Stock Option Plan and options outstanding thereunder will be appropriately adjusted as to the type(s), number of securities and price per share of stock subject to such outstanding options.

The options and warrants set forth above have an exercise price equal to the fair market value of the underlying common stock on the date of grant. The term of all such options is ten years.

PROPOSAL TWO: RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS

The Board of Directors, upon the recommendation of the Audit Committee, has appointed the firm of Grant Thornton LLP (GT) as independent auditors to audit our financial statements for the year ending September 30, 2007, and has further directed that management submit the selection of independent public accountants for certification by the stockholders at the annual meeting. Representatives of GT are expected to be present at the annual meeting to respond to stockholders questions and to have the opportunity to make any statements they consider appropriate.

Stockholder ratification of the selection of GT as our independent auditors is not required by our Bylaws or otherwise. However, the Board is submitting the selection of GT to the stockholders for ratification as a matter of good corporate practice. If the stockholders fail to ratify the selection, the Board and the Audit Committee will reconsider whether or not to retain that firm. Even if the selection is ratified, the Board and the Audit Committee in their discretion may direct the appointment of a different independent accounting firm at any time during the year if they determine that such a change would be in the best interests of Sonic and its stockholders.

The ratification of the appointment of GT as independent public accountants requires the approval of a majority of the votes cast by holders of our shares. Shares may be voted for or withheld from this matter. Shares that are withheld and broker non-votes will have no effect on this matter because ratification of the appointment of GT requires a majority of the shares cast.

Recommendation of Board of Directors

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR PROPOSAL 2 RATIFYING THE APPOINTMENT OF GT AS INDEPENDENT AUDITORS FOR SONIC FOUNDRY.

Relations with Independent Auditors

GT has served as our independent public accountants since its appointment in July 2004. As stated in Proposal 2, the Board has selected GT to serve as our independent auditors for the fiscal year ending September 30, 2007.

Audit services performed by GT for fiscal years 2006 and 2005 consisted of the examination of our financial statements, review of fiscal quarter results, and services related to filings with the Securities and Exchange Commission (SEC). We also retained GT to perform certain other tax and consultative services. All fees paid to GT were reviewed, considered for independence and upon determination that such payments were compatible with maintaining such auditors independence, approved by Sonic s audit committee prior to performance.

Fiscal Years 2006 and 2005 Audit Firm Fee Summary

During fiscal years 2006 and 2005, we retained GT to provide services in the following categories and amounts:

	Years Ended September 30,	
	2006	**2005**
Audit Fees	$ 116,115	$ 94,397
Audit Related	16,640	10,950
Tax Fees	25,231	20,637
Other Fees		

All of the services described above were approved by Sonic s audit committee and prior to performance. The Audit Committee may, in its discretion, delegate to one or more of its members the authority to pre-approve any audit or non-audit services to be performed by the independent auditors, provided that any such approvals are presented to the Audit Committee at its next scheduled meeting. The audit committee has determined that the payments made to its independent accountants for these services are compatible with maintaining such auditors independence.

REPORT OF THE AUDIT COMMITTEE [1]

The Audit Committee s role includes the oversight of our financial, accounting and reporting processes, our system of internal accounting and financial controls and our compliance with related legal and regulatory requirements, the appointment, engagement, termination and oversight of our independent auditors, including conducting a review of their independence, reviewing and approving the planned scope of our annual audit, overseeing the independent auditors audit work, reviewing and pre-approving any audit and non-audit services that may be performed by them, reviewing with management and our independent auditors the adequacy of our internal financial controls, and reviewing our critical accounting policies and the application of accounting principles. The Audit Committee held four meetings during fiscal 2006.

Mssrs. Kleinman, Weis and Peercy meet the rules of the SEC for audit committee membership and are independent as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act and under Nasdaq listing standards. In April 2004, the Board approved revisions to the Audit Committee Charter to reflect new rules and standards set forth in certain SEC regulations as well as changes to Nasdaq listing standards. A copy of the Audit Committee Charter was attached as Exhibit A to the 2004 proxy statement filed on April 26, 2004, and is available on Sonic s website.

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[1] The material in this report is not soliciting material , is not deemed filed with the SEC, and is not to be incorporated by reference in any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in such filing.

As set forth in the Audit Committee Charter, management of Sonic is responsible for the preparation, presentation and integrity of Sonic s financial statements and for the effectiveness of internal control over financial reporting. Management and the accounting department are responsible for maintaining Sonic s accounting and financial reporting principles and internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. The independent auditors are responsible for auditing Sonic s financial statements and expressing an opinion as to their conformity with generally accepted accounting principles.

We have reviewed and discussed with our independent auditors, GT, matters required to be discussed pursuant to Statement on Auditing Standards No. 61 (Communications with Audit Committees). We have received from the auditors a formal written statement describing the relationships between the auditor and Sonic that might bear on the auditor s independence consistent with Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees). We have discussed with GT matters relating to its independence, including a review of both audit and non-audit fees, and considered the compatibility of non-audit services with the auditors independence.

The members of the Audit Committee are not full-time employees of Sonic and are not performing the functions of auditors or accountants. As such, it is not the duty or responsibility of the Audit Committee or its members to conduct field work or other types of auditing or accounting reviews or procedures or to set auditor independence standards. Members of the Committee necessarily rely on the information provided to them by management and the independent accountants. Accordingly, the Audit Committee s considerations and discussions referred to above do not assure that the audit of Sonic s financial statements has been carried out in accordance with generally accepted auditing standards, that the financial statements are presented in accordance with generally accepted accounting principles or that Sonic s auditors are in fact independent .

We have reviewed and discussed with management and GT the audited financial statements. We discussed with GT the overall scope and plans of their audit. We met with GT, with and without management present, to discuss results of their examination, their evaluation of Sonic s internal controls, and the overall quality of Sonic s financial reporting.

Based on the reviews and discussions referred to above and our review of Sonic s audited financial statements for fiscal 2006, we recommended to the Board that the audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended September 30, 2006, for filing with the SEC.

Respectfully submitted,

AUDIT COMMITTEE

David C. Kleinman, Chair
Gary R. Weis
Paul S. Peercy

EXECUTIVE OFFICERS OF SONIC

Our executive officers, who are appointed by the Board of Directors, hold office for one-year terms or until their respective successors have been duly elected and have qualified. There are no family relationships between any of the executive officers of Sonic.

Rimas P. Buinevicius is our Chairman of the Board of Directors and Chief Executive Officer. (See Nominee for Director .)

Darrin T. Coulson, age 41, has been our Chief Operating Officer since November 2006, our Senior Vice President of Worldwide Field Operations from August 2005 to November 2006 and served as Regional Sales Manager from November 2004 to August 2005. From May 2003 to November 2004, Mr. Coulson was President of BxVideo, a rich media services company he founded. From March 1994 to November 2001, Mr. Coulson served in various capacities for FORE Systems and its successor corporation, Marconi PLC, including Executive Vice President and General Manager of Global Services and President of the Americas Enterprise Business division, a $700 million enterprise.

Monty R. Schmidt is our Chief Technology Officer and a Director. (See Directors Continuing in Office .)

Kenneth A. Minor, age 44, has been our Chief Financial Officer since June 1997, Assistant Secretary from December 1997 to February 2001 and Secretary since February 2001. From September 1993 to April 1997, Mr. Minor was employed as Vice President and Treasurer for Fruehauf Trailer Corporation, a manufacturer and global distributor of truck trailers and related after market parts and service where he was responsible for financial, treasury and investor relations functions. Prior to 1993, Mr. Minor served in various senior accounting and financial positions for public and private corporations as well as the international accounting firm of Deloitte Haskins and Sells. Mr. Minor is a certified public accountant and has a B.B.A. degree in accounting from Western Michigan University.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table shows information known to us about the beneficial ownership of our Common Stock as of January 19, 2007, by each stockholder known by us to own beneficially more than 5% of our Common Stock, each of our executive officers named in the Summary Compensation Table (Named Executive Officers), each of our directors, and all of our directors and executive officers as a group. Unless otherwise noted, the mailing address for these stockholders is 222 West Washington Avenue, Madison, Wisconsin 53703.

Beneficial ownership is determined in accordance with the rules of the SEC, and includes voting or investment power with respect to shares. Shares of common stock issuable upon the exercise of stock options or warrants exercisable within 60 days after January 19, 2007, which we refer to as Presently Exercisable Options, are deemed outstanding for computing the percentage ownership of the person holding the options but are not deemed outstanding for computing the percentage ownership of any other person. Unless otherwise indicated below, to our knowledge, all persons named in the table have sole voting and investment power with respect to their shares of common stock, except to the extent authority is shared by spouses under applicable law. The inclusion of any shares in this table does not constitute an admission of beneficial ownership for the person named below.

Based on currently available Schedules 13D and 13G filed with the SEC, we do not know of any beneficial owners of more than 5% of our Common Stock, other than listed below.

Name of Beneficial Owner(1)	Number of Shares of Class Beneficially Owned	Percent of Class(2)
Common Stock		
Monty R. Schmidt (3)	3,326,271	9.4%
Rimas P. Buinevicius(4)	2,486,342	6.8
Arnold B. Pollard(5) 733 Third Avenue New York, NY 10017	542,830	1.5
Frederick H. Kopko, Jr.(6) 20 North Wacker Drive Chicago, IL 60606	403,192	1.1
Kenneth A. Minor(7)	379,671	1.1
Darrin T. Coulson(8)	330,754	*
David C. Kleinman(9) 1101 East 58th Street Chicago, IL 60637	235,000	*
Gary R. Weis(10) P.O. Box 272	95,000	*

Deerfield, IL 60015		
Paul S. Peercy(10)		
1415 Engineering Dr		
Madison, WI 53706	80,400	*
All Executive Officers and Directors as a Group (9 persons)(11)	7,879,460	20.6%

* less than 1%

(1) Sonic believes that the persons named in the table above, based upon information furnished by such persons, have sole voting and investment power with respect to the number of shares indicated as beneficially owned by them.
(2) Applicable percentages are based on 35,279,304 shares outstanding, adjusted as required by rules promulgated by the Securities and Exchange Commission.
(3) Includes 183,135 shares subject to Presently Exercisable Options.
(4) Includes 1,183,333 shares subject to Presently Exercisable Options.
(5) Consists of 542,830 shares subject to Presently Exercisable Options.
(6) Includes 220,000 shares subject to Presently Exercisable Options.
(7) Includes 365,274 shares subject to Presently Exercisable Options.
(8) Includes 83,332 shares subject to Presently Exercisable Options.
(9) Consists of 235,000 shares subject to Presently Exercisable Options.
(10) Includes 80,000 shares subject to Presently Exercisable Options.
(11) Includes an aggregate of 2,972,904 Presently Exercisable Options.

The following table sets forth all the cash compensation paid by Sonic during the three fiscal years ended September 30, 2006 to our chief executive officer and our other executive officers who were serving as executive officers as of September 30, 2006.

		Annual Compensation			Long Term Compensation	
Name and Principal Position	**Fiscal Year**	**Salary**	**Bonus**	**Other Annual Compensation(1)**	**Awards Securities Underlying Options(#)**	**All Other Compensation**
Rimas P. Buinevicius	2006	$ 294,231	$ 50,000	$ 2,993		
	2005	248,077	40,000		50,000	
Chief Executive Officer and Chairman	2004	192,308		1,541		
Darrin T. Coulson(3)	2006	200,000	86,003	637		
	2005	139,615			225,000	
Chief Operating Officer	2004					
Monty R. Schmidt	2006	217,692	50,000	10,920		
	2005	199,039	40,000		50,000	
Chief Technology Officer and Director	2004	168,269		2,404		19,424(2)
Kenneth A. Minor	2006	189,038	50,000	5,311		
	2005	173,077	40,000	4,821	50,000	
Chief Financial Officer and Secretary	2004	144,230		4,825		5,826(2)

(1) Consists of personal use of company vehicle included as portion of executive s taxable compensation.
(2) Consists of compensation earned and deferred pursuant to Sonic s deferred compensation plan, along with accrued interest.
(3) Mr. Coulson became an executive officer in August 2005.

Employment Agreements

We entered into employment agreements with Rimas P. Buinevicius and Monty R. Schmidt and renewed them on substantially the same terms as the prior agreements in January 2001. The salaries of each of Messrs. Buinevicius and Schmidt are subject to increase each year at the discretion of the Board of Directors. Messrs. Buinevicius and Schmidt are also entitled to incidental benefits of employment under the agreements. Each of the employment agreements provides that if (i) Sonic Foundry breaches its duty under such employment agreement, (ii) the employee s status or responsibilities with Sonic Foundry has been reduced, (iii) Sonic Foundry fails to perform its obligations under such employment agreement, or (iv) after a Change in Control of Sonic Foundry, Sonic Foundry s financial prospects have significantly declined, the employee may terminate his employment and receive all salary and bonus owed to him at that time, prorated, plus three times the highest annual salary and bonus paid to him in any of the three years immediately preceding the termination. If the employee becomes disabled, he may terminate his employment and receive all salary owed to him at that time, prorated, plus a lump sum equal to the highest annual salary and bonus paid to him in any of the three years immediately preceding the termination. Pursuant to the employment agreements, each of Messrs. Buinevicius and Schmidt has agreed not to disclose our confidential information and not to compete against us during the term of his employment agreement and for a period of two years thereafter. Such non-compete clauses may not be enforceable, or may only be partially enforceable, in state courts of relevant jurisdictions.

A Change in Control is defined in the employment agreements to mean: (i) a change in control of a nature that would have to be reported in our proxy statement, ; (ii) Sonic Foundry is merged or consolidated or reorganized into or with another corporation or other legal person and as a result of such merger, consolidation or reorganization less than 75% of the outstanding voting securities or other capital interests of the surviving, resulting or acquiring corporation or other legal person are owned in the aggregate by our stockholders immediately prior to such merger, consolidation or reorganization; (iii) Sonic Foundry sells all or substantially all of its business and/or assets to any other corporation or other legal person, less than 75% of the outstanding voting securities or other capital interests of which are owned in the aggregate by our stockholders, directly or indirectly, immediately prior to or after such sale; (iv) any person (as the term person is used in Section 13(d) (3) or Section 14(d) (2) of the Securities Exchange Act of 1934 (the Exchange Act) had become the beneficial owner (as the term beneficial owner is defined under Rule 13d-3 or any successor rule or regulation promulgated under the Exchange Act) of 25% or more of the issued and outstanding shares of our voting securities; or (v) during any period of two consecutive years, individuals who at the beginning of any such period constitute our directors cease for any reason to constitute at least a majority thereof unless the election, or the nomination or election by our stockholders, of each new director was approved by a vote of at least two- thirds of such directors then still in office who were directors at the beginning of any such period.

OPTIONS GRANTED IN FISCAL 2006

Sonic grants options to its executive officers under our employee stock option plans. As of September 30, 2006, options to purchase a total of 3,902,174 shares were outstanding under the plans, and options to purchase 3,276,124 shares remained available for grant thereunder. No options were granted to, or exercised by, Named Executive Officers during fiscal 2006.

The following tables show for the fiscal year ended September 30, 2006 certain information regarding options held at year-end by the Named Executive Officers.

2006 FISCAL YEAR-END OPTION VALUES

	Number of Unexercised Options/SARs at Fiscal Year-End(#)	**Value of Unexercised In-the-Money Options/SARs at Fiscal Year-End($)**

	Exercisable	Unexercisable	Exercisable	Unexercisable
Rimas P. Buinevicius	1,166,666	33,334	$ 1,126,666	$ 29,334
Darrin T. Coulson	74,999	150,001	71,249	142,501
Monty R. Schmidt	166,468	33,334	152,045	29,334
Kenneth A. Minor	348,607	33,334	400,536	29,334

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance
	(a)	(b)	(c)
Equity compensation plans approved by security holders (1)	2,792,067	$ 2.82	2,716,649
Equity compensation plans not approved by security holders (2)	1,810,107	1.17	759,475
Total	4,602,174	$ 2.17	3,476,124

(1) Consists of Employee Stock Option Plan and the Directors Stock Option Plan. For further information regarding these plans, reference is made to Note 5 of the financial statements.
(2) Consists of the Non-Qualified Stock Option Plan. For further information regarding this plan, reference is made to Note 5 of the financial statements.

REPORT OF THE EXECUTIVE COMPENSATION COMMITTEE [1]

The Executive Compensation Committee (the Committee) of the Board of Directors is composed entirely of outside Directors who have never been employees of Sonic. The Committee sets and administers the policies governing annual compensation of executive officers, including cash compensation and stock option programs for executive employees.

Compensation Policies

Sonic Foundry operates in the competitive and rapidly changing high technology and rich media communications environment. The goals of our executive compensation program are to motivate executives to achieve our business objectives in this environment and reward them for their achievement, foster teamwork, and attract and retain executive officers who contribute to our long-term success. During fiscal 2006, we used primarily salary, sales commissions, incentive bonuses and personal use of company vehicles to meet these goals. Sonic s executive compensation programs are intended to attract and retain qualified executives and to motivate them to achieve goals that will lead to appreciation of stockholder value.

Our philosophy and guiding principles are to provide compensation levels that are comparable to those offered by other leading high technology companies. Our compensation policies align the interests of our officers with the long-term interests of our stockholders through stock ownership and stock compensation. Another principle is that a substantial portion of each executive s compensation be in the form of an incentive bonus. Receipt of this bonus, is contingent upon

[1] The material in this report is not soliciting material, is not deemed filed with the SEC and is not to be incorporated by reference in any filing of Sonic under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

individual and company performance. A bonus plan for the year 2007 was established for Darrin Coulson in November 2006. The amount of Mr. Coulson s bonus will primarily be based on sales. The Compensation Committee awarded bonuses to the other executive officers totaling $450,000 in January 2007. These bonuses were based on inp;

7,195 7,192

Accumulated amortization

Customer relationship
(2,294) (2,135)
Lease agreements
(3,100) (2,854)

(5,394) (4,989)

Accumulated impairment

Customer relationship
(15) (15)
Lease agreements
(913) (912)

(928) (927)

Net intangible assets
$873 $1,276

Amortization of intangible assets was allocated to the following categories of cost and expenses:

	Three Months Ended March 31,	
	2010	2009
	(unaudited)	(unaudited)
Cost of revenues	$ 246	$ 344
Sales and marketing expenses	159	159
Total amortization expenses	$ 405	$ 503

Future expected amortization of intangible assets as of March 31, 2010 is as follows:

2010	$ 684
2011	189
	$ 873

5. Goodwill

During the year ended December 31, 2008, the Group acquired several companies in the advertising businesses. These acquisitions were unrelated to each other. Pursuant to a series of acquisition agreements signed with each of the acquired entities ex-owners in 2008 (original acquisition agreements), the purchase consideration for each acquisition would be settled in cash and is contingent based on the operational results

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agreed and confirmed by the Group and each of the acquired entities ex-owners for each individual 12-month period in a 2-year earn-out period following respective acquisition dates (earn-out period).

The contingent purchase price consideration for each entity is payable when each individual 12-month period during the earn-out period is completed and the operational results were agreed and confirmed. As such, the purchase price allocation cannot be completed until the contingencies are resolved. Therefore, the contingent consideration was not determinable beyond a reasonable doubt at the date of acquisition, and no goodwill was recognized due to the contingent nature of the consideration. However, a liability is recorded for the estimated fair value of identifiable net assets acquired, which represents the amount of negative goodwill upon initial purchase price allocation. Upon resolution of the contingency, adjustment to goodwill or against the identifiable net assets is to be made in accordance with SFAS No. 141 (ASC Topic 805).

Management performs a goodwill impairment test for each of its reporting units as of December 31 of each year or when circumstances change that would more likely than not that the carrying amount of goodwill may be impaired. As a result of impairment tests, the Group recorded a goodwill impairment loss of $1,677 and $11,861 for the three months ended on March 31, 2010 and 2009, respectively.

During the first quarter of 2010, the contingent consideration in connection with the second 12-month earn-out period of Shanghai Haiya Advertising Co., Ltd. (Haiya), Shanghai Botang Advertising Co., Ltd. (Botang) and Ad-Icon Company Limited (HK Ad-Icon) were resolved and is estimated to be $1,075. These amounts were recorded as additional goodwill and were immediately impaired as there has been no material changes in the fair value of the reporting unit subsequent to December 31, 2009, the most recent impairment analysis date.

The Group applied the income approach to estimate the fair value of its reporting units for goodwill impairment tests. The key assumptions used in this approach, which requires significant management judgment, include business assumptions, growth rate, terminal value, discount rate, and tax amortization benefit.

The changes in carrying amount of goodwill are as follows:

	March 31, 2010 (unaudited)	December 31, 2009
Beginning balance of goodwill	$45,891	$ 12,955
Goodwill recorded as a result of contingent consideration resolved	1,075	48,672
Impairment of goodwill	(1,677)	(15,749)
Translation adjustment	11	13
Ending balance of goodwill	$45,300	$ 45,891

6. Accrued expenses and other payables

Accrued expenses and other payables consist of the following:

	March 31, 2010 (unaudited)	December 31, 2009
Accrued payroll and staff benefits	$ 2,221	$ 2,559
Accrued professional fee	1,855	2,852
Business tax and surcharges payable	8,120	7,074
Contingent liabilities (Note 12(c))	844	844
Accrued liabilities for abandonment of lease	1,889	597
Other accrued liabilities	59	1,972

Total accrued expenses and other payables	$14,988	$15,898

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7. Warrant

The Company has a total of 13,400,000 warrants outstanding prior to the business combination. Each warrant entitles the registered holder to purchase one share of the Company s common stock at a price of $6.00 to $8.00 per share at any time commencing on the completion of a business combination. The warrants have a four years term and will expire in November 2011.

The Company issued 1,519,182 warrants to the SearchMedia International shareholders or warrantholders in the business combination and 428,219 warrants to the note holder.

Each of the warrants issued to a SearchMedia International shareholder, warrantholder or note holder in the business combination entitles the registered holder to purchase one share of SearchMedia Holding s common stock at a price ranging from $0.0001 to $8.14 per share, subject to adjustment, at any time. The exercise price and number of ordinary shares issuable on exercise of the warrants may be adjusted in certain circumstances including in the event of a share dividend, or recapitalization, reorganization, merger or consolidation. However, the warrants will not be adjusted for issuances of ordinary shares at a price below their respective exercise prices. The warrants will expire three years from the date of issuance of such warrant.

During January 2010, the Company repurchased in aggregate, 1,738,500 warrants in the open market for total consideration of $3,809 under a Board authorized plan. 7,710 warrants were exercised during the first quarter of 2010 and the Company received net proceed of $8.7 thousand. As of March 31, 2010, there were 13,601,191 warrants outstanding.

8. Share-based payments

Effective on January 1, 2008, the board of directors and shareholders of the SearchMedia International approved and adopted the 2008 Share Incentive Plan (the Share Incentive Plan) which provides for the granting of up to 1,796,492 share options and restricted share units to the eligible employees to subscribe for ordinary shares of SearchMedia International. The granted stock options and restricted share units were subsequently converted into SearchMedia Holdings stock options and restricted shares on October 30, 2009 in the business combination pursuant to the Share Exchange Agreement.

(a) Share options

Details of stock options activity during the first quarter of 2010 was as follows:

	Number of options	**Weighted average exercise price per share**	**Weighted average remaining contractual term**	**Aggregate fair value**
Balance as of January 1, 2010	423,797	3.19		
Granted	770,000	6.86		1,929
Forfeited	(30,392)	7.02		(55)
Balance as of March 31, 2010	1,163,405	5.52	9.16 years	
Options exercisable at March 31, 2010	321,614	3.90	8.41 years	

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The Company determined the estimated grant-date fair value of share options based on the Binomial Tree option-pricing model using the following assumptions:

Options granted to employee:	2010	2009
Risk-free rate of return	1.54%	3.43%
Weighted average expected option life	10 years	10 years
Expected volatility rate	64.0%	63.30%
Dividend yield	0%	0%

The expected volatility in the table above was based on the weighted average volatility of several comparable U.S. listed companies in the advertising industry with operations in the PRC. Management believes that the weighted average volatility of such companies is a reasonable benchmark to use in estimating the expected volatility of the Company s ordinary shares.

The Company has accounted for these options in accordance with ASC Topic 718, *Compensation Stock Compensation* (formerly SFAS No. 123R), by measuring compensation cost based on the grant-date fair value and recognizing the cost over the period during which an employee is required to provide service in exchange for the award.

During the first quarter of 2010, 545,000 options to purchase common shares of the Company were granted to senior executives of the Company with the options vesting one-third annually over a three year period. A total of 225,000 options were also granted to Board members with vesting one year from the date of grant.

The amount of compensation cost recognized for these share options was $401 and $22 for the three months ended March 31, 2010 and 2009, respectively. As of March 31, 2010, unrecognized share-based compensation cost in respect of granted share options amounted to $2,394.

(b) Restricted share units

Detail of restricted share unit activity during the first quarter of 2010 was as follows:

	Number of restricted share units granted	**Grant-date fair value**	**Weighted average remaining contractual term**
Balance as of January 1, 2010	463,779		
Granted	100,000	605	
Forfeitures			
Balance as of March 31, 2010	563,779		8.92 years
Units vested as of March 31, 2010	264,730		8.88 years

During the first quarter of 2010, 100,000 restricted shares were granted to a senior executive of the Company with the shares of restricted stock vesting on the third year anniversary of the date of grant. The fair value of the restricted share units was estimated using the closing quoted market price at the date of grant.

The Group recognized compensation cost (included in general and administrative expenses in the consolidated statements of operations) for these restricted share units of $290 and $34 for the three months period ended March 31, 2010 and 2009, respectively.

As of March 31, 2010, unrecognized share-based compensation cost in respect of granted restricted share units amounted to $1,335, which is expected to be recognized over a weighted average period of 16.5 months.

9. Related party transactions and balances

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(a) Related party transactions

In the ordinary course of business, the Group enters into certain transactions with its related parties. Management believes that these related party transactions were conducted at normal commercial terms. For the periods presented, material related party transactions are summarized as follows for the three months ended March 31, 2010 and 2009:

	Note	Three Months Ended March 31, 2010 (unaudited)	Three Months Ended March 31, 2009 (unaudited)
Revenue from provision of advertising services	(i)	$ 141	$ 1,106
Expenses for leases of advertising space	(ii)	$ 244	$ 254

Notes:

(i) Represents amounts received / receivable from affiliated entities of senior management personnel of certain companies acquired by Jingli, for provision of advertising services to these entities. The transactions are conducted on terms comparable to the terms of similar transactions with third parties.

(ii) Represents amounts paid / payable to affiliated entities of senior management personnel of certain companies acquired by Jingli, for leases of advertising spaces from these entities. The transactions are conducted on terms comparable to the terms of similar transactions with third parties.

(b) Amounts due from / to related parties are analyzed as follows:

	Note	March 31, 2010 (unaudited)	December 31, 2009
Customer payments collected on behalf of the Group	(i)	$3,870	$ 2,018
Receivables for provision of advertising services	(ii)	505	453
Advances to ex-owners of acquired companies	(iii)	799	369
Due from related parties		$5,174	$ 2,840
Operating expenses paid on behalf of the Group	(iv)	112	195
Payables for the lease of advertising space	(v)	303	151
Due to related parties		$ 415	$ 346

Note:

(i) Represents customer payments collected by the Company s shareholders and senior management personnel of Jingli s acquired subsidiaries on behalf of the Group companies which had not been remitted to the Group companies as of the balance sheet date. During the three months ended March 31, 2010 and 2009, certain customers remitted cash to affiliated companies controlled by shareholders of the Company and senior management personnel of certain subsidiaries of the Company to settle the amounts they owed to the Group. The amounts received by the shareholders and the senior management personnel are repaid back to the Group on a periodic basis. The balance is expected to be repaid to the Group within 12 months.

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(ii) Represents amount receivable from affiliated companies of certain companies acquired by Jingli for advertising services provided by the Group to these entities as described in the note (i) above. These amounts are repayable in accordance with normal payment terms with other unrelated customers.
(iii) Represents the advances made by the Group to ex-owners of certain companies acquired by Jingli. The amounts are interest free and are expected to be settled within 12 months from the balance sheet date and are secured by the contingent purchase price payable of certain companies acquired by Jingli to the previous owners of the acquired companies.
(iv) Represents operating expenses paid by the senior management personnel of certain companies acquired by Jinglli on behalf of the Group. The amounts are interest free, unsecured and have no fixed terms of repayment.
(v) Represents operating lease payments payable to affiliated companies of certain companies acquired by Jingli for leases of advertising space as described in note (ii) above. The amounts are repayable in accordance with normal payment terms with other unrelated advertising space suppliers.

10. Interest expense

	Three Months Ended March 31,	
	2010 (unaudited)	2009 (unaudited)
Bank loan interest	$ 13	$ 7
Convertible promissory notes interest		450
Interest on short-term loan from a third party lender		79
Total interest expense	$ 13	$ 536

During 2009, SearchMedia International issued convertible promissory notes to investors prior to the business combination. All these notes were either repaid or converted into SearchMedia Holdings common stocks or warrants upon the business combination with SearchMedia International Limited as of October 31, 2009.

11. Income taxes

Cayman Islands

Under the current laws of the Cayman Islands, the Company is not subject to tax on its income or capital gains. In addition, upon any payment of dividends by the Company, no withholding tax is imposed.

Peoples Republic of China

The Company s consolidated subsidiaries and VIEs in the PRC are governed by the income tax law of the PRC and file separate income tax returns. The entities acquired by Jingli in 2008 are subject to PRC enterprise income tax at 25% on their assessable profits.

Under the new tax law and related implementation rules, a withholding tax is applied on the gross amount of dividends received by the Company from its PRC consolidated subsidiaries and VIEs after January 1, 2008; however undistributed earnings prior to January 1, 2008 are exempted from withholding tax. The implementation rules provide that the withholding tax rate is 10% or the applicable rate specified in a tax treaty. The Company has not provided for income taxes on accumulated earnings of its PRC subsidiaries as of December 31, 2008 since these earnings are intended to be reinvested indefinitely in the PRC. It is not practicable to estimate the amount of additional taxes that might be payable on such undistributed earnings.

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Hong Kong

Ad-Icon and Great Talent are subject to Hong Kong profits tax at a tax rate of 16.5% on their assessable profits.

For the three months ended March 31, 2010 and 2009, substantially all of the Group s income before income taxes is derived from the PRC. Income tax expense consists of the following:

	Three Months Ended March 31,	
	2010	2009
	(unaudited)	(unaudited)
Current tax		
- PRC	$ 442	$ 1,092
- HK	18	9
Deferred tax		
- PRC	(73)	(320)
- HK		
Total income tax expense	$ 387	$ 781

The actual income tax expense reported in the consolidated statements of operations differs from the expected income tax expense computed by applying the PRC statutory tax rate of 25% for the quarter ended March 31, 2010 and 2009, respectively to income before income taxes as a result of the following:

	Three Months Ended March 31,	
	2010	2009
	(unaudited)	(unaudited)
Computed expected tax expense	$ (742)	$ (3,393)
Effect of differential tax rate on income of Ad-Icon	(9)	(4)
Effect of non-PRC entities not subject to income tax	302	397
Non-deductible expenses	432	3,028
Tax loss which no deferred tax asset was recognized	404	884
Income not subject to tax		(131)
Actual income tax expense	$ 387	$ 781

Non-deductible expenses primarily represent goodwill impairment which is not deductible for tax purpose and entertainment expenses in excess of statutory limits for tax purpose.

The tax effects of the Group s temporary differences that give rise to significant portions of the deferred tax assets and liabilities are as follows:

	March 31, 2010	December 31, 2009
	(unaudited)	
Deferred tax assets-current:		
- Tax loss carried forwards of a subsidiary	$ 23	$ 23
- Allowance for doubtful accounts	405	430
- Accrued expenses	27	27

	455	480
Deferred tax liabilities non-current:		
Intangible assets	(217)	(316)
Net deferred tax assets	$ 238	$ 164

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The realization of the future tax benefits of a deferred tax asset is dependent on future taxable income against which such tax benefits can be applied or utilized and the consideration of the scheduled reversal of deferred tax liabilities and any available tax planning strategies. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. All available evidence must be considered in the determination of whether sufficient future taxable income will exist since the ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible and tax loss carryforwards are utilized. Such evidence includes, but is not limited to, the financial performance of the entities, the market environment in which these entities operate and the length of relevant carryover periods. Sufficient negative evidence, such as cumulative net losses during a three-year period that includes the current year and the prior two years, may require that a valuation allowance be established against the deferred tax assets.

For the three months ended March 31, 2010 and 2009, the Group did not have unrecognized tax benefits, and it does not expect that the amount of unrecognized tax benefits will change significantly within the next 12 months. No interest and penalties related to unrecognized tax benefits were accrued at the date of initial adoption of FIN 48 and as of March 31, 2010 and December 31, 2009.

According to the PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of taxes is due to computational errors made by the taxpayer or the withholding agent. The statute of limitations is extended to five years under special circumstances, where the underpayment of taxes is more than USD15 (RMB 100). In the case of transfer pricing issues, the statute of limitation is ten years. There is no statute of limitation in the case of tax evasion. The tax returns of the Company s consolidated subsidiaries and VIEs in the PRC for the tax years beginning in 2004 are subject to examination by the relevant tax authorities. The tax returns of the Company s operating subsidiary in the HKSAR for the tax years beginning in 2002 are subject to examination by the relevant tax authorities.

12. Commitments and contingencies

(a) Operating lease commitments

The Group leases space primarily inside elevators, light boxes and billboards to display the content of its customers advertisements, and office premises under operating lease arrangements. These operating leases do not contain provisions for contingent rentals.

Rental expenses under operating leases were allocated to the following categories of cost and expenses:

	Three Months Ended March 31,	
	2010 (unaudited)	2009 (unaudited)
Cost of revenues	$ 6,088	$ 6,873
General and administrative expenses	236	472
Total rental expenses	$ 6,324	$ 7,345

As of March 31, 2010 future minimum rental payments under non-cancellable operating leases having initial or remaining lease terms of more than one year are as follows:

Year	
2010	$ 15,408
2011	6,565
2012	3,070
2013	696
2014	181
Thereafter	11

$	25,931

(b) Capital commitment

The Group has no material capital commitment as of March 31, 2010.

(c) Contingency

The Group is periodically involved in legal proceedings and has made full provision for operational claims of $844 as of March 31, 2010. Some complaints received after March 31, 2010 was disclosed under subsequent events.

13. Subsequent events

The Company evaluated all events and transactions after March 31, 2010 through the date these financial statements were issued and the material subsequent events were as follows:

During the second and third quarters of 2010, the Company amended the earnout agreements with the following subsidiaries: Qingdao Kaixiang Advertising Co., Ltd, Beijing Wanshuizhiyuan Advertising Co., Ltd, Shanghai Haiya Advertising Co., Ltd, Shanghai Botang Advertising Co., Ltd, Wenzhou Rigao Advertising Co., Ltd., Wuxi Ruizhong Advertising Co., Ltd and Shenyang Jingli Advertising Co., Ltd. The amended earnout agreements provides for the extension of the time period by one to more than two years for required cash and stock payments. The amended earnout agreements also provided for the extension of the employment agreements of certain key members of management of these subsidiaries.

On April 22, 2010, the Company received a notice from the NYSE Amex LLC (Amex), indicating that it was not in compliance with Amex s continued listing criteria because the Company did not timely file its Annual Report on Form 10-K for the year ended December 31, 2009. On May 5, 2010, the Company submitted to Amex an initial Plan of Compliance, setting forth actions the Company had taken and would take to bring the Company into compliance. On May 25, 2010, the Company received a notice from Amex, indicating that it was not in compliance with Amex s continued listing criteria because the Company did not timely file its Quarterly Report on Form 10-Q for the period ended March 31, 2010. On June 8, 2010, the Company submitted to Amex a supplemental plan of compliance, setting forth actions the Company had taken and would take to bring the Company into compliance. Amex initially accepted the Company s Plan of Compliance, as supplemented, on June 22, 2010 and extended the deadline for compliance such that the Company s filing of Annual Report on Form 10-K on or before October 15, 2010 and the Company s filing of its first quarter Form 10-Q on or before November 15, 2010 would bring the Company into compliance with the standards set forth in Amex delinquency notices. On October 13, 2010, the Company amended its Plan of Compliance and requested an additional extension to file the Form 10-K by October 29, 2010 and the 2010 first quarter Form 10-Q by December 15, 2010. These requests were approved by Amex on October 21, 2010. The Company submitted its Form 10-K on October 29, 2010.

On June 26, 2010, the Company completed its acquisition of Zhejiang Continental Advertising Co., Ltd. (Continental) in a combination of cash and stock transaction. The stock component of the transaction is expected to be paid in 2012, based on Continental s 2011 financial performance and the Company s 2012 stock price.

A complaint was filed on June 23, 2010 by an ex-owner of Xinshichuang claimed for unpaid acquisition considerations and other expenses of approximately $1.3 million. The Company has vigorously contested such claim and we believe such claim does not have merit.

A shareholder complaint was filed on September 13, 2010 by Sid Murdeshwar against the Company and certain of the Company s current and former directors and officers (the Individual Defendants) as a purported class action on behalf of the Company s shareholders in the United States District Court for the Central District of California. The case was filed under the caption Sid Murdeshwar, Individually and on Behalf of All Others Similarly Situated, Plaintiff v. SearchMedia Holdings Limited f/k/a Ideation Acquisition Corp., Robert N. Fried, Phillip Frost, Rao Uppaluri, Steven D. Rubin, Glenn Halpryn, Thomas E. Beier, David

H. Moskowitz, Shawn Gold, Garbo Lee, Paul Conway, Qinying Liu, Earl Yen, and Jennifer Huang, Defendants. The complaint alleges, among other things, that the Company s directors violated the federal securities laws by making false and misleading statements regarding Ideation s acquisition of the target company, SearchMedia International and by overstating SearchMedia International s financial results. The complaint further alleges that the Individual Defendants are liable for the alleged misrepresentations as controlling persons. The complaint seeks certification of a class of the Company s shareholders, an award of compensatory damages, an award of reasonable fees and costs incurred in this action, and such other relief as the Court deems just and proper.

In addition, we have been notified that the U.S. Securities and Exchange Commission, Los Angeles Regional Office, is conducting a formal investigation regarding the issues that are the subject of our restatement of financial results announced on August 20, 2010. We intend to cooperate fully with the SEC during this investigation process.

We cannot predict the costs or potential liabilities that may arise in connection with the purported class action, SEC investigation or any other related investigation or litigation.

In August 2010, subject to stockholder approval, the Board approved an increase of the number of authorized shares to be awarded under 2008 Plan from 1,796,492 shares to 3,000,000 shares which may be granted to designated employees, directors and consultants of the Company.

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

The following discussion should be read in conjunction with the information contained in the consolidated financial statements of the Company and the notes thereto appearing elsewhere herein and in conjunction with the Management s Discussion and Analysis set forth in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. Readers should carefully review the risk factors disclosed in the Company s Form 10-K for the year ended December 31, 2009 filed by the Company with the Securities and Exchange Commission (SEC).

As used in this report, the terms Company , SearchMedia Holdings , we , our and us refer to SearchMedia Holding Limited.

PRELIMINARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains forward-looking statements within the meaning of the federal securities laws. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as anticipate, expect, intend, plan, will, we believe, management believes and similar lang forward-looking statements are based on the current expectations of SearchMedia Holdings and are subject to certain risks, uncertainties and assumptions, including but not limited to, those set forth in the discussion under Management s Discussion and Analysis of Financial Condition and Results of Operations in this report. Actual results may differ materially from results anticipated in these forward-looking statements. We base the forward-looking statements on information currently available to us, and we assume no obligation to update them.

Investors are also advised to refer to the information in our previous filings with the SEC, especially on Forms 10-K, 10-Q, 8-K and 6-K, in which we discuss in more detail various important factors that could cause actual results to differ from expected or historic results. It is not possible to foresee or identify all such factors. As such, investors should not consider any list of such factors to be an exhaustive statement of all risks and uncertainties or potentially inaccurate assumptions.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This section should be read together with the Summary of Significant Accounting Policies included as Note 2 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2009.

RECENT ACCOUNTING PRONOUNCEMENT

In January 2010, the FASB issued Accounting Standards Update 2010-05 (ASU 2010-05), Compensation Stock Compensation (Topic 718) . This standard codifies EITF Topic D-110 Escrowed Share Arrangements and the Presumption of Compensation and is effective immediately. The provisions of ASU 2010-05 did not have a material effect on the financial position, results of operations or cash flows of the Company and is effective immediately.

In January 2010, the FASB issued Accounting Standards Update 2010-06 (ASU 2010-06), Fair Value Measurements and Disclosures (Topic 820) : Improving Disclosures about Fair Value Measurements. This amendment to Topic 820 has improved disclosures about fair value measurements on the basis of input received from the users of financial statements. This is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early adoption is permitted. The provisions of ASU 2010-06 did not have a material effect on the financial position, results of operations or cash flows of the Company.

In February 2010, the FASB issued Accounting Standards Update 2010-09 (ASU 2010-09), Subsequent Events (Topic 855). The amendments remove the requirements for an SEC filer to disclose a date, in both issued and revised financial statements, through which subsequent events have been reviewed. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. ASU 2010-09 is effective for interim or annual financial periods ending after June 15, 2010. The provisions of ASU 2010-09 did not have a material effect on the financial position, results of operations or cash flows of the Company.

In February 2010, the FASB issued Accounting Standards Update 2010-10 (ASU 2010-10), Consolidation (Topic 810). The amendments to the consolidation requirements of Topic 810 resulting from the issuance of Statement 167 are deferred for a reporting entity s interest in an entity (1) that has all the attributes of an investment company or (2) for which it is industry practice to apply measurement principles for financial reporting purposes that are consistent with those followed by investment companies. An entity that qualifies for the deferral will continue to be assessed under the overall guidance on the consolidation of variable interest entities in Subtopic 810-10 (before the Statement 167 amendments) or other applicable consolidation guidance, such as the guidance for the consolidation of partnerships in Subtopic 810-20. The deferral is primarily the result of differing consolidation conclusions reached by the International Accounting Standards Board (IASB) for certain investment funds when compared with the conclusions reached under Statement 167. The deferral is effective as of the beginning of a reporting entity s first annual period that begins after November 15, 2009, and for interim periods within that first annual reporting period, which coincides with the effective date of Statement 167. Early application is not permitted. The provisions of ASU 2010-10 are effective for the Company beginning in 2010. The adoption of ASU 2010-10 did not have a material impact on the financial position, results of operations or cash flows of the Company.

In March 2010, the FASB issued Accounting Standards Update 2010-11 (ASU 2010-11), Derivative and Hedging (Topic 815). All entities that enter into contracts containing an embedded credit derivative feature related to the transfer of credit risk that is not only in the form of subordination of one financial instrument to another will be affected by the amendments in this Update because the amendments clarify that the embedded credit derivative scope exception in paragraph 815-15-15-8 through 15-9 does not apply to such contracts. ASU 2010-11 is effective at the beginning of the reporting entity s first fiscal quarter beginning after June 15, 2010. The provisions of ASU 2010-11 are not expected to have a material effect on the financial position, results of operations or cash flows of the Company.

In April 2010, the FASB issued Accounting Standards Update 2010-13 (ASU 2010-13), Compensation-Stock Compensation (Topic 718). This Update provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The amendments in ASU 2010-13 are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The provision of ASU 2010-13 are not expected to have a material effect on the financial position, results of operations or cash flows of the Company.

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RESULTS OF OPERATIONS THREE MONTHS ENDED MARCH 31, 2010 AS COMPARED TO THREE MONTHS ENDED MARCH 31, 2009

The following table sets forth the amounts and the percentage relationship to revenues of certain items in our consolidated statements of operations for the quarters ended March 31, 2010 and 2009:

	Three Months Ended March 31,		Increase/	Increase/
	2010	2009	(Decrease)	(Decrease) %
(Amounts in thousands)	(unaudited)	(unaudited)		
Revenues	$ 8,472	$ 10,898	$ (2,426)	(22%)
Cost of revenues	(6,179)	(7,509)	1,330	(18%)
Gross profit	2,293	3,389	(1,096)	(32%)
Operating expenses				
Sales and marketing expenses	(526)	(672)	146	(22%)
General and administrative expenses	(2,380)	(3,778)	1,398	(37%)
Total operating expenses	(2,906)	(4,450)	1,544	(35%)
Loss from operations	(613)	(1,061)	448	(42%)
Interest expense, net	(13)	(536)	523	(98%)
Decrease in fair value of liability warrant		525	(525)	(100%)
Loss on impairment of goodwill	(1,677)	(11,861)	10,184	(86%)
Loss on abandonment of lease	(1,292)	(153)	(1,139)	744%
Other income / (expense), net	626	(485)	1,111	(229%)
Total other (expense)	(2,356)	(12,510)	10,154	(81%)
Loss before income taxes	(2,969)	(13,571)	10,602	(78%)
Provision for income taxes	(387)	(781)	394	(50%)
Net loss	$ (3,356)	$ (14,352)	$ 10,996	(77%)

Revenue. We generate our revenues from providing advertising services over our network which consists primarily from our billboard, transit and elevator poster frame platforms.

Revenue was net of business tax of $0.6 million and $0.8 million for the three months ended March 31, 2010 and 2009, respectively. Gross revenue for the three months ended March 31, 2010 and 2009 was $9.1 million and $11.7 million, respectively.

Revenues for the quarter ended March 31, 2010 were $8.5 million compared to $10.9 million for the quarter ended March 31, 2009. Revenue in 2010 decreased primarily due to expiration of certain billboard contracts and delay of certain billboard advertising campaigns in the first quarter of 2010 to the second quarter and a decrease in revenue from our Jingli subsidiary as a result of a smaller elevator network, which declined from $1.0 million in the first quarter of 2009 to $0.6 million in the first quarter of 2010. The decreases were partially offset by a $0.2 million increase in the first quarter of 2010 revenues from one of our elevator subsidiaries. We intend to increase the number of contracts in the future in addition to increasing the average revenue per contract.

Cost of revenues. The cost of revenues consists primarily of operating lease cost of advertising space for displaying advertisements, depreciation of advertisement display equipment, amortization of intangible assets

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relating to lease agreements and direct staff and material costs associated with production and installation of advertisement content.

Cost of revenues for the quarter ended March 31, 2010 was $6.2 million compared to $7.5 million for the quarter ended March 31, 2009. The cost of revenues for both periods primarily consisted of leasing cost to site owners and managers. The cost of revenues as a percentage of revenues was 72.9% for the quarter ended March 31, 2010, as compared to 68.9% for the quarter ended March 31, 2009. This increase was due primarily to changes in the mix of service offerings and the cost associated with our network expansion, and lower utilization rate in early 2010. We intend to increase our margins in the future through enhancing our occupancy rates while also increasing our average revenue per contract.

Gross profit. Our gross profit declined from $3.4 million in 2009 to $2.3 million in 2010 primarily due to a decrease in operating profits at two of our billboard subsidiaries by $2.0 million due to the increase in billboard concession cost. The decrease of the gross profit was partially offset by the increase of our elevator business.

Operating expenses. Selling and marketing expenses consist of marketing and promotion, amortization of intangible assets relating to customer relationship and sales commissions, payroll, traveling expenses, transportation and advertising expenses incurred by our selling and distribution team. General and administrative expenses consist primarily of salaries and benefits for management and administrative personnel, share-based compensation, rental and utility expenses.

Total operating expenses for the quarter ended March 31, 2010 were $2.9 million compared to $4.5 million for the quarter ended March 31, 2009. The components of operating expenses are set forth below:

Sales and marketing expenses. Sales and marketing expenses declined from $0.7 million for the quarter ended March 31, 2009 to $0.5 million for the quarter ended March 31, 2010, primarily as a result of the reduction of sales commissions, which decreased by $0.2 million in 2010 compared to 2009 primarily due to lower sales revenues.

General and administrative expenses. General and administrative expenses decreased from $3.8 million for 2009, to $2.4 million for 2010.

The following table describes our general and administrative expenses for the quarters ended March 31, 2010 and 2009. The decrease in bad debt expenses is primarily due to a subsequent settlement of accounts receivable for elevator subsidiaries. The increase in share-based compensation is partly due to new options granted. Staff cost declined from $1.1 million to $0.6 million as a result of increased efficiencies in our infrastructure and a reduction in staff. Professional fees in 2010 were $0.8 million lower than in 2009, primarily due to the decrease of one-time expenses related to the completion of the merger.

	Three Months Ended March 31,	
	2010	**2009**
(Amounts in thousands)	**(unaudited)**	**(unaudited)**
Staff cost	$ 643	$ 1,055
Professional fees	320	1,082
Rental expense	236	472
Bad debt (reversal) / provision	(174)	614
Share-based compensation	691	56
Others	664	499
	$ 2,380	$ 3,778

*Other expenses. T*otal other expenses for the quarter ended March 31, 2010 were $2.4 million compared to $12.5 million for the quarter ended March 31, 2009. Significant components of the other expenses are set forth below:

*Interest expense***.** Interest expense decreased by $0.5 million in 2010 compared to 2009. The 2009 amount primarily relates to the interest of $0.5 million on the convertible promissory notes. Interest expense costs in the first quarter of 2010 were mainly related to the short term bank loan.

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Loss on impairment of goodwill. As a result of the reduction of the estimated value of as part of annual impairment tests, goodwill was reduced by $1.7 million in the first quarter of 2010 and $11.9 million in the first quarter of 2009.

Loss on abandonment of lease. For our elevator subsidiary Jingli, we determined that a substantial portion of rental elevators may not be utilized in the future due to the decision to optimize the media assets. As a result, we recorded a $1.3 million abandonment loss in the first quarter of 2010 and $0.2 million in the first quarter of 2009.

*Provision for income taxes***.** Income tax expense decreased from $0.8 million in the first quarter of 2009 to $0.4 million in the first quarter of 2010. Although we had consolidated net loss, the PRC statutory tax rate was 25% for our subsidiaries with taxable income. Increase in income tax expense was also due to the fact that our administrative and interest expenses and certain operating expenses for our consolidated variable interest entities were not deductible for income tax purposes.

*Net loss***.** As a result of the foregoing, we had a net loss of $3.4 million for the quarter ended March 31, 2010, as compared to a net loss of $14.4 million for the quarter ended March 31, 2009.

Cash Flow Analysis

The following table presents a summary of our cash flows and beginning and ending cash balances for the quarters ended March 31, 2010 and 2009:

	Three Months Ended March 31,	
(Amounts in thousands)	**2010 (unaudited)**	**2009 (unaudited)**
Net cash used in operating activities	$ (4,113)	$ (302)
Net cash used in investing activities	(716)	(1,862)
Net cash (used in) / provided by financing activities	(3,733)	3,359
Effect of foreign currency exchange rate fluctuation on cash and cash equivalents	10	
Net (decrease) / increase in cash and cash equivalents	(8,552)	1,195
Cash and cash equivalents at beginning of the period	$ 29,398	$ 5,096
Cash and cash equivalents at end of the period	$ 20,846	$ 6,291

Cash Flows from Operating Activities. Net cash used in operating activities was $4 million and $0.3 million for the quarters ended March 31, 2010 and 2009, respectively. The increase in net cash used in operating activities was primarily due to the $5.4 million increase for working capital. The increase was partially offset by the decrease of net loss from $14.4 million in 2009 to $3.4 million in 2010. The increased cash out-flow was also attributed to the increase of payments due from related parties for period ended March 31, 2010 compared to 2009.

Cash Flows from Investing Activities. Net cash used in investing activities was $0.7 million and $1.9 million for the quarters ended March 31, 2010 and 2009, respectively. The $1.2 million decrease in cash used in investing activities in the first quarter of 2010 compared to the first quarter of 2009 was primarily due to a $1.1 million decrease in cash paid for acquisitions in the first quarter of 2010 compared to the first quarter of 2009.

Cash Flows from Financing Activities. Net cash used in financing activities were $3.7 million for the quarter ended March 31, 2010 and net cash provided by financing activities was $3.4 million for the quarter ended March 31, 2009. The $7.1 million increase in net cash used in financing activities in the first quarter of 2010 compared to the first quarter of 2009 was primarily due to a $3.8 million repurchase of warrants in 2010 and a $3.3 million proceeds from issuance of convertible promissory notes and warrants in 2009.

Cash

Our cash balance at March 31, 2010 was $20.8 million, representing a decrease of $8.6 million from $29.4 million at December 31, 2009. The decrease was mainly attributable to three reasons: 1) a $3.4 million working capital decrease in the first quarter of 2010; 2) a total earn-out payment of $0.7 million to the ex-owners of subsidiaries; and 3) the repurchase of warrants for $3.8 million.

Liquidity and Capital Resources

Net current liabilities increased by $5.4 million to $5.8 million at March 31, 2010 as compared to the net current liabilities at December 31, 2009. Total current assets decreased by $5.3 million from $50.6 million at December 31, 2009 to $45.3 million at March 31, 2010. The decrease in current assets was primarily due to the decrease in cash of $8.6 million, including a $3.8 million repurchase of the Company warrant on the open market.

We are obligated to pay earn-out payments over the next two to three years in connection to our acquisitions of a number of advertising businesses. The amount of earn-out consideration typically depends, among other factors, on the annual financial results of an acquired entity in a two-year post-closing period starting from the date of acquisition based on mutual agreement by the Company and the ex-owners of the subsidiaries. Our acquisition payable was approximately $16.7 million as of March 31, 2010 including earn-out consideration with respect to the relevant acquired entities financial results for 2008 and 2009.

During the second and third quarters of 2010, we amended the earn-out agreements with seven of our subsidiaries. The amended earn-out agreements provide for the extension of the time period by one to more than two years for required cash and stock payments. As a result of the aforementioned amendments and previous payments, we estimate the remaining earn-out payable is approximately $23.8 million. Of such payable approximately $5.9 million is payable within the next twelve months and $17.9 million is payable after the next twelve months and within the next two to three years. We also estimate that more than 50% of the estimated earn-out payable is payable in stock. Based on the performance of the acquired companies to date and forecast for the rest of the payment period we believe that we currently have sufficient capital to pay the required earn-out payments over the next twelve months. However, due to a variety of factors which cannot presently be ascertained, including without limitation, the amount of working capital that we have available, and the financial performance of both the Company and the acquired companies entitled to receive an earn-out payment, we may not have sufficient liquidity to meet our earn-out obligations. If we do not have sufficient liquidity to meet our earn-out obligations when they come due, and such failure cannot be remedied through renegotiation of the terms of such earn-outs with the acquiring companies or the raising of the required proceeds on reasonable terms, our cash flows are likely to be adversely and materially impacted.

Our short-term borrowing of $0.6 million as of March 31, 2010 represents a short-term bank loan guaranteed by management personnel of a subsidiary, bears interest at LIBOR minus 1%, has maturity through April 2010 and does not contain any financial covenants.

We anticipate that our material capital expenditures for the next twelve months will be approximately $1 million for frames and billboard structures, and operating lease obligations of $14.2 million. We believe that we will be able to fund our capital expenditures, operating lease payments and our anticipated operating cash requirements for at least the next twelve months and satisfy any remaining obligations from our working capital and anticipated cash flows from operations.

In addition, we may need additional cash resources in the future if we find and wish to pursue opportunities for investment, acquisition, strategic cooperation or other similar actions. If we ever determine that our cash requirements exceed our amounts of cash and cash equivalents on hand, we may seek to issue debt or equity securities or obtain a credit facility. Any issuance of equity securities could cause dilution to our

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shareholders. Any incurrence of indebtedness could increase our debt service obligations and cause us to be subject to restrictive operating and financial covenants. It is possible when we need additional cash resources, financing will only be available to us in amounts or on terms not acceptable to us or that financing will not be available at all.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required for smaller reporting companies, as defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended (the Exchange Act).

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We evaluated the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act as of March 31, 2010. This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. As a result of previously disclosed material weaknesses in our internal control over financial reporting that remain unremediated as of March 31, 2010, identified below, our principal executive officer and principal financial officer concluded that, as of March 31, 2010, our disclosure controls and procedures were not effective to ensure (1) that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC s rules and forms, and (2) that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate, to allow for timely decisions regarding required disclosure.

Internal Control over Financial Reporting

In assessing the effectiveness of our internal control over financial reporting as of December 31, 2009, management identified material weaknesses in our internal control over financial reporting relating to the following:

- Revenue recognition and accounts receivable;
- Disclosure, approval, and documentation of transactions among entities related to prior owners of acquired subsidiaries (which we refer to as related entity transactions);
- Recording of various erroneous transactions by certain employees;
- Recording of certain assets and other accounting irregularities related to acquisitions;
- Procedures related to diligence and approval of transactions; and
- Confirmation of payments related to acquisitions.

The results of these material weaknesses in our internal control over financial reporting and the impact of these weaknesses on our results of operations were more fully described in our Annual Report on Form 10-K for the year ended December 31, 2009.

Our management has discussed the material weakness in our internal control over financial reporting described above with our audit committee and our audit committee has approved and adopted a remediation plan from the management to address these material weaknesses. During the quarterly period ended March 31, 2010 and through the date of this filing, we made continuous changes to our internal control over financial reporting in order to address and remediate the material weaknesses identified:

- We appointed a new Chief Financial Officer in January 2010, replaced certain accounting personnel and hired more qualified accountants at its corporate offices and subsidiary locations.

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We have established our process and procedures governing our internal reporting. We also performed analytical and detail review of all general ledger accounts, prepared and independently reviewed critical information for financial reporting.

We have enhanced our procedure documentation for unusual or infrequent transactions, such as business valuation and acquisitions, and engaged qualified third party specialists to assist management with preparing documentation to support such transactions and their disclosure in our financial statements.

We identified key internal control points and continue to design and implement effective controls for each business cycle, particularly with regard to revenues recognition, accounts receivable, related party transactions and payments approval.

The Company s legal counsel together with external consultants have developed a set of written compliance policies on topics related to fiduciary duties of officers and directors; Foreign Corrupt Practices Act risks; insider trading; Code of Business Ethics and Conduct and Sarbanes Oxley. We also set up an independent third party whistleblower hotline. We plan to provide regular tailored training to relevant senior management.

Pursuant to Exchange Act Rule 13a-15(d), our efforts described above constituted material changes to the internal control structure. Not all the material weaknesses noted in the earlier filings have been remediated as of March 31, 2010 and we implemented further changes to our internal control over financial reporting through the date of this filing. Our efforts involved management, outside consultants and our audit committee, which approved and provided oversight in the execution of the remediation plan. We intend to allocate a sufficient level of resources to ensure that our internal control structure will continue to improve and functions properly and effectively.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

Not required for smaller reporting companies, as defined in Rule12b-2 of the Exchange Act.

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

During January 2010, we repurchased an aggregate of 1,738,500 warrants in the open market for a total consideration of $3.8 million under a plan authorized by the board of directors. On December 29, 2009, the board of directors authorized a plan to repurchase up to a value of $5.0 million in common stock or warrants. This plan does not have an expiration date.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Warrants Purchased	(b) Average Price Paid per Warrant	(c) Total Number of Warrants Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Warrants that May Yet Be Purchased Under the Plans or Programs (Amount in thousands)

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved).

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibits:

10.1 Executive Employment Agreement between SearchMedia Holdings Limited and Wilfred Chow dated December 30, 2009 (incorporated by reference to Exhibit 10.1 of the Registrant s current report on Form 8-K dated January 6, 2010).*

10.2 Executive Employment Agreement between SearchMedia Holdings Limited and Paul Conway dated February 1, 2010 incorporated by reference to Exhibit 10.1 of the Registrant s current report on Form 8-K dated February 3, 2010).*

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Management contract or compensatory plan or arrangement

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SIGNATURES

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

	SEARCHMEDIA HOLDINGS LIMITED
Date: December 15, 2010	By: /s/ Paul Conway Paul Conway Chief Executive Officer (Principal Executive Officer)
Date: December 15, 2010	By: /s/ Wilfred Chow Wilfred Chow Chief Financial Officer (Principal Financial and Accounting Officer)

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