AVOCENT CORP
Form 10-Q
October 31, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 26, 2003 or

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

For the period from to /

Commission file number: 000-30575

AVOCENT CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

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

256-430-4000

(Registrant s Telephone Number, Including Area Code)

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

ý Yes o No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended).

ý Yes o No

As of October 28, 2003, the number of outstanding shares of the Registrant s Common Stock was 46,899,938.

AVOCENT CORPORATION

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AVOCENT CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited in thousands, except per share data)

	For the three months ended September 26, 2003	For the three months ended September 27, 2002	For the nine months ended September 26, 2003	For the nine months ended September 27, 2002
Net sales	$ 76,482	$ 64,490	$ 218,256	$ 189,612
Cost of sales	32,909	31,252	94,401	94,495
Gross profit	43,573	33,238	123,855	95,117
Research and development expenses	7,103	6,176	21,569	19,585
Acquired in-process research and development expense		6,000		6,000
Selling, general and administrative expenses	16,838	15,262	51,621	50,653
Amortization of intangible assets	4,739	5,474	17,051	16,068
Total operating expenses	28,680	32,912	90,241	92,306
Income from operations	14,893	326	33,614	2,811
Net investment income	1,182	1,364	3,689	4,229
Net realized investment gains (losses)	3,014	(125)	2,804	(269)
Other income (expense), net	1	(28)	(417)	(141)
Income before provision for income taxes	19,090	1,537	39,690	6,630
Provision for income taxes	5,614	1,862	10,701	3,085
Net income (loss)	$ 13,476	$ (325)	$ 28,989	$ 3,545
Earnings (loss) per share:				
Basic	$ 0.29	$ (0.01)	$ 0.63	$ 0.08
Diluted	$ 0.28	$ (0.01)	$ 0.61	$ 0.08
Weighted average shares used in computing earnings (loss) per share:				
Basic	46,347	45,016	45,900	44,931
Diluted	47,770	45,016	47,261	45,473

See notes accompanying these condensed consolidated financial statements.

AVOCENT CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	September 26, 2003 (unaudited)	December 31, 2002 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 59,264	$ 61,699
Investments maturing within one year	121,164	107,619
Accounts receivable, net	47,387	36,313
Income taxes receivable	398	609
Other receivables, net	534	1,191
Inventories, net	17,529	24,422
Other current assets	5,289	3,256
Deferred tax assets	4,574	5,932
Total current assets	256,139	241,041
Investments	91,007	44,849
Property held for lease, net	1,575	1,723
Property and equipment, net	36,316	24,313
Goodwill	203,625	203,625
Other intangible assets, net	35,460	52,601
Other assets	587	455
	$ 624,709	$ 568,607
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 7,038	$ 6,416
Accrued wages and commissions	7,330	7,743
Accrued liabilities	14,682	13,662
Income taxes payable	9,757	6,901
Total current liabilities	38,807	34,722
Deferred tax liabilities	11,481	16,213
Total liabilities	50,288	50,935
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000 shares authorized, no shares issued and outstanding		
Common stock, $0.001 par value; 200,000 shares authorized, 46,465 and 45,210 shares issued and outstanding as of September 26, 2003 and December 31, 2002, respectively	46	45
Additional paid-in capital	959,837	936,288
Accumulated other comprehensive income	219	14
Deferred compensation	(2,231)	(6,236)
Accumulated deficit	(383,450)	(412,439)
Total stockholders equity	574,421	517,672
	$ 624,709	$ 568,607

See notes accompanying these condensed consolidated financial statements.

AVOCENT CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	For the nine months ended September 26, 2003	For the nine months ended September 27, 2002
Cash flows from operating activities:		
Net income	$ 28,989	$ 3,545
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,445	3,288
Amortization of intangible assets	17,051	16,068
Stock-based compensation	3,994	10,722
Acquired in-process research and development expense		6,000
Amortization of premiums on investments	2,574	1,637
Net realized investment (gains) losses	(2,804)	269
Income tax benefit from exercise of stock options	5,537	
Changes in operating assets and liabilities, net of effects of purchase of 2C in 2002:		
Accounts receivable, net	(11,074)	12,558
Other receivables, net	657	951
Inventories, net	6,893	2,593
Other assets	(1,927)	436
Accounts payable	622	1,857
Accrued wages and commissions	(413)	1,483
Accrued liabilities	1,020	(3,398)
Income taxes, current and deferred	(307)	(2,691)
Net cash provided by operating activities	54,257	55,318
Cash flows from investing activities:		
Purchase of 2C Computing Inc., net of cash acquired		(23,224)
Purchases of property and equipment	(15,447)	(5,023)
Purchases of investments	(157,858)	(120,272)
Maturities of investments	95,129	61,403
Proceeds from sales of available-for-sale investments	3,350	36
Net cash used in investing activities	(74,826)	(87,080)
Cash flows from financing activities:		
Repayment of short-term debt assumed in the 2C acquisition		(890)
Proceeds from employee stock option exercises	16,215	1,920
Proceeds from employee stock purchase plan	1,809	1,243
Net cash provided by financing activities	18,024	2,273
Effect of exchange rate changes on cash and cash equivalents	110	52

Net decrease in cash and cash equivalents		(2,435)		(29,437)
Cash and cash equivalents at beginning of period		61,699		80,506
Cash and cash equivalents at end of period	$	59,264	$	51,069

See notes accompanying these condensed consolidated financial statements.

AVOCENT CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, in thousands)

Note 1. Basis of Presentation

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

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes contained in our Annual Report on Form 10-K for the year ended December 31, 2002, which is on file with the Securities and Exchange Commission and is also available on our website.

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

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

Note 2. Inventories

Inventories consisted of the following:

	September 26, 2003 (unaudited)	December 31, 2002 (audited)
Raw materials	$ 4,870	$ 7,560
Work-in-process	1,025	851

Finished goods		11,634		16,011
Inventories, net	$	17,529	$	24,422

Inventories above have been reduced by reserves for excess and obsolete inventories of $5,081 and $7,502, as of September 26, 2003 and December 31, 2002, respectively.

Note 3. Stock Options and Deferred Compensation

Deferred compensation We recorded $41,165 of deferred compensation related to Cybex employee stock options at the time of the merger of Apex and Cybex on July 1, 2000. Additionally, we recorded $2,752 of deferred compensation related to the Equinox employee stock options at the time of the acquisition on January 3, 2001. The deferred compensation is being amortized over the vesting period of the options for which it was recorded.

Stock option exercises Options to purchase 1,124 shares of our Common Stock were exercised during the nine months ended September 26, 2003. We received proceeds totaling $16,215 from these option exercises. Also, 131 shares of our Common Stock were issued during the nine months ending September 26, 2003 under our Employee Stock Purchase Plan. We received proceeds totaling $1,809 from these share issuances.

Note 4. Accumulated Other Comprehensive Income

We record foreign currency translation adjustments and unrealized holding gains or losses on our available-for-sale securities as accumulated other comprehensive income, which is included as a separate component of stockholders equity. For the nine months ended September 26, 2003 and September 27, 2002, total other comprehensive income (loss) amounted to $205 and ($5), respectively. As of September 26, 2003 and December 31, 2002, total accumulated other comprehensive income was $219 and $14, respectively.

Note 5. Earnings (Loss) Per Share

	Income (Loss) (Numerator)	Shares (Denominator)	Per-Share Amount
For the three months ended September 26, 2003			
Basic EPS			
Net income available to common stockholders	$ 13,476	46,347	$ 0.29
Effect of Dilutive Securities			
Stock options		1,423	
Diluted EPS			
Net income available to common stockholders and assumed conversions	$ 13,476	47,770	$ 0.28
For the three months ended September 27, 2002			
Basic EPS			
Net loss available to common stockholders	$ (325)	45,016	$ (0.01)
Effect of Dilutive Securities			
Stock options			
Diluted EPS			
Net loss available to common stockholders and assumed conversions	$ (325)	45,016	$ (0.01)
For the nine months ended September 26, 2003			
Basic EPS			
Net income available to common stockholders	$ 28,989	45,900	$ 0.63
Effect of Dilutive Securities			
Stock options		1,361	
Diluted EPS			
Net income available to common stockholders and assumed conversions	$ 28,989	47,261	$ 0.61
For the nine months ended September 27, 2002			
Basic EPS			
Net income available to common stockholders	$ 3,545	44,931	$ 0.08
Effect of Dilutive Securities			
Stock options		542	
Diluted EPS			
Net income available to common stockholders and assumed conversions	$ 3,545	45,473	$ 0.08

Note 6. Sales by Geographic Region

We report operations as a single operating segment; however, we report sales by geographic region. Following is a presentation of sales by geographic region for the three and nine month ended September 26, 2003 and September 27, 2002:

	For the Three Months Ended		For the Nine Months Ended	
	Sept. 26, 2003	**Sept. 27, 2002**	**Sept 26, 2003**	**Sept. 27, 2002**
Net sales:				
United States	$ 48,870	$ 38,987	$ 135,361	$ 116,843
Rest of the World	27,612	25,503	82,895	72,769
	$ 76,482	$ 64,490	$ 218,256	$ 189,612

As of September 26, 2003, long-lived assets totaled $276,976, which includes $269,016 held in the U.S. and $7,960 held outside of the U.S. As of December 31, 2002, long-lived assets totaled $282,262, which includes $280,423 held in the U.S. and $2,305 held outside of the U.S.

Note 7. Forward Contracts

We use forward contracts to reduce our foreign currency exposure related to the net cash flows from our international operations. The majority of these contracts are short-term contracts (three months or less) and are marked-to-market each quarter and included in trade payables, with the offsetting gain or loss included in other income (expense) in the accompanying statements of operations. At September 26, 2003, we had a liability related to one open forward contract, maturing in the fourth quarter of 2003, with a fair value at September 26, 2003 of approximately $1.

Note 8. Goodwill and Other Intangible Assets

Acquired other intangible assets subject to amortization are as follows:

	September 26, 2003		December 31, 2002	
	Gross Carrying Amounts	**Accumulated Amortization**	**Gross Carrying Amounts (audited)**	**Accumulated Amortization (audited)**
Developed technology	$ 65,740	$ 42,575	$ 65,740	$ 32,869
Patents and trademarks	17,549	8,593	17,350	5,663

Customer base and certification		4,113		2,874		21,113		16,013
Non-compete agreements		3,273		1,182		3,273		364
Other		101		92		101		67
	$	90,776	$	55,316	$	107,577	$	54,976

During the third quarter of 2003, we retired $17,000 of fully amortized customer base assets and the related accumulated amortization, which were recorded in 2000 at the merger of Apex Inc. and Cybex Computer Products Corporation and had a three year estimated useful life. The retirement had no impact on reported earnings.

The approximate estimated annual amortization for other intangible assets is as follows:

Years ending December 31:		
2003	$	21,200
2004	$	17,300
2005	$	10,500
2006	$	2,100
2007	$	1,500

In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, we test goodwill at least annually for impairment. Unless conditions warrant earlier review, we perform the annual impairment test in the fourth quarter of each year. There were no additions or deletions to the carrying amount of goodwill for the three and nine months ended September 26, 2003.

Note 9. Shannon Building Purchase

In June 2003, we purchased a facility in the free trade zone in Shannon, Ireland, for approximately $6,400. We transferred our European headquarters and manufacturing operations to the new building in July 2003 and vacated the previously leased facility, also in Shannon.

Note 10. Stock Based Compensation

We apply the intrinsic value method in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for our stock plans. Had compensation cost for our stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method prescribed in SFAS No. 123, *Accounting for Stock-Based Compensation*, our net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	Three Months ended		Nine Months Ended	
	Sept. 26, 2003	Sept. 27, 2002	Sept. 26, 2003	Sept. 27, 2002
Net income (loss) as reported	$ 13,476	$ (325)	$ 28,989	$ 3,545
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	709	1,582	3,706	9,370
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	6,700	8,072	22,053	28,650
Net income (loss) pro forma	$ 7,485	$ (6,815)	$ 10,642	$ (15,735)
Basic earnings (loss) per share as reported	$ 0.29	$ (0.01)	$ 0.63	$ 0.08
Basic earnings (loss) per share pro forma	$ 0.16	$ (0.15)	$ 0.23	$ (0.35)
Diluted earnings (loss) per share as reported	$ 0.28	$ (0.01)	$ 0.61	$ 0.08
Diluted earnings (loss) per share pro forma	$ 0.16	$ (0.15)	$ 0.23	$ (0.35)

The pro forma amounts reflected above are not representative of the effects on reported net income in future years because, in general, the options granted typically do not vest for several years and additional awards are made each year. The fair value of each option grant is estimated on the grant date using the Black-Scholes option-pricing model using the following weighted-average assumptions:

	Three Months Ended		Nine Months Ended	
	Sept. 26, 2003	Sept. 27, 2002	Sept. 26, 2003	Sept. 27, 2002
Dividend yield	0.0%	0.0%	0.0%	0.0%
Expected life (years)	4.5	5.0	4.5	5.0
Expected volatility	60.0%	67.5%	60.0%	67.5%
Risk-free interest rate	2.88%	2.93%	2.38 2.88%	2.93 - 4.47%

Note 11. Subsequent Event

In October 2003, Avocent Huntsville Corp. (formerly Cybex Computer Products Corporation), a wholly-owned subsidiary of Avocent Corporation, filed a complaint for patent infringement in the United States District Court for the Northern District of Alabama against ClearCube Technology, Inc. The ClearCube complaint seeks injunctive relief, damages, attorneys fees, and costs under three Avocent patents.

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

THE INFORMATION IN THIS ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS CONTAINS FORWARD-LOOKING STATEMENTS, INCLUDING, WITHOUT LIMITATION, STATEMENTS RELATING TO OUR FUTURE BUSINESS PROSPECTS AND ECONOMIC CONDITIONS IN GENERAL, STATEMENTS REGARDING OUR ENGINEERING AND DESIGN ACTIVITIES, PRODUCT DEVELOPMENT, AND NEW PRODUCT INTRODUCTIONS, STATEMENTS RELATING TO FUTURE PRODUCT DEMAND AND OUR FUTURE SALES, EARNINGS, GROSS PROFIT, INCOME, AND EXPENSES, STATEMENTS REGARDING INTERNATIONAL SALES, STATEMENTS ABOUT THE RATIO OF SALES AMONG OUR DISTRIBUTION CHANNELS, STATEMENTS REGARDING FUTURE INVENTORY LEVELS, STATEMENTS ABOUT THE TIMING, IMPLEMENTATION, AND BENEFITS OF OUR NEW ERP SYSTEM, STATEMENTS RELATING TO THE ENFORCEMENT OF OUR INTELLECTUAL PROPERTY RIGHTS, AND STATEMENTS RELATING TO ANTICIPATED CAPITAL SOURCES, NEEDS, AND USES.

THESE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THE RISKS ASSOCIATED WITH GENERAL ECONOMIC CONDITIONS, RISKS ATTRIBUTABLE TO FUTURE PRODUCT DEMAND, SALES, AND EXPENSES, RISKS ASSOCIATED WITH PRODUCT DESIGN EFFORTS, RISKS ASSOCIATED WITH RELIANCE ON A LIMITED NUMBER OF COMPONENT SUPPLIERS AND SINGLE SOURCE COMPONENTS, THE LOSS OF ONE OF OUR OEM CUSTOMERS, A REDUCTION OR FLUCTUATIONS IN SALES OF OUR OEM OR BRANDED PRODUCTS, INTENSE COMPETITION AND NEW PRODUCTS AND TECHNOLOGIES FROM EXISTING AND NEW COMPETITORS, RISKS RELATED TO PROTECTING OUR INTELLECTUAL PROPERTY RIGHTS, FLUCTUATIONS IN FOREIGN CURRENCIES, RISKS RELATED TO MERGER INTEGRATION, AND OTHER RISKS DETAILED IN OUR ANNUAL REPORT ON FORM 10-K, WHICH WAS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON MARCH 27, 2003.

Overview

We design, manufacture, and sell analog and digital KVM (keyboard, video and mouse) switching systems, serial connectivity devices, extension and remote access products, technologies, software, and display products for the computer industry. Data center managers and network administrators have increasingly complex and growing server populations, and our analog, digital, and serial switching solutions, as well as our extension and remote access products, technologies, and software, help them manage multiple servers and serially controlled devices from a single local or remote console consisting of a keyboard, video monitor, and mouse. Specifically, our products can provide significant cost reductions including lower initial investment, reduced utility costs, and space savings, as well as more efficient technical support capabilities.

We provide plug and play switching systems for many network administration, management, and storage problems faced by corporate customers, data centers, and server farms. Our switching solutions include products, technologies, and software sold or licensed under the Avocent, Apex, Cybex, Equinox, and 2C brands, including our *AMX , AutoView , DS Series , SwitchView®, OutLook®, and XP®4000 Series* products. Our switching systems and solutions help facilities managers and network administrators access multiple servers and serially controlled devices from one or more centralized or remote consoles, consolidate hardware requirements, and provide direct hardwired connections between the switch and the attached servers to facilitate access to those servers, even when the network is down. Our Equinox branded products add high-performance, reliable, and affordable server-based products for serial and dial-up access applications. The Equinox *SuperSerial* product line provides serial communications for security, commercial point-of-sale, process control, industrial automation, data collection, remote access, fax servers, Internet access, and custom applications. Our Digital Desktops product line includes the *Cstation* product. Initial applications for Cstation include financial trading floors where space is at a premium, industrial plant control environments that benefit from remote computers due to harsh or unsecured environments, and government installations that require high security afforded through the remote location of the computer and hard disk.

Our revenue is derived from sales to a limited number of OEMs who purchase our switching systems on a private-label or branded basis for integration and sale with their own products and branded sales which are made either through our reseller and distributor network or to a limited number of direct customers. For the nine months ended September 26, 2003, branded sales were 55% of net sales, while sales to our OEM customers were 45% of net sales. We do not have contracts with many of these customers, and in general, they are obligated to purchase products from us only pursuant to binding purchase orders. The loss of, or material decline in orders from, our OEM customers would have a material adverse effect on our business, financial condition, results of operation, and cash flow. Our top five customers, including OEMs and distributors, accounted for approximately 63% of our sales for the nine months ended September 26, 2003.

We sell our products in the United States, Canada, Europe, and Asia as well as in other foreign markets. Sales within the United States accounted for approximately 62% of sales in the nine months ended September 26, 2003, while sales outside of the United States accounted for 38% of sales in the nine months ended September 26, 2003.

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

We are currently experiencing increased price competition in the market for all of our products, and we expect that pricing pressures will continue to increase in the future. In addition, general economic conditions are not as favorable as they were in prior years, and our revenue growth rate has slowed. Depending on future general economic conditions and other factors, our revenue could decline in the future.

We received ISO 9000:2000 accreditation for our global business processes during the first quarter of 2003. We believe ISO accreditation will become a requirement for doing business with several of our OEM customers.

Many of our executive officers and directors are vested in significant amounts of options to purchase shares of our common stock and continue to vest in additional shares on a regular basis. These officers and directors have informed us that they have sold and may sell additional shares of our common stock to provide personal liquidity and diversify their portfolios.

Our stockholders approved the adoption of the Avocent Corporation 2003 Stock Option Plan at the annual meeting of stockholders held in June 2003. Under the 2003 Stock Option Plan, 2.0 million shares of our common stock are reserved for issuance and we have issued approximately 496,000 options under this plan through September 26, 2003. We expect to file a registration statement on Form S-8 to register the shares authorized for issuance under this plan during the fourth quarter of 2003.

Results of Operations

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

	Three Months Ended		Nine Months Ended	
	Sept. 26, 2003	Sept. 27, 2002	Sept. 26, 2003	Sept. 27, 2002
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	43.0	48.5	43.3	49.8
Gross profit	57.0	51.5	56.7	50.2
Operating expenses:				
Research and development expenses	9.3	9.6	9.9	10.3
Acquired in-process research and development expense		9.3		3.2
Selling, general and administrative expenses	22.0	23.6	23.6	26.7
Amortization of intangible assets	6.2	8.5	7.8	8.5
Total operating expenses	37.5	51.0	41.3	48.7
Income from operations	19.5	0.5	15.4	1.5
Net investment income	1.5	2.2	1.7	2.2
Net realized investment gains (losses)	3.9	(0.2)	1.3	(0.1)
Other income (expense), net	0.1	(0.1)	(0.2)	(0.1)
Income before provision for income taxes	25.0	2.4	18.2	3.5
Provision for income taxes	7.4	2.9	4.9	1.6
Net (loss) income	17.6%	(0.5)%	13.3%	1.9%

Net sales. Net sales increased 19% to $76.5 million for the third quarter of 2003 from $64.5 million for the third quarter of 2002. The increase in sales resulted from the strength of both our OEM and branded channels in the third quarter of 2003 as compared to the third quarter of 2002. Both the branded channel and the OEM channel benefited from revenue from increased sales of our digital products and from new products introduced during the second half of 2002 and the first nine months of 2003. The new products include the AMX, the AVR, and OEM versions of our digital product family. Additionally, sales of our SwitchView product line increased due to shipments of new products, as well as increased sales of our Secure SwitchView SC products. Overall, new products accounted for approximately $7.6 million of third quarter 2003 net sales.

Sequentially, our sales increased approximately $5.9 million from the second quarter of 2003. The sequential increase in sales can be attributed primarily to strength in our U.S. sales. U.S. branded sales increased 13% over the second quarter of 2003, while U.S. OEM sales increased 7%. International sales increased slightly, led primarily by a rebound in our branded and OEM business in Asia. Sales in the Asia Pacific region increased approximately $1.1 million sequentially, while our business in Europe was relatively flat from the second quarter of 2003. Europe s performance in the third quarter of 2003 was consistent with trends from prior years as the European markets are usually slower in the third quarter due to extended vacations taken during the later summer months.

On a year-over-year basis, sales through our branded channel increased 23% from $35.0 million in the third quarter of 2002 to $43.1 million in the third quarter of 2003. OEM sales increased 13% from $29.5 million in the third quarter of 2002 to $33.4 million in the third quarter of 2003. Branded sales were 56% of sales for the third quarter of 2003 compared to 54% of sales for the third quarter of 2002. OEM sales were 44% of sales for the third quarter of 2003 compared to 46% of sales for the third quarter of 2002.

On a year-over-year basis, we experienced an increase in sales both within the United States and internationally. Sales within the United States increased 25% to $48.9 million in the third quarter of 2003 from $39.0 million in the third quarter of 2002. International sales increased 8% to $27.6 million in the third quarter of 2003 from $25.5 million in the third quarter of 2002. Sales within the United States were 64% of sales for the third quarter of 2003 and were 60% of sales in the third quarter of 2002. International sales were 36% and 40% of sales for the third quarter of 2003 and 2002, respectively.

Net sales increased 15% to $218.3 million for the first nine months of 2003 from $189.6 million for the first nine months of 2002. As with the third quarter, the increase in sales resulted from new product introductions and from increased sales of our digital products. The strength in sales on a year-to-date basis was evident both in U.S. and international sales. Sales within the United States increased by approximately 16% to $135.4 million in the first nine months of 2003 from $116.8 million in the first nine months of 2002. International sales increased approximately 14% from $72.8 million in the first nine months of 2002 to $82.9 million in the first nine months of 2002.

We anticipate growth in sales of our digital, AMX, and SwitchView product lines and modest increased revenue from our embedded applications and licensing arrangements to contribute to an increase in revenue for both our branded and OEM businesses in the fourth quarter of 2003. In the past, revenue in our fourth quarter of each year has typically been higher than revenue in prior quarters for that year. In addition, we typically see a sequential decline in revenue from the fourth quarter of a year to the first quarter of the following year. While it is difficult to predict revenue in any quarter, we expect that this pattern will continue in the future.

Gross profit. Gross profit may be affected by a variety of factors, including: the ratio of sales among our distribution channels, as OEM sales typically have lower gross margins than our branded sales; absorption of fixed costs as sales levels fluctuate; product mix, raw materials, and labor costs; new product introductions by us and by our competitors; and the level of our outsourcing of manufacturing and assembly services. Gross margin increased to 57.0% in the third quarter of 2003 as compared to 51.5% in the third quarter of 2002. The primary reasons for strong margins in the third quarter of 2003 were cost reductions attained from our suppliers and a favorable customer and product mix. Our costs declined in the third quarter of 2003 primarily due to improved pricing from our vendors. Our U.S. branded sales increased significantly from the prior year, and these sales typically carry a higher gross margin than our OEM and international sales. Our digital products and AMX products have higher gross margins than our other products and accounted for over 40% of total sales for the third quarter of 2003, compared to 25% of sales for the third quarter of 2002. However, price decreases granted to our OEM customers and discounts given to certain new international customers during the third quarter offset the effect of the higher sales of the newer products and resulted in the sequential decrease in gross margins from 57.6% in the second quarter of 2003. Gross margin increased to 56.7% for the first nine months of 2003 from 50.2% for the first nine months of 2002, also as a result of the factors discussed above. In the fourth quarter of 2003, we expect gross margin to be in the 55% to 58% range as we anticipate OEM and international sales will increase as a percentage of our sales mix. For the longer term, competitive and customer pressures may result in decreased prices for our products, reducing our gross margins.

Research and development expenses. Research and development expenses include compensation for engineers, support personnel, outside contracted services and materials costs, and are expensed as they are incurred. Research and development expenses were $7.1 million, or 9.3% of net sales, in the third quarter of 2003 compared to $6.2 million, or 9.6% of net sales, for the third quarter of 2002. The increase in the amount spent on research and development can be attributed to an increase in headcount, and an increase in materials, certification, and testing of products currently in development. The increase in headcount is the result of the hiring of software engineers to support software embedded within our expanding suite of digital offerings. In addition, we continue to establish more engineering test labs in order to improve completion time for developing and testing new products. We believe that the timely development of innovative products and enhancements to existing products is essential to maintaining our competitive position. Year-to-date research and development expenses for 2003 increased to $21.6 million from $19.6 million year-to-date in 2002 for the reasons listed above. As a percentage of net sales, year-to-date research and development expenses decreased slightly to 9.9% from 10.3%. We expect research and development expenditures to be 4% to 7% higher in the fourth quarter of 2003 as compared to the third quarter of 2003.

Acquired in-process research and development expense. The in-process research and development expense of $6.0 million in the three and nine months ended September 27, 2002 is comprised solely of the acquisition costs of 2C attributable to in-process technologies. The charges for in-process technologies are non-recurring.

Selling, general and administrative expenses. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as some merger and acquisition related expenses, rent, utilities, legal and accounting expenses, bad debts, advertising, promotional material, trade show expenses, and related travel costs. Selling, general and administrative expenses were $16.8 million, or 22.0% of net sales, for the third quarter of 2003 compared to $15.3 million, or 23.6% of net sales, for the third quarter of 2002. The increase in selling, general and administrative expenses was due primarily to increased labor costs as a result of additions to headcount and higher advertising costs. Our additions to headcount were the result of hiring sales staff in Europe, Asia, and certain regions of the U.S. to strengthen our sales force in key regions and the hiring of additional information technology staff to support our enterprise resource planning information system project. The increased advertising expense was the result of expenses related to the rollout of new products. Year-to-date selling, general, and administrative expenses increased slightly to $51.6 million, or 23.6% of net sales for 2003, from $50.7 million, or 26.7% of year-to-date net sales in 2002. The first quarter of 2002 was heavily affected by $2.7 million in legal fees related to patent litigation, as well as $2.0 million of compensation expense recorded as the result of a cashless option exercise. Looking ahead, we expect legal and accounting costs related to corporate governance initiatives (including the Sarbanes-Oxley Act of 2002 and other regulatory changes) and continued protection of our intellectual property rights to increase. Additionally, we expect increased costs related to additional sales staffing, product rollout programs, increased trade show activity, increased advertising activity, and increased travel costs related to these efforts. Accordingly, we expect selling, general and administrative expenditures to increase 4% to 7 % in the fourth quarter of 2003 from the level we experienced in the third quarter of 2003.

Amortization of intangible assets. Amortization of $4.7 million in the third quarter of 2003 is comprised of the amortization of the identifiable intangible assets created as a result of the merger transaction between Apex and Cybex and the acquisitions of Equinox and 2C, while amortization of $5.4 million in the third quarter of 2002 includes the amortization of the identifiable intangible assets created as a result of the merger transaction between Apex and Cybex, the acquisition of Equinox and one month of amortization of similar assets related to the acquisition of 2C. The decrease in amortization expense relates primarily to recording no amortization expense for the customer base recorded at the merger of Apex and Cybex, as this asset had an estimated life of three years and was fully amortized at the end of the second quarter of 2003. The reduction in amortization expense was partially offset by the addition of a three months of expense for intangible assets recorded in connection with the acquisition of 2C in August of 2002. Year-to-date, amortization expense increased from $16.1 million in the first nine months of 2002 to $17.1 million in the first nine months of 2003 as a result of the factors mentioned above.

Net investment income. Net investment income decreased to $1.2 million in the third quarter of 2003 from $1.4 million in the third quarter of 2002. For the first nine months, net investment income decreased to $3.7 million in 2003 from $4.2 million in 2002. Although we had more cash and investments during the third quarter and in the first nine months of 2003 than in 2002, interest income declined due to lower interest rates.

Net realized investment gains (losses). Net realized investment gains (losses) increased from a loss of $125,000 in the third quarter of 2002 to a gain of $3.0 million in the third quarter of 2003, almost entirely as a result of a recognized gain on the disposition of an equity investment. For the first nine months, net realized investment gains (losses) increased from a

loss of $269,000 in 2002 to a gain of $2.8 million in 2003 as a result of the factors mentioned above.

Other income (expense), net. Net other income (expense) improved from an expense of $28,000 in the third quarter of 2002, to income of $1,000 in the third quarter of 2003. The increase related primarily to an improvement in foreign exchange losses recorded in the third quarter of 2003 as compared to the losses recorded in the third quarter of 2002. This improvement relates primarily to the change in the exchange rate of the dollar versus the euro. Due to larger foreign exchange losses in the first quarter of 2003 as compared to the first quarter of 2002, net other income (expense) increased from an expense of $141,000 in the first nine months of 2002 to an expense of $418,000 in the first nine months of 2003.

Provision for income taxes. The provision for income taxes was approximately $5.6 million for the third quarter of 2003 compared to $1.9 million in the third quarter of 2002. The change in taxes resulted from the impact of merger related expenses on lower sales volume and taxable income in the second quarter of 2002 as compared to higher sales volume and higher taxable income in 2003. Also affecting our tax rate was the mix of our pre-tax profit among our U.S. and international subsidiaries. For the year, the provision for income taxes was approximately $10.7 million for the first nine months of 2003, compared to $3.1 million for the first nine months of 2002, as a result of the factors mentioned above.

Net income (loss). Net income for the third quarter of 2003 was $13.5 million compared to a loss of $325,000 for the third quarter of 2002 as a result of the above factors, including the increase in our revenues, an increase in our margins, and an increase in realized investment gains, partially offset by an increase in selling, general and administrative charges and research and development expenses. In addition, there was a one-time expense in 2002 for in-process research and development costs acquired from 2C without a similar expense in 2003. Net income as a percentage of sales for the third quarter of 2003 was 17.6%, compared to a net loss as a percentage of sales of 0.5% for the third quarter of 2002. Our net income for the first nine months of 2003 was $29.0 million compared to $3.5 million for the first nine months of 2002, again as a result of the above factors. Net income as a percentage of sales for the first nine months of 2003 was 13.3%, compared to 1.9% for the first nine months of 2002.

Liquidity and Capital Resources

As of September 26, 2003, our principal sources of liquidity consisted of over $271 million in cash, cash equivalents, and investments. We have no outstanding debt or available credit facilities as of this filing.

Our operating activities generated cash of over $54 million in the first nine months of 2003 compared to approximately $55 million in the first nine months of 2002. The cash flow from operations in the first nine months of 2003 is primarily the result of increased net income and our continued focus on managing our inventory, which were offset by an increase in receivables as of September 26, 2003. Inventories declined from $24.4 million at December 31, 2002 to $17.5 million at September 26, 2003. The decline in inventory was the result of the continued efforts of our global operations group to increase turnover by consuming existing supplies while maintaining adequate inventory to meet customer demands. Also affecting inventory levels was a strong increase in sales during September. Revenues in our third quarter typically trend upward during September, as Europeans return from extended summer vacations. We anticipate that inventories will be slightly higher at the end of 2003 as we replenish the supply of inventories sold at the end of the third quarter of 2003. We recorded a tax benefit from the exercise of stock options of almost $5.5 million in the first nine months of 2003. We experienced significant exercises of stock options in the first nine months of 2003 as our stock achieved new 52-week highs at several points during 2003. An increase in receivables partially offset the impact of the decline in inventory and the reduction in our current income tax payable due to the exercises of stock options. The increase in receivables was a result of the timing and volume of sales in the latter part of the third quarter of 2003. In addition, we recorded a realized gain of almost $3.2 million during the third quarter related to the disposition of an equity investment.

In the ordinary course of business, we may at any point in time have a significant amount of contractual commitments not yet recognized in our financial statements. These commitments relate primarily to our need to schedule the purchase of inventories in advance of the related forecasted sales to customers. We have longer lead times for the products we purchase from suppliers based in Asia than those for our U.S. based and European suppliers. Our actual contractual commitments are typically limited to products needed for the next one to three months of forecasted sales. The liabilities for these inventory purchases along with the related inventory assets are typically recognized upon our receipt of the related products. We also have at any point in time a variety of short term contractual commitments for services such as advertising, marketing, accounting, legal, and research and development activities. The liabilities for these services and the related expenses are typically recognized upon our receipt of the related services.

During 2003 we commenced implementation of a new enterprise resource planning system which we expect to have fully operational in 2004. We have capitalized costs related to the ERP project of approximately $7.4 million through September 26, 2003. We expect the total project cost of implementing the system to be in the range of $11.0

million to $12.2 million. We expect the new system will provide many benefits, including more detailed information to improve the ways we manage inventory, customer relationships and operating expenses. The implementation of the new system involves a number of risks, as detailed in the Risk Factors contained in our Form 10-K for December 31, 2002.

During the second quarter of 2003, we purchased a facility in Shannon, Ireland for approximately $6.4 million. We occupied the building during July 2003.

We intend to use a portion of our cash and investments for strategic acquisitions of technologies and companies that will enhance and complement our existing technologies and help increase our sales.

Investments

Our investments consist of corporate bonds, municipal bonds, commercial paper, mortgage backed securities guaranteed by U.S. government agencies, and common stock. Debt securities that we have the positive intent and ability to hold to maturity are classified as held-to-maturity securities and are reported at amortized cost. Debt and equity securities not classified as held-to-maturity securities and that have readily determinable fair values are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders equity. We periodically review our investment portfolio for investments considered to have sustained an other-than-temporary decline in value. Upon review of our investment portfolio as of September 26, 2003, no investment was considered to have sustained an other-than-temporary decline, and no impairment charges were recorded.

Critical Accounting Policies

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements:

We review customer contracts to determine if all of the requirements for revenue recognition have been met prior to recording revenues from sales transactions. We generally record sales revenue upon shipment of our products, net of any discounts, since we generally do not have significant post delivery obligations, the product price is fixed and determinable, collection of the resulting receivable is probable, and product returns are reasonably estimable. We generally ship products upon receipt of a purchase order from a customer. We record revenue in accordance with the applicable terms of each respective customer contract. Accordingly, revenue on products shipped FOB destination is recorded when the customer takes possession of the goods, and revenue on products shipped FOB shipping point is recorded when the goods leave our facilities. Shipping and handling fees are included in net sales, and the related costs are included in cost of sales in the accompanying consolidated statements of operations

We accrue for sales returns as a reduction of sales and cost of sales based on our experience from historical customer returns, which we believe provides a reasonable estimate of future returns. Our sales agreements generally include a one-month unconditional return policy. We also allow additional rights of return to certain distributors, which generally extend the return period to 90 days. If actual future customer returns are less favorable than those projected by management, additional sales return costs may be incurred. The reserve is included as a reduction in the carrying value of accounts receivable in the accompanying consolidated balance sheets.

Prior to extending credit to a new customer, we perform a detailed credit review of the customer and establish credit limits based on the results of our credit review. We review collection experience periodically to determine if the customer s payment terms and credit limits need to be revised. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. If circumstances change with regard to individual receivable balances that had previously been determined to be uncollectible (and for which a specific reserve had been established), a reduction in our allowance for doubtful accounts may be required.

We carry our inventory at the lower of cost or market, with cost being determined using the first-in, first-out method. We use standard costs for material, labor, and manufacturing overhead to value our inventory. We review and revise our standard costs on a quarterly basis. Therefore, our inventory costs approximate actual costs at the end of each reporting period. We write down our inventory for estimated obsolescence or unmarketable inventory to the estimated market value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

We provide for the estimated cost of product warranties at the time revenue is recognized. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers and contract manufacturers, our warranty obligation is affected by product failure rates, failure rates of purchased components integrated into our products, material usage, and other rework costs incurred in correcting a product failure. Should actual product failure rates, material usage, or other rework costs differ from our estimates, revisions to our estimated warranty liability may be required.

We hold investments in various publicly-traded debt securities, including mortgaged-backed and other asset-backed securities. We record an investment impairment charge when we believe an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment s current carrying value, thereby possibly requiring an impairment charge in the future.

We also invest in privately held entities and generally record our investments in these entities at cost or we use the equity method if we have the ability to exercise significant influence over the entity. We review our investments in these entities periodically to determine if circumstances (both financial and non-financial) exist that indicate that we will not recover our initial investment. We record impairment charges on investments having a carrying value that is greater than the value that we would reasonably expect to receive in an arm s length sale of the investment.

During the first quarter of 2003 we began implementing a new ERP system. In accordance with SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, we are capitalizing the direct costs incurred during the application development stage of the implementation. The costs capitalized to date for the new system totaled $7.4 million as of September 26, 2003.

Item 3. Quantitative and Qualitative Disclosures About Market Risks.

Our primary market risk is the potential loss arising from increases in interest rates, which could have an adverse impact on the fair value of our investment securities. Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing the return on our investment portfolio through the investment of available funds. We diversify our investment portfolio by investing in a variety of highly-rated investment-grade securities and through the use of different investment managers. Our investment securities portfolio is primarily invested in securities with maturities (or interest rate resets) of two years or less with at least an investment grade rating to minimize interest rate and credit risk as well as to provide for an immediate source of funds. Market risk, calculated as the potential change in fair value in our investment portfolio resulting from a hypothetical 10% change in interest rates, was not material at September 26, 2003. We generally hold investment securities until maturity.

We face foreign currency exchange rate risk to the extent that the value of certain foreign currencies relative to the U.S. dollar affects our financial results. Our international operations transact a portion of our business in currencies other than the U.S. dollar, predominantly the euro, and changes in exchange rates may positively or negatively affect our revenues, gross margins, operating expenses, and retained earnings since these transactions are reported by us in U.S. dollars. We occasionally purchase foreign currency forwards aimed at limiting the impact of foreign currency fluctuations. These instruments provide only limited protection against currency exchange risks, and there can be no assurance that such an approach will be successful, especially if a significant and sudden decline occurs in the value of local currencies. At September 26, 2003, we had one open forward contract, maturing in the fourth quarter of 2003, with a fair value at September 26, 2003 of approximately $1,000.

Item 4. Controls and Procedures.

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) *Changes in internal control over financial reporting*. There was no significant change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control and financial reporting. However, we are in the process of implementing a new ERP system, which we expect, when implemented, will enhance internal controls over financial reporting through the automation and standardization of certain controls and processes and support our anticipated future growth.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

In May 2001, Avocent Redmond Corp. (formerly Apex Inc.), our wholly-owned subsidiary, filed a complaint for patent infringement in the United States District Court for the Southern District of New York against Raritan Computer Inc. The Raritan complaint sought injunctive relief, damages, attorneys fees and costs under three Apex patents. After a seven day bench trial in New York in January of 2002, U.S. District Judge Milton Pollack found that there was no infringement of these patents by Raritan and ordered that judgment be entered in favor of Raritan.

In April 2003, the United States Court of Appeals for the Federal Circuit issued its ruling on our appeal in this patent litigation. The Court of Appeals ruled in favor of Avocent Redmond Corp. by vacating the non-infringement decision of the District Court for the Southern District of New York and remanding the case for further proceedings consistent with the Court of Appeals opinion.

In September 2003, Raritan petitioned the United States Supreme Court for a Writ of Certiorari to review the Court of Appeals decision. Our response to the petition will be filed with the Supreme Court later this quarter.

In October 2003, Avocent Huntsville Corp. (formerly Cybex Computer Products Corporation), another wholly-owned subsidiary, filed a complaint for patent infringement in the United States District Court for the Northern District of Alabama against ClearCube Technology, Inc. The ClearCube complaint seeks injunctive relief, damages, attorneys fees, and costs under three Avocent patents.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

31.1 Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer

31.2 Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer

32.1 Sarbanes-Oxley Act Section 906 Certifications of Chief Executive Officer and Chief Financial Officer

(b) Reports on Form 8-K

On July 17, 2003, we furnished a Report on Form 8-K with the SEC regarding the public dissemination of a press release announcing the financial results for our second quarter and nine months ended June 27, 2003.

ITEMS 2, 3, 4, AND 5 ARE NOT APPLICABLE AND HAVE BEEN OMITTED.

SIGNATURES

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

AVOCENT CORPORATION.
(Registrant)

Date: October 31, 2003

/s/ Douglas E. Pritchett
Douglas E. Pritchett
Senior Vice President of Finance, Chief Financial Officer,
Treasurer and Assistant Secretary (Principal Financial Officer)