

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended May 31, 2007

or

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

Commission file number: 0-28839

**Audiovox Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**13-1964841**

(I.R.S. Employer  
Identification No.)

**180 Marcus Blvd., Hauppauge, New York**

(Address of principal executive offices)

**11788**

(Zip Code)

Registrant's telephone number, including area code: (631) 231-7750

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

Yes X No \_\_\_\_

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

Large accelerated filer \_\_\_\_ Accelerated filer X Non-accelerated filer \_\_\_\_

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

Yes \_\_\_\_ No X

Number of shares of each class of the issuer's common stock outstanding as of the latest practicable date.

<u>Class</u>	<u>As of July 9, 2007</u>
Class A Common Stock	20,719,499 Shares
Class B Common Stock	2,260,954 Shares

# Audiovox Corporation

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## PART I - FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

**Audiovox Corporation and Subsidiaries**  
**Consolidated Balance Sheets**  
*(In thousands, except share data)*

	<b>May 31, 2007</b>	<b>February 28, 2007</b>
	(unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 15,461	\$ 15,473
Short-term investments	108,658	140,872
Accounts receivable, net	109,833	86,003
Inventory	116,724	104,972
Receivables from vendors	15,754	13,935
Prepaid expenses and other current assets	15,556	11,427
Income tax receivable	2,769	3,518
Deferred income taxes	2,489	2,492
Total current assets	387,244	378,692
Investment securities	14,062	13,179
Equity investments	12,037	11,353
Property, plant and equipment, net	19,668	18,019
Goodwill	24,202	17,514
Intangible assets	57,914	57,874
Deferred income taxes	2,438	1,858
Other assets	616	631
Total assets	<u>\$ 518,181</u>	<u>\$ 499,120</u>

*See accompanying notes to consolidated financial statements.*

**Audiovox Corporation and Subsidiaries**  
**Consolidated Balance Sheets (continued)**  
*(In thousands, except share data)*

	<b>May 31, 2007</b>	<b>February 28, 2007</b>
	(unaudited)	
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$38,593	\$34,344
Accrued expenses and other current liabilities	30,001	26,564
Accrued sales incentives	10,438	7,410
Bank obligations	3,533	2,890
Current portion of long-term debt	1,626	1,524
Total current liabilities	84,191	72,732
Long-term debt	4,929	5,430
Other tax liabilities	4,171	3,347
Capital lease obligation	5,660	5,676
Deferred compensation	8,482	7,573
Total liabilities	107,433	94,758
Commitments and contingencies		
Stockholders' equity:		
Series preferred stock, \$.01 par value; 1,500,000 shares authorized, no shares issued or outstanding	-	-
Common stock:		
Class A, \$.01 par value; 60,000,000 shares authorized, 22,336,546 and 22,005,346 shares issued, 20,643,499 and 20,312,299 shares outstanding at May 31, 2007 and February 28, 2007, respectively	223	220
Class B convertible, \$.01 par value; 10,000,000 shares authorized, 2,260,954 shares issued and outstanding	22	22
Paid-in capital	274,464	271,056
Retained earnings	153,462	151,363
Accumulated other comprehensive loss	(444)	(1,320)
Treasury stock, at cost, 1,693,047 shares of Class A common stock	(16,979)	(16,979)
Total stockholders' equity	410,748	404,362
Total liabilities and stockholders' equity	\$518,181	\$499,120

*See accompanying notes to consolidated financial statements.*

**Audiovox Corporation and Subsidiaries**  
**Consolidated Statements of Operations**  
**For the Three Months Ended May 31, 2007 and 2006**  
*(In thousands, except share and per share data)*  
*(unaudited)*

	<u>2007</u>	<u>2006</u>
Net sales	\$ 128,254	\$ 111,299
Cost of sales	<u>105,065</u>	<u>91,200</u>
Gross profit	<u>23,189</u>	<u>20,099</u>
Operating expenses:		
Selling	8,797	7,061
General and administrative	13,699	11,325
Engineering and technical support	<u>2,262</u>	<u>1,765</u>
Total operating expenses	<u>24,758</u>	<u>20,151</u>
Operating loss	<u>(1,569)</u>	<u>(52)</u>
Other income (expense):		
Interest and bank charges	(667)	(560)
Equity in income of equity investees	942	948
Other, net	<u>1,467</u>	<u>1,921</u>
Total other income	<u>1,742</u>	<u>2,309</u>
Income from continuing operations before income taxes	173	2,257
Income tax expense	<u>52</u>	<u>475</u>
Net income from continuing operations	121	1,782
Net income (loss) from discontinued operations, net of tax	<u>2,111</u>	<u>(260)</u>
Net income	<u>\$ 2,232</u>	<u>\$ 1,522</u>
Net income (loss) per common share (basic):		
From continuing operations	\$ 0.01	\$ 0.08
From discontinued operations	<u>0.09</u>	<u>(0.01)</u>
Net income per common share (basic)	<u>\$ 0.10</u>	<u>\$ 0.07</u>
Net income (loss) per common share (diluted):		
From continuing operations	\$ 0.01	\$ 0.08
From discontinued operations	<u>0.09</u>	<u>(0.01)</u>
Net income per common share (diluted)	<u>\$ 0.10</u>	<u>\$ 0.07</u>
Weighted-average common shares outstanding (basic)	<u>22,775,052</u>	<u>22,369,348</u>
Weighted-average common shares outstanding (diluted)	<u>22,847,113</u>	<u>22,548,039</u>

*See accompanying notes to consolidated financial statements.*

**Audiovox Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**For the Three Months Ended May 31, 2007 and 2006**  
*(In thousands)*  
*(unaudited)*

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Net income	\$2,232	\$1,522
Net (income) loss from discontinued operations	<u>(2,111)</u>	<u>260</u>
Net income from continuing operations	121	1,782
Adjustments to reconcile net income to net cash (used in) provided by continuing operating activities:		
Depreciation and amortization	1,167	981
Bad debt expense (recovery)	110	(104)
Equity in income of equity investees	(942)	(948)
Non-cash compensation adjustment	(998)	131
Tax benefit on stock options exercised	(865)	-
Changes in operating assets and liabilities (net of assets and liabilities acquired):		
Accounts receivable	(21,166)	4,420
Inventory	(9,133)	5,024
Receivables from vendors	(1,778)	3,625
Prepaid expenses and other	(901)	(1,266)
Investment securities-trading	(910)	(69)
Accounts payable, accrued expenses, accrued sales incentives and other current liabilities	7,359	3,993
Income taxes payable	<u>839</u>	<u>1,762</u>
Net cash (used in) provided by operating activities	(27,097)	19,331
Cash flows from investing activities:		
Purchases of property, plant and equipment	(2,401)	(421)
Proceeds from sale of property, plant and equipment	66	-
Proceeds from distribution from an equity investee	257	737
Purchase of short-term investments	(5,600)	(38,605)
Proceeds from sale of short-term investments	37,750	13,000
Purchase of patents	-	(475)
Purchase of acquired businesses	<u>(6,699)</u>	<u>-</u>
Net cash provided by (used in) investing activities	23,373	(25,764)

**Audiovox Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows (continued)**  
**For the Three Months Ended May 31, 2007 and 2006**  
*(In thousands)*  
*(unaudited)*

	<u>2007</u>	<u>2006</u>
Cash flows from financing activities:		
Borrowings from bank obligations	662	-
Repayments on bank obligations	-	(1,314)
Principal payments on capital lease obligation	(16)	(21)
Proceeds from exercise of stock options	2,546	-
Principal payments on debt	(478)	(464)
Repurchase of Class A Common Stock	-	(308)
Tax benefit on stock options exercised	865	-
Net cash provided by (used in) financing activities	<u>3,579</u>	<u>(2,107)</u>
Effect of exchange rate changes on cash	<u>133</u>	<u>85</u>
Net decrease in cash and cash equivalents	(12)	(8,455)
Cash and cash equivalents at beginning of period	<u>15,473</u>	<u>16,280</u>
Cash and cash equivalents at end of period	<u><u>\$15,461</u></u>	<u><u>\$7,825</u></u>

*See accompanying notes to consolidated financial statements.*

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**May 31, 2007**  
*(Dollars in thousands, except share and per share data)*  
*(unaudited)*

(1) Basis of Presentation

The accompanying unaudited interim consolidated financial statements of Audiovox Corporation and subsidiaries ("Audiovox" or the "Company") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and in accordance with accounting principles generally accepted in the United States of America and include all adjustments (consisting of normal recurring adjustments), which, in the opinion of management, are necessary to present fairly the consolidated financial position, results of operations and cash flows for all periods presented. The results of operations are not necessarily indicative of the results to be expected for the full fiscal year. These consolidated financial statements do not include all disclosures associated with consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, these statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto contained in the Company's Form 10-K for the fiscal year ended February 28, 2007. Certain reclassifications have been made to prior year amounts on the accompanying balance sheet in order to conform to the current year presentation (Note 10).

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in those financial statements as well as the disclosure of contingent assets and liabilities at the date of the consolidated financial statements. These judgments can be subjective and complex, and consequently, actual results could differ from those estimates and assumptions. Significant estimates made by the Company include the allowance for doubtful accounts, inventory valuation, fair value of stock based compensation, income taxes, valuation of long-lived assets, accrued sales incentives and warranty reserves. A summary of the Company's significant accounting policies is identified in Note 1 of the Consolidated Financial Statements in the Company's Form 10-K for the fiscal year ended February 28, 2007. There have been no changes to the Company's significant accounting policies subsequent to February 28, 2007, except for the accounting for uncertain tax positions (Note 10).

The Company has one reportable segment, the Electronics Group, which is organized by product category. The Electronics Group consists of six wholly-owned subsidiaries: American Radio Corp., Audiovox Electronics Corporation, Audiovox Accessories Corp., Audiovox German Holdings GmbH, Audiovox Venezuela, C.A. and Code Systems, Inc. The Company markets its products under the Audiovox® and other brand names. Unless specifically indicated otherwise, all amounts and percentages presented in the notes below are exclusive of discontinued operations.

(2) Accounting for Stock-Based Compensation

The Company has various stock based compensation plans, which are more fully described in Note 1 of the Company's Form 10-K for the fiscal year ended February 28, 2007.

No stock option awards vested or were granted during the periods presented, accordingly no stock-based compensation expense has been recorded for the three months ended May 31, 2007 and 2006. At May 31, 2007, the Company had no unrecognized compensation cost as all stock options were fully vested.

Information regarding the Company's stock options is summarized below:



**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
**May 31, 2007**

	<u>Number of Shares</u>	<u>Weighted- Average Exercise Price</u>
Outstanding and exercisable at February 28, 2007	1,784,652	\$12.97
Granted	-	-
Exercised	(331,200)	7.69
Forfeited/expired	(5,000)	13.54
Outstanding and exercisable at May 31, 2007	<u>1,448,452</u>	<u>\$14.19</u>

(3) Discontinued Operations

The net income (loss) from discontinued operations for the three months ended May 31, 2007 and 2006 is primarily due to legal settlements and related legal and administrative costs associated with contingencies pertaining to the Company's discontinued Cellular business (see Note 15).

The following is a summary of the results of discontinued operations:

	<u>Three Months Ended May 31,</u>	
	<u>2007</u>	<u>2006</u>
Net sales from discontinued operations	\$ -	\$ -
Income (loss) from discontinued operations before income taxes	\$ 3,247	\$ (329)
Income tax expense (benefit)	1,136	(69)
Net income (loss) from discontinued operations	<u>\$ 2,111</u>	<u>\$ (260)</u>

(4) Net Income Per Common Share

Basic net income per common share is based upon the weighted-average common shares outstanding during the period. Diluted net income per common share reflects the potential dilution that would occur if common stock equivalent securities or other contracts to issue common stock were exercised or converted into common stock.

There are no reconciling items which impact the numerator of basic and diluted net income per common share. A reconciliation between the denominator of basic and diluted net income per common share is as follows:

	<u>Three Months Ended May 31,</u>	
	<u>2007</u>	<u>2006</u>
Weighted-average common shares outstanding (basic)	22,775,052	22,369,348
Effect of dilutive securities:		
Stock options	<u>72,061</u>	<u>178,691</u>
Weighted-average common shares and potential common shares outstanding (diluted)	<u>22,847,113</u>	<u>22,548,039</u>

Stock options totaling 1,000,000 and 1,315,422 for the three months ended May 31, 2007 and 2006, respectively, were not included in the net income per diluted share calculation because the exercise price of these options was greater than the average market price of the Company's common stock during these

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
**May 31, 2007**

periods.

(5) Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss of \$444 and \$1,320 at May 31, 2007 and February 28, 2007, respectively, includes the net accumulated unrealized loss on the Company's available-for-sale investment securities of \$1,570 and \$1,561 at May 31, 2007 and February 28, 2007, respectively, and foreign currency translation gains of \$1,126 and \$241 at May 31, 2007 and February 28, 2007, respectively.

The Company's total comprehensive income was as follows:

	<b>Three Months Ended May 31,</b>	
	<b>2007</b>	<b>2006</b>
Net income (loss)	\$2,232	\$1,522
Other comprehensive income (loss):		
Foreign currency translation adjustments	885	968
Unrealized holding loss on available-for-sale investment securities arising during the period, net of tax	(9)	(391)
Other comprehensive income, net of tax	876	577
Total comprehensive income	<u>\$3,108</u>	<u>\$2,099</u>

The changes in the net unrealized holding loss on available-for-sale investment securities arising during the periods presented above are net of tax benefits of \$6 and \$240 for the three months ended May 31, 2007 and 2006, respectively.

(6) Supplemental Cash Flow Information/Changes in Stockholders' Equity

The following is supplemental information relating to the consolidated statements of cash flows:

	<b>Three Months Ended May 31,</b>	
	<b>2007</b>	<b>2006</b>
Cash paid during the period:		
Interest (excluding bank charges)	\$615	\$498
Income taxes (net of refunds)	357	152

Non-Cash Transactions

During the three months ended May 31, 2007 and 2006, the Company recorded a non-cash compensation (benefit) charge of \$(998) and \$131 respectively, related to the rights under call/put options previously granted to certain employees. The benefit recorded during the three months ended May 31, 2007 was due to a reduction in the call/put liability calculation as a result of the Oehlbach acquisition (Note 7).

Changes in Stockholders' Equity

During the three months ended May 31, 2007, 331,200 stock options were exercised yielding proceeds of \$2,546 to the Company. In addition, the Company recorded an \$865 increase to paid in capital as a result of the tax benefit realized upon exercise of stock options during the three months ended May 31, 2007.

As a result of the implementation of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), an adjustment of \$133 was recorded to decrease the beginning balance of retained earnings at March 1, 2007 in connection with a cumulative effect of a change in accounting principle (Note 10).

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
**May 31, 2007**

(7) Business Acquisitions

Thomson Accessories

On January 29, 2007, the Company acquired Thomson's Americas consumer electronics accessory business as well as rights to the RCA, Recoton, Spikemaster, Ambico and Discwasher brands for consumer electronics accessories for \$60,427.

As part of the acquisition price, the Company agreed to pay Thomson a 0.75% fee related to future net sales of the RCA brand for five years from the date of acquisition. This fee amounted to \$142 for the three months ended May 31, 2007 and has been preliminarily allocated to intangible assets (Note 8).

The results of operations of this acquisition have been included in the consolidated financial statements from the date of acquisition. The purpose of this acquisition is to enhance the Company's market share in the accessory business, which includes rights to the RCA brand and other brand names.

The following summarizes the preliminary allocation of the purchase price to the fair value of the assets acquired and liabilities assumed at the date of acquisition:

Assets acquired:	
Inventory	\$31,664
Prepaid expenses and other current assets	2,312
Tradename	46,735
Total assets acquired	<u>\$80,711</u>
Liabilities assumed:	
Accounts payable	\$17,489
Accrued expenses and other liabilities	2,795
Total liabilities assumed	<u>\$20,284</u>
Cash paid	<u>\$60,427</u>

The allocation of the purchase price and liabilities assumed is preliminary (Note 8).

Oehlbach

On March 1, 2007, Audiovox German Holdings GmbH completed the stock acquisition of Oehlbach Kabel GmbH ("Oehlbach"), a European market leader in the accessories field. As consideration for Oehlbach, the Company paid the following:

Purchase Price (net of cash acquired)	\$6,411
Acquisition related costs	<u>146</u>
Total Purchase Price	\$6,557

In addition, a contingent payment may be due by the Company if certain earning targets are generated by Oehlbach for a period of three years after the acquisition date (March 1, 2010). The earnings target calculation requires that if the accumulated Oehlbach operating income, including or excluding certain items exceeds 3,290 Euros over the cumulative three year period, the Company is liable to pay the excess of the operating income amount (as defined in the purchase agreement) over 3,290 Euros but not to exceed 1,000 Euros. As of May 31, 2007 no amount has been accrued for the contingency payment as the earnings target was not reached.

The results of operations of this acquisition have been included in the consolidated financial statements from the date of acquisition. The purpose of this acquisition is to enhance the Company's international market share in the accessory business.

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
**May 31, 2007**

The following summarizes the allocation of the purchase price to the fair value of the assets acquired and liabilities assumed at the date of acquisition:

Assets acquired:	
Accounts receivable, net	\$2,215
Inventory	1,939
Prepaid expenses and other current assets	60
Property, plant and equipment	337
Goodwill	6,688
Total assets acquired	<u>\$11,239</u>
Liabilities assumed:	
Accounts payable	\$601
Accrued expenses and other liabilities	2,383
Income taxes payable	891
Long-term debt	807
Total liabilities assumed	<u>\$4,682</u>
Cash paid	\$6,557

The allocation of the purchase price and liabilities assumed is preliminary (Note 8).

The following unaudited pro-forma financial information for the three months ended May 31, 2006 represents the combined results of the Company's operations as if the Oehlbach and Thomson acquisitions had occurred on March 1, 2006. The unaudited pro-forma financial information does not necessarily reflect the results of operations that would have occurred had the Company constituted a single entity during such period.

	<b>Three Months Ended May 31, 2006</b>
	(unaudited)
Net sales	\$159,624
Net income	1,640
Net income per share-diluted	0.07

(8) Goodwill and Intangible Assets

The change in goodwill is as follows:

Balance at February 28, 2007	\$17,514
Purchase of Oehlbach (Note 7)	<u>6,688</u>
Balance at May 31, 2007	<u><u>\$24,202</u></u>

At February 28, 2007, intangible assets consisted of the following:

	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Total Net Book Value</b>
Patents subject to amortization	\$625	\$193	\$432
Trademarks/Tradenames not subject to amortization	56,835	-	56,835
Contract subject to amortization (5 years)	<u>1,104</u>	<u>497</u>	<u>607</u>

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
**May 31, 2007**

Total	<u>\$58,564</u>	<u>\$690</u>	<u>\$57,874</u>
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At May 31, 2007, intangible assets consisted of the following:

	<u>Gross Carrying Value</u>	<u>Accumulated Amortization</u>	<u>Total Net Book Value</u>
Patents subject to amortization	\$625	\$240	\$385
Trademarks/Tradenames not subject to amortization	56,977	-	56,977
Contract subject to amortization (5 years)	<u>1,104</u>	<u>552</u>	<u>552</u>
Total	<u>\$58,706</u>	<u>\$792</u>	<u>\$57,914</u>

During the three months ended May 31, 2007, the Company made a contingent payment of \$142 in connection with the RCA brand, which has been preliminarily allocated to trademarks not subject to amortization (Note 7).

The Company recorded amortization expense of \$102 and \$88 for the three months ended May 31, 2007 and 2006, respectively. The estimated aggregate amortization expense for the cumulative five years ending May 31, 2012 amounts to \$898.

(9) Equity Investments

As of May 31, 2007 and February 28, 2007, the Company had a 50% non-controlling ownership interest in Audiovox Specialized Applications, Inc. ("ASA") which acts as a distributor of televisions and other automotive sound, security and accessory products for specialized vehicles, such as RV's and van conversions.

The following presents summary financial information for ASA. Such summary financial information has been provided herein based upon the individual significance of ASA to the consolidated financial information of the Company.

	<u>May 31, 2007</u>	<u>February 28, 2007</u>
Current assets	\$25,275	\$23,409
Non-current assets	4,781	4,716
Current liabilities	5,981	5,420
Members' equity	24,075	22,705
	<u>Three Months Ended May 31,</u>	
	<u>2007</u>	<u>2006</u>
Net sales	\$19,506	\$15,884
Gross profit	5,304	4,902
Operating income	1,646	1,642
Net income	1,884	1,896

The Company's share of income from ASA for the three months ended May 31, 2007 and 2006, was \$942 and \$948 respectively. In addition, the Company received distributions from ASA totaling \$257 during the three months ended May 31, 2007, which was recorded as a reduction to equity investments in the accompanying consolidated balance sheet.

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
**May 31, 2007**

(10) Income Taxes

Quarterly Tax Provision

Interim period tax provisions are generally based upon an estimated annual effective tax rate per taxable entity, including evaluations of possible future events and transactions, and are subject to subsequent refinement or revision. When the Company is unable to estimate a part of its annual income or loss, or the related tax expense or benefit, the tax expense or benefit applicable to that item is reported in the interim period in which the income or loss occurs. A valuation allowance is provided when it is more likely than not that some portion, or all, of the deferred tax assets will not be realized.

The effective tax rate from continuing operations for the three months ended May 31, 2007 was 30.1%, compared to 21.0% in the prior year. The increase in the effective tax rate is due to lower tax exempt interest income earned on short-term investments, which results in the Company's effective tax rate being less than the statutory rate.

FIN 48

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109, Accounting for Income Taxes" ("FIN 48"). FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and requires increased disclosures.

The Company adopted the provisions of FIN 48 on March 1, 2007 which resulted in a \$133 adjustment to decrease retained earnings in connection with a cumulative effect of a change in accounting principle. The amount of unrecognized tax benefits at May 31, 2007 was \$4,171, all of which would impact the Company's effective tax rate, if recognized. The Company recognizes accrued interest and penalties associated with unrecognized tax benefits as part of the income tax provision. As of May 31, 2007, the Company had \$629 of accrued interest and penalties in connection with unrecognized tax benefits.

There was no material change in the amount of uncertain tax benefits recognized during the three months ended May 31, 2007. It is possible that the amount of unrecognized tax benefits could change in the next 12 months, however, the Company does not expect the change to have a significant impact on its results of operations or financial position.

The Internal Revenue Service ("IRS") is conducting an examination of the Company's U.S. federal income tax returns for the fiscal years 2004, 2005 and 2006 as part of the IRS's Compliance Assurance Process program. In addition, the Company files in numerous state and foreign jurisdictions with varying statutes of limitations.

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
**May 31, 2007**

(11) Accrued Sales Incentives

A summary of the activity with respect to sales incentives is provided below:

	<b>Three Months Ended May 31,</b>	
	<b>2007</b>	<b>2006</b>
Opening balance	\$7,410	\$8,512
Accruals	7,714 *	3,001
Payments and credits	(3,323)	(3,560)
Reversals for unearned sales incentive	(347)	(629)
Reversals for unclaimed sales incentives	(1,016)	(379)
Ending balance	<u>\$10,438</u>	<u>\$6,945</u>

\* Includes \$325 of sales incentives acquired from the Oehlbach acquisition (Note 7).

(12) Product Warranties and Product Repair Costs

The following table provides a summary of the activity with respect to product warranties and product repair costs:

	<b>Three Months Ended May 31,</b>	
	<b>2007</b>	<b>2006</b>
Opening balance	\$9,586	\$9,947
Liabilities accrued for warranties issued during the period	2,691	1,382
Warranty claims paid during the period	(2,953)	(2,306)
Ending balance	<u>\$9,324</u>	<u>\$9,023</u>

(13) Financing Arrangements

The Company has the following financing arrangements:

	<b>May 31, 2007</b>	<b>February 28, 2007</b>
<u>Bank Obligations</u>		
Domestic bank obligations (a)	\$ -	\$ -
Venezuela bank obligations (b)	219	-
Euro Asset-Based lending obligation (c)	3,314	2,890
Total bank obligations	<u>\$3,533</u>	<u>\$2,890</u>
<u>Debt</u>		
Euro term loan agreement (d)	\$5,179	\$5,461
Oehlbach (e)	850	-
Other (f)	526	1,493
Total debt	<u>\$6,555</u>	<u>\$6,954</u>

**Audiovox Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements, continued**  
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(a) Domestic Bank Obligations

At May 31, 2007, the Company has an unsecured credit line to fund the temporary short-term working capital needs of the domestic operations. This line expires on August 31, 2007 and allows aggregate borrowings of up to \$25,000 at an interest rate of Prime (or similar designations) plus 1%. As of May 31, 2007 and February 28, 2007, no direct amounts are outstanding under this agreement. At May 31, 2007, the Company had \$3,586 in commercial and standby letters of credit outstanding, which reduces the amount available under the unsecured credit line.

(b) Venezuela Bank Obligations

In October 2005, Audiovox Venezuela entered into a credit facility borrowing arrangement which allows for principal borrowings up to \$1,000 plus accrued interest. The facility requires minimum monthly interest payments at an annual interest rate of 13% until the expiration of the facility on February 14, 2008. Audiovox Corporation has secured this facility with a \$1,200 standby letter of credit. At February 28, 2007, no direct amounts were outstanding under this agreement.

(c) Euro Asset-Based Lending Obligation

The Company has a 16,000 Euro accounts receivable factoring arrangement and a 6,000 Euro Asset-Based Lending ("ABL") (finished goods inventory and non factored accounts receivable) credit facility for the Company's subsidiary, Audiovox Germany, which expires on October 25, 2007 and is renewable on an annual basis. Selected accounts receivable are purchased from the Company on a non-recourse basis at 85% of face value and payment of the remaining 15% upon receipt from the customer of the balance of the receivable purchased. In respect of the ABL credit facility, selected finished goods are advanced at a 60% rate and non factored accounts receivables are advanced at a 50% rate. The rate of interest is the three month Euribor plus 2.5%, and the Company pays 0.4% of its gross sales as a fee for the accounts receivable factoring arrangement. As of May 31, 2007, the amount of accounts receivable and finished goods available for factoring exceeded the amounts outstanding under this obligation.

(d) Euro Term Loan Agreement

On September 2, 2003, Audiovox Germany borrowed 12 million Euros under a new term loan agreement. This agreement was for a 5-year term loan with a financial institution consisting of two tranches. Tranche A is for 9 million Euros and Tranche B is for 3 million Euros. Tranche B has been fully repaid. Payments under Tranche A are due in monthly installments and interest accrues at 2.75% over the Euribor rate. Any amount repaid may not be reborrowed. The term loan becomes immediately due and payable if a change of control occurs without permission of the financial institution. In April 2005, the maturity of the term loan was prolonged to August 30, 2010 with a pre-payment option.

Audiovox Corporation guarantees 3 million Euros of this term loan. The term loan is secured by the pledge of the stock of Audiovox Germany on all brands and trademarks of Audiovox Germany. The term loan requires the maintenance of certain yearly financial covenants that are calculated according to German Accounting Standards. Should any of the financial covenants not be met, the financial institution may charge a higher interest rate on any outstanding borrowings and/or call the loan. The short and long term amounts outstanding under this agreement were \$1,554 and \$3,625 respectively, at May 31, 2007 and \$1,524 and \$3,937, respectively, at February 28, 2007.

(e) Oehlbach

In connection with the Oehlbach acquisition (Note 7), the Company acquired short and long term debt payable to various third parties. The interest rate on the debt ranges from 4.2% to 6.1% and



**Audiovox Corporation and Subsidiaries**  
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is payable from May 2008 to March 2011.

(f) Other Debt

This amount represents a call/put option owed to certain employees of Audiovox Germany.

(14) Other Income

Other income is comprised of the following:

	<u>Three Months Ended May 31,</u>	
	<u>2007</u>	<u>2006</u>
Interest income	\$1,411	\$1,588
Rental income	138	138
Miscellaneous	(82)	195
Total Other, net	<u>\$1,467</u>	<u>\$1,921</u>

(15) Contingencies and Derivative Settlement

Contingencies

The Company is currently, and has in the past been, a party to various routine legal proceedings incident to the ordinary course of business. If management determines, based on the underlying facts and circumstances, that it is probable a loss will result from a litigation contingency and the amount of the loss can be reasonably estimated, the estimated loss is accrued for. The Company believes there has been no material change to the matters disclosed in Note 17 of the Company's Form 10-K for the fiscal year ended February 28, 2007, however, due to the uncertainty of these matters, the company disclosed the following:

Certain consolidated class actions transferred to a Multi-District Litigation Panel of the United States District Court of the District of Maryland against the Company and other suppliers, manufacturers and distributors of hand-held wireless telephones alleging damages relating to exposure to radio frequency radiation from hand-held wireless telephones are still pending. No assurances regarding the outcome of this matter can be given, as the Company is unable to assess the degree of probability of an unfavorable outcome or estimated loss or liability, if any. Accordingly, no estimated loss has been recorded for the aforementioned case.

The products the Company sells are continually changing as a result of improved technology. As a result, although the Company and its suppliers attempt to avoid infringing known proprietary rights, the Company may be subject to legal proceedings and claims for alleged infringement by its suppliers or distributors, of third party patents, trade secrets, trademarks or copyrights. Any claims relating to the infringement of third-party proprietary rights, even if not meritorious, could result in costly litigation, divert management's attention and resources, or require the Company to either enter into royalty or license agreements which are not advantageous to the Company or pay material amounts of damages.

Under the asset purchase agreement for the sale of the Company's Cellular business to UTSI, the Company agreed to indemnify UTSI for any breach or violation by ACC and its representations, warranties and covenants contained in the asset purchase agreement and for other matters, subject to certain limitations. Significant indemnification claims by UTSI could have a material adverse effect on the Company's financial condition and results of operation. The Company is not aware of any such claim(s) for indemnification.

Derivative Settlement

In November 2004, several purported double derivative, derivative and class actions were filed in the Court

**Audiovox Corporation and Subsidiaries**  
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**May 31, 2007**

of Chancery of the State of Delaware, New Castle County challenging approximately \$27,000 made in payments from the proceeds of the Asset Sale to UTStarcom, Inc. These actions were subsequently consolidated into a single derivative complaint (the "Complaint"), *In re Audiovox Corporation Derivative Litigation*. The Complaint challenges the payment of \$16,000 to Mr. Christopher pursuant to a Personally Held Intangibles Agreement, an additional \$4,000 to Mr. Christopher pursuant to an Agreement and General Release, \$1,916 to Mr. Shalam pursuant to an amendment to his Long-Term Incentive Award, \$5,000 distributed to ACC employees other than Mr. Christopher and the extension of certain options to Mr. Christopher. The Complaint alleges that: (i) the payments should be rescinded on grounds including, inter alia, material misrepresentation, breach of fiduciary duty and mistake, (ii) the recipients of the various payments were unjustly enriched, and (iii) the directors of Audiovox breached their fiduciary duties to Audiovox and its shareholders.

This matter was settled in May 2007 and received final Chancery court approval in June 2007. As a result of the settlement, the Company is to receive \$6,750 in gross proceeds, of which \$1,500 was received as of May 31, 2007. The remaining gross proceeds of \$5,250 is recorded in other current assets on the accompanying consolidated balance sheet as of May 31, 2007 and was subsequently collected in June 2007. The gross proceeds were partially offset by \$2,378 in plaintiff legal fees which was recorded in accrued expenses on the accompanying consolidated balance sheet as of May 31, 2007 and subsequently paid in June 2007. In addition, the Company accrued \$1,023 in legal and administrative costs as of May 31, 2007 for defending all outstanding ACC legal claims. The items discussed above resulted in a pre-tax benefit of \$3,349 being recorded in discontinued operations for the three months ended May 31, 2007.

(16) New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurement. SFAS 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157, but does not expect the adoption of this pronouncement to have a material impact on the Company's financial position or results of operations.

In February 2007, the FASB released SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159") to provide companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS 159 is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 is effective for fiscal years beginning after November 15, 2007 with early adoption permitted. The Company is currently evaluating the impact of SFAS 159, but does not expect the adoption of this pronouncement to have a material impact on the Company's financial position or results of operations.

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

### **Forward-Looking Statements**

Certain information in this Quarterly Report on Form 10-Q would constitute forward-looking statements, including but not limited to, information relating to the future performance and financial condition of the Company, the plans and objectives of the Company's management and the Company's assumptions regarding such performance and plans that are forward-looking in nature and involve certain risks and uncertainties. Actual results could differ materially from such forward-looking information.

We begin Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") with an overview of the business. This is followed by a discussion of the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. In the next section, we discuss our results of operations for the three months ended May 31, 2007 compared to the three months ended May 31, 2006. We then provide an analysis of changes in our balance sheets and cash flows, and discuss our financial commitments in the sections entitled "Liquidity and Capital Resources." We conclude this MD&A with a discussion of "Related Party Transactions" and "Recent Accounting Pronouncements".

Unless specifically indicated otherwise, all amounts and percentages presented in our MD&A below are exclusive of discontinued operations and are in thousands, except for per share amounts.

### **Business Overview**

Audiovox Corporation ("Audiovox", "We", "Our", "Us" or "Company") is a leading international distributor and value added service provider in the accessory, mobile and consumer electronics industries. We conduct our business through six wholly-owned subsidiaries: American Radio Corp., Audiovox Electronics Corporation ("AEC"), Audiovox Accessories Corp., Audiovox German Holdings GmbH ("Audiovox Germany"), Audiovox Venezuela, C.A and Code Systems, Inc. ("Code"). We market our products under the Audiovox® brand name and other brand names, such as Acoustic Research®, Advent®, Ambico®, Car Link®, Chapman®, Code-Alarm®, Discwasher®, Heco®, Jensen®, Mac Audio®, Magnate®, Movies 2 Go®, Phase Linear®, Prestige®, Pursuit®, RCA®, Recoton®, Road Gear® and Spikemaster®, as well as private labels through a large domestic and international distribution network. We also function as an OEM ("Original Equipment Manufacturer") supplier to several customers and presently have one reportable segment ("Electronics Group"), which is organized by product category.

We have recently integrated and continue to integrate the following acquisitions, discussed below, into our existing business structure:

In March 2007, Audiovox German Holdings GmbH completed the acquisition of Oehlbach, a European market leader in the accessories field, for a total purchase price of \$6,557, in addition to a contingent earn out payment, not to exceed 1 million euros. The purpose of this acquisition was to expand our electronics accessory product line to international markets.

In January 2007, we completed the acquisition of Thomson's Americas consumer electronics accessory business for a total purchase price of approximately \$60,427 plus a five year fee related to the RCA brand in connection with future sales. The purpose of this acquisition was to enhance our market share in the accessory

business, which includes the rights to the RCA brand for consumer electronics accessories as well as the Recoton, Spikemaster, Ambico and Discwasher brands for use on any product category and the Jensen, Advent, Acoustic Research and Road Gear brands for consumer electronics accessories.

We continue to monitor economic and industry conditions in order to evaluate potential synergistic business acquisitions that would allow us to leverage overhead, penetrate new markets or expand our existing business distribution.

Effective March 1, 2007, the Company reported “accessories” as a separate product category due to the growth in the accessories product line as a result of the Thomson and Oehlbach acquisitions. In addition, the Company’s former mobile and consumer product categories are now combined and recorded in the “Electronics” product category. As such, certain reclassifications have been made to prior year amounts as the Company currently reports sales data for the following two product categories:

Electronics products include:

- mobile multi-media video products, including in-dash, overhead, headrest and portable mobile video systems,
- autosound products including radios, speakers, amplifiers and CD changers,
- satellite radios including plug and play models and direct connect models,
- automotive security and remote start systems,
- automotive power accessories,
- car to car portable navigation systems,
- rear observation and collision avoidance systems,
- LCD and Plasma flat panel televisions,
- home and portable stereos,
- HDTV Antennas, WiFi Antennas and HDMI accessories,
- two-way radios, digital multi-media products such as personal video recorders and MP3 products,
- home speaker systems and home theater in a box,
- portable DVD players, and
- flat panel TV mounting systems.

Accessories products include:

- antennas,
- home electronic accessories such as cabling, power cards and performance enhancing electronics, and
- remotes, iPod specialized products, wireless headphones and other connectivity products.

We believe the Electronics Group has an expanding market with a certain level of volatility related to both domestic and international new car sales, increased competition by manufacturers, technological advancements, discretionary consumer spending and general economic conditions. Also, all of our products are subject to price fluctuations which could affect the carrying value of inventories and gross margins in the future.

## **Segment**

We have determined that we operate in one segment, the Electronics Group based on review of SFAS No. 131 “*Disclosures about Segments of an Enterprise and Related Information*”. Characteristics of our operations which are relied on in making and reviewing business decisions include the similarities in our products, the commonality of our customers across brands, our unified marketing strategy, and the nature of the financial information used by our Executive Officers. Management reviews the financial results of the Company based on the performance of the Electronics Group.

## Critical Accounting Policies and Estimates

As disclosed in our Form 10-K for the fiscal year ended February 28, 2007, the discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements require us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements. These judgments can be subjective and complex, and consequently, actual results could differ from those estimates. Our most critical accounting policies and estimates relate to revenue recognition; sales incentives; accounts receivable; inventory, goodwill and other intangible assets; warranties, stock-based compensation and income taxes. Since February 28, 2007, there have been no changes in our critical accounting policies or changes to the assumptions and estimates related to them, except for the accounting for uncertain tax positions.

## Results of Operations

As you read this discussion and analysis, refer to the accompanying consolidated statements of operations, which present the results of our operations for the three months ended May 31, 2007 and 2006. We analyze and explain the differences between periods based on the specific line items of the consolidated statements of operations.

### Three months ended May 31, 2007 compared to the three months ended May 31, 2006

The following tables set forth, for the periods indicated, certain statement of operations data for the three months ended May 31, 2007 and 2006.

#### *Net Sales*

	<u>Three Months Ended May 31,</u>		<u>\$</u>	<u>%</u>
	<u>2007</u>	<u>2006</u>	<u>Change</u>	<u>Change</u>
Electronics	\$94,984	\$107,356	\$(12,372)	(11.5) %
Accessories	33,270	3,943	\$29,327	743.8 %
Total net sales	<u>\$128,254</u>	<u>\$111,299</u>	<u>\$16,955</u>	<u>15.2 %</u>

Electronics sales, which represented 74.1% of net sales for the three months ended May 31, 2007, decreased primarily due to the following:

- reduced consumer goods sales of approximately \$11,590 as a result of declining prices and product volume sales of flat panel TV's throughout the electronics industry coupled with a delay in receipt of LCD panel shipments from suppliers.
- an approximate \$4,689 decline in video sales as a result of a decline in mobile video and shuttle system sales.
- The above decreases were partially offset by a \$7,212 increase in audio sales as a result of improved sales in the Jensen Mobile, Phase Linear and Satellite radio product lines.

Accessories sales, which represented 25.9% of net sales for the three months ended May 31, 2007 increased due to incremental sales generated from the recently acquired Thomson and Oehlbach operations. The Company expects accessory sales to represent a higher percentage of total net sales as compared to the prior year due to the acquisitions of Oehlbach and Thomson in March 2007 and January 2007, respectively.

Sales incentive expense increased \$4,033 to \$6,026 for the three months ended May 31, 2007 as a result of an increase in accessories net sales which historically offer more sales incentive programs. The increase in sales incentive expense was partially offset by a \$355 increase in reversals. We believe the reversal of earned but unclaimed sales incentives upon the expiration of the claim period is a disciplined, rational, consistent and systematic method of reversing unclaimed sales incentives. These sales incentive programs are expected to continue and will either increase or decrease based upon competition and customer demands.

#### *Gross Profit*

	<b>Three Months Ended May 31,</b>	
	<b>2007</b>	<b>2006</b>
Gross profit	\$23,189	\$20,099
Gross margins	18.1%	18.1%

Gross margins remained consistent with the prior period at 18.1%. Gross margins were favorably impacted by margins generated from the recently acquired accessories companies as well as improved margins in electronic products due to focusing sales effects on more profitable product lines. Gross margins were adversely impacted by increased warehouse and assembly costs as a result of transition costs necessary to facilitate the newly acquired accessories companies as well as increased inventory provisions as a result of increased accessories sales due to acquisitions and increased warranty and repair costs.

#### *Operating Expenses and Operating Loss*

	<b>Three Months Ended May 31,</b>		<b>\$</b>	<b>%</b>
	<b>2007</b>	<b>2006</b>	<b>Change</b>	<b>Change</b>
Operating expenses:				
Selling	\$ 8,797	\$ 7,061	\$ 1,736	24.6%
General and administrative	13,699	11,325	2,374	21.0%
Engineering and technical support	2,262	1,765	497	28.2%
Total operating expenses	24,758	20,151	4,607	22.9%
Operating loss	\$ (1,569)	\$ (52)	\$ (1,517)	2,917.3%

Operating expenses increased \$4,607 or 22.9% for the three months ended May 31, 2007, as compared to the prior year. As a percentage of net sales, operating expenses increased to 19.3% for the three months ended May 31, 2007, from 18.1% in the prior year. The increase in total operating expenses is due to the recently acquired Thomson and Oehlbach operations which had total operating expense of \$5,511 for the three months ended May 31, 2007.

Selling expenses increased \$1,736 or 24.6% due to \$2,215 of selling expenses during the three months ended May 31, 2007 for the recently acquired operations of Thomson and Oehlbach. This increase was partially offset by a decrease in advertising due to a decline in the budgeted amounts for print media advertising.

General and administrative expenses increased \$2,374 or 21.0% due to:

- \$2,912 of expenses during the three months ended May 31, 2007 for the recently acquired operations of Thomson and Oehlbach, and
- \$214 increase in bad debt expense due to an increase in sales and accounts receivable balances.

- The above increases were partially offset by a \$998 benefit related to a call/put option previously granted to certain employees. The benefit recorded for the three months ended May 31, 2007 was due to a reduction in the call/put liability calculation as a result of the Oehlbach acquisition.

Engineering and technical support expenses increased \$497 or 28.2% due to \$382 of expenses during the three months ended May 31, 2007 for the recently acquired operations of Thomson and Oehlbach, and an increase in domestic direct labor as a result of wage increases.

*Other (Expense) Income*

	<b>Three Months Ended May 31,</b>		<b>\$</b>	<b>%</b>
	<b>2007</b>	<b>2006</b>	<b>Change</b>	<b>Change</b>
Interest and bank charges	\$(667)	\$(560)	\$(107)	19.1 %
Equity in income of equity investees	942	948	(6)	(0.6)
Other, net	1,467	1,921	(454)	(23.6)
Total other income	<u>\$1,742</u>	<u>\$2,309</u>	<u>\$(567)</u>	<u>(24.6) %</u>

Interest and bank charges increased as a result of acquiring additional debt in connection with the acquisition of Oehlbach as well as increased working capital needs of foreign subsidiaries. Interest and bank charges represent expenses for debt and bank obligations of Audiovox Germany and Venezuela and interest for a capital lease.

Other income decreased due to a decline in interest income as a result of a decline in short-term investment holdings due to cash utilized for acquisitions as well as additional working capital needs for.

*Income Tax Provision*

The effective tax rate for the three months ended May 31, 2007 was 30.1% compared to 21.0% in the prior period. The increase in the effective tax rate is due to lower tax exempt interest income earned on our short-term investments, which results in our effective tax rate being less than the statutory rate.

*Income (Loss) from Discontinued Operations*

The following is a summary of financial results included within discontinued operations:

	<b>Three Months Ended May 31,</b>	
	<b>2007</b>	<b>2006</b>
Net sales from discontinued operations	<u>\$ -</u>	<u>\$ -</u>
Income (loss) from discontinued operations before income taxes	\$ 3,247	\$ (329)
Income tax expense (benefit)	<u>1,136</u>	<u>(69)</u>
Net income (loss) from discontinued operations	<u>\$ 2,111</u>	<u>\$ (260)</u>

Net income (loss) from discontinued operations for the three months ended May 31, 2007 and 2006 is primarily due to legal settlements and related costs pertaining to our discontinued Cellular business. The increase in income from discontinued operations for the three months ended May 31, 2007 is due to a derivative legal settlement which resulted in pre-tax income of \$3,349 (see Note 15 of Notes to the Consolidated Financial Statements).

## *Net Income*

Net income for the three months ended May 31, 2007 was \$2,232 compared to \$1,522 in the prior year. Income per share for the three months ended May 31, 2007 was \$0.10 (diluted) as compared to income per share of \$0.07 (diluted) for the prior year. Net income was favorably impacted by sales incentive reversals of \$1,363 (\$831 after taxes) and \$1,008 (\$796 after taxes) for the three months ended May 31, 2007 and 2006, respectively. Net income for the three months ended May 31, 2007 was also favorably impacted by \$2,111 in income from discontinued operations as a result of a derivative legal settlement.

## **Liquidity and Capital Resources**

### **Cash Flows, Commitments and Obligations**

As of May 31, 2007, we had working capital of \$303,053, which includes cash and short-term investments of \$124,119 compared with working capital of \$305,960 at February 28, 2007, which included cash and short-term investments of \$156,345. The decrease in short-term investments is primarily due to the acquisition of Oehlbach as well as additional working capital needs. We plan to utilize our current cash position and short-term investments as well as collections from accounts receivable to fund the current operations of the business. However, we may utilize all or a portion of current capital resources to pursue other business opportunities, including acquisitions.

Operating activities used cash of \$27,097 for the three months ended May 31, 2007 compared to cash provided of \$19,331 in 2006. Net income from continuing operations for the three months ended May 31, 2007 was \$121 compared to \$1,782 in the prior year. The increase in cash used by operating activities as compared to the prior year was primarily due to an increase in accounts receivable and inventory balances.

The following significant fluctuations in the balance sheet accounts impacted cash flows from operations:

- Cash flows from operating activities for the three months ended May 31, 2007 were impacted by an increase in accounts receivable primarily due to increased sales and the timing of collections. Accounts receivable turnover approximated 5.3 during the three months ended May 31, 2007 compared to 5.1 in the prior year.
- Cash flows from operations were impacted by an increase in inventory due to increased purchases for future sales projections. Inventory turnover approximated 3.8 during the three months ended May 31, 2007 compared to 3.9 in the prior year.
- In addition, cash flows from operating activities for the three months ended May 31, 2007 were favorably impacted by an increase in accounts payable due to the timing of payments. The timing of payments made can fluctuate and are often impacted by the timing of inventory purchases, operating expenses and the amount of inventory on hand.

Investing activities provided cash of \$23,373 during the three months ended May 31, 2007, primarily due to the sales (net of purchases) of short-term investments partially offset by the Oehlbach acquisition and purchases of property, plant and equipment. Investing activities used cash of \$25,764 during the three months ended May 31, 2006, primarily due to purchase (net of sales) of short-term investments.

Financing activities provided \$3,579 during the three months ended May 31, 2007, primarily from the exercise of stock options partially offset by payment of bank obligations and debt. Financing activities for the three months ended May 31, 2006 used cash of \$2,107, primarily from the purchase of treasury stock and payment of bank obligations and debt.

As of May 31, 2007, we have a domestic credit line to fund the temporary short-term working capital needs of the Company. This line expires on August 31, 2007 and allows aggregate borrowings of up to \$25,000



at an interest rate of Prime (or similar designations) plus 1%. In addition, Audiovox Germany has a 16,000 Euro accounts receivable factoring arrangement and a 6,000 Euro Asset-Based Lending (“ABL”) credit facility and Audiovox Venezuela has a \$1,000 credit facility borrowing arrangement with an interest rate of 13%.

Certain contractual cash obligations and other commercial commitments will impact our short and long-term liquidity. At May 31, 2007, such obligations and commitments are as follows:

<b>Contractual Cash Obligations</b>	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 Years</b>
Capital lease obligation (1)	\$11,841	\$522	\$1,043	\$1,069	\$9,207
Operating leases (2)	20,375	3,322	4,740	3,337	8,976
Total contractual cash obligations	\$32,216	\$3,844	\$5,783	\$4,406	\$18,183

  

<b>Other Commercial Commitments</b>	<b>Amount of Commitment Expiration per period</b>				
	<b>Total Amounts Committed</b>	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 years</b>
Bank obligations (3)	\$3,533	\$3,533	-	-	-
Stand-by letters of credit (4)	2,265	2,265	-	-	-
Commercial letters of credit (4)	1,321	1,321	-	-	-
Debt (5)	6,555	1,626	3,997	932	-
Unconditional purchase obligations (6)	107,163	107,163	-	-	-
Total commercial commitments	\$120,837	\$115,908	\$3,997	\$932	-

1. Represents total payments (interest and principal) due under a capital lease obligation which has a current (included in other current liabilities) and long term principal balance of \$66 and \$5,660, respectively at May 31, 2007.
2. We enter into operating leases in the normal course of business.
3. Represents amounts outstanding under the Audiovox Germany factoring agreement and Venezuela bank obligation at May 31, 2007.
4. Commercial letters of credit are issued during the ordinary course of business through major domestic banks as requested by certain suppliers. We also issue standby letters of credit to secure certain bank obligations and insurance requirements.
5. Represents amounts outstanding under a loan agreement for Audiovox Germany. This amount also includes amounts due under a call-put option with certain employees of Audiovox Germany.
6. Open purchase obligations represent inventory commitments. These obligations are not recorded in the consolidated financial statements until commitments are fulfilled and such obligations are subject to change based on negotiations with manufacturers.

We regularly review our cash funding requirements and attempt to meet those requirements through a combination of cash on hand, cash provided by operations, available borrowings under bank lines of credit and possible future public or private debt and/or equity offerings. At times, we evaluate possible acquisitions of, or investments in, businesses that are complementary to ours, which transactions may require the use of cash. We

believe that our cash, other liquid assets, operating cash flows, credit arrangements, access to equity capital markets, taken together, provides adequate resources to fund ongoing operating expenditures. In the event that they do not, we may require additional funds in the future to support our working capital requirements or for other purposes and may seek to raise such additional funds through the sale of public or private equity and/or debt financings as well as from other sources. No assurance can be given that additional financing will be available in the future or that if available, such financing will be obtainable on terms favorable when required.

#### **Off-Balance Sheet Arrangements**

We do not maintain any off-balance sheet arrangements, transactions, obligations or other relationships with unconsolidated entities that would be expected to have a material current or future effect upon our financial condition or results of operations.

#### **Related Party Transactions**

During 1998, we entered into a 30-year capital lease for a building with our principal stockholder and chairman, which was the headquarters of the discontinued Cellular operation. Payments on the capital lease were based upon the construction costs of the building and the then-current interest rates. The current effective interest rate on the capital lease obligation is 8%. On November 1, 2004, we entered into an agreement to sublease the building to UTStarcom for monthly payments of \$46 until November 1, 2009. We also lease another facility from our principal stockholder which expires on November 30, 2016. Total lease payments required under all related party leases for the five-year period ending May 31, 2012 are \$6,170.

#### **New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurement. SFAS 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of SFAS 157, but we do not expect the adoption of this pronouncement will have a material impact on our financial position or results of operations.

In February 2007, the FASB released SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159") to provide companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 with early adoption permitted. We are currently evaluating the impact of SFAS 159, but do not expect the adoption of this pronouncement to have a material impact on our financial position or results of operations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There has been no significant change in our market risk sensitive instruments since February 28, 2007.

**ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, these disclosure controls and procedures are effective at a “reasonable assurance” level.

There were no material changes in our internal control over financial reporting (as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the three month period ended May 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

See Note 15 of the Notes to the Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q and Note 17 of the Form 10-K for the fiscal year ended February 28, 2007 for information regarding legal proceedings.

### **ITEM 1A. RISK FACTORS**

There have been no material changes from the risk factors previously disclosed in the Company's Form 10-K for the fiscal year ended February 28, 2007.

## **ITEM 6. EXHIBITS**

<u>Exhibit Number</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act of 1934 (filed herewith).
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act of 1934 (filed herewith).
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

## **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.

AUDIOVOX CORPORATION

By: /s/Patrick M. Lavelle  
Patrick M. Lavelle  
President and Chief  
Executive Officer

Dated: July 10, 2007

By: /s/Charles M. Stoehr  
Charles M. Stoehr  
Senior Vice President and  
Chief Financial Officer