CLEARONE COMMUNICATIONS INC
Form 10-K
October 13, 2009

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

FORM 10-K

(Mark One)

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

For the fiscal year ended June 30, 2009

OR

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

For the transition period from ________ to ________

Commission file number 001-33660

CLEARONE COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Utah	87-0398877
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5225 Wiley Post Way, Suite 500
Salt Lake City, Utah 84116
(Address of principal executive offices, including zip code)

(801) 975-7200
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: Title of each class	Name of each exchange on which registered
Common Stock, $0.001	The NASDAQ Capital

par value Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.¨Yes xNo

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.¨Yes xNo

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. xYes ¨No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ¨Yes xNo

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "larger accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Larger Accelerated Filer ¨	Accelerated Filer ¨
Non-Accelerated Filer ¨ (Do not check if a smaller reporting company)	Smaller Reporting Company x

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

The aggregate market value of the shares of voting common stock held by non-affiliates was approximately $19,605,000 at December 31, 2008, based on the $3.93 closing price for the Company's common stock on the NASDAQ Capital Market on such date. For purposes of this computation, all officers, directors, and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed to be an admission that such officers, directors, or 10% beneficial owners are, in fact, affiliates of the registrant.

The number of shares of ClearOne common stock outstanding as of October 9, 2009 was 8,929,002.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held November 30, 2009 are incorporated by reference into Part III of this report.

INDEX

i

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements reflect our views with respect to future events based upon information available to us at this time. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from these statements. Forward-looking statements are typically identified by the use of the words "believe," "may," "could," "will," "should," "expect," "anticipate," "estimate," "project," "propose," "plan," "intend," and sim expressions. Examples of forward-looking statements are statements that describe the proposed development, manufacturing, and sale of our products; statements that describe our results of operations, pricing trends, the markets for our products, our anticipated capital expenditures, our cost reduction and operational restructuring initiatives, and regulatory developments; statements with regard to the nature and extent of competition we may face in the future; statements with respect to the sources of and need for future financing; and statements with respect to future strategic plans, goals, and objectives. Forward-looking statements are contained in this report under "Business" included in Item 1 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Qualitative and Quantitative Disclosures About Market Risk" included in Items 7 and 7A of Part II of this Annual Report on Form 10-K. The forward-looking statements are based on present circumstances and on our predictions respecting events that have not occurred, that may not occur, or that may occur with different consequences and timing than those now assumed or anticipated. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors, including the risk factors discussed in this report under the caption "Item 1A Risk Factors." These cautionary statements are intended to be applicable to all related forward-looking statements wherever they appear in this report. The cautionary statements contained or referred to in this report should also be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. Any forward-looking statements are made only as of the date of this report and we assume no obligation to update forward-looking statements to reflect subsequent events or circumstances.

PART I

References in this Annual Report on Form 10-K to "ClearOne," "we," "us," "CLRO" or "the Company" refer to ClearOne Communications, Inc., a Utah corporation, and, unless the context otherwise requires or is otherwise expressly stated, its subsidiaries.

ITEM 1. BUSINESS

Overview

ClearOne is a communications solutions company that develops and sells audio conferencing systems and related products for audio, video and web conferencing systems and applications. We enjoy the number one position in the global professional audio conferencing market with more than 50% of the global market share. The reliability, flexibility and performance of our comprehensive solutions create a natural communications environment that saves organizations time and money by enabling more effective and efficient communication. We develop, manufacture, market, and service a comprehensive line of high-quality audio conferencing products under personal, tabletop, premium and professional (installed audio) categories. We also manufacture and sell media carts for audio and video conferencing. We have an established history of product innovation and plan to continue to apply our expertise in audio engineering to develop and introduce innovative new products and enhance our existing products. We believe the performance and reliability of our high-quality audio products create a natural communications environment, which saves organizations of all sizes time and money by enabling more effective and efficient communication.

Our products are used by organizations of all sizes to accomplish effective group communication. Our end-users range from some of the world's largest and most prestigious companies and institutions to small and medium-sized businesses, educational institutions, and government organizations as well as individual consumers. We sell our products to these end-users primarily through a network of independent distributors who in turn sell our products to dealers, systems integrators, and value-added resellers. We also sell products on a limited basis directly to dealers, systems integrators, value-added resellers, and end-users.

ClearOne was formed as a Utah corporation in 1983 organized under the laws of the State of Utah. Our website address is www.clearone.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports are available, free of charge, on our website as soon as reasonably practicable after we file electronically such material with, or furnish it to, the SEC.

For a discussion of certain risks applicable to our business, results of operations, financial position, and liquidity see the risk factors described in “Items 1A, Risk Factors” below.

Business Strategy

We currently participate in the following audio conferencing markets:

Market	Typical Number of Participants
· Professional Conferencing (Installed Audio)	20-200
· Premium Conferencing	8-30
· Tabletop Conferencing	1-30
· Personal Conferencing	1-15

Our goal is to maintain our market leadership in the professional conferencing category, continue building on our leadership in premium conferencing category (a category we created), and further penetrate the tabletop conferencing and personal conferencing markets. We will continue to improve our existing high-quality products and develop new products for stand alone audio conferencing applications or to integrate with leading video and web conferencing systems and applications. The principal components of our strategy to achieve this goal are set forth below.

Provide a superior conferencing experience

We have been developing audio technologies since 1981 and believe we have established a reputation for providing some of the highest quality group audio conferencing solutions in the industry. Our proprietary audio signal processing technologies, including Distributed Echo Cancellation®, have been the core of our professional conferencing products and are the foundation for our new product development in other conferencing categories. We plan to build upon our reputation of being a market leader and continue to provide the highest quality products and technologies to the customers, partners and markets we serve.

Offer greater value to our customers and partners

To provide our customers and partners with audio conferencing products that offer high value, we are focused on listening to our customers and partners and delivering products to meet their needs. By offering high quality products that are designed to solve conferencing ease-of-use issues and are easy to install, configure, and maintain, we believe we can provide greater value to our customers and partners and enhance business communications and decision making.

Leverage and extend ClearOne technology leadership and innovation

We continue to focus on developing cutting edge conferencing products and are committed to incorporating the latest technologies into our new and existing product lines. Key to this effort is adopting emerging technologies such as Voice over Internet Protocol (VoIP), wideband audio, wireless connectivity, and convergence of voice and data networks, exploring new application models for our premium and personal audio conferencing technologies, and developing products based on internationally accepted standards and protocols.

Expand and strengthen sales channels

We continue to expand and strengthen domestic and international sales channels through the addition of key distributors and dealers that expand beyond our traditional audio-video channels that carry our professional conferencing products. We continue to direct significant sales efforts toward channel partners who are focused on the tabletop and personal conferencing markets. We also continue to strengthen our presence within the telephony reseller channel, which is best suited to sell our RAV™ premium conferencing systems, MAX® tabletop conference phones, and CHAT® personal conferencing products.

Broaden our product offerings

We believe that we offer the industry's most complete audio conferencing product line, including the following:

- Professional conferencing products that are used in executive boardrooms, courtrooms, hospitals, and auditoriums that integrate with leading video and telepresence systems
- Premium conferencing products that integrate with leading video and web conferencing systems and applications
- Tabletop conferencing phones used in conference rooms and offices
- Personal conferencing products that enable hands-free audio communications in new ways such as through PCs, laptops, cell phones and handsets.

We also provide a comprehensive portfolio of media carts that play a key role in providing equipment mobility and making conferencing equipment easy to access and use. We plan to continue to broaden and expand our product offerings to meet the evolving needs of our customers and partners, address changes in the markets we currently serve, and effectively target new markets for our products.

Develop strategic partnerships

To stay on the leading edge of product and market developments, we plan to continue to identify partners with expertise in areas strategic to our growth objectives. We will work to develop partnerships with leaders in markets complimentary to conferencing who can benefit from our audio products and technologies and through whom we can access new market growth opportunities. We entered into partnerships with Avistar, Microsoft, Skype, Vidyo and others to offer personal conferencing products uniquely suited to their systems and applications.

Strengthen existing customer and partner relationships through dedicated support

We have developed outstanding technical and sales support teams that are dedicated to providing customers and partners with the best available service and support. We believe our technical support is recognized as among the best in the industry and we will continue to invest in the necessary resources to ensure that our customers and partners have access to the information and support they need to be successful in using our products. We also dedicate significant resources to providing product training to our channel partners worldwide.

Markets and Products

Products Overview

The performance and reliability of our high-quality audio conferencing products enable effective and efficient communication between geographically separated businesses and organizations by connecting them to their employees, customers and partners. We offer a full range of audio conferencing products including, professional conferencing products used in executive boardrooms, courtrooms, hospitals, classrooms, and auditoriums, premium conferencing products that interface with video and web conferencing systems, tabletop conferencing phones used in conference rooms and offices, and personal conferencing products that can be used with laptops and other portable devices. For each of the last three fiscal years, our professional conferencing products and tabletop conference phones have together contributed in excess of 85 percent of our consolidated revenue. Our audio conferencing products feature our proprietary Distributed Echo Cancellation® and noise cancellation technologies to enhance communication during a conference call by eliminating echo and background noise. Most of our products also feature proprietary audio processing technologies such as adaptive modeling and first-microphone priority, which combine to deliver clear, crisp and full-duplex audio. These technologies enable natural and fatigue-free communication between distant conferencing participants.

We believe the principal drivers of demand for audio conferencing products are the following:

- Availability of easy-to-use conferencing systems and applications
- Voice quality of audio conferencing systems as compared to the quality of telephone handset speakerphones
- Expansion of global, regional, and local corporate enterprises

Other factors that we expect to have a significant impact on the demand for audio conferencing systems include the following:

- Availability of affordable audio conferencing solutions for small businesses and home offices
- Growth of distance learning and corporate training programs
- Increasing adoption of teleworking
- Decreases in travel due to cost and carbon footprint considerations
- Transition to the Internet Protocol (IP) network from the traditional public switched telephone network (PSTN) and the deployment of VoIP applications

We expect these growth factors to be offset by direct competition from high-end telephone handset speakerphones, new and existing competitors in the audio conferencing market, the technological volatility of IP-based products, and continued pressures on enterprises to reduce spending.

Professional Audio Conferencing Products

We enjoy the number one position in the global professional audio conferencing market with more than 50% of the global market share. We have been developing high-end, professional conferencing products since 1991 and believe we have established strong brand recognition for these products worldwide. Our professional conferencing products include the Converge® Pro, XAP® and Converge 560/590 product lines. The Converge SR 1212 product features similar technologies and is used for sound reinforcement applications.

The Converge Pro product line, which replaced the popular XAP® series of audio conferencing systems, leads our professionally installed audio products line of product offerings. The Converge Pro series delivers a significant feature set and performance improvements including unprecedented proprietary acoustical echo cancellation, noise cancellation, full duplex performance, enhanced management capabilities, and simplified configuration utilities. We continue to expand the Converge Pro product line with the addition of the Converge 880T and 880TA products which consolidates the functionality of an audio amplifier and telephone interface into a single product. These products offer easier installation and increased features to our customers and partners. The Converge SR 1212 is a digital matrix mixer that provides advanced audio processing, microphone mixing, and routing for sound reinforcement. This product line was also expanded with the addition of the Converge SR 1212A which integrates a 4 channel audio amplifier, our proprietary DARE® feedback eliminator and industry leading expandability with the features of the Converge SR1212 into a single product. These products are comprehensive audio processing systems designed to excel in the most demanding acoustical environments and routing configurations. These products are also used for integrating high-quality audio with video and web conferencing systems.

In response to our customers' and partners' need for professional audio solutions that would fit the budgetary requirements for mid-sized conference rooms, the Converge 560 and Converge 590 professional conferencing products were designed. These products are positioned between our professional and premium conferencing product lines both in terms of functionality and price, and are an excellent fit for rooms requiring customized microphone (up to nine microphones) and speaker configurations along with connectivity to leading video and web conferencing systems and applications.

In June 2008, we announced the introduction of two models of Converge Amplifiers, PA2250 and PA4160. However, for operational and strategic reasons, the products were discontinued.

We also offer a Tabletop Controller for the Converge Pro and XAP product lines. This affordable solution gives users the ability to easily start and navigate an audio conference without the need for touch panel control systems, which can be expensive, complex, or intimidating to users. The dial pad on the controller resembles a telephone keypad for instant familiarity and users can dial a conference call as easily as dialing a telephone. The Tabletop Controller can be significantly less expensive than touch-screen panel control systems, which require considerable integration and programming time and costs.

Frost and Sullivan, a leading global research and consulting group, awarded us their Product Line Strategy Award for both 2007 and 2006. This award is presented each year to a company that has demonstrated the most insight into customer needs and product demands within their industry, and has optimized its product line by leveraging products with the various price, performance, and feature points required by the market.

In November 2008, Frost and Sullivan awarded us their 2008 Global Market Leadership Award. This award is given to the company that has exhibited excellence in all areas of the market leadership process, including the identification of market challenges, drivers and restraints, as well as strategy development and methods of addressing changing market dynamics. Frost & Sullivan noted that ClearOne not only has the largest market share in the installed audio segment, but has also put into practice growth and implementation strategies to a degree well above most of their competitors. We were recognized for our ability to expand our market share, integrate new technologies into our portfolio of products, and maintain market-leading pricing.

Premium Conferencing Products

RAV audio conferencing product is a complete, out-of-the-box system that includes an audio mixer, Bose® loudspeakers, microphones, and a control device that can be either wired or wireless. The RAV product uniquely combines the sound quality of a professionally installed audio system with the simplicity of a conference phone and can be easily connected to rich-media devices, such as video or web conferencing systems, to deliver enhanced audio performance. RAV is strategically positioned between our professional and tabletop conferencing products in price and functionality, and fills an important audio conferencing solution requiring integration of quality audio with leading video and web conferencing systems and applications. RAV offers many powerful audio processing technologies from our professional conferencing products without the need for professional installation and programming.

Tabletop Conferencing Phones

MAX line of tabletop conferencing phones utilizes many of the high-end echo cancellation, noise cancellation, and audio processing technologies found in our professional audio conferencing products.

MAX product line is comprised of the following product families: the MAX® EX and MAXAttach™; MAX Wireless and MAXAttach Wireless; and MAX IP™ and MAXAttach IP™ tabletop conferencing phones. MAX Wireless was the industry’s first wireless conferencing phone. Designed for use in executive offices or small conference rooms with multiple participants, MAX Wireless can be moved from room to room within 150 feet of its base station. MAXAttach Wireless was the industry’s first and remains the only dual-phone, completely wireless solution. This system gives customers tremendous flexibility in covering larger conference room areas.

The MAX EX and MAXAttach wired phones feature an industry-first unique capability – instead of just adding extension microphones for use in larger rooms, the conference phones can be daisy chained together, up to a total of four phones. This provides even distribution of microphones, loudspeakers, and controls for better sound quality and improved user access in medium to large conference rooms. In addition, all MAXAttach wired versions can be used separately when they are not daisy-chained together.

The MAX IP and MAXAttach IP are VoIP tabletop conference phones which are based on the industry-standard SIP signaling protocol. These phones can also be daisy-chained together, up to a total of four phones providing outstanding room and control coverage that other VoIP conference phones on the market cannot match.

Our latest addition to the MAX family is MAX IP Response Point. Response Point is an innovative new phone system from Microsoft® that utilizes voice recognition technology to create an easy to use experience for small business users. MAX IP Response Point is the first and only conference phone for the response point phone system, bringing high performance audio to small business. MAX IP Response Point contains HDConference™, our suite of high-performance audio processing technologies and provides the ability to daisy-chain up to four phones together. In January 2009, Internet Telephony magazine recognized MAX IP Response Point as a recipient of its 2008 Product of the Year Award.

Personal Conferencing Products

CHAT™ line of conferencing speaker phones delivers our trademark crystal-clear full-duplex audio performance, and can be used in a variety of applications with a wide number of devices including the following:

PCs & Macs	VoIP telephony applications such as Skype; Popular audio instant messaging (IM) applications like Yahoo, MSN, Google, etc.; enterprise softphones; audio for web-based videoconferencing applications; gaming; music playback
Cell phones	Connects to the 2.5mm headset jack of many cell phones for hands-free, full-duplex audio conferencing
Telephones	Connects to the headset jack (certain phone models) for hands-free, full-duplex audio conferencing
iPods & MP3 players	For full-bandwidth audio playback
Desktop video conferencing systems	For hands-free, full-duplex audio conferencing

CHAT 50 attracted significant media coverage and has won many recognitions since its introduction including, PC Magazine’s Editors’ Choice Award in March 2006 and Portable Computer Magazine’s Best for Business Products Award for 2007.

CHAT 150 offers many of the same connectivity options as CHAT 50, but features three microphones in a larger form factor for use by a larger number of participants compared to CHAT 50. Customers have the ability to add a high-quality, full-duplex speaker phone to their handsets, and still retain the full functionality that comes with today’s handsets, including access to company directory, voicemail access, audio bridge functions, etc. CHAT 150 makes it possible to introduce quality conferencing capability without the need for extending an additional analog PBX line.

During 2009 CHAT 170 and CHAT 70 was introduced to fill the needs for a hands-free speakerphone for individuals using Microsoft's unified communications platform, Office Communications Server 2007. CHAT 70 is similar to CHAT 50 with single microphone, while CHAT 170 has three microphones like CHAT 150. CHAT 70 and CHAT 170 utilizes technologies shared by CHAT 50 and CHAT 150 including HDConference and full duplex audio technologies. CHAT 70 and CHAT 170 are the perfect audio peripherals for greatly enhanced collaboration through unified communication. True to their plug-and-play capability, CHAT 70 and CHAT 170 require no drivers to be installed and plugs into a USB port - enabling all incoming Office Communicator calls to ring on the CHAT 70 or CHAT 170. In the short period since its introduction, CHAT 170 has already gained industry-wide recognition and media awards.

CHAT 60 and CHAT 160 were introduced after June 30, 2009 to support Skype users.

Our personal conferencing products have become popular with large enterprises and organizations. We entered into partnerships with Avistar, Microsoft, Skype, Vidyo and others to offer personal conferencing products uniquely suited to their systems and applications for their enterprise users and consumers.

Other Products

We complement our audio conferencing products with microphones, media carts for audio and video conferencing. Our wide selection of wood, metal, and laminate media carts features audiovisual carts; plasma screen carts and video conferencing carts.

We expanded our Titan media carts line with the Titan Articulating Arm Dual Plasma Cart in June 2009. This innovative product features an articulating plasma mounting system that folds the monitor support arms for angle viewing, transportation and storage. Once folded the cart will fit into standard elevators or through standard doorways while accommodating most Plasma or LCD displays up to 50”.

The latest addition to the media cart product line is the The ClearPresence Dual Media Cart. It accommodates two 42" to 50" flat screen monitors for video and audio conferencing systems. The ClearPresence media cart is designed for strength and reliability and constructed of steel with a high gloss black finish and stainless steel accents. Included are two universal mounts for flat screen monitors and an adjustable mount for a high definition videoconferencing camera. The ClearPresence Dual Media Cart is ideal for corporate meeting rooms, courtrooms, training rooms, and video conferencing rooms.

Marketing and Sales

We primarily use a two-tier channel model, through which we sell our products directly to a worldwide network of independent audiovisual, information technology, and telecommunications distributors, who then sell our products to independent systems integrators, dealers, and value-added resellers, who in turn work directly with the end-users of our products for product fulfillment and installation. We also sell our products on a limited basis directly to certain dealers, systems integrators, value-added resellers, and end-users.

In fiscal 2009, approximately $24.2 million, or 68 percent, of our total product sales were generated in the United States and product sales of approximately $11.5 million, or 32 percent, were generated outside the United States. Revenue from product sales to customers outside of the United States accounted for approximately 30 percent of our total product sales from continuing operations for fiscal 2008. We sell our products in more than 70 countries worldwide. We anticipate that the portion of our total product revenue from international sales will continue to increase as we further enhance our focus on developing new products, establishing new channel partners, strengthening our presence in key growth areas, complying with regional environmental regulatory standards, and improving product localization with country-specific product documentation and marketing materials.

Distributors

We sell our products directly to approximately 100 distributors throughout the world. Distributors purchase our products at a discount from list price and resell them on a non-exclusive basis to independent systems integrators, dealers, and value-added resellers. Our distributors maintain their own inventory and accounts receivable and are required to provide technical and non-technical support for our products to the next level of distribution participants. We work with our distributors to establish appropriate inventory stocking levels. We also work with our distributors to maintain relationships with our existing systems integrators, dealers, and value-added resellers.

Independent Integrators, Dealers, and Resellers

Our distributors sell our products worldwide to approximately 1,000 independent system integrators, telephony value-added resellers, IT value-added resellers, and PC dealers on a non-exclusive basis. While dealers, resellers, and system integrators all sell our products directly to the end-users, system integrators typically add significant value to each sale by combining our products with products from other manufacturers as part of an integrated system solution. Dealers and value-added resellers usually purchase our products from distributors and may bundle our products with products from other manufacturers for resale to the end-user. We maintain close working relationships with our reseller partners and offer them education and training on all of our products.

Marketing

Much of our marketing effort is conducted in conjunction with our channel partners, who provide leverage for us in reaching existing and prospective customers worldwide. We also regularly attend industry forums and exhibit our products at multiple regional and international trade shows, often with our channel partners. These trade shows provide exposure for our brand and products to a wide audience.

In addition to advertising our products in popular publications serving the conferencing industry, we also conduct public relations initiatives to get press coverage and product reviews in industry and non-industry publications alike.

Customers

We do not believe that any end-user accounted for more than 10 percent of our total revenue during fiscal 2009 or 2008. In fiscal 2009, revenues included sales to three distributors that represented approximately 58 percent of total revenue. Each of these three distributors, NewComm Distributing, Starin Marketing and VSO Marketing, accounted for more than 10 percent of consolidated revenue. As discussed above, these distributors facilitate product sales to a large number of independent systems integrators, dealers, and value-added resellers and subsequently to their end-users. The loss of one or more distributors could reduce revenue and have a material adverse effect on our business and results of operations. As of June 30, 2009, our shipped orders on which we had not recognized revenue were $4.7 million and our backlog of unshipped orders was $381,000.

Competition

The conferencing products market is characterized by intense competition and rapidly evolving technology. We compete with businesses having substantially greater financial, research and product development, manufacturing, marketing, and other resources. If we are not able to continually design, manufacture, and successfully market new or enhanced products or services that are comparable or superior to those provided by our competitors and at comparable or better prices, we could experience pricing pressures and reduced sales, gross profit margins, profits, and market share, each of which could have a materially adverse effect on our business.

Our competitors vary within each product category. We believe we are able to differentiate ourselves and therefore successfully compete as a result of the high audio quality of our products resulting from our proprietary audio signal processing technologies, technical and channel support services, and the strength of our brand.

We believe the principal factors driving sales are the following:

- Quality and functionality of the products
- Broad and deep channel partnerships
- Established history of successful world-wide installations for diverse vertical markets
- Brand name recognition
- Quality of customer and partner support, and
- Effective sales and marketing communication

In the professional audio conferencing systems and sound reinforcement markets, our main competitors include Biamp Systems, Harman International, Lectrosonics, Peavey, Polycom, and Shure and their OEM partners, with several other companies potentially poised to enter the market. We have been enjoying the number one position in the global professional audio conferencing market with more than 50% of the global market share. We uniquely contributed to the professional conferencing market with the introduction of the Audio Perfect (“AP”) product line a number of years ago, followed by the XAP and recently with the introduction of Converge Pro. We believe we continue to enjoy a strong reputation with the system integrators and audio visual consultants.

We believe we created a new audio conferencing category with the introduction of the RAV platform, which we call premium conferencing. RAV is a unique product with capabilities we do not believe can be found on any other competing system.

In the tabletop conferencing market, our primary competitors are Aethra, Konftel, LifeSize, Panasonic and Polycom and their OEM partners. We believe MAX products are competitive due to strategic pricing, unique ability to attach or daisy chain multiple phones together and proprietary digital signal processing technologies, which we believe are the most advanced in the industry.

The personal conferencing market has seen a number of new entrants. Our primary competitors in the personal conferencing market are Actiontec, Iogear, mVox, Phoenix Audio and Polycom and their OEM partners. We believe that our CHAT family of products offer unique advantages in their superior audio performance and their abilities to connect to multiple devices for variety of applications.

Our media carts compete primarily with the products of Accuwood, Comlink, and Video Furniture International.

In each of the markets in which we compete, many of our competitors may have access to greater financial, technical, manufacturing, and marketing resources, and as a result they may respond more quickly or effectively to new technologies and changes in customer preferences. We cannot provide assurance that we will continue to compete effectively in the markets we serve.

Regulatory Environment

Regulations regarding the materials used in manufacturing, the process of disposing of electronic equipment and the efficient use of energy require additional time to obtain regulatory approvals of new products in international markets. Such regulations may impact our ability to expand our sales in a timely and cost-effective manner and as a result our business could be harmed.

Sources and Availability of Raw Materials

We manufacture our products through contract manufacturers, who are generally responsible to source and procure required raw materials and components. Most of the components that our contract manufacturers require for manufacturing our products are readily available from a number of sources. We continually work with our contract manufacturers to seek alternative sources for all our components and raw materials requirements to ensure higher quality and better pricing. Contract manufacturers and their vendors are qualified by Corporate Quality Assurance. We work with our contract manufacturers to ensure raw materials and components conform to specifications.

Seasonality

Our audio conferencing products revenue has historically been strongest during the second and fourth quarters though the variations between the quarters are not consistently significant. There can be no assurance that any historic sales patterns will continue and, as a result, sales for any prior quarter are not necessarily indicative of the sales to be expected in any future quarter.

Product Development

We are committed to research and product development and view our continued investment in research and product development as a key ingredient to our long-term business success. Our research and product development expenditures were approximately $7.5 million in fiscal 2009 and $7.1 million in fiscal 2008.

Our core competencies in research and product development include many audio technologies, including telephone echo cancellation, acoustic echo cancellation, and noise cancellation using advanced digital signal processing technology. We also have expertise in wireless technologies, VoIP, and software and network application development. We believe that ongoing development of our core technological competencies is vital to develop new products and to enhance existing products.

Manufacturing

Currently, all of our products are manufactured by third-party manufacturers. Our primary contract manufacturers are Idea Chip Technologies, Inovar and Flextronics.

Intellectual Property and Other Proprietary Rights

We believe that our success depends in part on our ability to protect our proprietary rights. We rely on a combination of patent, copyright, trademark, and trade secret laws and confidentiality agreements and processes to protect our proprietary rights. The laws of foreign countries may not protect our intellectual property to the same degree as the laws of the United States.

We generally require our employees, customers, and potential distribution participants to enter into confidentiality and non-disclosure agreements before we disclose any confidential aspect of our technology, services, or business. In addition, our employees are required to assign to us any proprietary information, inventions, or other technology created during the term of their employment with us. However, these precautions may not be sufficient to protect us from misappropriation or infringement of our intellectual property.

We currently have about 30 patents that are issued, pending, or applied for that cover conferencing products and technologies. The expiration dates of issued patents range from 2018 to 2025. We hold 15 registered trademarks and have also applied for registration for 10 trademarks. Registered trademarks include ClearOne, XAP, MAX, AccuMic, Audio Perfect, Distributed Echo Cancellation, Gentner, and others. We have also filed for trademarks for RAV, Converge, Chat, and others. We have received or filed for registered copyrights of certain of our source code for acoustic echo cancellation and other related audio signal processing algorithms.

Employees

As of June 30, 2009, we had 103 full-time employees. Of these employees, 84 were located in our Salt Lake City office, 13 in other U.S. locations, two in the United Kingdom and four in Asia. None of our employees are subject to a collective bargaining agreement and we believe our relationship with our employees is good. We occasionally hire contractors with specific skill sets to meet our operational needs.

Dispositions

During fiscal 2005, we sold our Canadian audiovisual integration services business to 6351352 Canada Inc. During fiscal 2006, we sold our document and educational camera product line to Ken-A-Vision Manufacturing Co. Inc.

ITEM 1A. RISK FACTORS

Investors should carefully consider the risks described below. The risks described below are not the only ones we face and there are risks that we are not presently aware of or that we currently believe are immaterial that may also impair our business operations. Any of these risks could harm our business. The trading price of our common stock could decline significantly due to any of these risks, and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Annual Report on Form 10-K, including our June 30, 2009 consolidated financial statements and related notes.

Risks Relating to Our Business

We face intense competition in all markets for our products and services; our operating results will be adversely affected if we cannot compete effectively against other companies.

The markets for our products and services are characterized by intense competition and pricing pressures and rapid technological change. We compete with businesses having substantially greater financial, research and product development, manufacturing, marketing, and other resources. If we are not able to continually design, manufacture, and successfully introduce new or enhanced products or services that are comparable or superior to those provided by our competitors and at comparable or better prices, we could experience pricing pressures and reduced sales, gross profit margins, profits, and market share, each of which could have a materially adverse effect on our business.

Difficulties in estimating customer demand in our products segment could harm our profit margins.

Orders from our distributors and other distribution participants are based on demand from end-users. Prospective end-user demand is difficult to measure. This means that our revenue during any fiscal quarter could be adversely impacted by low end-user demand, which could in turn negatively affect orders we receive from distributors and dealers. Our expectations for both short- and long-term future net revenues are based on our own estimates of future demand.

Revenue for any particular time period is difficult to predict with any degree of certainty. We typically ship products within a short time after we receive an order; consequently, unshipped backlog has not historically been a good indicator of future revenue. We believe that the level of backlog is dependent in part on our ability to forecast revenue mix and plan our manufacturing accordingly. A significant portion of our customers' orders are received during the last month of the quarter. We budget the amount of our expenses based on our revenue estimates. If our estimates of sales are not accurate and we experience unforeseen variability in our revenue and operating results, we may be unable to adjust our expense levels accordingly and our gross profit and results of operations will be adversely affected. Higher inventory levels or stock shortages may also result from difficulties in estimating customer demand.

Our sales depend to a certain extent on government funding and regulation.

In the audio conferencing products market, the revenue generated from sales of our audio conferencing products for distance learning and courtroom facilities depend on government funding. In the event government funding for such initiatives was reduced or became unavailable, our sales could be negatively impacted. Additionally, many of our products are subject to governmental regulations. New regulations could significantly impact sales in an adverse manner.

Environmental laws and regulations subject us to a number of risks and could result in significant costs and impact on revenue

Regulations regarding the materials used in manufacturing, the process of disposing of electronic equipment and the efficient use of energy require additional time to obtain regulatory approvals of new products in international markets. Such regulations may impact our ability to expand our sales in a timely and cost-effective manner and as a result our business could be harmed.

Product development delays or defects could harm our competitive position and reduce our revenue.

We have, in the past, and may again experience, technical difficulties and delays with the development and introduction of new products. Many of the products we develop contain sophisticated and complicated circuitry, software and components, and utilize manufacturing techniques involving new technologies. Potential difficulties in the development process that could be experienced by us include difficulty in the following:

- meeting required specifications and regulatory standards;
- meeting market expectations for performance;
- hiring and keeping a sufficient number of skilled developers;
- obtaining prototype products at anticipated cost levels;
- having the ability to identify problems or product defects in the development cycle; and
- achieving necessary manufacturing efficiencies.

Once new products reach the market, they may have defects, or may be met by unanticipated new competitive products, which could adversely affect market acceptance of these products and our reputation. If we are not able to manage and minimize such potential difficulties, our business and results of operations could be negatively affected.

Our profitability may be adversely affected by our continuing dependence on our distribution channels.

We market our products primarily through a network of distributors who in turn sell our products to systems integrators, dealers, and value-added resellers. All of our agreements with such distributors and other distribution participants are non-exclusive, terminable at will by either party, and generally short-term. No assurances can be given that any or all such distributors or other distribution participants will continue their relationship with us. Distributors and to a lesser extent systems integrators, dealers, and value-added resellers cannot easily be replaced and the loss of revenues and our inability to reduce expenses to compensate for the loss of revenue could adversely affect our net revenue and profit margins.

Although we rely on our distribution channels to sell our products, our distributors and other distribution participants are not obligated to devote any specified amount of time, resources, or efforts to the marketing of our products or to sell a specified number of our products. There are no prohibitions on distributors or other resellers offering products that are competitive with our products and some do offer competitive products. The support of our products by distributors and other distribution participants may depend on the competitive strength of our products and the price incentives we offer for their support. If our distributors and other distribution participants are not committed to our products, our revenue and profit margins may be adversely affected.

Additionally, we offer our distributors price protection on their inventory of our products. If we reduce the list price of our products, we will compensate our distributors for the respective products that remain in their inventory on the date the price adjustment becomes effective provided that they have taken delivery of the products within the last 35 days. Our net revenue and profit margins could adversely be affected if we reduce product prices significantly or distributors happen to have significant inventory on-hand of the affected product at the time of a price reduction. Further, if we do not have sufficient cash resources to compensate distributors on terms satisfactory to them or us, our price protection obligations may prevent us from reacting quickly to competitive market conditions.

Reporting of channel inventory by distributors.

We defer recognition of revenue from product sales to distributors until the return privilege has expired, which approximates when product is sold-through to customers of our distributors. We evaluate, at each quarter-end, the inventory in the channel through information provided by our distributors. We use this information to determine the amount of inventory in the channel, and the appropriate revenue and cost of goods sold associated with those channel products. We cannot guarantee that the third party data, as reported, or that our assumptions and judgments regarding total channel inventory revenue and cost of goods sold will be accurate. We periodically audit a limited number of distributors.

We depend on an outsourced manufacturing strategy.

We outsource the manufacture of all of our products to third-party manufacturers located in both the U.S. and Asia. If any of these manufacturers experience difficulties in obtaining sufficient supplies of components, component prices significantly exceed anticipated costs, an interruption in their operations, or otherwise suffer capacity constraints, we would experience a delay in shipping these products which would have a negative impact on our revenue. Should there be any disruption in services due to natural disaster, economic or political difficulties, quarantines, transportation restrictions, acts of terror, or other restrictions associated with infectious diseases, or other similar events, or any other reason, such disruption would have a material adverse effect on our business. Operating in the international environment exposes us to certain inherent risks, including unexpected changes in regulatory requirements and tariffs, and potentially adverse tax consequences, which could materially affect our results of operations. Currently, we have no second source of manufacturing for a portion of our products.

The cost of delivered product from our contract manufacturers is a direct function of their ability to buy components at a competitive price and to realize efficiencies and economies of scale within their overall business structure. If they are unsuccessful in driving efficient cost models, our delivered costs could rise, affecting our profitability and ability to compete. In addition, if the contract manufacturers are unable to achieve greater operational efficiencies, delivery schedules for new product development and current product delivery could be negatively impacted.

Product obsolescence could harm demand for our products and could adversely affect our revenue and our results of operations.

Our industry is subject to technological innovations that could render existing technologies in our products obsolete and thereby decrease market demand for such products. If any of our products become slow-moving or obsolete and the recorded value of our inventory is greater than its market value, we will be required to write down the value of our inventory to its fair market value, which would adversely affect our results of operations. In limited circumstances, we are required to purchase components that our outsourced manufacturers use to produce and assemble our products. Should technological innovations render these components obsolete, we will be required to write down the value of this inventory, which could adversely affect our results of operations.

If we are unable to protect our intellectual property rights or have insufficient proprietary rights, our business would be materially impaired.

We currently rely primarily on a combination of trade secrets, copyrights, trademarks, patents, patents pending, and nondisclosure agreements to establish and protect our proprietary rights in our products. No assurances can be given that others will not independently develop similar technologies, or duplicate or design around aspects of our technology. In addition, we cannot assure that any patent or registered trademark owned by us will not be invalidated, circumvented or challenged, or that the rights granted hereunder will provide competitive advantages to us. Litigation may be necessary to enforce our intellectual property rights. We believe our products and other proprietary rights do not infringe upon any proprietary rights of third parties; however, we cannot assure that third parties will not assert infringement claims in the future. Our industry is characterized by vigorous protection of intellectual property rights. Such claims and the resulting litigation are expensive and could divert our attention, regardless of the merit of such claims. In the event of a claim, we might be required to license third-party technology or redesign our products, which may not be possible or economically feasible.

We currently hold only a limited number of patents. To the extent that we have patentable technology for which we have not filed patent applications, others may be able to use such technology or even gain priority over us by patenting such technology themselves.

International sales account for a significant portion of our net revenue and risks inherent in international sales could harm our business.

International sales represent a significant portion of our total product revenue. We anticipate that the portion of our total product revenue from international sales will continue to increase as we further enhance our focus on developing new products for new markets, establishing new distribution partners, strengthening our presence in emerging economies, and improving product localization with country-specific product documentation and marketing materials. Our international business is subject to the financial and operating risks of conducting business internationally, including the following:

- unexpected changes in, or the imposition of, additional legislative or regulatory requirements;
- unique environmental regulations;
- fluctuating exchange rates;
- tariffs and other barriers;
- difficulties in staffing and managing foreign sales operations;
- import and export restrictions;
- greater difficulties in accounts receivable collection and longer payment cycles;
- potentially adverse tax consequences;
- potential hostilities and changes in diplomatic and trade relationships; and
- disruption in services due to natural disaster, economic or political difficulties, quarantines, transportation, or other restrictions associated with infectious diseases.

We may not be able to hire and retain qualified key and highly-skilled technical employees, which could affect our ability to compete effectively and may cause our revenue and profitability to decline.

We depend on our ability to hire and retain qualified key and highly skilled employees to manage, research and develop, market, and service new and existing products. Competition for such key and highly-skilled employees is intense, and we may not be successful in attracting or retaining such personnel. To succeed, we must hire and retain employees who are highly skilled in the rapidly changing communications and Internet technologies. Individuals who have the skills and can perform the services we need to provide our products and services are in great demand. Because the competition for qualified employees in our industry is intense, hiring and retaining employees with the skills we need is both time-consuming and expensive. We may not be able to hire enough skilled employees or retain the employees we do hire. In addition, provisions of the Sarbanes-Oxley Act of 2002 and related rules of the SEC impose heightened personal liability on some of our key employees. The threat of such liability could make it more difficult to identify, hire and retain qualified key and highly-skilled employees. We have relied on our ability to grant stock options as a means of recruiting and retaining key employees. Recent accounting regulations requiring the expensing of stock options will impair our future ability to provide these incentives without incurring associated compensation costs. Our inability to hire and retain employees with the skills we seek could hinder our ability to sell our existing products, systems, or services or to develop new products, systems, or services with a consequent adverse effect on our business, results of operations, financial position, or liquidity.

We rely on third-party technology and license agreements.

We have licensing agreements with various suppliers for software and hardware incorporated into our products. These third-party licenses may not continue to be available to us on commercially reasonable terms, if at all. The termination or impairment of these licenses could result in delays of current product shipments or delays or reductions in new product introductions until equivalent designs could be developed, licensed, and integrated, if at all possible, which would have a material adverse effect on our business.

We may have difficulty in collecting outstanding receivables.

We grant credit to substantially all of our customers without requiring collateral. In times of economic uncertainty, the risks relating to the granting of such credit would typically increase. Although we monitor and mitigate the risks associated with our credit policies, we cannot ensure that such mitigation will be effective. We have experienced losses due to customers failing to meet their obligations. Future losses could be significant and, if incurred, could harm our business and have a material adverse effect on our operating results and financial position.

Interruptions to our business could adversely affect our operations.

As with any company, our operations are at risk of being interrupted by earthquake, fire, flood, and other natural and human-caused disasters, including disease and terrorist attacks. Our operations are also at risk of power loss, telecommunications failure, and other infrastructure and technology based problems. To help guard against such risks, we carry business interruption loss insurance to help compensate us for losses that may occur.

Risks Relating to Share Ownership

Our stock price fluctuates as a result of the conduct of our business and stock market fluctuations.

The market price of our common stock has experienced significant fluctuations and may continue to fluctuate significantly. The market price of our common stock may be significantly affected by a variety of factors, including the following:

- statements or changes in opinions, ratings, or earnings estimates made by brokerage firms or industry analysts relating to the market in which we do business or relating to us specifically;
- disparity between our reported results and the projections of analysts;
- the shift in sales mix of products that we currently sell to a sales mix of lower-gross profit product offerings;
- the level and mix of inventory levels held by our distributors;
- the announcement of new products or product enhancements by us or our competitors;
- technological innovations by us or our competitors;
- success in meeting targeted availability dates for new or redesigned products;
- the ability to profitably and efficiently manage our supplies of products and key components;
- the ability to maintain profitable relationships with our customers;
- the ability to maintain an appropriate cost structure;
- quarterly variations in our results of operations;
- general consumer confidence or general market conditions or market conditions specific to technology industries;
- domestic and international economic conditions;
- unexpected changes in regulatory requirements and tariffs;
- our ability to report financial information in a timely manner; and
- the markets in which our stock is traded.

Rights to acquire our common stock could result in dilution to other holders of our common stock.

As of June 30, 2009, we had outstanding options to acquire approximately 1.2 million shares of our common stock at a weighted average exercise price of $5.62 per share. An additional 805,000 shares remain available for grant under our 2007 Plan. During the terms of these options, the holders thereof will have the opportunity to profit from an increase in the market price of the common stock. The existence of these options may adversely affect the terms on which we can obtain additional financing, and the holders of these options can be expected to exercise such options at a time when we, in all likelihood, would be able to obtain additional capital by offering shares of our common stock on terms more favorable to us than those provided by the exercise of these options.

Sales of additional shares of our common stock could have a negative effect on the market price of our common stock.

Sales of substantial amounts of our common stock in the public market could adversely affect prevailing market prices and could impair our ability to raise capital through the sale of our equity securities. Most shares of common stock currently outstanding are eligible for sale in the public market, subject in certain cases to compliance with the requirements of Rule 144 under the securities laws. Shares issued upon the exercise of stock options granted under our stock option plan generally will be eligible for sale in the public market. We also have the authority to issue additional shares of common stock and shares of one or more series of preferred stock. The issuance of such shares could dilute the voting power of the currently outstanding shares of our common stock and could dilute earnings per share.

We have previously identified material weaknesses in our internal controls.

In our Form 10-K for the fiscal year ending June 30, 2006 and Form 10-K/A-2 for the fiscal year ending June 30, 2008, we reported and identified a material weakness in our internal controls. Although we believe we have remedied this weakness through the commitment of considerable resources, we are always at risk that any future failure of our own internal controls or the internal control at any of our outsourced manufacturers or partners could result in additional reported material weaknesses. Any future failures of our internal controls could have a material impact on our market capitalization, results of operations, or financial position, or have other adverse consequences.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We currently occupy a 36,279 square-foot facility in Salt Lake City, Utah under the terms of an operating lease expiring in December 2013 which supports our principal administrative, sales, marketing, customer support, and research and product development facility. We also occupy a 23,712 square-foot warehouse in Salt Lake City under the terms of an operating lease expiring in November 2013 which warehouses our inventory for fulfillment, serves as our fulfillment and repair center, as well as a 6,500 square-foot facility in Salt Lake City under the terms of an operating lease expiring in December 2011 which warehouses our inventory for fulfillment. Finally, we lease approximately 4,000 square-feet in warehouse space in Hong Kong under the terms of two operating leases both expiring in February 2010 which support our partners and customers located in the Asia-Pacific region.

We believe our current facilities are adequate to meet our needs for the foreseeable future and that suitable additional or alternative space will be available in the future on commercially reasonable terms as needed.

ITEM 3. LEGAL PROCEEDINGS

See Note 8 – Commitments and Contingencies of the Notes to Consolidated Financial Statements (Part II, Item 8) for information regarding legal proceedings in which we are involved.

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

No matter was submitted to a vote of security holders through the solicitation of proxies or otherwise during the fourth quarter of the fiscal year covered by this report.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock has been traded on the Nasdaq Capital Market under the symbol CLRO since August 14, 2007. The following table sets forth high and low sale prices (or high and low bid quotations) of our common stock for each fiscal quarter indicated as reported on the applicable exchange or market.

	2009		2008	
	High	Low	High	Low
First Quarter	$ 5.00	$ 3.10	$ 7.25	$ 4.40
Second Quarter	4.74	3.27	7.42	5.00
Third Quarter	4.06	3.00	5.81	4.50
Fourth Quarter	3.25	2.47	5.07	3.66

On October 9, 2009, the closing price for our common stock as reported on the Nasdaq Capital Market was $2.85.

Shareholders

As of October 9, 2009, there were 8,929,002 shares of our common stock issued and outstanding and held by approximately 500 shareholders of record. This number includes each broker dealer and clearing corporation, that hold shares for customers, as a single shareholder.

Dividends

We have not paid a cash dividend on our common stock and do not anticipate doing so in the foreseeable future. We intend to retain earnings to fund future working capital requirements, infrastructure needs, growth, product development, and our stock repurchase program.

Securities Authorized for Issuance under Equity Compensation Plans

We currently have two equity compensation plans, our 1998 Stock Option Plan (the "1998 Plan") and our 2007 Equity Incentive Plan (the "2007 Plan").

Issuer Purchases of Equity Securities

See Note 9 – Shareholders' Equity of the Notes to Consolidated Financial Statements (Part II, Item 8) for information regarding issuer purchases of equity shares.

ITEM 6. SELECTED FINANCIAL DATA

None.

17

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our consolidated financial statements and related notes included in this report, as well as our other filings with the SEC. This discussion contains forward-looking statements based on current expectations that involve risks and uncertainties, such as our plans, objectives, expectations, and intentions, as set forth under "Disclosure Regarding Forward-Looking Statements." Our actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth in the following discussion and under the caption "Risk Factors" in Item 1A and elsewhere in this report. Unless otherwise indicated, all references to a year reflect our fiscal year that ends on June 30.

OVERVIEW

We develop, manufacture, market, and service a comprehensive line of high-quality audio conferencing products. The products range from personal conferencing products to tabletop conferencing phones to professionally installed audio systems. We also manufacture and sell conferencing media carts. Our products are used by organizations of all sizes to accomplish effective group communication. Our end-users range from some of the world's largest and most prestigious companies and institutions to small and medium-sized businesses, educational institutions, and government organizations as well as individual consumers. We sell our products to these end-users primarily through a network of independent distributors who in turn sell our products to dealers, systems integrators, and value-added resellers. We also sell products on a limited basis directly to dealers, systems integrators, value-added resellers, and end-users.

We derive a major portion (approximately 68%) of our revenue from North America. Our share of revenue from foreign markets outside North America increased steadily over the years.

The conferencing products market is characterized by intense competition and rapidly evolving technology. Our competitors vary within each product category. We continue to enjoy the leadership position with respect to professionally installed audio category and were able to expand our market share of personal conferencing products. However we face significant competition in premium and tabletop categories due to price pressures, evident from the decline in premium and tabletop revenues.

The deep recession that affected the global economy impacted our financials, especially during the last two quarters of fiscal year 2009. Except for the personal conferencing products all other product categories suffered a drop in the revenue when compared with fiscal year 2008. Despite the reduction in gross profit by $2.2 million, net income before tax for the year increased by $1.1 million from the previous year largely due to the reversal of $1.1 million contingent liability recorded with respect to "indemnification of former officers" and recognition of insurance settlement proceeds of $1.1 million. However income after tax reduced by $3 million due to the increase in tax expense by $4.1 million. The tax expense increased significantly during fiscal year 2009 since we had the benefit in fiscal year 2008 of reversal of $4.7 million in valuation allowance recorded against deferred tax assets and a reversal of $3.3 million accrual for a contingent liability associated with indemnification agreements with two former officers.

During the fiscal year 2009, we repurchased 1,343,000 shares of our common stock at a total cost of approximately $6.77 million through a tender offer.

During the fiscal year 2008, we repurchased 835,000 shares of our common stock at a total cost of approximately $4.3 million in open market and private block transactions.

18

DISCUSSION OF OPERATIONS

Results of Operations

The following table sets forth certain items from our consolidated statements of operations for the fiscal years ended June 30, 2009 and 2008, together with the percentage of total revenue which each such item represents.

(in thousands of dollars)

	Fiscal Year 2009		Fiscal Year 2008		2009 vs. 2008 Favorable (Unfavorable)	
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
Revenue	$35,700	100.0%	$38,758	100.0%	$(3,058)	-7.9%
Cost of goods sold	15,323	42.9%	16,204	41.8%	881	5.4%
Gross profit	20,377	57.1%	22,554	58.2%	(2,177)	-9.7%
Operating expenses (benefit):						
Sales and marketing	7,529	21.1%	990,434			
1,800,000	520,842	651,894	784,358	916,998	1,050,434	
1,900,000	550,842	689,394	829,358	969,498	1,110,434	
2,000,000	580,842	726,894	874,358	1,021,998	1,170,434	
2,100,000	610,842	764,394	919,358	1,074,498	1,230,434	
2,200,000	640,842	801,894	964,358	1,126,998	1,290,434	
2,300,000	670,842	839,394	1,009,358	1,179,498	1,350,434	
2,400,000	700,842	876,894	1,054,358	1,231,998	1,410,434	
2,500,000	730,842	914,394	1,099,358	1,284,498	1,470,434	
2,600,000	760,842	951,894	1,144,358	1,336,998	1,530,434	
2,700,000	790,842	989,394	1,189,358	1,389,498	1,590,434	
2,800,000	820,842	1,026,894	1,234,358	1,441,998	1,650,434	

Under the pension plans, covered compensation includes salary and bonus; each officer can expect to receive an annual retirement benefit equal to average annual compensation for the five most highly compensated years out of the last ten years of creditable service multiplied by the number that is equal to 1.5% of total years of creditable service, but not in excess of 60% of such average compensation, less an offset for the annual Railroad Retirement Act annuity.

Table of Contents

On September 25, 2001, the Board of Directors approved agreements between Norfolk Southern and each of Messrs. Prillaman, Tobias and Wolf, providing enhanced pension benefits in exchange for each individual s continued employment with Norfolk Southern for an additional two years. A form of these agreements was filed as an exhibit to Norfolk Southern s Form 10-Q for the quarter ended September 30, 2001. Because Messrs. Prillaman, Tobias and Wolf remained employed with Norfolk Southern through September 30, 2003, each has received an additional three years of creditable service and his benefit is based on average annual compensation for the three most highly compensated years, instead of the five most highly compensated years, out of the last ten years of creditable service. On January 24, 2006, the Board of Directors approved a Retirement Agreement between Norfolk Southern and Mr. Goode (described below), which provides that Mr. Goode s pension benefit also is based on average annual compensation for the three most highly compensated years, instead of the five most highly compensated years, out of the last ten years of creditable service.

As of January 1, 2006, Mr. Moorman s five-year average annual compensation was $621,845 and he had approximately 33 years of creditable service. As of January 1, 2006, the respective three-year average compensation and approximate years of creditable service (including the additional three years of service for Messrs. Prillaman, Tobias and Wolf pursuant to the enhanced pension benefit agreements) for the other Named Executive Officers were: Mr. Goode, $2,703,620 and 40 years; Mr. Prillaman, $1,138,784 and 39 years; Mr. Tobias, $1,201,097 and 39 years; Mr. Wolf, $1,201,097 and 36 years.

Retirement Agreement

On January 24, 2006, the Norfolk Southern Corporation Board of Directors approved a Retirement Agreement between Norfolk Southern Corporation and David R. Goode. The Retirement Agreement calls for Mr. Goode to provide consulting services to Norfolk Southern for a five-year period beginning on March 1, 2006, relating to (1) transition of Mr. Goode's duties and responsibilities to his successor; (2) strategic acquisitions, dispositions, capital raising activities and major financings; (3) compensation matters; (4) business strategy planning; and (5) public speaking engagements and other public appearances on behalf of Norfolk Southern. In the Retirement Agreement, Mr. Goode also agreed not to compete with Norfolk Southern or solicit employees or customers away from the company for five years and agreed to waive his rights under his change-in-control agreement. In return, the Retirement Agreement provides Mr. Goode with the enhanced pension benefits described above under Pension Plans.

On January 24, 2006, the Compensation Committee of Norfolk Southern's Board of Directors approved a Waiver Agreement between Norfolk Southern Corporation and Mr. Goode. The Waiver Agreement provides for the modification of the terms of 81,036 Restricted Shares granted to Mr. Goode in 2004 and 2005 under the Long-Term Incentive Plan, and 54,023.6 Restricted Stock Units granted to Mr. Goode in 2004 and 2005 under the Restricted Stock Unit Plan, which Mr. Goode otherwise would have forfeited upon retirement. Under the Waiver Agreement, these Restricted Shares and Restricted Stock Units remain subject to their applicable restriction period, except in the event of death, and a non-compete provision until January 29, 2007, with respect to the Restricted Shares and Restricted Stock Units granted in 2004, and January 27, 2010, with respect to the Restricted Shares and Restricted Stock Units granted in 2005.

Table of Contents

Copies of the Retirement Agreement and the Waiver Agreement were filed as exhibits to Norfolk Southern s Form 8-K dated January 27, 2006.

Change-in-Control Arrangements

In 1996, the Board of Directors approved change-in-control agreements between Norfolk Southern and each of the Named Executive Officers (as well as with certain other key employees). A form of these agreements, the terms of which were reviewed by outside legal counsel to Norfolk Southern, was filed as an exhibit to Norfolk Southern s 2001 Annual Report on Form 10-K. In connection with the Retirement Agreement described above, Mr. Goode waived his rights under his change-in-control agreement. The agreements provide the following economic protections in the event of an involuntary or other specified termination during the twenty-four month period following a change-in-control of Norfolk Southern: (a) severance compensation payments equal, in the case of each Named Executive Officer, to three times the sum of their Base Pay and Incentive Pay (most other covered employees are entitled to receive a lower multiple of Base Pay and Incentive Pay); (b) redemption of outstanding Performance Share Units and of outstanding, vested, but by their terms otherwise non-exercisable options (subject to restrictions, if any, in the case of persons, such as each Named Executive Officer, imposed under Section 16 of the Securities Exchange Act of 1934) and payment of dividend equivalents on outstanding options and Performance Share Units; (c) payment of an amount equal to the present value of the projected value of amounts deferred under the Officers' Deferred Compensation Plan or the Executives Deferred Compensation Plan; (d) eligibility for certain Benefits (principally medical, insurance and death benefits) for up to three years following Termination; and (e) certain additional service credit under Norfolk Southern's retirement plans. The Agreements also provide for payment of any Federal excise tax that may be imposed on payments made pursuant to these Agreements.

As consideration for these agreements, and to help encourage management continuity, the Named Executive Officers agreed not to engage in competing employment for a period of three years from the date they executed the agreements and, if they accept benefits payable or provided under the agreements, one year from their termination date. Each of these agreements is terminable by either party on twenty-four months notice; however, the term of the prohibition on engaging in competing employment is not affected by termination of an agreement.

In 2002, the Board of Directors agreed to abide by a stockholder approved proposal that future severance agreements with senior executives that exceed 2.99 times the sum of the executive s base salary plus bonus require stockholder approval.

COMPENSATION COMMITTEE REPORT

This report describes the compensation philosophy of Norfolk Southern s Compensation Committee with respect to the compensation of Executive Officers, the components of Norfolk Southern s compensation program and the manner in which 2005 compensation determinations were made for the Named Executive Officers.

The Compensation Committee was composed entirely of independent directors and met seven times during 2005. Among other things, the Compensation Committee was responsible in 2005 for

Table of Contents

recommending to the Board the salaries of Executive Officers, administering Norfolk Southern s annual cash incentive plans (the Executive Management Incentive Plan and the Management Incentive Plan), the Restricted Stock Unit Plan and the Long-Term Incentive Plan.

BASE SALARY: Although the Board believes that a substantial portion of each Executive Officer s total compensation should be performance-based, both it and the Compensation Committee seek to assure that the base salaries of the Executive Officers are competitive with those earned by individuals in comparable positions.

Specifically, the Compensation Committee compares the Chief Executive Officer s base salary to base salaries paid to chief executive officers of other U.S. corporations of comparable size and other holding companies of Class I railroads (the same companies comprising the S&P Railroad Index included in the Performance Graph). This data is compiled by Norfolk Southern s Human Resources Department and by outside compensation consultants retained by the Compensation Committee.

The Compensation Committee believes generally that the Chief Executive Officer s salary should be set between the 25th and 50th percentile of the base salaries paid to chief executive officers of other U.S. corporations of comparable size and competitively (within the mid-range of compensation practice) with those of the chief executive officers of the other holding companies of Class I railroads. Mr. Goode and Mr. Moorman made no recommendation concerning, nor did they play any role in determining, their respective base salaries (or other compensation). These compensation decisions were made by the independent members of the Board at sessions without Mr. Goode or Mr. Moorman present.

The independent members of the Board determined Mr. Goode s salary based on their assessment of Norfolk Southern s performance, including its total operating revenues and net income, and market considerations, and did not base its determination on the application of any specific formula. For 2005, Mr. Goode did not receive a salary increase, which maintained his base salary between the 25th and the 50th percentile of the base salaries paid to chief executive officers of other U.S. corporations of comparable size and competitively (within the mid-range of compensation practice) with those of the chief executive officers of the other holding companies of Class I railroads. This decision was made considering his annual and long-term compensation.

Mr. Moorman s salary was not changed upon his promotion to Chief Executive Officer effective November 1, 2005. Effective January 1, 2006, Mr. Moorman s salary was increased to $750,000 upon the approval of the independent members of the Board in recognition of his expanded duties and responsibilities as Chief Executive Officer, which placed his base salary below the 25th percentile of the base salaries paid to chief executive officers of other U.S. corporations of comparable size. This decision was made considering his annual and long-term compensation.

The base salaries of the other Named Executive Officers as well as all other Executive Officers were evaluated, principally by Mr. Goode with respect to 2005, relative to survey data of base salaries for comparable positions at a large number of U.S. corporations of comparable size, including but not limited to those included in the S&P 500 Index and S&P Railroad Index;

both of these indices are included in the Performance Graph. This data was compiled by Norfolk Southern s Human Resources Department and by outside compensation consultants retained by the Compensation Committee. The Compensation Committee s general intention is to set the base salaries of Executive Officers around the 50th percentile of their peers in the respective groups with whom they are compared. With respect to 2005 base salaries, Mr. Goode discussed with the Compensation Committee the specific contributions and performance of each of the Executive Officers, including each of the Named Executive Officers. Based on these discussions, comparative salary data and each Executive Officer s performance in light of the length of service in his or her current position, Mr. Goode made 2005 base salary recommendations that were submitted for Compensation Committee and Board approval. Effective January 1, 2006, the salaries of Messrs. Prillaman, Tobias and Wolf were increased based on their individual performance and the competitiveness of their compensation compared to executives holding similar positions in comparable organizations.

ANNUAL INCENTIVE COMPENSATION: Norfolk Southern provides annual incentive compensation through the Executive Management Incentive Plan (EMIP), which is designed and administered to ensure that a significant portion of each Executive Officer s total annual cash compensation is based on Norfolk Southern s annual financial performance. For 2005, awards to Executive Officers, including Named Executive Officers, under EMIP, and to participants in Norfolk Southern s Management Incentive Plan (MIP), are paid, if at all, based on Norfolk Southern s performance relative to two pre-determined criteria: operating ratio for the year and pre-tax net income. The performance standards relative to these two criteria are established by the Compensation Committee not later than the end of the first month of each incentive year.

Part of the Compensation Committee s philosophy is that, to the extent Norfolk Southern achieves EMIP goals, the total of each Executive Officer s base salary and EMIP award should become increasingly competitive with the total annual cash compensation paid by comparable organizations. In years in which those goals are not realized, the Executive Officers will receive less or no incentive pay.

Specifically, 2005 incentive pay opportunities for Mr. Goode were determined by the Compensation Committee by comparing Mr. Goode s total annual cash compensation with that paid to the chief executive officers of other U.S. corporations of comparable size. The Compensation Committee determines incentive pay opportunities for the other Executive Officers annually based on its review of the annual cash compensation of comparable positions at companies of comparable size, including but not limited to those identified in the Performance Graph. Mr. Moorman s incentive pay opportunities for 2005 were not changed upon his promotion to Chief Executive Officer effective November 1, 2005.

Using that criteria, in November 2004, the Compensation Committee set Mr. Goode s target 2005 incentive opportunity at 200% of his 2005 base salary, Mr. Moorman s at 150% of his 2005 base salary and Mr. Prillaman s, Mr. Tobias and Mr. Wolf s at 125% of their 2005 base salary. Actual payments, if any, are based on the extent to which established performance standards are achieved.

Table of Contents

For 2005, all Executive Officers earned 100% of their individual target incentive opportunity EMIP awards, and each of the other officers and key employees earned 100% of their individual target incentive opportunity EMIP or MIP awards, as applicable.

As a result, total 2005 cash compensation 2005 base salary and 2005 EMIP awards paid in 2006 earned by Mr. Goode was positioned at approximately the 68^{th} percentile of other U.S. corporations of comparable size.

LONG-TERM INCENTIVE COMPENSATION: For 2005, the Board and the Compensation Committee believed that a substantial component of each Executive Officer s total direct compensation should be based on and reflect Norfolk Southern s efficient use of assets, its profitability and the total returns (stock price appreciation and dividends) to its stockholders. This objective was supported through the making of annual grants of stock options, Performance Share Units and Restricted Shares under the Long-Term Incentive Plan (LTIP) and Restricted Stock Units under the Restricted Stock Unit Plan (RSUP) to each Executive Officer, including each of the Named Executive Officers.

For 2005 awards, LTIP authorized awards of stock options, Performance Share Units, Restricted Shares and other equity-based incentive awards. RSUP provides for the grant of Restricted Stock Units, the value of which is measured by the fair market value of Norfolk Southern Corporation Common Stock and which are payable in cash upon satisfaction of applicable restrictions. These LTIP and RSUP arrangements are intended to ensure that the longer-term financial interests of the Executive Officers are directly aligned with those of Norfolk Southern s stockholders. Specifically, LTIP is intended to provide Executive Officers with the opportunity to acquire a meaningful beneficial stock ownership in Norfolk Southern and RSUP is intended to provide Executive Officers with compensation reflecting the total returns to stockholders without providing actual stock ownership.

In determining LTIP and RSUP awards for 2005, the Compensation Committee considered the total direct compensation historically generated by long-term awards and the recipients other compensation (base salary, annual incentive compensation) as they relate to comparable positions in U.S. companies of comparable size. The mix of long-term awards varies from year to year to reflect, among other things, the relative expected value of each type of award. The number of stock options, Performance Share Units, Restricted Shares and Restricted Stock Units granted in 2005 was determined so as to place the total compensation of Mr. Goode and the other Executive Officers, contingent upon the achievement of specified corporate performance, around the 75^{th} percentile of total compensation for their respective peer groups. Mr. Moorman s long-term awards for 2005 were not changed upon his promotion to Chief Executive Officer effective November 1, 2005.

At its January 2005 meeting, the Compensation Committee granted stock options under LTIP to each of the Executive Officers and to other officers and key employees at an exercise price equal to the fair market value of the shares on the effective date of grant. These options are exercisable during a ten-year period following the date of grant, after a one-year vesting period has elapsed. On all stock options granted in 2005 to the Executive Officers, for the first five years following the

Table of Contents

date stock options are granted, Norfolk Southern pays dividend equivalents in cash to each Executive Officer on unexercised options equal to the dividend paid on Norfolk Southern Corporation Common Stock.

At the same January 2005 meeting, the Compensation Committee granted Performance Share Units under LTIP that provide the Executive Officers and other officers and key employees the opportunity to earn awards (that will be paid either in cash or in shares of Norfolk Southern Corporation Common Stock, or in some combination thereof) during the first quarter of 2008. The number of Performance Share Units actually payable to recipients is based on criteria specified in LTIP specifically, Norfolk Southern s three-year (*i.e.*, 2005-2007) average Return on Average Capital Invested, three-year average Operating Ratio and three-year Total Stockholder Return, evaluated relative to performance measures established by the Compensation Committee and set out in the schedules below. One-third of the Performance Share Units granted in 2005 are available to be earned based on each of the three performance criteria.

Table of Contents

2005-2007 Cycle Total Stockholder Return (TSR) vs. S&P 500		2005-2007 Cycle Return on Average Capital Invested (ROACI)	
Three-Year Average TSR vs. S&P 500	**Percentage of Performance Share Units Earned**	**Three-Year Average ROACI**	**Percentage of Performance Share Units Earned**
90th percentile and above	100%	19% and above	100%
80th	90%	18%	90%
70th	85%	17%	80%
60th	80%	16%	70%
50th	75%	15%	60%
40th	50%	14%	50%
30th	30%	13%	40%
25th and below	0%	12%	30%
		11%	20%
		10%	10%
		Below 10%	0%

2005-2007 Cycle Operating Ratio (OpR)	
Three-Year NS Average OpR	**Percentage of Performance Share Units Earned**
70% or below	100%
75%	75%
	50%
	25%

80%	0%
85%	
Above 85%	

Also at the January 2005 meeting, the Compensation Committee granted Restricted Shares under LTIP to the Executive Officers, and to other officers and key employees. The Restricted Shares are subject to a five-year restriction period (three years if specified performance criteria are achieved), during which the holder has voting power but not investment power over the shares and receives dividends on the shares as declared on Norfolk Southern Corporation Common Stock.

The Compensation Committee also granted Restricted Stock Units under RSUP to each of the Executive Officers in 2005. The Restricted Stock Unit awards are subject to a five-year restriction period (three years if specified performance criteria are achieved), during which Norfolk Southern pays in cash to each Executive Officer dividend equivalents on the Restricted Stock Units equal to the dividend paid on Norfolk Southern Corporation Common Stock.

Table of Contents

For 2005, Mr. Goode was granted options (including 2,932 Incentive Stock Options that may receive capital gains treatment) on 110,000 shares of Norfolk Southern Corporation Common Stock, 66,000 Restricted Shares, 44,000 Restricted Stock Units and the opportunity to earn up to 110,000 Performance Share Units; Mr. Moorman was granted options (including 2,932 Incentive Stock Options that may receive capital gains treatment) on 45,000 shares of Norfolk Southern Corporation Common Stock, 54,000 Restricted Shares, 36,000 Restricted Stock Units and the opportunity to earn up to 45,000 Performance Share Units; the other three Named Executive Officers as a group were awarded options (including in the case of each such officer, 2,932 Incentive Stock Options that may receive capital gains treatment) on a total of 105,000 shares of Norfolk Southern Corporation Common Stock, 126,000 Restricted Shares, 84,000 Restricted Stock Units and the opportunity to earn up to 105,000 Performance Share Units.

OTHER COMPENSATION: As described under the Pension Plans caption, Norfolk Southern maintains a supplemental pension plan that provides benefits to Executive Officers otherwise denied under Norfolk Southern s defined benefit pension plan because of applicable Internal Revenue Code limitations on qualified plan benefits. This supplemental pension plan is designed to assist in retaining Executive Officers by ensuring that they receive the benefit of continued service to Norfolk Southern. In addition, in January 2006, the Compensation Committee approved an agreement between Norfolk Southern and Mr. Goode related to Mr. Goode s retirement, as described under the Retirement Agreement caption on page 27.

In summary, the Compensation Committee believes that the compensation program for Executive Officers, including the Named Executive Officers, was designed to offer opportunities competitive with those of similar positions at comparable American corporations. More importantly, the Compensation Committee believes that each Executive Officer s compensation was appropriately structured and administered so that a substantial component of total compensation is dependent upon, and directly related to, Norfolk Southern s efficient use of assets, its profitability and the total returns to its stockholders.

Section 162(m) of the Internal Revenue Code generally limits to $1 million the corporate federal income tax deduction for non-performance based compensation paid in a year to any of the Executive Officers. Norfolk Southern s executive compensation program has been carefully considered in light of the applicable tax rules. Accordingly, Norfolk Southern amended the Long-Term Incentive Plan in 2005 with stockholder approval to permit the grant of performance-based compensation that meets the requirements of Section 162(m). However, the Board and the Compensation Committee believe that tax-deductibility is but one factor to be considered in fashioning an appropriate compensation package for executives. The Compensation Committee reserves and will continue to exercise its discretion in this area so as to serve the best interests of Norfolk Southern and its stockholders.

2005 Members of the Compensation Committee

Gene R. Carter, *Chair*

Burton M. Joyce, *Member*

Jane Margaret O Brien, *Member*

Harold W. Pote, *Member*

34

Table of Contents

PERFORMANCE GRAPH*

The line graph below compares the yearly percentage change in the cumulative total stockholder return on Norfolk Southern Corporation Common Stock, the cumulative total return of the S&P Composite-500 Stock Price Index and the S&P Railroad Stock Price Index for the five-year period commencing December 31, 2000, and ending December 31, 2005. This data is furnished by Bloomberg Financial Markets.

*Assumes that the value of the investment in Norfolk Southern Corporation Common Stock and each index was $100 on December 31, 2000, and that all dividends were reinvested.

Table of Contents

STOCKHOLDER PROPOSALS

Stockholders are entitled to submit proposals on matters appropriate for stockholder action consistent with SEC regulations and with Norfolk Southern s Bylaws. Any such proposal for the 2007 Annual Meeting of Stockholders must comply with applicable regulations and be **received** by the Corporate Secretary, Norfolk Southern Corporation, Three Commercial Place, Norfolk, Virginia 23510-9219, as follows:

To be eligible for inclusion in Norfolk Southern s proxy statement and form of proxy, it must be received no later than November 23, 2006; or to be eligible to be presented from the floor for vote at the meeting (but not intended for inclusion in Norfolk Southern s proxy materials), it must be received during the period that begins December 2, 2006, and ends February 10, 2007.

By order of the Board of Directors,
DEZORA M. MARTIN
Corporate Secretary

36

Table of Contents

NORFOLK SOUTHERN CORPORATION

CHARTER

OF THE AUDIT COMMITTEE

OF THE BOARD OF DIRECTORS

Committee s Role and Purpose

The Audit Committee (Committee) is a standing committee, the chair and members of which are appointed annually by the Board of Directors not later than at its Organizational Meeting. The Committee meets a minimum of four times per year, establishes its own procedures (including designating a chair, if necessary) and acts by majority vote when at least a quorum is present. In general, the Committee s function is to assist the Board in discharging fully its statutory and fiduciary responsibilities with respect to oversight of the Corporation s financial statements and reports, internal controls and related matters. The Committee also facilitates communication among the Board, the independent registered public accounting firm, the Corporation s financial and senior management and its Internal Audit Department.

While the Committee has oversight responsibilities and powers as set forth in this Charter, it is not the responsibility of the Committee to prepare the Corporation s financial statements or to plan or conduct audits to determine if such statements are complete, accurate and in accordance with Generally Accepted Accounting Principles (GAAP). This is the responsibility of Management and the independent registered public accounting firm. Management also is responsible for compliance with applicable laws, regulations, internal controls and procedures, and with the Corporation s disclosure controls and procedures, internal operating and compliance policies, and codes of conduct and ethics.

Accordingly, the Committee s purpose includes, without limitation:

(a) Assisting board oversight of the:

- accuracy and integrity of the Corporation s financial statements and periodic financial reports, and

- the Corporation s compliance with legal and regulatory requirements;

(b) Direct responsibility for the engagement of independent registered public accounting firm based on an assessment of their qualifications and independence;

(c) Evaluation of the performance of the independent registered public accounting firm and internal audit function; and

(d) Preparation of the Audit Committee Report required by SEC rules to be included in the Corporation s annual proxy statement.

Table of Contents

Committee Membership

The Board s policy requires that the Committee must consist of no fewer than three directors, each of whom satisfies all requirements, applicable at the time, of the Securities and Exchange Commission (SEC) and of the New York Stock Exchange (NYSE). No member may be a serving executive officer of the Corporation. Each member must be free of any relationship that would interfere with the exercise of her or his independent judgment and must meet the Board s definition of independence and financial literacy, and at least one member must have accounting or related financial management expertise. Additionally, if a Committee member serves on the audit committee of more than three public companies, the Committee and the Board must determine that such simultaneous service does not impair the ability of such member to effectively serve on the Corporation s Audit Committee. The Committee seeks to maintain at least one member who is an audit committee financial expert as defined by the SEC. Committee members shall accept directors fees as their sole form of compensation from the Corporation.

Principal Committee Duties, Responsibilities and Powers

The Committee will have the full cooperation of Management, including unrestricted access, in the Committee s sole discretion, to personnel, books and records, and shall have all the resources it deems necessary. The Committee shall have sole power and authority to engage and evaluate the independent registered public accounting firm and other outside counsel and experts. The Corporation shall provide funding, as determined by the Committee, for payment of such auditors or advisors.

Among the Committee s principal duties and responsibilities, which it discharges as a fiduciary, are the following:

(1) Oversee the services, activities and independence of the Corporation s independent registered public accounting firm. To carry out this responsibility, to the extent (a) required by law or by applicable rules or regulations of the SEC, NYSE, Financial Accounting Standards Board (FASB) or other body with jurisdiction, or (b) the Committee determines is appropriate, the Committee:

- has sole authority to engage, evaluate and, if necessary, replace the independent registered public accounting firm (subject to shareholder ratification, as applicable);
- will pre-approve all audit and non-audit services of the independent registered public accounting firm; review the annual audit plan (including scope, staffing, reliance on Management and general audit approach); approve estimates of and final fees for such services; and evaluate the extent to which the provision of services is consistent with auditor independence;
- annually, obtain and review a report from the independent registered public accounting firm describing: the firm s internal quality-control procedures; any material issues raised by the most recent internal quality review, or peer review, of the firm, or by any inquiry or investigation of governmental or professional authorities, within the preceding five years,

Table of Contents

respecting any audit carried out by the firm, and any steps taken to deal with any such issues; all relationships between the independent registered public accounting firm and the Corporation;

- annually, review and discuss with the independent registered public accounting firm all matters required at the time by (a) Statement on Auditing Standards (SAS) No. 61 and (b) the written disclosures required by the Independent Standards Board Standard No. 1 (as either may be amended, supplemented or superseded) regarding the auditors independence;

- prior to the filing of the Corporation s quarterly and annual financial statements and reports with the SEC, meet to review the financial statements with the independent registered public accounting firm (for quarterly information, as required by SAS No. 100 (formerly SAS No. 71), as it may be amended, supplemented or superseded), including significant findings prepared by the independent registered public accounting firm regarding applicability of accounting principles and practices, the adequacy of internal controls over financial reporting and disclosure controls and procedures, and receive the independent registered public accounting firm s review letter or audit opinion, as applicable, on such statements and reports;

- quarterly, meet with the independent registered public accounting firm to review those matters required at the time by SAS No. 61 (as may be amended, supplemented or superseded), including all critical accounting policies and practices, all alternative treatments of financial information and disclosures within GAAP that have been discussed with Management, and the ramifications of such alternative disclosures and treatments, the disclosure or treatment preferred by the auditors, and other material written communications between the independent registered public accounting firm and Management;

- periodically, meet privately with the independent registered public accounting firm to review any audit problems, difficulties, significant disagreements with Management regarding financial statement presentation or content, and Management s response, and determine whether the independent registered public accounting firm have been subject, either directly or indirectly, to any action to fraudulently influence, coerce, manipulate or mislead the auditors;

- will set clear hiring policies for employees or former employees of the independent registered public accounting firm;

(2) **Oversee the activities of Management in its preparation of the Corporation s financial statements and related financial disclosures.** To carry out this responsibility, to the extent it deems appropriate, the Committee will:

- prior to the filing of the Corporation s quarterly and annual financial statements and reports with the SEC, meet to review and discuss with Management: (1) financial statements, (2) an advanced draft of the MD&A, (3) the adequacy of internal controls over financial reporting and disclosure controls and procedures, and (4) other information that could significantly affect the quality of such statements and reports;

Table of Contents

- quarterly, review and discuss with Management all critical accounting policies and estimates identified by Management;
- quarterly, review the existence and substance of significant accruals, reserves or other financial reporting judgments that, in the opinion of Management or the independent registered public accounting firm, had or may have a material impact on the financial statements, and any significant changes in accounting and financial reporting standards proposed by the SEC, NYSE, FASB, or other body having regulatory jurisdiction;
- discuss earnings press releases, as well as any financial information and earnings guidance provided to analysts and rating agencies;
- quarterly, discuss CEO and CFO certifications of the Corporation s financial statements and reports;
- annually, receive and review the Report of Management, assessing the effectiveness of internal control over financial reporting and reporting on updates to the Compendium of Internal Controls;
- periodically, meet privately with the chief financial officer and the controller to discuss any matters that require confidential and/or discreet discussion, review and/or handling.

(3) **Periodically review with Management the areas of greatest risk to the operations and financial results of the Corporation,** such as safety of operations, environmental regulations, major pending litigation, matters pertaining to financing costs and credit ratings, tax issues, any other major financial risks and exposures and the steps Management has taken or intends to take to manage and control such risks. The Committee will, to the extent it considers appropriate:

- periodically meet with Management to review such areas of risk and discuss steps to govern the process by which risk assessment and management is undertaken by Management;
- oversee activities of the internal audit function including staffing, training, budget, audit planning and charter, review significant issues raised by its periodic reports, and Management s responses, review its responsibilities, authorities and reporting relationships, and assure the continuing independence and objectivity of the internal auditors;
- approve decisions regarding the appointment or removal of the chief audit executive;
- periodically, meet privately with the chief audit executive to discuss any matters that require confidential and/or discreet discussion, review and/or handling;
- review with the chief legal officer and other appropriate Management, legal and regulatory matters that may have a material impact on the financial statements;
- review with the chief audit executive, chief legal officer and other members of Management as deemed necessary by the Committee, the scope and effectiveness of the Corporation s compliance policies, procedures and activities;

Table of Contents

- review, as necessary, with the chief audit executive and other members of Management as appropriate, the procedures established for the receipt, retention, and treatment of complaints received, including confidential, anonymous submissions by employees, or others, of concerns regarding questionable accounting or auditing matters, and significant cases of alleged employee conflict of interest, ethical violations, misconduct, or fraud, the volume and nature of calls to the Internal Audit Hotline and other matters similar in nature; and

- receive annually the results of internal audit reviews of officers expense accounts/perquisites and employee conflict-of-interest questionnaires.

(4) Appropriately record deliberations and decisions of the Committee and regularly report to the Board the Committee s activities and conclusions with respect to the principal matters it has considered and such other items as the Board may request, including (a) the Committee s review and discussion of the quarterly and annual audited financial statements with Management and the independent auditor and its recommendation that the Corporation s audited financial statements be included in the annual Form 10-K filing with the SEC; (b) any mandatory report that the Committee has approved for inclusion in a proxy statement of the Corporation or mandatory affirmation regarding the independence and qualifications of members of the Committee; (c) its assessments and conclusions concerning the Committee s annual review and evaluation of the adequacy of this Charter; and (d) its assessments and conclusions concerning the Committee s annual performance evaluation.

Table of Contents

Two More Ways to Vote Your Proxy
VOTE BY TELEPHONE OR INTERNET

24 Hours a Day 7 Days a Week

Save Your Company Money It s Fast and Convenient

TELEPHONE		**INTERNET**		**MAIL**
1-866-874-4879		https://www.proxyvotenow.com/nsc		
Use any touch-tone telephone. Have your Proxy Card in hand. Follow the simple recorded instructions.	***OR***	Go to the website address shown above. Have your Proxy Card in hand. Follow the simple instructions.	***OR***	Mark, sign and date your Proxy Card. Detach card from this Form. Return the card in the postage-paid envelope provided.

Your telephone or Internet vote authorizes the named proxies to vote your shares in the same manner and to the same extent as if you marked, signed and returned the proxy card. **If you have submitted your proxy by telephone or the Internet, there is no need for you to mail back your proxy card.**

1-866-874-4879
CALL TOLL-FREE TO VOTE

..

ÚDETACH PROXY CARD HERE IF YOU ARE NOT VOTING BY TELEPHONE OR INTERNETÚ

x

Votes MUST be indicated

(x) in Black or Blue ink.

Norfolk Southern Corporation recommends a vote FOR the following items, and this proxy card will be voted accordingly if no choice is specified:

	For All	Withhold For All	Exceptions*		For	Against	Abstain
1. ELECTION OF DIRECTORS	..	..	..	2. Ratification of the appointment of KPMG LLP, independent	..	..	..

registered public accounting firm, as Norfolk Southern s independent auditors for the year ending December 31, 2006.

Nominees 2009:
1. Daniel A. Carp, 2. Steven F. Leer, 3. Charles W. Moorman, IV

Exceptions ______________________________

***(Instructions: To withhold authority to vote for individual nominee(s), mark the Exceptions box and write the name(s) on the above blank line; proxy will be voted FOR remaining nominees.)**

In addition, in their discretion, the Proxies are authorized to vote upon such other business as may properly come before the meeting or any adjournment thereof.

To change your address, please mark this box and write your new address below. ¨

Please sign exactly as the name appears hereon. If stock is held in names of joint owners, both should sign. If signing as attorney, trustee, executor, administrator, custodian, guardian or authorized representative, please indicate full title as such

Sign, Date and Return the Proxy Card Promptly Using the Enclosed Envelope.

______________________________	______________________________
Date Share Owner sign here	Co-Owner sign here

Table of Contents

ÚDetach Proxy Card HereÚ

NORFOLK SOUTHERN CORPORATION

THREE COMMERCIAL PLACE, NORFOLK, VIRGINIA 23510-2191

PROXY FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD MAY 11, 2006

This Proxy is Solicited on Behalf of the Board of Directors

The undersigned hereby appoints and authorizes Gerald L. Baliles, Gene R. Carter and Landon Hilliard, and each or any of them, proxy for the undersigned, with full power of substitution, to represent and vote all shares of Norfolk Southern common stock held by the undersigned with the same force and effect as the undersigned at the Annual Meeting of Stockholders of Norfolk Southern Corporation to be held at The Roper Performing Arts Center, 340 Granby Street, Norfolk, Virginia, on Thursday, May 11, 2006, at 10:00 A.M., Eastern Daylight Time, and at any adjournments, postponements or reschedulings thereof, upon the matters more fully set forth in the Proxy Statement, dated March 23, 2006, and to transact such other business as properly may come before such meeting(s).

The undersigned acknowledges receipt of the Notice and Proxy Statement dated in each case March 23, 2006. All other proxies heretofore given by the undersigned to vote shares of Norfolk Southern common stock are expressly revoked hereby.

THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED IN THE MANNER DIRECTED ON THE OTHER SIDE BY THE UNDERSIGNED STOCKHOLDER. **IF NO DIRECTION IS MADE,** THIS PROXY WILL BE VOTED **FOR** THE ELECTION OF DIRECTORS AND RATIFICATION OF KPMG AS INDEPENDENT AUDITORS.

(Continued, and to be **MARKED, DATED AND SIGNED** on the other side)

NORFOLK SOUTHERN CORPORATION
P.O. BOX 11145
NEW YORK, N. Y. 10203-0145