ANNUAL REPORT **2004**

Avid Technology, Inc.

make manage move | media™

Avid®

The transition to high definition is in full swing, as makers of TV shows, commercials, music videos, and films are increasingly incorporating HD into their workflows.

Broadcasters of all sizes are converting tape-based production pipelines to all-digital workflows that cover every step of the process—from footage acquisition to final playout.

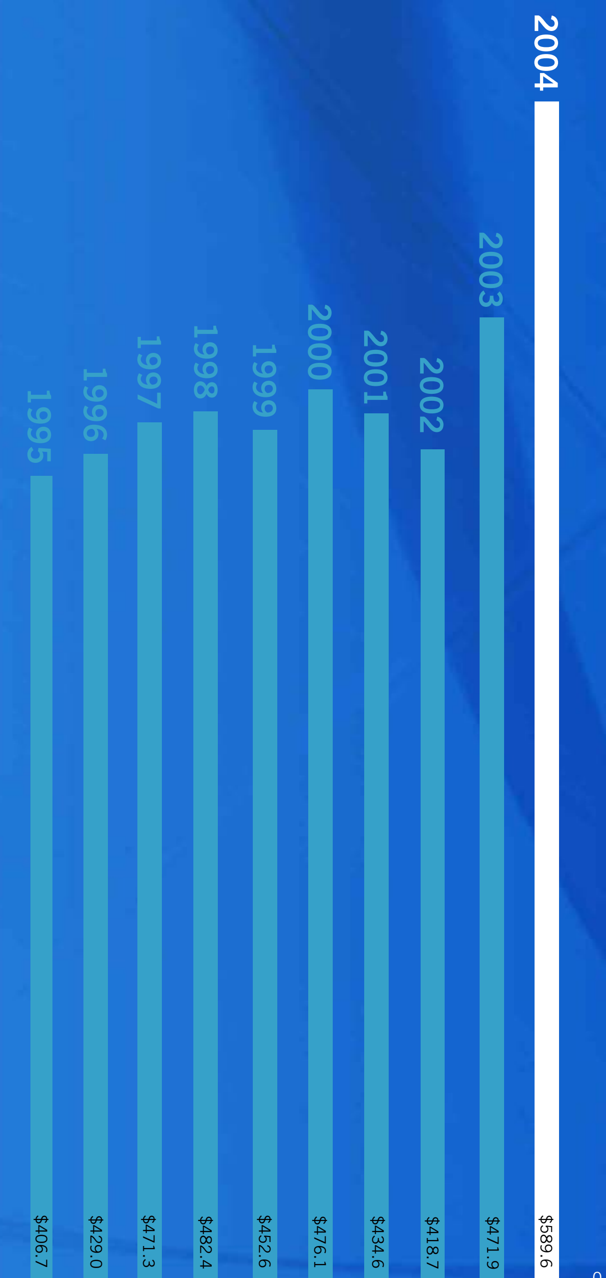
Game developers and visual effects artists are **demanding integrated pipelines** that encompass 3D animation, digital asset management, and nonlinear editing.

The expanding scope of digital media has created a need for networking solutions that enable **real-time collaboration** and help manage the entire work chain—including ingest, editing, compositing, finishing, asset management, archiving, and distribution.

Professional recording and live-sound engineers are **embracing the paradigm of computer-based digital mixing.**

In the fast-growing home recording industry, **the personal computer has become the production medium of choice,** displacing the hardware-based portable studio.

By all accounts, 2004 was an extremely successful year for Avid, characterized by outstanding financial performance, significant growth and diversification, continued technological innovation, and recognition at the highest echelons of the industries we serve.



In 2004, Avid's revenues exceeded $500 million for the first time in the company's history.

Consolidated Statement of Operations Data

(In thousands, except per share and employee data)

Year ended December 31, 2004	2003	2002
Net revenues		
$589,605	$471,912	$418,719
Gross margin		
56.7%	55.6%	50.5%
Net income		
$71,701	$40,889	$2,999
Net income per share – diluted		
$2.05	$1.25	$0.11

Consolidated Balance Sheet Data

As of December 31, 2004	2003	2002
Cash and marketable securities		
$155,419	$196,309	$89,034
Total assets		
$576,234	$348,119	$235,803
Total stockholders' equity		
$424,621	$227,105	$123,564
Employees		
2,014	1,582	1,556

LEADERSHIP

To our shareholders

In 2004, we delivered solid results each quarter, culminating in record annual revenues of nearly $590 million—an increase of 25% over 2003, our highest annual growth rate since 1995. Our net income for 2004 was also a record at $71.7 million, or $2.05 per diluted share—up more than 60% from 2003.

These results reflected a period of significant expansion for Avid. We grew organically in our core video postproduction, broadcast, and audio businesses, and we made strategic acquisitions of audio and digital asset management businesses that broadened our opportunities in those areas.

In video postproduction, the transition to High Definition (HD) continued to be a business driver for Avid, since many of our customers have been upgrading their production pipelines to accommodate this technological shift. In 2004, we transitioned our Avid DNA™ product family to HD, with second-generation versions of our Media Composer® Adrenaline™ and Avid Xpress® Pro systems that support a variety of HD formats and resolutions—and give our customers the ability to select the tool and price point that is best suited for their needs. We also introduced Avid DNxHD™ encoding technology, which enables customers to work at uncompressed HD image quality using standard-definition file sizes.

In broadcast, we surpassed our goals in 2004, closing the year with more than 100 deals signed, and bringing to more than 250 the total number of Avid digital broadcast conversions either under way or completed. These installations ranged from large, diversified customers—like ABC and Reuters—to smaller, regional facilities that are converting to Avid end-to-end workflows. Regardless of the size, complexity, or geographical location of their installations, broadcasters continue to turn to Avid for our proven leadership in developing solutions that deliver maximum return on investment.

Avid Executive Team

(Top Row)

Michael J. Rockwell
Vice President and
Chief Technology Officer

Ethan E. Jacks
Vice President of Business Development
and Chief Legal Officer

Charles L. Smith
Vice President and
General Manager, Avid Video

Patricia A. Baker
Vice President of Human Resources

(Bottom Row)
Joseph Bentivegna
Vice President and
Chief Operating Officer, Avid Video

David A. Krall
President and Chief Executive Officer

David M. Lebolt
Vice President and
General Manager, Digidesign

Carol L. Reid
Vice President and Corporate Controller

Paul J. Milbury
Vice President and
Chief Financial Officer

Our audio division represented one of the biggest growth areas for Avid, with a better than 40% increase in revenues over the previous year. One of the highlights was the introduction of the Digidesign® ICON integrated console environment, a solution that streamlines the recording, editing, processing, and mixing of audio material for high-end customers.

At the other end of the audio business spectrum, we diversified our portfolio by acquiring M-Audio, a leading provider of digital audio and MIDI solutions for the home studio market. The addition of M-Audio to the Avid family represents a strong growth opportunity, since the M-Audio product line complements Digidesign's strengths among professionals and "prosumers"—and the combined entity can reach new customers that we would not otherwise reach as strongly on our own.

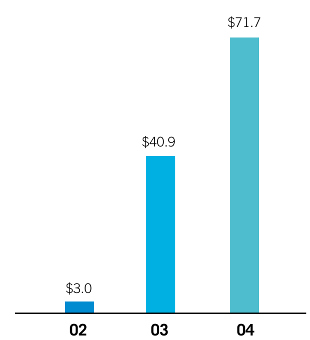
For our customers in the 3D animation and digital asset management industries, we introduced the Avid computer graphics pipeline—an end-to-end solution that combines our SOFTIMAGE®|XSI® 3D content creation software, our Alienbrain® Studio asset management software, and Avid video and film editing, compositing, and finishing systems. As an integrated pipeline, these products can offer our customers an environment of industry-leading tools that meet a wide range of budgetary and content-creation needs.

These successes capped a year in which our tradition of technological innovation was rewarded with our second Oscar® statuette, representing the 2003 Scientific and Technical Award for the design, development, and implementation of the Digidesign Pro Tools® digital audio workstation. Combined with our first Oscar statuette—which recognized the concept, design, and engineering of the Avid Film Composer® system—this achievement makes Avid one of only a handful of companies to be honored with two Oscar statuettes for technological innovations.

We're very proud of the results that we achieved in 2004, and our outlook for 2005 is even better with an aggressive plan for continued growth among all of the customer segments that we serve.

David Krall
President and CEO

> "In 2004, Avid achieved record revenue and net income through organic growth and strategic acquisitions."



Net income increased 75% from 2003 to 2004.

primetime tv …

In the 2004 fall television season, 28 primetime shows were finished in HD using the Avid DS Nitris® system—nearly a 40% increase over shows finished in HD the previous year on Avid systems.

recorded music …

All of the No. 1 hits on the Billboard Hot 100 and Hot R&B Singles charts in 2004 were made using Digidesign Pro Tools digital audio workstation technology.

film …

Every film nominated for a 2004 Academy Award® in the Best Picture, Directing, Film Editing, Sound Editing, Sound Mixing, Visual Effects, and Best Animated Feature categories was made using at least one Avid solution.

broadcast …

By the end of 2004, 250 Avid digital broadcast conversions had been completed or were underway. This total represents only 20% of the broadcast customers that Avid has targeted for conversion.

HD …

The worldwide HDTV adoption rate is expected to reach 52 million homes by 2009—more than five times the total of 10 million homes in March 2005.

(source: In-Stat)

video games …

Global video game spending is expected to grow at an annual rate of 20%, reaching $55.6 billion by 2008.

(source: PricewaterhouseCoopers LLP)

education …

One third of the 4,500 colleges and universities in North America are offering film or media majors.

next generation …

Free versions of Avid's professional software products have been downloaded by millions of users:

- Pro Tools Free—3 million downloads since October 2000
- Avid Free DV—385,000 downloads since January 2003
- SOFTIMAGE|XSI EXP for Half-Life 2—90,000 downloads since March 2004

As recently as a generation ago, the nonlinear editing of film, video, and audio in a computer-based platform was a novel concept—an idea so futuristic that it challenged conventional wisdom and pushed the boundaries of the imagination. Today, virtually all entertainment and news programming undergoes some degree of digital editing, and in many instances, the media stays in the digital domain through the entire postproduction process. By tapping into the power of digital processing, content creators have unlocked a world of seemingly infinite possibilities, where production tools afford users the freedom to go as far as their ideas can take them.

This wholesale transformation in the way digital media professionals conceive, create, manage, store, and distribute their work is a tribute to Avid's history of innovation—which began with the introduction of the first Media Composer system in 1989. That innovation continues today with a vast array of industry-leading products and technologies for the film, video, television, broadcast, audio, and 3D animation industries.

As always, Avid is committed to staying at the forefront of these industries by helping the world's top media artists achieve—and even exceed—their creative goals.

Avid®

VIDEO

In all the major markets of Avid's video division—postproduction, broadcast, computer graphics, and storage and networking—business dynamics and technology trends have combined to create major opportunities.

POSTPRODUCTION

From shooting to screening to mastering, more and more postproduction professionals are relying on HD. In the 2004-2005 U.S. television season, 28 primetime shows were finished in HD using the Avid DS Nitris solution—nearly a 40% increment over shows finished in HD the previous year on Avid systems. This growth in HD production is reflected in the worldwide HDTV adoption rate, which is currently estimated at 10 million homes and expected to increase to 52 million homes by 2009.

As HD enters the mainstream, the absence of unified production standards has resulted in a complex technological landscape that demands flexible, broad-based solutions. Avid's approach has always been to provide the most extensive HD format support in the industry—ensuring that our customers can handle any project that comes through the door.

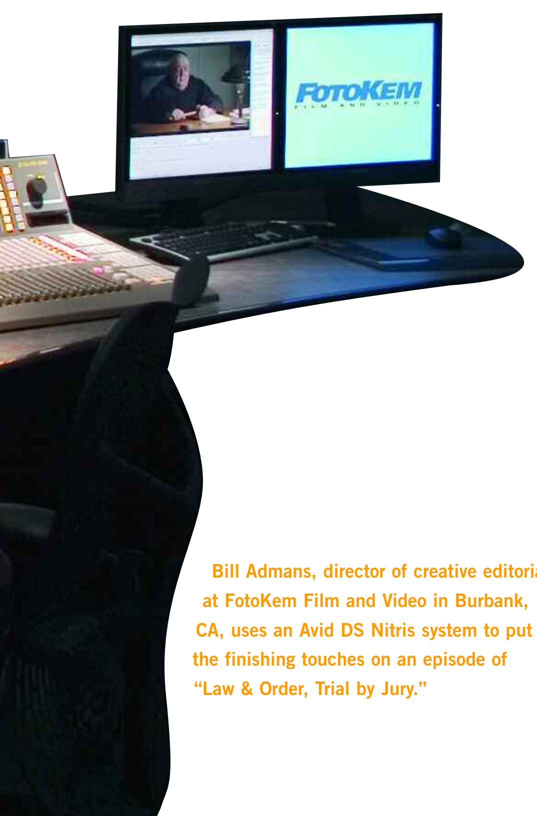
The Media Composer Adrenaline family is renowned throughout the postproduction industry for its real-time HD, SD, and DV performance, legendary image quality, and industry-standard Avid editing environment.

Image of ATG Javelin jet courtesy of IMS Productions, Colorado Springs, CO.

While enterprise customers enhance their businesses by venturing into HD postproduction, independent filmmakers, corporate trainers, event videographers, and hobbyists are turning to DV-based solutions—including HDV—to help them turn out professional-quality projects within modest budgets. To capitalize on this momentum, Avid has expanded its offerings to include the Avid Xpress Studio system—an all-in-one content creation suite that offers video editing, audio production, 3D animation, visual effects, and DVD authoring applications, plus professional video and audio hardware components.

Reaching out to the content creators of tomorrow, Avid's postproduction products are finding a home at a growing number of schools that are committed to preparing students for careers in media production. In North America alone, one third of the estimated 4,500 colleges and universities are now offering film or media majors. This creates the potential for Avid to make further inroads in that area—where installations range from a handful of editing systems to vast, shared-storage networks that give large groups of students valuable, hands-on experience.

> "Avid has made it easy for us to offer a wide range of options to fit different needs and budgets—from a commercial that needs real-time HD finishing with full color correction on Avid DS Nitris, to an independent film that needs DV capture, portability, and HD editing on Avid Xpress Pro and output on Media Composer Adrenaline HD."
>
> — Dave Ballard
> President and owner, LAB 601, Atlanta



Bill Admans, director of creative editorial at FotoKem Film and Video in Burbank, CA, uses an Avid DS Nitris system to put the finishing touches on an episode of "Law & Order, Trial by Jury."

The Avid Xpress Studio system offers integrated video editing, audio production, 3D animation, compositing and titling, and DVD authoring software products—plus professional video and audio production hardware.

BROADCAST

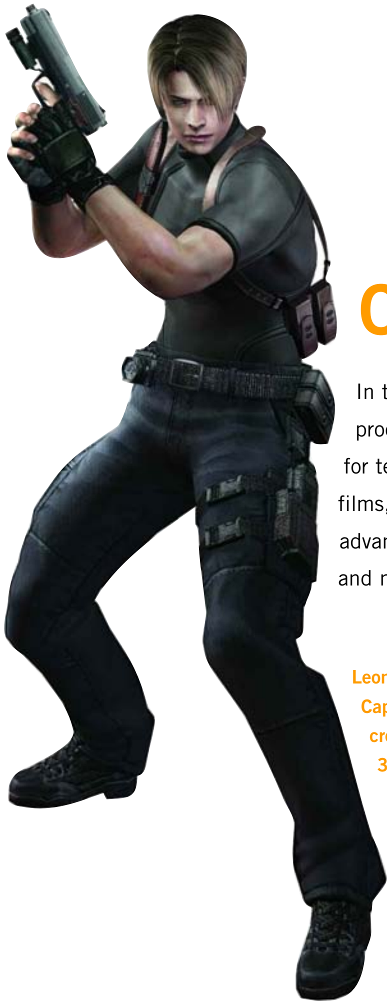
In the broadcast industry, more and more facilities are converting to digital production environments, allowing them to ingest, edit, play out, and archive news and other programming—all in a tape-free domain. By reaping the benefits of a digital workflow, these customers are able to maximize their ROI and stay ahead of the competition—which now includes traditional networks, cable and satellite channels, and the Internet.

While the trend toward digital conversions has fueled Avid's success in the broadcast industry, this market remains largely untapped. By Avid's estimates, only 20% of medium-to-large broadcast facilities have made the transition to digital—and more than half of those customers have implemented Avid solutions. That leaves an estimated 1,800 major broadcasters around the world still using analog production pipelines—and therefore targets for conversion.

The AirSpeed™ broadcast server offers a range of workflow capabilities, format compatibility, and connectivity and control. It features VTR-like local operation with front-panel monitoring, remote programmability, and interoperability with the Avid Unity™ for News family of shared-storage solutions.

> "Avid's intelligent end-to-end workflow facilitates content sharing between our radio and TV platforms and associated assets nationwide, and provides us with a migration path to HD. Our viewers have come to expect the highest quality programming from CBC/Radio-Canada, and these new tools will allow us to build on that in the most efficient manner."

- Ray Carnovale
Vice President and Chief Technology Officer, CBC/Radio-Canada



COMPUTER GRAPHICS

In the same way that our end-to-end broadcast workflow has helped customers increase their productivity, Avid's computer graphics pipeline provides an integrated production environment for teams of game developers and visual effects artists. Whether working on video games, films, TV shows, live broadcasts, commercials, or music videos, these professionals can take advantage of a pipeline that features Avid's award-winning 3D, digital asset management, and nonlinear editing solutions.

Leon S. Kennedy, a character in the Capcom game series "Resident Evil," created using the SOFTIMAGE|XSI 3D digital content creation tool.

STORAGE AND NETWORKING

The greater the complexity of the digital production environment, the more urgent the need for efficient, shared-storage solutions that deliver a true collaborative workflow. Avid's strength in this area has allowed us to take a clear lead in the broadcast industry, and many of the attributes that we've brought to that market—robust storage, integrated digital asset management, and real-time collaboration—also apply to film, video, TV, audio, and animation workflows.

As those industries migrate toward HD, the data rates associated with HD resolutions require very large amounts of bandwidth and storage capacity. To overcome this challenge, Avid developed the Avid DNxHD encoding technology, which enables an HD workflow with the storage capacity and bandwidth requirements of SD files—but with the image quality of 10-bit uncompressed HD files. By lowering the barrier to entry for HD—and making the source code for Avid DNxHD technology licensable for free—Avid is helping to accelerate the adoption of HD technology throughout the industry.

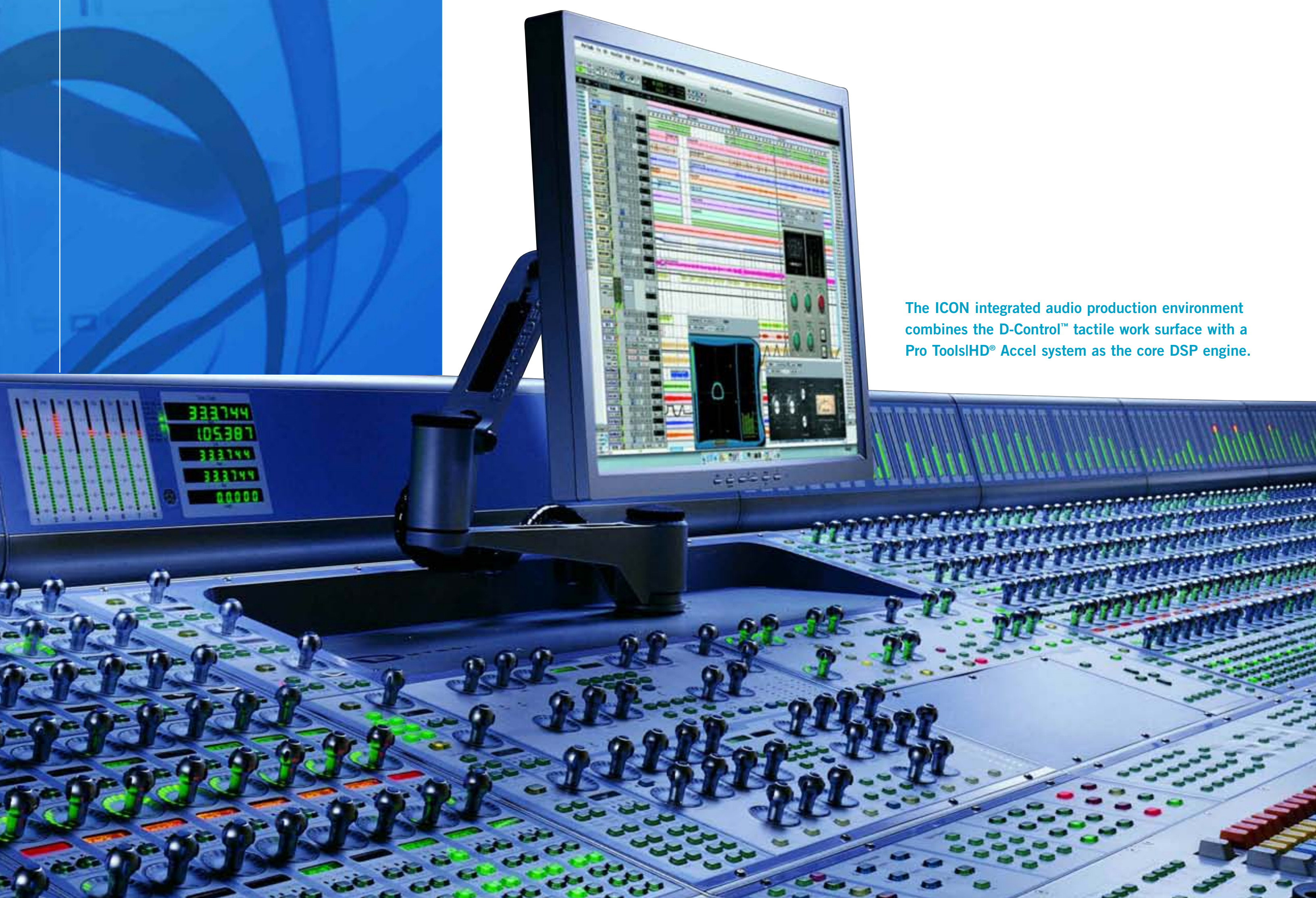
The Avid Unity family of shared media networks offers unmatched real-time, simultaneous collaboration using uncompressed SD and high-efficiency Avid DNxHD encoded media.

AUDIO

For Avid's audio division, Digidesign, the ongoing shift away from linear recording toward computer-based production has opened opportunities for professionals and home recordists alike.

PROFESSIONAL RECORDING & MIXING

The continued growth of the award-winning Pro Tools digital audio workstation has fueled interest in professional products that provide sophisticated control of the recording, editing, processing, and mixing functions of the core system. To meet this demand, Digidesign created the ICON integrated console environment, a system that offers the feel and functionality of standalone mixing consoles—but at a much lower price. The initial success of ICON—with 150 systems sold in the first six months to film and television postproduction suites, music mixing studios, and educational institutions—demonstrates that the recording industry is ready for a new approach toward mixing.



The ICON integrated audio production environment combines the D-Control™ tactile work surface with a Pro Tools|HD® Accel system as the core DSP engine.

Sound engineer Dave Haines mixes a live performance by hip-hop band The Black Eyed Peas on the Digidesign VENUE system, featuring the D-Show™ digital console.

LIVE SOUND

Just as studio owners and engineers have embraced the concept of computer-based mixing, live-sound mixers are increasingly adopting digital workflows. With this market in mind, Digidesign recently introduced the VENUE system, which offers sound-reinforcement professionals the same level of functionality offered in the studio: full-featured mixing capabilities, uncompromising sound quality, and integration with the Pro Tools platform.

HOME STUDIO

M-Audio markets a broad line of consumer and professional recording equipment, including computer peripherals, keyboards, microphones, software, and studio monitors.

While the VENUE and ICON systems cater to Digidesign's professional customer base, the Pro Tools LE™ line of digital audio workstations continues to drive Digidesign's home studio business.

To further leverage its strength in the low end of the audio business, Avid in 2004 acquired M-Audio—a leader in digital audio and MIDI solutions for electronic musicians and home recordists. With a wealth of experience and brand equity in that market, M-Audio promises to drive Avid's expansion into consumer audio and complement Digidesign's proven strength in the adjacent "prosumer" segment.

"I never imagined that I could buy a system that would increase my workflow as much as the ICON has. I am getting my mixes done faster and having more fun than ever. This is an unparalleled musical tool."

– Nathaniel Kunkel
Grammy® nominated and Emmy® award-winning producer, engineer, and mixer

With a year of outstanding results behind us, huge opportunities ahead of us, and a team of talented and passionate individuals committed to leadership in quality, price performance, and versatility, Avid is in a stronger position than ever to continue its success in the film, television, video, broadcast, audio, and animation industries.

In our 17-year history, we have held fast to a tradition of excellence, innovation, and service to our customers—and those principles continue to guide every decision we make today. We pride ourselves on closely following the emerging trends of our ever-evolving industries to create products that live up to the expectations—and imaginations—of our most demanding customers.

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

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURUSANT
TO SECTIONS 13 OR 15(D) OF THE SECURITIES ACT OF 1934

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

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 0-21174

AVID TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Delaware	04-2977748
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Avid Technology Park, One Park West, Tewksbury, MA	01876
(Address of principal executive offices)	(Zip Code)

(978) 640-6789
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock $.01 Par Value
(Title of Class)

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES √ NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2) YES √ NO

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $1,721,782,981.11 based on the closing price of the Common Stock on the NASDAQ National Market on June 30, 2004.

The number of shares outstanding of the registrant's Common Stock as of February 22, 2005, was 35,062,778.

Documents Incorporated by Reference

Document Description	10-K Part
Portions of the Registrant's Proxy Statement for the 2005 Annual Meeting of Stockholders	III

This Annual Report on Form 10-K contains a number of forward-looking statements. Any statements contained herein (including without limitation statements to the effect that Avid Technology, Inc. ("We", the "Company" or "Avid") or our management "believes", "expects", "anticipates", "plans" and similar expressions) that are not statements of historical fact should be considered forward-looking statements. There are a number of important factors that could cause our actual results to differ materially from those indicated by such forward-looking statements. These factors include, without limitation, those set forth in "Certain Factors That May Affect Future Results."

PART I

ITEM 1. BUSINESS

OVERVIEW

We develop, market, sell and support a wide range of software and hardware for digital media production, management and distribution. Digital media are video, audio or graphic elements in which the image, sound or picture is recorded and stored in digital values, as opposed to analog, or tape-based, signals. Our diverse range of product and service offerings enables customers to "Make, Manage and Move Media."

Make Media. Our Video and Film Editing and Effects ("Video") segment offers digital, non-linear video and film editing systems and 3D and special-effects software that enable users to manipulate moving pictures and sound in a faster, easier, more creative, and more cost-effective manner than using traditional analog tape-based systems. Non-linear systems allow editors to access material instantaneously rather than requiring them to work sequentially. Our Audio segment offers digital audio software applications and hardware systems for music, film, television, video, broadcast, streaming media, and web development. These systems are based upon proprietary audio hardware, software, and control surfaces, and allow users to record, edit, mix, process, and master audio in an integrated manner.

Manage Media. We provide complete network, storage, and database solutions based on our Avid Unity MediaNetwork technology. This technology enables users to simultaneously share and manage media assets throughout a project or organization. The ability to effectively manage digital media assets is a critical component of success for many broadcast and media companies with multiple nonlinear editing workstations in a range of geographic locations. As a result, professionals can collaborate seamlessly on all production elements, and streamline the process for cost-effectively delivering compelling media experiences and quickly "re-purposing" or finding new uses or markets for media assets.

Move Media. We offer products that allow our customers to distribute media over multiple platforms - including air, cable or satellite, or through the Internet. In addition, we provide technology for playback directly to air for broadcast television applications. Many of our products also support the broadcast of streaming Internet video.

Our products are used worldwide in production and post-production facilities; film studios; network, affiliate, independent and cable television stations; recording studios; advertising agencies; government and educational institutions; corporate communication departments; and game developers and Internet professionals. Projects produced by our customers using our products have been honored with Oscar®, Emmy®, and Grammy® awards, as well as a host of other international awards. In addition, we have also received numerous awards for technical innovations, including Oscars, Emmys and a Grammy. (Oscar is a registered trademark and service mark of the Academy of Motion Picture Arts and Sciences. Emmy is a registered trademark of ATAS/NATAS. Grammy is a registered trademark of The National Academy of Recording Arts and Sciences, Inc.)

RECENT ACQUISITIONS

In September 2004, we acquired Avid Nordic AB, a Sweden-based reseller of Avid products operating in the Nordic and Belgium/Netherlands/Luxembourg regions of Europe. We previously had no ownership interest in Avid Nordic. The acquisition allows Avid to serve customers directly in this region.

In August 2004, we acquired California based Midiman, Inc. (d/b/a M-Audio), a leading provider of digital audio and MIDI (Music Industry Digital Interface) solutions for electronic musicians and audio professionals. We have integrated M-Audio into our Audio segment and will market M-Audio's line of audio products alongside Digidesign's digital audio workstations. M-Audio's consumer product line, including peripherals, keyboards, speakers and sound libraries, is a complement to Digidesign's professional and home audio solutions.

In January 2004, we acquired Munich, Germany-based NXN Software GmbH, a leading provider of asset and production management systems targeted for the entertainment and computer graphics industries. We believe that the addition of NXN will enhance our film and video postproduction, broadcast news, and 3D product lines by enriching them with a feature set that facilitates media creation and management. NXN has been integrated into our Video segment.

DIGITAL MEDIA CONTENT MARKETS

Digital formats and tools have largely displaced analog processes in many markets, such as word processing, spreadsheets, publishing, graphics, and electronic and mechanical design. Markets that use film, video and audio media are also migrating to digital formats. Technical advances in digital media content-creation tools have made this migration easier, allowing users to create and manipulate more complex content incorporating several elements of digital media. For example, many video games now include live-action video, detailed 3D graphics, and high quality audio, all created, manipulated, and played back in digital form. Feature films, such as "Harry Potter & the Prisoner of Azkaban," "Van Helsing," and "Motorcycle Diaries," to name a few, integrate sophisticated computer-generated special effects into traditional live action shots.

We currently sell our products and services in two principal markets: video and film editing and effects, and audio. Both of these markets are transitioning from well-established analog content-creation processes to digital content-creation tools.

Our video and film editing and effects market consists of professional users, over-the-air broadcast and cable companies, and corporate, government, and educational users. Professional users include independent production and post-production companies that produce video and film material, such as feature films, commercials, entertainment and documentary programming, industrial videos, and music videos; professional character animators and video game developers; and television facilities, film studios, and certain large corporations that perform digital media production and post-production in-house. Our customers also include a wide variety of companies that originate news programming, including national and international broadcasters, such as the British Broadcasting Corporation, the National Broadcasting Company, TV Azteca of Mexico, and France Television, as well as network affiliates, local independent television stations, web news providers and local and regional cable operators that produce news programming. Finally, users in corporations and various other institutional settings employ digital media tools to create and distribute information enriched by the addition of digital media content to their customers and employees.

Our audio market is comprised of professional music studios, project studios, film and television production and post-production facilities, television and radio broadcasters, DVD, web and other "new media" production studios, corporate, government, and educational facilities, as well as home-hobbyists and enthusiasts. These users range from individuals to large multi-national corporations. Our audio products are employed in a wide variety of applications, including recording, editing, mixing, processing and mastering.

STRATEGY

Our mission is to serve the industries that Make, Manage and Move Media. Our strategy consists of four key elements:

Continue to Deliver Best-of-Breed Products to Professional Content Creators in Video and Audio Markets.

We continue to focus on markets where digital media content creation already takes place, and we believe we enjoy a leadership position in each of these primary markets. These include the professional video and film editing and effects market (film and television studios, independent production and post-production firms, and broadcast, including hard news, long form news, and promotion), and the audio market (music, audio production, and post-production). We plan to strengthen our positions in these markets by continuing to enhance our existing products and by introducing new products that satisfy a broader range of customer needs that are developed internally, jointly with third parties or through acquisitions. In 2004 we acquired NXN Software GmbH, a leading provider of asset and production management systems targeted for the entertainment and computer graphics industries. We also acquired M-Audio, a leading provider of digital audio and MIDI solutions for musicians and audio professionals.

Deliver Seamlessly Integrated Workflow for Customers that Work with Multiple Systems or Multiple Media Disciplines.

We continue to invest significant resources in enhancing the interoperability of our broad array of products that Make, Manage and Move Media. To satisfy the demands of the post-production and broadcast markets, we are committed to delivering integrated solutions to our users, not just point products. For example, with Avid Unity Network-based collaborative workgroups, we are seeking to enable all of our products to connect to one another through the sharing of common media production assets and information about the media, or metadata, in a seamless workflow that encompasses all the disciplines in content creation – acquisition, editing, image manipulation, graphics, audio, mastering, encoding and distribution. An Avid Unity for News solution, for example, can facilitate all the tasks required to create news stories for broadcast by leveraging the aggregate power of all of our tools. The entire process, including capturing news feeds, managing scripts and announcer recordings, editing and manipulating video, audio and graphics elements, delivering the finished product to a video server for playback, automated repurposing of the story for web distribution, and streaming the repurposed content to the consumer, can be accomplished seamlessly by an array of our products working together, connected in an Avid Unity workgroup.

Support Open Standards for Media, Metadata and Application Program Interfaces (APIs).

Beyond interoperability within the Avid family of products, we seek to design all of our products so that they are based on and can work with a variety of established industry-wide standards, including computer platforms, operating systems, networking protocols, data compression, and digital media handling formats. We have been a leader in defining and developing the Advanced Authoring Format, or AAF, a multimedia file format that enables content creators to easily exchange digital media and metadata, across platforms and between systems and applications. AAF saves time, simplifies project management, and preserves valuable metadata that can be lost when transferring media between applications.

In order to address the needs for collaboration and efficient workflow in a local-area network (LAN) or wide-area network (WAN) environment, we offer the Avid Unity Productivity Tools, such as Avid Unity MediaManager and Avid Unity TransferManager products. MediaManager makes media accessible to more people by providing a simple Web browser interface to search, view, and select high resolution video on any desktop. TransferManager enables local or geographically dispersed content creators to collaborate easily by facilitating the exchange of digital media. TransferManager streamlines and automates the task of transferring production assets between editing systems, between collaborative Avid Unity workgroups, and between Avid Unity workgroups and external Avid editing or video server systems.

Deliver Excellent Customer Service, Support and Training.

In order to succeed, we must provide experienced, accessible and knowledgeable customer service. We try to create a culture at Avid that encourages every employee to focus on exceptional customer service. We seek to train our support staff in a broad range of applications, operating systems, and storage and networking solutions. In addition, we work with resellers in the major regions of the world who also have the capability to deliver various levels of application and hardware support directly to end users. We also offer training throughout the world in all areas of content creation though a team of experienced educational specialists.

PRODUCTS

The following section describes our major products and product families within the markets into which they are sold, organized by reportable segment. Information about our reportable segments, including total revenues, operating income and total assets, as well as a geographic breakdown of our revenues and long-lived assets, can be found in Footnote N to our Consolidated Financial Statements in Item 8.

VIDEO AND FILM EDITING AND EFFECTS PRODUCTS

Video and Film Editing

Avid's award-winning digital nonlinear editing tools are used by film, video, audio, animation, games, and broadcast professionals to create the world's most recognizable media. Among Academy Award nominees for the 2004 eligibility year, every film nominated in the categories of Best Picture, Directing, Film Editing, Sound Editing, Sound Mixing, Visual Effects, and Best Animated Feature employed at least one Avid solution in the postproduction process. In the recording industry, every No. 1 single on the Billboard Hot 100 chart in 2004 was created using Avid digital audio workstation technology.

Avid DNA Family

The family of Avid Digital Nonlinear Accelerator (Avid DNA) products is based on a hybrid architecture that leverages the power of the host CPU while offloading media processing tasks to more efficient, purpose-built hardware. The three hardware components of the Avid DNA product family are Avid Nitris, Avid Adrenaline, and Avid Mojo. They are used in combination with our software solutions in the following products described below: Avid DS Nitris, Media Composer Adrenaline, Media Composer Adrenaline HD, Avid NewsCutter Adrenaline FX, Avid NewsCutter XP, Avid Xpress Pro with Avid Mojo, Avid Xpress Pro HD with Avid Mojo, and Avid Xpress Studio Complete. The Mojo accelerator can also be used in conjunction with Digidesign Pro Tools and SOFTIMAGE|XSI systems.

Media Composer Family

This group of digital nonlinear editing products includes the Media Composer Adrenaline HD, Media Composer Adrenaline, Media Composer, and Film Composer systems. These products are used widely for editing on television programs, commercials, feature films, and independent films and comprised 17%, 16% and 19% of our consolidated net revenues in 2004, 2003 and 2002, respectively.

Avid Xpress Family

The Avid Xpress family is made up of portable editing systems that include the Avid Xpress DV, Avid Xpress Pro, Avid Xpress Pro HD, and Avid Xpress Studio systems. All Avid Xpress Pro solutions can be augmented with the Avid Mojo accelerator. The Avid Xpress Studio system can be augmented with both the Avid Mojo accelerator and the Digidesign 002 audio interface. These products are designed to meet the needs of media professionals, video/film educators, Internet video developers and others involved with video and multimedia production.

Finishing and Compositing

Professionals who create feature films, television programs, commercials, and music videos use our real-time, uncompressed high-definition (HD) and standard-definition (SD) solutions for master-quality finishing, effects, color correction, and to conform with our offline editing systems. Our line of finishing and compositing solutions includes the Avid DS Nitris and Avid DS Nitris Editor systems – which deliver advanced uncompressed HD editing and finishing capabilities for the most demanding applications – and the industry-standard Avid Symphony finishing system.

High-Definition (HD) Solutions

Our wide range of HD products and technologies offer customers the most comprehensive format and resolution support in the industry, as well as a comprehensive workflow between our editing system and our shared-storage networks. Our solutions that support HD include the Avid DS Nitris, Avid Media Composer Adrenaline HD, Avid Xpress Pro HD, and Avid Unity MediaNetwork systems.

Avid DNxHD

Avid DNxHD is an 8- or 10-bit HD encoding format that enables collaborative HD postproduction with the same storage bandwidth and capacity requirements as uncompressed SD files. While the size of Avid DNxHD files is as manageable as working with SD files, the quality of the original HD image is preserved because no sub-sampling of the raster or pixel reduction takes place in the encoding process. Consistent with our strategy of supporting open standards, the source code for Avid DNxHD technology is licensable free of charge through the Avid Web site, enabling users to compile it on any platform.

Broadcast

We offer broadcast customers a wide range of solutions to fit their needs – whether they are looking to integrate new technology into existing operations or implement all-digital workflows across a wide network of stations.

News Production & Editing

Our array of news production and editing systems includes the Avid Media Browse system and the Avid NewsCutter family: the Avid NewsCutter Adrenaline FX, Avid NewsCutter Effects, and Avid NewsCutter XP editors.

Ingest and Playout

The Avid AirSpeed broadcast video server offers users a wide range of workflow capabilities and format compatibility, as well as flexible connectivity. It features complete interoperability with the Avid Unity for News family of shared storage solutions and with our nonlinear editing systems. The AirSpeed CountDown solution enhances playout automation by allowing users to view, manage, and edit playlists on up to five AirSpeed servers.

Newsroom Automation

Our line of newsroom automation solutions include the Avid iNEWS family, which comprises the Avid iNEWS 2.0, Avid iNEWS ControlAir, and Avid iNEWS Multibyte systems. Avid Active ContentManager system is also used to automate content management and distribution functions.

Media Network Solutions

Avid Unity for News is a powerful media network solution that allows broadcasters to accelerate the entire production process, from ingest to archive. It links analog and digital acquisition, editing, newsroom computer systems, graphics, audio, and distribution in a managed, real-time, shared-storage environment. Products in this category include the Avid Unity MediaNetwork system and the Avid Unity LANshare for News system.

Avid Computer Graphics

The Avid Computer Graphics production pipeline ties together 3D animation, digital asset management, and nonlinear editing tools in a comprehensive, integrated CG production environment. These tools include:

- SOFTIMAGE|XSI, our flagship 3D content creation solution;
- Alienbrain Studio, Avid's digital asset management software for entertainment and computer graphics professionals; and
- the Avid DS Nitris HD finishing and compositing solution.

Storage & Workgroups

Our shared media networks offer simultaneous, real-time collaboration workflows that support a wide range of uncompressed SD formats as well as the high-efficiency Avid DNxHD encoding technology. These Storage and Workgroups products include the Avid Unity MediaNetwork and Avid Unity LANshare systems, which link analog and digital acquisition, editing, graphics, audio, and distribution in a managed, real-time, shared-storage environment. In addition, the media network solutions and Workgroups and Productivity Tools described above, plus local storage products such as Avid MediaDock Ultra 320, MediaDock 2+, MediaDrive rS 320/LDV, MediaDrive rS FireWire, and MEDIArray II are part of our Storage and Workgroups offerings. This product family accounted for approximately 18%, 19% and 15% of our consolidated net revenues in 2004, 2003 and 2002, respectively.

Avid Assurance Support

Avid Assurance is our annual maintenance support offering for the Avid Video and Film Editing and Effects products described above.

Avid Assurance provides software and application support to meet the needs of our customers including isolating hardware issues, resolving software issues, and generally helping our customers to fully utilize their applications. In addition to Avid Assurance, we offer other services to our customer including training programs and installation services. Total service offerings represented 10%, 10% and 9% of our consolidated net revenues in 2004, 2003 and 2002, respectively.

AUDIO PRODUCTS

Avid's audio division, Digidesign, manufactures digital audio production systems for recording engineers, mixers, film sound editors, sound designers, live sound engineers, and other audio professionals. The audio business also includes M-Audio, a business unit of Digidesign that specializes in digital audio and MIDI solutions for electronic musicians and audio professionals.

Digidesign Products

Pro Tools Products

Developed by our Digidesign audio division, Pro Tools is a multi-track, non-linear digital audio workstation comprising a variety of hardware options and bundled software that runs on Macintosh and Windows platforms. The Pro Tools workstation provides solutions for the entire audio production process, including recording, editing, signal processing, sound synthesis, integrated surround mixing and mastering. Pro Tools users work in the prosumer and professional music, film, television, radio, multimedia, DVD, and Internet production markets. Pro Tools systems support a rich third party development environment, with more than 100 development partners providing a variety of additional software and hardware add-on options.

Digidesign offers Pro Tools systems in a variety of price points and configurations, ranging from high-end systems for professional music and post-production, to the affordable Mbox, Digi 002, and Digi 002 Rack systems for home production studios. The first Pro Tools|HD system, which began shipping in early 2002, was further enhanced in October 2003 by the introduction of the Pro Tools|HD Accel card which provides greatly increased power in the DSP hardware (the basis of all Pro Tools|HD systems) that performs the audio processing. The Mbox product, introduced in early 2002, is an "all-in-one" two-channel USB audio interface with integral inputs for microphone, instrument or line level signals. Bundled with Pro Tools LE software, the Mbox system integrates audio recording, editing and mixing in an affordable, portable package for entry-level users, as well as professionals who wish to use additional low cost satellite systems. The Digi 002 product, introduced in late 2002, is a more comprehensive home audio production device. The Digi 002 combines a versatile multi-channel audio interface with multiple microphone or line level preamplifiers, a full-featured and compact control surface with touch-sensitive motorized faders, and can also act as a standalone compact digital mixer. It communicates with the bundled Pro Tools LE software via a 1394 FireWire connection. The Digi 002 Rack product was introduced in 2003, and is a more compact, rack-mountable version of the 002, without the motorized fader control features. The Pro Tools product family accounted for approximately 24%, 25% and 27% of our consolidated net revenues in 2004, 2003 and 2002, respectively.

D-Control and ICON

The D-Control mixing surface is Digidesign's high-end, expandable hardware control surface for tactile control of Pro Tools software and hardware. It also contains a stand-alone audio monitoring system called XMON. A D-Control combined with a Pro Tools HD system and one or more PRE multi-channel microphone pre-amplifiers can replace all the recording, editing, processing, surround mixing, monitoring, pre-amplification and control capabilities found on a more traditional analog or digital console. We describe such a combination system as an "ICON" or Integrated Console Environment. D-Control connects to the host computer (and Pro Tools software) via Ethernet, serving as a comprehensive front end for professional Pro Tools systems. With its modular design, a D-Control mixing surface can be customized to fit any studio, providing from 16 to 80 channels of simultaneous control.

ProControl

Our ProControl product line provides a solution similar to D-Control and ICON at a lower price point. Like D-Control, it connects via Ethernet to a Pro Tools-equipped computer, and provides a comprehensive front end and full tactile control of Pro Tools functions. The ProControl mixing surface can be customized to fit any studio, providing from 8 to 48 channels of simultaneous control. The Edit Pack option adds integrated control of advanced editing and surround mixing features, rounding out the ProControl product range.

Control|24

Our Control|24 product is a mixing control surface that combines hands-on access to Pro Tools software features and high-quality microphone pre-amplifiers from Focusrite. The Control|24 product communicates with the host computer (and Pro Tools software) via Ethernet, and provides tactile control of most Pro Tools functions. The Control|24 product is a 24-fader, fixed-size control surface, designed for music production and broadcast applications.

AVoption|V10 and AVoption|XL

The AVoption|XL and AVoption|V10 hardware options for Pro Tools systems allow users to record, edit and process sound synchronized with Avid-format, non-linear digital video. Designed for post-production professionals working in film, TV and video, the AVoption products enable capture, playback, and basic editing of broadcast-quality picture from projects originating on Avid Media Composer, Film Composer and Symphony systems. V10 shipped in April 2004, and is based on the Avid DNA video technology. It provides support for a greater number of video resolutions and interface standards including SDI, and a basis for future support for HD video. Both versions include the DigiTranslator software option that provides users with a high level of media and metadata interchange with any of our compatible video editing systems.

M-Audio Products

Audio interfaces

M-Audio's audio interfaces dovetail with Digidesign's Pro Tools LE product line, allowing users access to high-quality sound in and out of a computer at even more affordable prices. Users can create a PC-based audio recorder over PCI, USB or FireWire standard connections on their personal computers utilizing bundled or add-on software. M-Audio interfaces offer a wide range of input and output configurations from stereo to multi-channel surround. Popular models include the PCI Audiophile series, FireWire 410 and 1814, USB 24/96 and keyboard-equipped audio interfaces such as Ozone and Ozonic.

Keyboards

M-Audio's USB-based keyboards allow users to send MIDI *(*Musical Instrument Digital Interface*)* messages directly to a personal computer allowing users to access sound creation software and control a variety of other musical functions without the need for an additional MIDI interface peripheral. Because M-Audio keyboards do not require embedded sound creating hardware, we can offer high quality keyboards at affordable prices. Our keyboards come in various sizes including 25 notes, 49 notes, 61 notes, and 88 notes, weighted or unweighted, and with and without a variety of sliders and knobs.

MIDI interfaces

Our MIDI interfaces allow the computer to communicate with external MIDI-compatible peripheral devices such as synthesizers, effects devices and drum machines over a standard USB connection.

Speakers, Add-On Software and Microphones

M-Audio manufacturers a variety of affordable, high-quality self-powered monitor speakers that provide stereo or multi-channel surround monitoring (BX series), and distributes several software product lines popular in music production, and creates sound libraries for commonly used software. We also manufacture a suite of high-quality yet affordable condenser and dynamic microphones. These ancillary products allow customers to purchase entire home recording packages which include all of the essential tools required to make music recordings from a single manufacturer.

SALES AND SERVICE

We market and sell our solutions through a combination of direct and indirect sales channels.

From our traditional presence in the high-end post-production market to broadcast news, low-cost post-production, and audio solutions, we strive for balanced market and geographic sales coverage. We sell our products primarily through a network of more than 2500 independent distributors, value-added resellers and dealers. We supplement these channels with a team of internal sales representatives directly serving select customers and markets.

We provide customer service and support directly through regional telephone support centers and major-market field service representatives, and indirectly through strategically located dealers, value-added resellers and authorized third-party service providers. Customers may choose from a variety of support offerings, including 24-hour telephone support, quick-response on-site assistance, hardware replacement and extended warranty and software upgrades. Customer training is available directly from us or through field-based authorized third-party Avid training centers around the world.

MANUFACTURING AND SUPPLIERS

Our manufacturing operations consist primarily of the testing of subassemblies and components purchased from third parties, the duplication of software, and the configuration, assembly and testing of board sets, software, related hardware components and complete systems. We also rely on independent contractors to manufacture components and subassemblies to our specifications. Our systems undergo testing and quality assurance at the final assembly stage. We are dependent on a number of sole source vendors for certain key hardware components of our products. For the risks associated with our reliance upon certain vendors, see "Certain Factors that May Affect Future Results" under Item 7.

Our manufacturing facilities are located in Tewksbury, Massachusetts; Dublin, Ireland; Madison, Wisconsin; Menlo Park, California and Irwindale, California. We also contract with third-party manufacturing facilities in the United States and overseas for certain component parts.

INTELLECTUAL PROPERTY

We regard our software and hardware as proprietary and protect it under the laws of patents, copyrights, trademarks, and trade secrets, and through contractual provisions.

We have obtained patents and have registered copyrights, trademarks and service marks in the United States and foreign countries. In particular, as of December 31, 2004, we held 200 United States patents and had 79 patent applications pending with the United States Patent and Trademark Office with expiration dates through 2021. We have also registered or applied to register various trademarks and service marks in the U.S. and a number of foreign countries, including Avid®, Media Composer®, NewsCutter®, Digidesign®, Pro Tools®, M-Audio®, Softimage®, XSI®, and Alienbrain®. Although we believe ownership of our patents, copyrights, trademarks and service marks, and trade secrets is an important factor in our business, our success relies primarily on the innovative skills, technical competence, and marketing abilities of our personnel.

Our software is licensed to end-users pursuant to either shrink-wrap, embedded or on-line licenses, or signed license agreements. Our products generally contain copy protection and/or copy-detection features to guard against unauthorized use. Policing unauthorized use of computer software is difficult, and software piracy is a persistent problem for the software industry. This problem is particularly acute in international markets. We participate in an anti-piracy program through an external association of software vendors.

RESEARCH AND DEVELOPMENT

Our research and development efforts are focused on the development of digital media content-creation tools and workgroup solutions that operate primarily on the Macintosh and Windows platforms. We are committed to delivering best-in-class video, film, 3D animation, and audio editing systems to meet the needs of professionals in the television, film, music, broadcast news production, and industrial post-production markets, and of end-users in the educational and corporate markets. Our research and development efforts also include networking and storage initiatives to deliver standards-based media transfer and media asset management tools, as well as stand-alone and network-attached media storage systems for workgroups. Our systems are designed to be Internet-enabled with technology for encoding and streaming media over the Internet.

Our research and development operations are primarily located in Tewksbury, Massachusetts; Daly City, California; Madison, Wisconsin; Irwindale, California; Munich, Germany; and Montreal, Canada. We also employ independent contractors in the United States and abroad for some of our research and development activities.

COMPETITION

The markets for our products are highly competitive and subject to rapid change. Our competition is fragmented, with a large number of suppliers providing different types of products to different markets.

Video Postproduction and 3D

In the TV, video, and film postproduction markets, we compete primarily with vendors that offer similar digital editing and effects products based on standard computer platforms. These competitors include AJA Video Systems Inc., Adobe Systems Incorporated, Apple Computer, BlackMagic Design Pty. Ltd., Discreet (a division of Autodesk, Inc.), Pinnacle Systems, Inc., Quantel Inc., and Sony Corporation. In the 3D/animation sector, we compete with other manufacturers of content creation solutions for the video game, feature film, and related markets, including Discreet, Alias, and NewTek, Inc.

Broadcast

In the broadcast sphere, we compete with vendors of video servers and traditional broadcast equipment that now offer nonlinear editing and shared storage systems such as Leitch, Thomson Grass Valley and Sony Corporation for news, sports, and special programming for television. Other vendors of competitive products targeting these markets include Omneon, Pinnacle Systems, and Quantel. Primary competitors to the Avid iNEWS newsroom computer are Associated Press (ENPS), and Dalet. We expect continued competition from these vendors as they develop and introduce digital media products.

Data Storage and Digital Asset Management

Avid competes in the data storage market with companies such as ADIC, Apple Computer, Ciprico, EMC Corporation, Hewlett-Packard, IBM, Medea Corporation, Rorke Data (a subsidiary of Bell Microproducts), and SGI. In digital asset management, the Alienbrain product family – which Avid acquired in January 2004 from NXN Software GmbH – is focused primarily on animation, electronic graphics and video gaming markets where it competes primarily with Perforce Software, Inc., and also with offerings from Microsoft (Visual SourceSafe) and Borland Software Corporation (StarTeam).

Audio

In the audio market, we compete primarily with (a) suppliers of disk-based digital audio workstation software/hardware products such as Emagic (a subsidiary of Apple Computer), Mark of the Unicorn (MOTU), Merging Technologies, and Steinberg Media Technologies (a subsidiary of Yamaha Corporation), and (b) manufacturers of professional analog and digital mixing consoles for studio production and live sound mixing including AMS Neve Ltd., DiGiCo Ltd, Euphonix, Midas (a division of Telex Communications), Solid State Logic Ltd., and Yamaha Corporation. Digidesign and M-Audio compete with manufacturers of low-cost computer-connected audio I/O hardware such as Creative Technology Ltd, Ego Systems Inc., Loud Technologies, Inc., Roland, Tascam (a division of TEAC Corporation), and Yamaha Corporation. In addition, M-Audio also competes in the categories of MIDI keyboard/controllers, MIDI interfaces, speakers, pre-amplifiers and microphones, with many of the companies already listed and others.

There can be no assurance that these companies will not introduce products that are more directly competitive with our products.

EMPLOYEES

We employed 2,014 people as of December 31, 2004.

WEBSITE ACCESS

We make available free of charge on our website, www.avid.com, copies of our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports, as soon as reasonably practicable after such material is filed with the Securities and Exchange Commission, and in any event on the same day. Additionally, we will provide paper copies of all such filings free of charge upon request.

Alternatively, these reports can be accessed at the SEC's internet website: www.sec.gov.

ITEM 2. PROPERTIES

Our principal administrative, sales and marketing, research and development, support, and manufacturing facilities are located in three adjacent buildings in an office park located in Tewksbury, Massachusetts. Our leases on these buildings expire in June 2010. In September 2000, we subleased a portion of this space to an unrelated company. This sublease has been extended and expires in 2007.

We lease facilities in Dublin, Ireland; Madison, Wisconsin; Menlo Park, California and Irwindale, California for the manufacture and distribution of our products. We lease office space in Daly City, California for our Digidesign headquarters, including its administrative, sales and marketing, and research and development activities, and in Iver Heath, United Kingdom, for our European headquarters, including administrative, sales, and support functions. Finally, we lease facilities in Montreal, Canada, and Munich, Germany which house certain administrative, research and development, and support operations. In December 2002, we vacated portions of our leased space in Daly City and Montreal. In July 2003 we subleased a portion of our space in Montreal to an unrelated company. This sublease expires in January 2007.

In September 1995, our United Kingdom subsidiary entered into a 15-year lease in London, England. We vacated this property in 1999 as part of our corporate restructuring actions, and have currently sublet all of this space. We also maintain sales and marketing support offices in leased facilities in various other locations throughout the world.

We anticipate that our leased facilities will be adequate for our needs during 2005.

ITEM 3. LEGAL PROCEEDINGS

On March 11, 1996, we were named as a defendant in a patent infringement suit filed in the United States District Court for the Western District of Texas by Combined Logic Company, a California partnership located in Beverly Hills, California. On May 16, 1996, upon our motion, the suit was transferred to the United States District Court for the Southern District of New York. The complaint alleged infringement by Avid of U.S. patent number 4,258,385, and sought injunctive relief, treble damages, costs, and attorneys' fees. In our answer to the complaint, we asserted that we did not infringe the patent and that the patent was invalid. In August 2004, we filed a Motion To Dismiss based on Combined Logic's failure to prosecute. An oral hearing on the Motion was held on November 5, 2004 and the District Court granted the Motion on November 22, 2004. The District Court entered Judgment in our favor on December 10, 2004, dismissing the suit with prejudice. Combined Logic Company filed a Notice Of Appeal to the Court of Appeals for the Second Circuit on January 6, 2005. On February 14, 2005, we filed a Motion To Dismiss For Lack of Jurisdiction. On February 15, 2005, Combined Logic, by letter to the Second Circuit, indicated that it did not object to the dismissal of its appeal and did not object to the relief sought in our Motion. Because of the foregoing facts, we consider this matter terminated.

We receive inquiries from time to time with regard to possible patent infringement claims. If any infringement is determined to exist, we may seek licenses or settlements. In addition, as a normal incidence of the nature of our business, various claims, charges, and litigation have been asserted or commenced against the Company arising from or related to contractual or employee relations, intellectual property rights or product performance. We do not believe these claims will have a material adverse effect on our financial position or results of operations.

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

No matters were submitted to a vote of our security holders during the last quarter of the fiscal year ended December 31, 2004.

EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below is (i) the name and age of each of our executive officers; (ii) the position(s) presently held by each person; and (iii) the principal occupation held by each person for at least the past five years.

EXECUTIVE OFFICER	AGE	POSITION(S)
David A. Krall	44	President and Chief Executive Officer
Patricia A. Baker	57	Vice President of Human Resources
Joseph Bentivegna	44	Vice President and Chief Operating Officer, Avid Video
Ethan E. Jacks	51	Vice President of Business Development, Chief Legal Officer and Corporate Secretary
David M. Lebolt	48	Vice President and General Manager, Audio
Paul J. Milbury	56	Vice President and Chief Financial Officer
Carol L. Reid	57	Vice President and Corporate Controller

Michael J. Rockwell	38	Vice President of Software Engineering and Chief Technology Officer
Charles L. Smith	44	Vice President and General Manager, Avid Video

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DAVID A. KRALL. Mr. Krall has served as President since October 1999 and Chief Executive Officer since April 2000. Previously, he served as Avid's Chief Operating Officer from October 1999 to April 2000. Prior to that, Mr. Krall served in various capacities at Digidesign: Chief Operating Officer of Digidesign from July 1998 to October 1999, Vice President of Engineering from June 1996 to July 1998 and Director of Program Management from May 1995 to June 1996.

PATRICIA A. BAKER. Ms. Baker has served as Vice President of Human Resources since November 2002. From May 1996 to November 2002, Ms. Baker was responsible for human resource matters at Digidesign. Prior to joining Avid, Ms. Baker held senior human resources positions at major firms specializing in the medical, pharmaceutical, and industrial and specialty chemical industries. Ms. Baker was also President of The Baker Group, an independent consulting firm that focused on both strategic organizational planning and executive team building.

JOSEPH BENTIVEGNA. Mr. Bentivegna has served as Vice President and Corporate Operating Officer, Avid Video since November 2004. Previously, he served as Vice President of Video Development and Operations from August 2001 to November 2004. Prior to that, he held a variety of other positions at Avid, including Vice President and General Manager of Avid Media Solutions from June 2000 to August 2001, Vice President of Worldwide Operations from January 1999 to June 2000, Vice President and General Manager of Asia Operations from September 1998 to January 1999 and Vice President of Worldwide Manufacturing from June 1996 to September 1998. From November 1991 to June 1996 Mr. Bentivegna held various other positions at Avid. Prior to that he held various positions in operations for Access Technology, Inc., a developer of application software.

ETHAN E. JACKS. Mr. Jacks has served as Vice President of Business Development since June 1999 and Chief Legal Officer since June 2000. From May 2000 to December 2000, Mr. Jacks also served as Acting Chief Financial Officer and from March 1999 to June 2000 as General Counsel. Prior to joining Avid, Mr. Jacks was Vice President and General Counsel for Molten Metal Technology, Inc. from November 1991 to October 1998. Mr. Jacks was also engaged in the private practice of law for eleven years, including as a partner at McDermott, Will & Emery.

DAVID M. LEBOLT. Mr. Lebolt has served as Vice President and General Manager of Audio since July 2002. Previously, Mr. Lebolt held a variety of positions at Digidesign, including Vice President of Product Strategy from November 1999 to July 2002, Director of Product Strategy from November 1998 to November 1999, and Pro Tools Product Line Manager from February 1994 to November 1998. Before joining Digidesign in 1994, Mr. Lebolt was a professional keyboardist, producer, arranger and composer. He also has experience in music advertising and music production, and has received both Clio and Emmy® awards for his production work.

PAUL J. MILBURY. Mr. Milbury has served as Vice President and Chief Financial Officer since December 2000. Prior to joining Avid, Mr. Milbury was Chief Financial Officer of iBelong.com, Inc. from April 2000 to December 2000, and Chief Financial Officer of JuniorNet Corporation from October 1998 to April 2000. Prior to that, Mr. Milbury spent 19 years at Digital Equipment Corporation (now part of Hewlett-Packard Computer Corporation), where in 1995 he became Vice President and Treasurer.

CAROL L. REID. Ms. Reid has served as Vice President and Corporate Controller since November 1998. Prior to joining the Company, Ms. Reid spent 20 years at Digital Equipment Corporation (now part of Hewlett-Packard Computer Corporation), where she was Vice President of Internal Audit from January 1998 to November 1998 and Assistant Treasurer/Director from October 1994 to January 1998.

MICHAEL J. ROCKWELL. Mr. Rockwell has served as Vice President of Software Engineering since December 2003 and as Chief Technology Officer since August 2001. Previously, Mr. Rockwell was Vice President and General Manager of Avid Internet Solutions from June 2000 to August 2001, and Chief Architect for Software Engineering of Digidesign from January 1997 to November 1999. Mr. Rockwell's prior positions with Digidesign included Director of Application Development from March 1995 to January 1997 and Director of Multi-Media Products from April 1994 to March 1995.

CHARLES L. SMITH. Mr. Smith has served as Vice President and General Manager, Avid Video since November 2004. Previously, he served as Vice President of Worldwide Sales, Marketing and Services from November 1999 to November 2004. Prior to that, Mr. Smith served in various capacities at Digidesign: Vice President of Sales and Marketing from October 1996 to November 1999, Vice President of International Sales from August 1995 to October 1996, and Managing Director Digidesign UK from May 1993 to August 1995.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Our common stock is listed on the Nasdaq National Market under the symbol AVID. The table below shows the high and low sales prices of the common stock for each calendar quarter of the fiscal years ended December 31, 2004 and 2003.

2004	High	Low
First Quarter	$55.42	$38.43
Second Quarter	$61.68	$44.11
Third Quarter	$54.66	$40.90
Fourth Quarter	$62.57	$46.48

2003	High	Low
First Quarter	$24.15	$16.76
Second Quarter	$38.15	$21.86
Third Quarter	$57.95	$33.96
Fourth Quarter	$59.77	$44.65

On February 22, 2005, the last reported sale price of the Nasdaq National Market for our common stock was $64.55 per share. The approximate number of holders of record of our common stock at February 22, 2005 was 380. This number does not include shareholders for whom shares were held in a "nominee" or "street" name.

We have never declared or paid cash dividends on our capital stock and currently intend to retain all available funds for use in the operation of our business. We do not anticipate paying any cash dividends in the foreseeable future.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected condensed consolidated financial data. The selected consolidated financial data below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included elsewhere in this filing.

CONSOLIDATED STATEMENTS OF OPERATIONS DATA:
In thousands (except per share data)

	For the Year Ended December 31,				
	2004	2003	2002	2001	2000
Net revenues	$589,605	$471,912	$418,719	$434,638	$476,090
Cost of revenues	255,496	209,373	207,236	213,572	234,424
Gross profit	334,109	262,539	211,483	221,066	241,666
Operating expenses:					
Research and development	94,940	85,552	82,346	86,140	82,900
Marketing and selling	135,811	109,704	100,761	113,053	119,469
General and administrative	29,780	23,208	19,819	23,313	27,504
Restructuring and other costs, net	–	3,194	2,923	8,268	–
Amortization of intangible assets	3,641	1,316	1,153	31,168	66,872
Impairment of intangible assets	1,187	–	–	–	–
Total operating expenses	265,359	222,974	207,002	261,942	296,745
Operating income (loss)	68,750	39,565	4,481	(40,876)	(55,079)
Other income, net	1,339	1,874	218	5,529	3,730
Income (loss) before income taxes	70,089	41,439	4,699	(35,347)	(51,349)
Provision for (benefit from) income taxes	(1,612)	550	1,700	2,800	5,000
Net income (loss)	$71,701	$40,889	$2,999	($38,147)	($56,349)
Net income (loss) per common share – basic	$2.21	$1.40	$0.11	($1.49)	($2.28)
Net income (loss) per common share – diluted	$2.05	$1.25	$0.11	($1.49)	($2.28)
Weighted average common shares outstanding - basic	32,485	29,192	26,306	25,609	24,683
Weighted average common shares outstanding - diluted	35,003	32,653	26,860	25,609	24,683

CONSOLIDATED BALANCE SHEET DATA:
In thousands

	As of December 31,				
	2004	2003	2002	2001	2000
Cash, cash equivalents and marketable securities	$155,419	$196,309	$89,034	$72,961	$83,206
Working capital	176,384	196,605	94,130	85,490	96,585
Total assets	576,234	348,119	235,803	215,806	266,482
Long-term debt and other liabilities	1,689	607	1,427	13,020	13,449
Total stockholders' equity	424,621	227,105	123,564	104,758	137,850

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

OVERVIEW

We develop, market, sell and support a wide range of software and hardware for digital media production, management and distribution. Digital media are video, audio or graphic elements in which the image, sound or picture is recorded and stored as digital values, as opposed to analog, or tape-based, signals. Our diverse range of product and service offerings enables customers to “Make, Manage, and Move Media.” We operate our business in two reporting segments, Video and Film Editing and Effects (Video) and Audio.

An important part of our strategy for the past few years has included expanding and enhancing our product lines and increasing revenues through both acquisitions and internal development of products. In January 2004, we acquired Munich, Germany-based NXN Software GmbH (“NXN”), a leading provider of asset and production management systems specifically targeted for the entertainment and computer graphics industries. This acquisition expands our offering in digital asset management by enabling our film and video post-production, broadcast, audio and 3D animation customers to leverage the workflow capabilities of the Alienbrain® product line. NXN has been integrated into our Video segment. In August 2004, we completed the acquisition of Irwindale, California-based M-Audio, a leading provider of digital audio and MIDI solutions for electronic musicians and audio professionals. We have integrated M-Audio into our Audio segment and will market its line of audio products alongside Digidesign's digital audio workstations for the professional and home/hobbyist markets. Finally, in September 2004, we acquired Avid Nordic AB, a Sweden-based distributor of Avid products operating in the Nordic and Benelux regions of Europe. This acquisition allows us to directly serve customers in this region. We previously had no ownership interest in Avid Nordic AB.

We generally derive approximately half of our revenues from customers outside the United States. This business is, for the most part, transacted through international subsidiaries and generally in the currency of the end-user customers. Therefore, we are exposed to the risk that changes in foreign currency could materially impact, either positively or adversely, our revenues, net income (loss) and cash flow. To hedge against the foreign exchange exposure of certain forecasted receivables, payables and cash balances of our foreign subsidiaries, we enter into short-term foreign currency forward-exchange contracts. We record gains and losses associated with currency rate changes on these contracts in results of operations, offsetting remeasurement gains and losses on the related assets and liabilities. The success of this hedging program depends on forecasts of transaction activity in the various currencies. To the extent that these forecasts are over- or understated during the periods of currency volatility, we could experience unanticipated currency gains or losses.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We regularly re-evaluate our estimates and judgments, including those related to revenue recognition; allowances for product returns and exchanges; allowance for bad debts; the valuation of inventories, goodwill and other intangible assets, income tax assets; and reserves for recourse under financing transactions. We base our estimates and judgments on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the amounts of revenue and expenses that are not readily apparent from other sources. Actual results may differ from these estimates.

We believe the following critical accounting policies most significantly affect the portrayal of our financial condition and involve our most difficult and subjective judgments.

Revenue Recognition and Allowances for Product Returns and Exchanges

We recognize revenue from sales of products upon receipt of a signed purchase order or contract and product shipment to distributors or end users, provided that collection is reasonably assured, the fee is fixed or determinable, and all other revenue recognition criteria of SOP 97-2, "Software Revenue Recognition", as amended, and Securities and Exchange Commission (“SEC”) Staff Accounting Bulletin (“SAB”) No. 104, “Revenue Recognition”, are met. Within our Video segment and for much of our Audio segment, we follow the guidance of SOP 97-2 for revenue recognition since our products and services are software-related. However, for certain offerings in our Audio segment, software is incidental to the delivered products and services. For these products, we record revenue based on satisfying the criteria in SAB No. 104.

In connection with many of our product sale transactions, customers typically purchase a one-year maintenance and support agreement. We recognize revenue from maintenance contracts on a ratable basis over their term. We recognize revenue from training, installation or other services as the services are performed.

We use the residual method to recognize revenues when an order includes one or more elements to be delivered at a future date and evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered element, typically maintenance and support, is deferred and the remaining portion of the total arrangement fee is recognized as revenue related to the delivered element. If evidence of the fair value of one or more undelivered elements does not exist, we defer all revenues and only recognize them when delivery of those elements occurs or when fair value can be established. Fair value is typically based on the price charged when the same element is sold separately to customers. However, in certain transactions, fair value is based on the renewal price of the undelivered element that is granted as a contractual right to the customer. Our current pricing practices are influenced primarily by product type, purchase volume, term and customer location. We review services revenues sold separately and corresponding renewal rates on a periodic basis and update, when appropriate, our fair value for such services used for revenue recognition purposes to ensure that it reflects our recent pricing experience.

In most cases, our products do not require significant production, modification or customization of software. Installation of the products is generally routine, requires minimal effort and is not typically performed by us. However, a growing number of transactions, those typically involving orders from end-users for a significant number of products for a single customer site, such as news broadcasters, require that we perform an installation effort that we deem to be complex and non-routine. In these situations, we do not recognize revenue for either the products shipped or the installation services until the installation is complete. In addition, if such orders include a customer acceptance provision, no revenue is recognized until the customer's acceptance of the products and services has been received or the acceptance period has lapsed.

Telephone support, enhancements and unspecified upgrades typically are provided at no additional charge during the product's initial warranty period (generally between 30 days and twelve months), which precedes commencement of the maintenance contracts. We defer the fair value of this support period and recognize the related revenue ratably over the initial warranty period. We also from time to time offer certain customers free upgrades or specified future products or enhancements. For each of these elements that is undelivered at the time of product shipment, we defer the fair value of the specified upgrade, product or enhancement and recognize that revenue only upon later delivery or at the time at which the remaining contractual terms relating to the upgrade have been satisfied.

In 2004, approximately 72% of our revenue was derived from indirect sales channels, including authorized resellers and distributors. Within our Video segment, our resellers and distributors are generally not granted rights to return products to us after purchase, and actual product returns from them have been insignificant to date. However, distributors of our Avid Xpress DV, Avid Xpress Pro and Avid Mojo product lines have a contractual right to return a percentage of prior quarter purchases. The return provision for these distributors has not had a material impact on our results of operations. In contrast, some channel partners, particularly those who resell our Audio products, are offered limited rights of return, stock rotation and price protection.

Channel partners within our Audio segment are granted return rights to return or exchange products on a case-by-case basis but are not provided a contractual right to do so. In compliance with Statement of Financial Accounting Standards ("SFAS") No. 48, "Revenue Recognition When Right of Return Exists", we record a provision for estimated returns and other allowances, as a reduction of revenues, in the same period that related revenues are recorded. Management estimates must be made and used in connection with establishing and maintaining a sales allowance for expected returns and other credits. In making such estimates, we analyze historical returns and credits and the amounts of products held by major resellers, and consider the impact of new product introductions, changes in customer demand, current economic conditions, and other known factors. We maintain a rolling history of returns on a product-by-product basis and analyze returns and credits by product category. Material differences may result in the amount and timing of our revenue for any period if our estimates of potential product returns or other reseller credits prove to be materially different from actual experience.

At the time of a sale transaction, we make an assessment of the collectibility of the amount due from the customer. Revenue is recognized only if we are reasonably assured that collection will occur. In making this assessment, we consider customer credit-worthiness and historical payment experience. If it is determined from the outset of the arrangement that collection is not reasonably assured based upon our credit review process, revenue is recognized on a cash-collected basis to the extent that the other criteria of SOP 97-2 and SAB 104 are satisfied. At the outset of the arrangement, we assess whether the fee associated with the order is fixed or determinable and free of contingencies or significant uncertainties. In assessing whether the fee is fixed or determinable, we consider the payment terms of the transaction, our collection experience in similar transactions without making concessions, and our involvement, if any, in third-party financing transactions, among other factors. If the fee is not fixed or determinable, revenue is recognized only as payments become due from the customer, provided that all other revenue recognition criteria are met. If a significant portion of the fee is due after our normal payment terms, which are generally 30, but can be up to 90, days after the invoice date, we evaluate whether we have sufficient history of successfully collecting past transactions with similar terms. If that collection history is successful, then revenue is recognized upon delivery of the products, assuming all other revenue recognition criteria are satisfied.

We record as revenue all amounts billed to customers for shipping and handling costs and record the actual shipping costs as a component of cost of revenues. We record reimbursements received from customers for out-of-pocket expenses as revenue, with related costs recorded as cost of revenues.

With respect to sales of "solutions", we are able to invoice the customer under a billing plan in advance of providing products and services or maintenance and support. In these instances, we record invoiced amounts and cash payments received prior to revenue recognition as deferred revenue.

Allowance for Bad Debts and Reserves for Recourse under Financing Transactions

We maintain allowances for estimated bad debt losses resulting from the inability of our customers to make required payments for products or services. When evaluating the adequacy of the allowances, we analyze accounts receivable balances, historical bad debt experience, customer concentrations, customer credit-worthiness and current economic trends. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

We provide third-party, lease financing options to many of our customers. Avid is not generally a party to the leases; however, during the terms of these leases, which are generally three years, we remain liable for any unpaid principal balance upon default by the end-user, but such liability is limited in the aggregate. See Footnote I to our Consolidated Financial Statements in Item 8. We record revenue from these transactions upon the shipment of our products since we believe that our collection experience with similar transactions supports our assessment that the fee is fixed or determinable. We have operated these programs for over nine years and to date defaults under the program have consistently ranged between 2% and 4%. We maintain reserves for estimated recourse losses under this financing program based on these historical default rates. While we have experienced insignificant losses from defaults to date under this program, deterioration in the financial condition of our customers who participate in the program could require additional reserves.

Inventories

Inventory in the digital media market, including our inventory, is subject to rapid technological change or obsolescence. We regularly review inventory quantities on hand and write down inventory to its realizable value to reflect estimated obsolescence or unmarketability based upon assumptions about future inventory demand (generally for the following twelve months), and market conditions. If actual future demand or market conditions are less favorable than estimates by management, additional inventory write-downs may be required.

Business Combinations

When we acquire new businesses, we use the purchase method of accounting as required by SFAS No. 141, "Business Combinations". We allocate the purchase price of businesses acquired to the assets, including intangible assets, acquired and the liabilities assumed based on their estimated fair values, with any amount in excess of such allocations designated as goodwill. Significant management judgments and assumptions are required in determining the fair value of acquired assets and liabilities, particularly acquired intangible assets. For example, it is necessary to estimate the portion of development efforts that are associated with technology that is in process and has no alternative future use. The valuation of purchased intangible assets is based upon estimates of the future performance and cash flows from the acquired business. If different assumptions are used, it could materially impact the purchase price allocation and our financial position and results of operations.

Goodwill and Intangible Assets

We assess the impairment of goodwill and identifiable intangible assets on at least an annual basis and whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. Factors we consider important that could trigger an impairment review include significant negative industry or economic trends, unanticipated competition, loss of key personnel, a more-likely than not expectation that a reporting unit or component thereof will be sold or otherwise disposed of, significant underperformance relative to the historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for our overall business, a significant decline in our stock price for a sustained period, a reduction of our market capitalization relative to our net book value and other such circumstances.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets", we no longer amortize goodwill and certain intangible assets. The goodwill impairment test prescribed by SFAS No. 142 requires us to identify reporting units and to determine estimates of the fair values of our reporting units as of the date we test for impairment. We have two reporting units that are currently the same as our operating segments, Video and Audio, as described in Note N of "Notes to Consolidated Financial Statements." Both of our reporting units include goodwill.

In the goodwill impairment analysis, the fair value of each reporting unit is compared to its carrying value, including goodwill. If the reporting unit's carrying value exceeds its fair value, we would record an impairment loss equal to the difference between the carrying value of the goodwill and its implied fair value. In determining the fair values of our reporting units, we first estimate the fair value of the total company by reference to the quoted market price of our stock and then allocate this fair value among our reporting units using a discounted cash flow valuation model. This model focuses primarily on estimates of future revenues and profits for each reporting unit. We estimate these amounts by evaluating historical trends, current budgets, operating plans and industry data. We completed our annual impairment tests as of the end of the fourth quarter of each year and concluded that no impairment charge was required. If future events cause the reporting units' fair value to decline below its carrying value, an impairment charge may be required.

In the identifiable intangibles impairment analysis, the fair value of each asset is compared to its carrying value. If the asset's carrying value is not recoverable and exceeds its fair value, we would record an impairment loss equal to the difference between the carrying value of the asset and its fair value. The carrying value of an asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. We analyzed certain of our identifiable intangible assets for impairment as of the end of the fourth quarter of 2004 and found some of them to be impaired as described in Footnote F to our Consolidated Financial Statements in Item 8.

Income Tax Assets

We record deferred tax assets and liabilities based on the net tax effects of tax credits, operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

We regularly review deferred tax assets for recoverability taking into consideration such factors as historical losses after deductions for stock compensation, projected future taxable income and the expected timing of the reversals of existing temporary differences. SFAS No. 109, "Accounting for Income Taxes", requires us to record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on the level of deferred tax assets as of December 31, 2004, the level of historical U.S. losses after deductions for stock compensation, and the level of outstanding stock options, which we anticipate will generate significant U.S. tax deductions in the future, we have determined that the uncertainty regarding the realization of these assets is sufficient to warrant the continued establishment of a full valuation allowance against the U.S. net deferred tax assets. In the year ended December 31, 2004, we removed the valuation allowance related to deferred tax assets in our Irish manufacturing operations. This resulted in a non–cash $2.1 million tax benefit recorded through our 2004 provision for income taxes. The decision to remove the valuation allowance was based on the conclusion that it was more likely than not that the deferred tax asset in Ireland would be realized.

Our assessment of the valuation allowance on the U.S. deferred tax assets could change in the future based upon our levels of pre-tax income and other tax related adjustments. Removal of the valuation allowance in whole or in part would result in a non-cash reduction in the provision for income taxes during the period of removal. In addition, because a portion of the valuation allowance as of December 31, 2004 was established to reserve certain deferred tax assets resulting from the exercise of employee stock options, in accordance with SFAS No. 109, removal of the valuation allowance related to these assets would result in a credit to additional paid-in capital within stockholders' equity rather than the provision for income taxes. If the valuation allowance of $140.8 million as of December 31, 2004 were to be removed in its entirety, an $84.9 million non-cash reduction in income tax expense and a $55.9 million credit to paid-in capital would be recorded in the period of removal. To the extent no valuation allowance is established for our deferred tax assets in future periods, future financial statements would reflect a non-cash increase in our provision for income taxes.

RESULTS OF OPERATIONS

The following table sets forth certain items from our consolidated statements of operations as a percentage of net revenues for the periods indicated:

	For the Year Ended December 31,		
	2004	2003	2002
Net revenues	100.0%	100.0%	100.0%
Cost of revenues	43.3%	44.4%	49.5%
Gross profit	56.7%	55.6%	50.5%
Operating expenses:			
Research and development	16.1%	18.1%	19.7%
Marketing and selling	23.0%	23.2%	24.0%
General and administrative	5.1%	4.9%	4.7%
Restructuring and other costs, net	–	0.7%	0.7%
Amortization of intangible assets	0.6%	0.3%	0.3%
Impairment of intangible assets	0.2%	–	–
Total operating expenses	45.0%	47.2%	49.4%
Operating income	11.7%	8.4%	1.1%
Interest and other income (expense), net	0.2%	0.4%	0.0%
Income before income taxes	11.9%	8.8%	1.1%
Provision for (benefit) from income taxes	(0.3%)	0.1%	0.4%
Net income	12.2%	8.7%	0.7%

Net Revenues

Our net revenues are derived mainly from the sales of computer-based digital, nonlinear media editing systems and related peripherals, licensing of related software, and sales of related software maintenance contracts. This market has been, and we expect it to continue to be, highly competitive. A significant portion of these revenues is generated by sales near the end of each quarter, which can impact our ability to accurately forecast revenues on a quarterly basis. Increasingly, revenues are also being derived from sales of "solutions" encompassing multiple products and networking capabilities that enable users to share and manage media throughout a project or organization. Such solution sales may include training and installation services, as well as workflow management assistance, to be provided by us or a third party. Depending upon the complexity of the arrangement and the level of our involvement, the revenues resulting from these solution sales may be deferred for one or more quarters while the services are being performed.

Net revenues increased 24.9%, from $471.9 million in 2003 to $589.6 million, in 2004. Revenues in our Video business increased $60.3 million or 18.2%, to $391.1 million from $330.9 million, while revenues in our Audio business grew by $57.4 million or 40.7%, to $198.5 million from $141.1 million. We estimate that approximately 118% or $71.0 million of the growth in the Video segment during 2004 relates to increased sales volume of our products and services, including a full year of sales of the Avid DNA family of products released during the second and third quarters of 2003. This increased volume growth was partially offset (18% or $10.7 million) by lower average selling prices of our various products despite favorable foreign currency exchange rates, especially with respect to the euro. Average selling prices also include the impact of price changes, discounting, and mix (higher or lower-end) of products sold. Included in our Video revenues are revenues from services. Service revenues increased $14.6 million or 31.5% to $61.1 million in 2004 from $46.5 million in 2003. Service revenues consist primarily of maintenance contracts, installations and training. For the Audio segment, the revenue growth in 2004 is attributed to the increased sales volume of Digidesign's core products as well as the acquisition of M-Audio in August of 2004 (which accounted for $26.2 million of the Audio revenue growth).

Net revenues increased 12.7% from $418.7 million in 2002 to $471.9 million in 2003. Revenues in our Video business increased $48.0 million or 17.0%, to $330.9 million from $282.9 million, while revenues in our Audio business grew by $5.2 million or 3.8%, to $141.1 million from $135.9 million. We estimate that approximately 73%, or $35.3 million, of the growth in the Video segment during 2003 relates to increased sales volume of our products and services, including the new Avid DNA family of products released during 2003. The remaining 27%, or $12.7 million, of growth is attributed to higher average selling prices of our various products, which in 2003 was particularly impacted by favorable foreign currency exchange rates, especially with respect to the euro. Average selling prices also include the impact of price changes, discounting, and mix (higher or lower-end) of products sold. Included in our Video revenues are revenues from services. Service revenues increased $9.6 million or 26.1% to $46.5 million in 2003 from $36.9 million in 2002. Service revenues consist primarily of maintenance contracts, installations and training. For the Audio segment, the revenue growth in 2003 is primarily the result of higher average selling prices of our products, including the favorable impact of foreign currency exchange rate changes.

Net revenues derived through indirect channels were approximately 72% for 2004 compared to 75% for 2003 and 81% for 2002. The increase in direct selling from 2003 to 2004 was due primarily to the growth in sales to our broadcast customers, which generally require a longer selling cycle with more direct support. We expect sales to broadcast customers will be an area of continued revenue growth in the future.

International sales (i.e., sales to customers outside the United States) accounted for 51% of our 2004 net revenues, compared to 49% for 2003 and 50% for 2002. International sales increased by $68.9 million or 29.5% in 2004 compared to 2003 and increased by $25.5 million or 12.2% in 2003 compared to 2002. The increase in international sales in 2004 occurred in Europe and Asia, with the impact of currency translation and the acquisition of M-Audio being factors. The increase in international sales in 2003 occurred principally in Europe, with the impact of currency translation being a factor.

Gross Margin

Cost of revenues consists primarily of costs associated with the procurement of components; post-sales customer support costs related to maintenance contract revenue and other services; the assembly, testing, and distribution of finished products; warehousing; and royalties for third-party software included in our products. The resulting gross margin fluctuates based on factors such as the mix of products sold, the cost and proportion of third-party hardware and software included in the systems sold, the offering of product upgrades, price discounts and other sales promotion programs, the distribution channels through which products are sold, the timing of new product introductions, sales of aftermarket hardware products such as disk drives, and currency exchange rate fluctuations.

Our gross margin increased to 56.7% in 2004 from 55.6% in 2003, which had increased from 50.5% in 2002. The gross margin increase in 2004 reflects primarily a favorable impact of foreign currency exchange rates on revenue, especially with respect to the euro. We also achieved reduced material and manufacturing overhead costs in the Video segment in 2004 as compared to 2003. The gross margin increase in 2003 primarily reflects a positive impact from higher average selling prices of our products, which in 2003 was particularly impacted by favorable foreign currency exchange rates, especially with respect to the euro. Average selling prices also include the impact of price changes, discounting, and mix (higher or lower-end) of products sold. We also achieved reduced material and manufacturing overhead costs in the Video segment in 2003 as compared to 2002.

Research and Development

Research and development expenses increased by $9.4 million or 11.0% in 2004 compared to 2003 and by $3.2 million or 3.9% in 2003 compared to 2002. The increase in expenditures in 2004 was primarily due to higher personnel-related costs partly due to the acquisitions of NXN and M-Audio during 2004 as well as to our 2004 bonus plan. These costs were somewhat offset by reduced consulting fees. The increase in expenditures in 2003 was primarily due to higher personnel-related costs, in particular accrued expenses associated with our 2003 bonus plan. These costs were somewhat offset by reductions in other spending categories. Research and development expenses decreased as a percentage of net revenues, to 16.1% in 2004 from 18.1% in 2003, and to 18.1% in 2003 from 19.7% in 2002, primarily as a result of the higher revenue base in 2004 compared to 2003 and 2003 compared to 2002.

Marketing and Selling

Marketing and selling expenses increased $26.1 million or 23.8% in 2004 compared to 2003, and increased $8.9 million or 8.9% in 2003 compared to 2002. The increase in 2004 was primarily due to higher personnel-related costs, including salaries and related taxes and benefits, partly due to the acquisitions of NXN, M-Audio and Avid Nordic during 2004, expenses associated with our 2004 bonus plan and commissions expense (due to higher revenues). Various marketing programs and increased advertising also contributed to the increase. The increase in 2003 was primarily due to higher personnel-related costs, including salaries and related taxes and benefits as well as expenses associated with our bonus plan and commissions expense (due to higher revenues). We also had higher net foreign exchange losses (specifically, remeasurement gains and losses on net monetary assets denominated in foreign currencies, offset by hedging gains and losses), which are included in marketing and selling expenses, in 2003. These increases were partially offset by lower marketing expenses such as advertising and direct mailings. Marketing and selling expenses decreased slightly as a percentage of net revenues, to 23.0% in 2004 from 23.2% in 2003, and to 23.2% in 2003 from 24.0% in 2002, primarily as a result of the higher revenue base in 2004 compared to 2003 and 2003 compared to 2002.

General and Administrative

General and administrative expenses increased by $6.6 million or 28.3% in 2004 compared to 2003, and increased by $3.4 million, or 17.1% in 2003 compared to 2002. The increase in expenditures in 2004 was primarily due to higher audit and legal fees as a result of complying with the Sarbanes-Oxley Act of 2002, and personnel-related costs, in particular expenses associated with our 2004 bonus plan. The increase in expenditures in 2003 was primarily due to higher personnel-related costs, in particular expenses associated with our 2003 bonus plan and, to a lesser extent, higher insurance costs and external legal fees as a result of complying with the Sarbanes-Oxley Act of 2002. General and administrative expenses increased slightly to 5.1% of net revenues in 2004 as compared to 4.9% in 2003. This percentage increase was due to the increases discussed above, with the impact being offset by the higher revenue base in 2004. General and administrative expenses increased as a percentage of net revenues to 4.9% in 2003 from 4.7% in 2002, primarily due to the increases in expenses discussed above.

Restructuring and Other Costs

Restructuring activity in 2004 was primarily related to paying down existing obligations on vacated facilities. Additionally, in September 2004, we recorded a charge of $0.2 million to reflect the decrease in rent to be received from one of our subtenants and reversed a charge of $0.2 million associated with unutilized space in Tewksbury. Our restructuring actions during 2003 consisted of severance and facility charges made to increase efficiencies and reduce expenses, and a revision to a previous restructuring charge recorded on unutilized space. In the first quarter of 2003, we recorded a charge of $1.2 million for employee terminations and $0.6 million for unutilized space in Santa Monica, California that included a write-off of leasehold improvements of $0.4 million. Also during 2003, we recorded charges of $1.5 million related to a revision of our estimate of the timing and amount of future sublease income associated with the Daly City facility discussed below based on working with a real estate broker during the year to attempt to sublease the space.

In December 2002, we recorded a charge of approximately $3.3 million in connection with vacating excess space in our Daly City, California; Tewksbury, Massachusetts; and Montreal, Canada facilities. The Tewksbury charge of $0.5 million was a revision of our estimate related to the August 2001 restructuring action discussed below, based on our attempts to sublet the related space during 2002. The remaining portion of the charge for Daly City and Montreal was the result of our ceasing to use a portion of each facility in December 2002 and hiring real estate brokers to assist in finding subtenants. We believe the Daly City charge of $2.4 million reflected a depressed real-estate market in the area.

During 2001, we implemented various restructuring plans to decrease costs through the consolidation of operations and the reduction of approximately 194 jobs worldwide. In connection with these plans, we recorded charges to operating expenses totaling $10.0 million. The restructuring charges included approximately $7.4 million for severance and related costs of terminated employees and $2.6 million for facility vacancy costs, of which $1.0 million represented non-cash charges relating to the disposition of leasehold improvements that were abandoned upon vacating the related properties in 2001 and 2002. These restructuring actions were expected to result in annual cost savings of approximately $11.0 million, and management believes that these savings were achieved. In connection with these and prior plans, we made cash payments in 2001 of $6.2 million related to personnel severance-related costs and $0.6 million related to vacated facilities. In 2002, we made severance related payments of $1.2 million, facilities-related payments of $0.7 million and wrote off $1.0 million of leasehold improvements. In 2003, we made severance-related payments of $1.5 million and facilities-related payments of $1.7 million. In 2004, we made facilities-related payments of $1.4 million.

As of December 31, 2004, we have an aggregate obligation under leases for which we have vacated the underlying facilities of approximately $18.6 million, including facilities in Daly City, California; Tewksbury, Massachusetts; London, England and Montreal; Canada. We have a remaining restructuring accrual balance for vacated facilities at December 31, 2004 of $3.5 million, which represents the difference between this aggregate obligation and expected future sublease income under actual or estimated potential sublease agreements. See Notes I and M to our Consolidated Financial Statements.

Amortization of and Impairment of Intangible Assets

In August 2004, we acquired M-Audio, a leading provider of digital audio and MIDI solutions for electronic musicians and audio professionals, for cash, net of cash acquired, of $79.6 million and stock and stock options with a fair value of $96.5 million. As part of the purchase accounting allocation, we recorded $38.4 million of identifiable intangible assets, consisting of completed technologies, customer relationships, a trade name and a non-compete covenant. The unamortized balance of the identifiable intangible assets relating to this acquisition was $36.6 million at December 31, 2004.

In September 2004, we acquired Avid Nordic AB for cash, net of cash acquired, of Euro 6.1 million ($7.4 million). As part of the purchase price allocation, we recorded $4.7 million of identifiable intangible assets consisting solely of customer relationships. The unamortized balance was $4.4 million at December 31, 2004.

In January 2004, we acquired NXN Software GmbH, a leading provider of asset and production management systems specifically targeted for the entertainment and computer graphics industries, for cash consideration of Euro 35 million ($43.7 million), less cash acquired. As part of the purchase accounting allocation, we recorded $7.2 million of identifiable intangible assets, consisting of completed technologies, customer relationships and a trade name. In December 2004, the customer relationships and the trade name were analyzed in accordance with FAS 144, and were determined to be impaired. See Note F to our Consolidated Financial Statements in Item 8. We recorded an impairment charge of $1.2 million for the quarter ended December 31, 2004. The remaining unamortized balance of the identifiable intangible assets relating to this acquisition was $4.8 million at December 31, 2004.

From 2000 to 2003, we recorded intangible assets as we acquired the following companies or their assets: Rocket Network, Inc. and Bomb Factory Digital, Inc. in 2003; iKnowledge, Inc. in 2002; iNews, LLC in 2001; and The Motion Factory, Inc. in 2000. In connection with these acquisitions, we allocated $7.7 million to identifiable intangible assets consisting of completed technologies and work force, and $2.2 million to goodwill. As of January 1, 2002, in connection with the adoption of SFAS 142, we reclassified $1.1 million of the previously recorded assembled work force intangible to goodwill and, as a result, ceased amortizing this amount. The unamortized balance of the identifiable intangible assets relating to these acquisitions was $1.0 million at December 31, 2004.

Included in the operating results for 2004, 2003 and 2002 is amortization of these intangible assets of $4.0 million, $1.3 million and $1.2 million, respectively. The increased levels of amortization primarily reflect the addition of the M-Audio assets acquired in August 2004 and the NXN assets acquired in January 2004. The unamortized balance of the identifiable intangible assets relating to all acquisitions was $46.9 million at December 31, 2004. We expect amortization of these intangible assets to be approximately $7.5 million in 2005, $7.0 million in 2006 and $6.2 million in 2007.

Other Income and Expense, Net

Other income and expense, net, generally consists of interest income, interest expense and equity in income of non-consolidated companies. During 2004, other income and expense, net, decreased $0.5 million from $1.9 million of income on a net basis in 2003 to $1.3 million in 2004. This decrease was due to a charge in 2004 of $1.1 million related to the settlement of a lawsuit, which was partly offset by increased interest income earned on higher average cash and investment balances.

During 2003, other income and expense, net, increased $1.7 million from $0.2 million in 2002. This increase was due to increased interest income earned on higher average cash and investment balances, as well as to the absence in 2003 of a $1.0 impairment charge recorded in 2002 to write down an investment in an unconsolidated entity accounted for under the cost method.

Provision for (Benefit from) Income Taxes

We account for income taxes under SFAS No. 109, “Accounting for Income Taxes.” SFAS No. 109 is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. We account for investment tax credits as a reduction of income taxes of the year in which the credit arises.

Our effective tax rate was (2)%, 1%, and 36%, respectively, for 2004, 2003, and 2002. The tax rate in each year is significantly affected by net changes in the valuation allowance against our deferred tax assets. We regularly review our deferred tax assets for recoverability taking into consideration such factors as historical losses after deductions for stock compensation, projected future taxable income and the expected timing of the reversals of existing temporary differences. SFAS No. 109 requires us to record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on the level of deferred tax assets as of December 31, 2004, the level of historical U.S. losses after deductions for stock compensation, and the level of outstanding stock options, which we anticipate will generate significant U.S. tax deductions in the future, we have determined that the uncertainty regarding the realization of these assets is sufficient to warrant the continued establishment of a full valuation allowance against the U.S. net deferred tax assets. In the quarter ended December 31, 2004, we removed the valuation allowance related to deferred tax assets in our Irish manufacturing operations. This resulted in a non–cash $2.1 million tax benefit reflected in the rate indicated above. The decision to remove the valuation allowance was based on the conclusion that it was more likely than not that the deferred tax asset in Ireland would be realized. Due to the removal of the valuation allowance, in future periods, we will have a non-cash increase to provision for income taxes related to our Irish operations.

Excluding the impact of the valuation allowance, our effective tax rate would have been 28% for 2004 and 26% for 2003. These rates differ from the Federal statutory rate of 35% primarily due to income in foreign jurisdictions, which have lower tax rates. Excluding the impact of the valuation allowance, our effective tax rate would have been 43% for 2002. This differs from the Federal statutory rate of 35% primarily due to state taxes, while savings due to the U.S. Federal Research Tax Credit more than offset a higher level of taxes from our foreign subsidiaries, which are taxed at different rates.

LIQUIDITY AND CAPITAL RESOURCES

We have funded our operations to date through both private and public sales of equity securities, including stock option exercises from our employee stock plans, as well as through cash flows from operations. As of December 31, 2004, our principal sources of liquidity included cash, cash equivalents and marketable securities totaling $155.4 million.

Net cash provided by operating activities was $81.4 million in 2004 compared to $58.6 million in 2003 and $25.4 million in 2002. In each case, cash generated from operating activities primarily reflects net income after adjustment for depreciation and amortization. In addition, 2004 cash flows reflect cash generated through increases in accounts payable and accrued expenses, partially offset by increases in accounts receivable and prepaid expenses and other current assets. In 2003, cash flows also reflect cash generated through increases in deferred revenues and accrued expenses, partially offset by a decrease in accounts payable. In 2002, cash flows also reflect cash generated through a decrease in accounts receivable and increases in accounts payable and deferred revenues. This was partially offset by an increase in inventories during 2002.

At December 31, 2004 and 2003, we held inventory in the amounts of $53.9 million and $38.3 million, respectively. These balances include stockroom, spares and demonstration equipment inventories at various locations, and inventory at customer sites related to shipments for which we have not yet recognized revenue. We review these balances regularly for excess quantities or potential obsolescence and make appropriate adjustments to write down the inventories to reflect their estimated realizable value. Of the $15.7 million increase in inventories from December 31, 2003 to 2004, approximately $11.3 million relates to the acquisition of M-Audio.

Accounts receivable increased by $28.3 million to $97.5 million at December 31, 2004 from $69.2 million at December 31, 2003, driven primarily by the year-over-year increase in net revenues. These balances are net of allowances for sales returns, bad debts and customer rebates, all of which we estimate and record based on historical experience. Days sales outstanding in accounts receivable increased from 49 days at December 31, 2003 to 50 days at December 31, 2004.

Net cash flow used in investing activities was $107.1 million in 2004, compared to $73.9 million in 2003 and $34.5 million in 2002. In 2004, we had net sales of marketable securities in the amount of $44.2 million. The marketable securities in which we invest our excess cash typically include corporate obligations, asset backed securities, commercial paper, taxable municipal obligations and U.S. Treasuries and other governmental obligations. We also expended cash of $135.5 million in 2004 for the acquisitions of M-Audio, NXN, and Avid Nordic and the final payment for Bomb Factory Digital. We purchased $15.2 million of property and equipment during 2004, compared to $8.0 million during 2003, and $9.4 million in 2002. Purchases of property and equipment in both 2004 and 2003 were primarily of computer hardware and software to support research and development activities and our information systems. Our capital spending program for 2005 is currently expected to be approximately $16.2 million, including purchases of hardware and software to support activities in the research and development, information systems and manufacturing areas, as well as for facilities renovations. However, this amount could increase in the event we enter into strategic business acquisitions or for other reasons.

During 2002, we made a cash payment of approximately $0.4 million to acquire selected assets of iKnowledge, Inc. As part of the purchase agreement, we were required to make certain contingent cash payments, depending upon the future revenues of the products acquired from iKnowledge through December 2004. As of December 31, 2004, contingent payments paid to date or owed were immaterial. In connection with the acquisition of The Motion Factory in 2000, we might have been required to make future contingent cash payments limited in the aggregate to $10.0 million, depending upon future revenues and/or gross margin levels through December 2004 of the products including technology we acquired from The Motion Factory. No contingent payments were paid or are owed through December 31, 2004.

During 2004, 2003 and 2002, we generated cash of approximately $29.4 million, $54.7 million and $12.7 million, respectively, from the issuance of common stock related to the exercise of stock options and our employee stock purchase plan. In 2002, we made a prepayment in full satisfaction of a $13.0 million note to Microsoft.

In connection with restructuring efforts during 2001 and prior periods, as well as with the identification in 2003 and 2002 of excess space in various locations, we have cash obligations of approximately $18.6 million under leases for which we have vacated the underlying facilities. We have an associated restructuring accrual of $3.5 million at December 31, 2004 representing losses to be incurred or expected to be incurred on subleases of space or lease vacancies. These payments will be made over the remaining terms of the leases, which have varying expiration dates through 2010, unless we are able to negotiate an earlier termination. All restructuring related payments will be funded through working capital. See Notes I and M to our consolidated financial statements.

Our cash requirements vary depending upon factors such as our planned growth, capital expenditures, the possible acquisition of businesses or technologies complementary to our business and obligations under past restructuring programs. We believe our existing cash, cash equivalents, marketable securities and funds generated from operations will be sufficient to meet our operating cash requirements for at least the next twelve months. In the event we require additional financing, we believe that we will be able to obtain such financing; however, there can be no assurance that we would be successful in doing so, or that we could do so on favorable terms.

CONTRACTUAL AND COMMERCIAL OBLIGATIONS INCLUDING OFF-BALANCE SHEET ARRANGEMENTS

The following table sets forth future payments that we are obligated to make, as of December 31, 2004, under existing debt agreements, leases and other arrangements (in thousands):

	Total	Less than 1 Year	1 – 3 Years	3 – 5 Years	After 5 Years
Capital lease obligations	$667	$502	$165	–	–
Operating leases	95,044	20,582	35,850	$27,898	$10,714
Unconditional purchase obligations	25,035	25,035	–	–	–
	$120,746	$46,119	$36,015	$27,898	$10,714

Other contractual arrangements that may result in cash payments or the issuance of Avid stock or options to purchase Avid stock consist of the following (in thousands):

	Total	Less than 1 Year	1 – 3 Years
Transactions with recourse	$17,199	$17,199	–
Stand-by letter of credit	4,300	–	$4,300
Contingent consideration for acquisitions	46,763	1,763	45,000
	$68,262	$18,962	$49,300

Through a third party, we offer lease financing options to our customers. During the terms of these financing arrangements, which are generally for three years, we remain liable for any unpaid principal balance in the event of a default on the lease by the end-user. Our liability is limited in the aggregate based on a percentage of initial amounts funded or, in certain cases, amounts of unpaid balances. As of December 31, 2004, our maximum exposure under this program was $17.2 million.

We have a stand-by letter of credit at a bank that is used as a security deposit in connection with our Daly City, California office space lease. In the event of a default on our lease the landlord would, as of December 31, 2004, be eligible to draw against this letter of credit to a maximum of $4.3 million, subject to an annual reduction of approximately $0.8 million but not below $2.0 million. The letter of credit will remain at $2.0 million throughout the remaining lease period, which runs through September 2009. As of December 31, 2004, we were not in default of this lease.

We conduct our business globally and, consequently, our results from operations are exposed to movements in foreign currency exchange rates. We enter into forward exchange contracts, which generally have one-month maturities, to reduce exposures associated with the foreign exchange exposures of certain forecasted third-party and intercompany receivables, payables and cash balances. At December 31, 2004, there were no open forward exchange contracts in place.

As part of the purchase agreements of both M-Audio and Avid Nordic AB, Avid may be required to make additional payments of up to $46.8 million contingent upon the operating results of M-Audio through December 31, 2005 and of Avid Nordic through August 31, 2005. See Note F to our Consolidated Financial Statements in Item 8.

RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued SFAS No. 151, “Inventory Costs”, an amendment of ARB No. 43, which is the result of its efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires idle facility expenses, freight, handling costs, and wasted material (spoilage) costs to be recognized as current-period charges. It also requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We are currently evaluating the impact of SFAS No. 151 on our consolidated financial statements.

On December 16, 2004, the FASB released SFAS No. 123R. This new accounting standard requires all forms of stock compensation, including stock options issued to employees, to be reflected as an expense in the Company’s financial statements. Public companies must adopt the standard by their first fiscal period beginning after June 15, 2005. SFAS No. 123R allows three alternative methods of transitioning to the standard: modified prospective application (MPA), without restatement of prior interim periods in the year of adoption; MPA with restatement of prior interim periods in the year of adoption; or modified retrospective application. The Company intends to use the MPA without restatement alternative and to apply the revised standard beginning in the quarter ending September 30, 2005. Although the Company has not finalized its analysis, it expects that the adoption of the revised standard will result in higher operating expenses and lower earnings per share. See Note B to our Consolidated Financial Statements for the pro forma impact on net income (loss) and income (loss) per common share as if we had historically applied the fair value recognition provisions of SFAS No. 123 to stock based employee awards.

On October 22, 2004, the President signed the American Jobs Creation Act of 2004 (“the Act”). The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends-received deduction for certain dividends from controlled foreign corporations. Although the deduction is subject to a number of limitations and significant uncertainty remains as to how to interpret numerous provisions in the Act, as of December 31, 2004, the Company believes that it has the information necessary to make an informed decision on the impact of the Act. Based on the information available, the Company has determined that its cash position in the U.S. is sufficient to fund anticipated needs. The Company also believes that the repatriation of income earned abroad would result in significant foreign withholding taxes that otherwise would not have been incurred as well as additional U.S. tax liabilities that may not be sufficiently offset by foreign tax credits. Therefore, the Company does not currently plan to repatriate any income earned abroad. These initial findings could change based on clarification of the rules and changes in facts and circumstances of the Company’s operations and/or cash requirements in the U.S.

CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

Some of the statements in this Form 10-K relating to our future performance constitute forward-looking statements. Such forward-looking statements are based upon management's current expectations and involve known and unknown risks. Realization of any of these risks may cause actual results to differ materially from the results described in the forward-looking statements. Certain of these risks are as follows:

Poor global economic conditions could adversely affect demand for our products and the financial condition of our suppliers, distributors and resellers.

The revenue growth and profitability of our business depends primarily on the overall demand for our products. If global economic conditions worsen, demand for our products may weaken, as could the financial health of our suppliers, distributors and resellers, and our business and results of operations could suffer.

Our performance will depend in part on continued market acceptance of our digital nonlinear editing products.

We continue to introduce new digital non-linear products based on our Digital Nonlinear Accelerator architecture, including upgrades and enhancements to our Media Composer Adrenaline and NewsCutter Adrenaline systems, as well as Avid Xpress Pro with Avid Mojo and Avid DS Nitris hardware. We will need to continue to focus marketing and sales efforts on educating potential customers and our resellers about the uses and benefits of these products. The future success of certain of these products, such as Avid DS Nitris, which enable high-definition production, will also depend on demand for high definition content and appliances, such as television sets and monitors, that utilize the high definition standard. In addition, there are several other risks involved with offering new products in general, including, without limitation, the possibility of defects or errors, failure to meet customer expectations, delays in shipping new products and the introduction of similar products by our competitors. At the same time, the introduction and transition to new products could have a negative impact on the market for our existing products, which could adversely affect our revenues and business.

The broadcast market is large, widely dispersed, and highly competitive, and we may not be successful in growing our customer base or predicting customer demand in this market.

We are continuing to enhance our presence in the digital broadcast market and have augmented our NewsCutter product offering with the Avid Unity for News products, and other server, newsroom, and browser products. The broadcast market is distinguished from our traditional video business in that turnkey, fully integrated, complex solutions (including the configuration of unique workflows), rather than discrete point products, are frequently required by the customer. Success in this market will require, among other things, creating and implementing compelling solutions and developing a strong, loyal customer base.

In addition, large, complex broadcast orders often require us to devote significant sales, engineering, manufacturing, installation, and support resources to ensure their successful and timely fulfillment. As the broadcast market converts from analog to digital, our strategy has been to build our broadcast solutions team in response to customer demand. To the extent that customer demand for our broadcast solutions exceeds our expectations, we may encounter difficulties in the short run meeting our customers' needs. Meanwhile, our competitors may devote greater resources to the broadcast market than we do, or may be able to leverage their market presence more effectively. If we are unsuccessful in expanding our share of this digital broadcast market or in predicting and satisfying customer demand, our business and revenues could be adversely affected.

A portion of our revenue is dependent on sales of large, complex solutions.

We expect sales of large, complex solutions to continue to constitute a material portion of our net revenue, particularly as news stations convert from analog, or tape-based, processes to digital formats. Our quarterly and annual revenues could fluctuate if:

- sales to one or more of our customers are delayed or are not completed within a given quarter;
- the contract terms preclude us from recognizing revenue during that quarter;
- news stations' migrations to networked digital infrastructure slows down;
- we are unable to complete complex customer installations on schedule;
- our customers reduce their capital investments in our products in response to slowing economic growth; and
- any of our large customers terminate their relationship with us or significantly reduce the amount of business they do with us.

When we acquire other companies or businesses, we become subject to potential events or circumstances that could hurt our business.

We periodically acquire other companies or businesses. For example, in January 2004, we acquired NXN Software GmbH, a company that manufactures asset and production management systems specifically targeted for the entertainment and computer graphics industries, and in August 2004, we acquired Midiman, Inc. (d/b/a M-Audio), a leading provider of digital audio and MIDI solutions for electronic musicians and audio professionals. The risks associated with such acquisitions include, among others:

- the difficulty of assimilating the operations, policies and personnel of the target companies;
- the failure to realize anticipated returns on investment, cost savings and synergies;
- the diversion of management's time and attention;
- the dilution existing stockholders may experience if we issue shares of our common stock or other rights to purchase our common stock as consideration in the acquisition;
- the potential loss of key employees of the target company;
- the difficulty in complying with a variety of foreign laws and regulations;
- the impairment of relationships with customers or suppliers;
- the risks associated with contingent payments and earnouts;
- the possibility of incurring debt and amortization expenses related to goodwill and other intangible assets; and
- unidentified issues not discovered in our due diligence process, which may include product quality issues and legal contingencies.

Such acquisitions often involve significant transaction-related costs and could cause disruption to normal operations. In the future, we may also make debt or equity investments. If so, we may fail to realize anticipated returns on such investments. If we are unable to overcome or mitigate these risks, they could undermine our business and lower our operating results.

The markets for our products are competitive, and we expect competition to intensify in the future.

The digital video and, audio markets are highly competitive, with limited barriers to entry, and are characterized by pressure to reduce prices, incorporate new features, and accelerate the release of new products. Some of our current and potential competitors have substantially greater financial, technical, distribution, support, and marketing resources than we do. Such competitors may use these resources to lower their product costs, allowing them to reduce prices to levels at which we could not operate profitably. Delays or difficulties in product development and introduction may also harm our business. In addition to price, our products must also compete favorably with our competitors' products in terms of reliability, performance, ease of use, range of features, product enhancements, reputation and training. If we are unable to compete effectively in our target markets, our business and results of operations could suffer.

New product announcements by our competitors and by us also could have the effect of reducing customer demand for our existing products. New product introductions require us to devote time and resources to training our sales channels in product features and target customers, with the temporary result that the sales channels may have less time to devote to selling our products. In addition, our introduction of new products and expansion into new markets can put us into competition with companies with whom we formerly collaborated. To the extent such companies discontinue their alliances with Avid, it could have a negative impact on our business.

Our products are complex, and may contain errors or defects resulting from such complexity.

As we continue to enhance and expand our product offerings, our products have grown increasingly complex and, despite extensive testing and quality control, may contain errors or defects. Such errors or defects could cause us to issue corrective releases and could result in loss of revenues, delay of revenue recognition, increased product returns, lack of market acceptance, and damage to our reputation.

We have a significant share of the audio market, and therefore our growth in this market will depend in part on our ability to successfully introduce new products.

Products from our Digidesign division have captured a significant portion of the audio market, due in large part to a series of successful product introductions. Our future success will depend in part upon our ability to offer, on a timely and cost-effective basis, new audio products and enhancements of our existing audio products. This can be a complex and uncertain process, and we could experience design, manufacturing, marketing, or other difficulties that delay or prevent the introduction of new or enhanced products, or the integration of acquired products, which, in turn, could harm our business.

A component of M-Audio's business strategy is to expand into the highly competitive consumer market channel, a sales channel in which we have limited experience.

Historically, a significant portion of our audio revenues has been derived from sales to professional musicians and studios. M-Audio is currently expanding its sales channel to include sales through the broader consumer market channel. Members of M-Audio's senior staff have experience in this market, but our overall experience addressing the consumer market channel is limited, and the process of developing a channel for non-specialty stores and establishing our products in these stores will be difficult. While we are not anticipating that a material portion of our revenues will come through this channel in the near term, there are costs related to pursuing the consumer market channel which are, to a large extent, fixed. As a result, we may be unable to adjust our spending in a timely manner to compensate for any unexpected revenue shortfall, which would harm our operating results. Also, to the extent we increase sales of our audio products through the consumer market channel, we expect to experience greater seasonality in sales of such products. Typically, sales of consumer electronics and software increase in the second half of the year, reaching their peak during the year-end holiday season.

Our use of independent firms and contractors to perform some of our product development and manufacturing activities could expose us to risks that could adversely impact our revenues.

Independent firms and contractors, some of whom are located in other countries, perform some of our product development and manufacturing activities. We generally own the software developed by these contractors. The use of independent firms and contractors, especially those located abroad, could expose us to risks related to governmental regulation (including tax regulation), intellectual property ownership and rights, exchange rate fluctuation, political instability and unrest, natural disasters, and other risks, which could adversely impact our revenues.

An interruption of our supply of certain products or key components from our sole source suppliers, or a price increase in such products or components, could hurt our business.

We are dependent on a number of specific suppliers for certain products and key components of our products. We purchase these sole source products and components pursuant to purchase orders placed from time to time. We generally do not carry significant inventories of these sole source products and components and have no guaranteed supply arrangements. If any of our sole source vendors should fail to produce such products or to supply or enhance such components, it could imperil our supply and our ability to continue selling and servicing products that use these components. Similarly, if any of our sole source vendors should encounter technical, operating or financial difficulties, it could threaten our supply of these products or components. While we believe that alternative sources for these products and components could be developed, or our products could be redesigned to permit the use of alternative components, an interruption of our supply could damage our business and negatively affect our operating results.

Our gross profit margin varies from product to product depending primarily on the proportion and cost of third-party hardware included in each product. From time to time, we add functionality and features to our products. If we effect such additions through the use of more, or more costly, third-party hardware, and are not able to increase the price of such products to offset these increased costs, our gross profit margin on these products could decrease and our operating results could be adversely affected.

We rely on third party software for some of our products and if we are unable to use or integrate such software, our product and service development may be delayed.

We rely on certain software that we license from third parties, including software that is bundled with our products and sold to end users and software that is integrated with internally developed software and used in our products to perform key functions. These third-party software licenses may not continue to be available on commercially reasonable terms, and the software may not be appropriately supported, maintained or enhanced by the licensors. The loss of licenses to, or inability to support, maintain and enhance any such software, could result in increased costs, or in delays or reductions in product shipments until equivalent software could be developed, identified, licensed and integrated, which would likely harm our business.

Qualifying and supporting our products on multiple computer platforms is time consuming and expensive.

Our software engineers devote significant time and effort to qualify and support our products on various computer platforms, including most notably, Microsoft and Apple platforms. Computer platform modifications and upgrades require additional time to be spent to ensure that our products will function properly. To the extent that the current configuration of the qualified and supported platforms changes or we need to qualify and support new platforms, we could be required to expend valuable engineering resources, which could adversely affect our operating results.

Our operating results are dependent on several unpredictable factors.

The revenue and gross profit from our products depend on many factors, including:

- mix of products sold;
- cost and proportion of third-party hardware and software included in such products;
- product distribution channels;
- acceptance of our new product introductions;
- product offers and platform upgrades;
- price discounts and sales promotion programs;
- volume of sales of aftermarket hardware products;
- costs of swapping or fixing products released to the market with defects;
- provisions for inventory obsolescence;
- competitive pressure on product prices;
- costs incurred in connection with "solution" sales, which typically have longer selling and implementation cycles; and
- timing of delivery of "solutions" to customers.

Changes in any of these factors could affect our operating results.

Our international operations expose us to significant exchange fluctuations, regulatory, intellectual property and other risks which could harm our operating results.

We generally derive approximately half of our revenues from customers outside of the United States. This business is, for the most part, transacted through international subsidiaries and generally in the currency of the end-user customers. Therefore, we are exposed to the risks that changes in foreign currency could adversely impact our revenues, net income (loss), and cash flow. To hedge against the foreign exchange exposure of certain forecasted receivables, payables and cash balances of our foreign subsidiaries, we enter into foreign currency forward-exchange contracts. The success of our hedging program depends on forecasts of transaction activity in the various currencies. To the extent that these forecasts are over- or understated during the periods of currency volatility, we could experience currency gains or losses.

Other risks inherent in our international operations include changes in regulatory practices, environmental laws, tax laws, trade restrictions and tariffs, longer collection cycles for accounts receivable, and greater difficulty in protecting intellectual property.

Our operating costs are tied to projections of future revenues, which may differ from actual results.

Our operating expense levels are based, in part, on our expectations of future revenues. Such future revenues are difficult to predict. A significant portion of our business occurs near the end of each quarter, which can impact our ability to precisely forecast revenues on a quarterly basis. Further, we are generally unable to reduce quarterly operating expense levels rapidly in the event that quarterly revenue levels fail to meet internal expectations. Therefore, if quarterly revenue levels fail to meet internal expectations upon which expense levels are based, our results of operations could be adversely affected.

Terrorism, acts of war, and other catastrophic events may seriously harm our business.

Terrorism, acts of war, or other catastrophic events may disrupt our business and harm our employees, facilities, suppliers, distributors, resellers or customers, which could significantly impact our revenue and operating results. The increasing presence of these threats has created many economic and political uncertainties that could adversely affect our business and stock price in ways that cannot be predicted. We are predominantly uninsured for losses and interruptions caused by terrorism, acts of war, and other conflicts and events.

If we fail to maintain strong relationships with our resellers, distributors, and suppliers, our ability to successfully deploy our products may be harmed.

We sell many of our video products and services, and substantially all of our audio products and services, indirectly through resellers and distributors. In our audio segment, a few distributors account for a significant portion of the revenue from sales of our audio products. The loss of one or more key distributors could reduce our revenues. The resellers and distributors of our video segment products typically purchase Avid software and Avid–specific hardware from us, and third-party components from various other vendors, in order to produce complete systems for resale. Any disruption to our resellers and distributors, or their third-party suppliers, could reduce our revenues. Increasingly, we are distributing our products directly, which could put us in competition with our resellers and distributors and could adversely affect our revenues. In addition, our resellers could diversify the manufacturers from whom they purchase products to sell to the final end-users, which could lead to a weakening of our relationships with our resellers and could adversely affect our revenues.

Most of the resellers and distributors of our video products are not granted rights to return products after purchase, and actual product returns from such resellers and distributors have been insignificant to date. However, our revenue from sales of audio products is generally derived from transactions with distributors and authorized resellers that typically allow limited rights of return, inventory stock rotation and price protection. Accordingly, reserves for estimated returns, exchanges and credits for price protection are recorded as a reduction of revenues upon shipment of the related products to such distributors and resellers, based upon our historical experience. To date, actual returns have not differed materially from management's estimates. However, if returns of our audio segment products were to exceed estimated levels, our revenues and operating results could be adversely impacted.

Changes in accounting rules could adversely affect our future operating results.

Our financial statements are prepared in accordance with U.S. generally accepted accounting principles. These principles are subject to interpretation by various governing bodies, including the Financial Accounting Standards Board and the Securities and Exchange Commission, which promulgate and interpret appropriate accounting regulations. A change from current accounting regulations, including accounting for stock-based compensation, will have a significant effect on our reported financial results.

Our future growth could be harmed if we lose the services of certain employees.

Our success depends upon the services of a talented and dedicated workforce, including members of our executive team and those in more technical positions. The loss of the services of one or more key employees could harm our business. Our success also depends upon our ability to attract and retain highly skilled new employees. Competition for such employees is intense in the industries and geographic areas in which we operate. In the past, we have relied on our ability to grant stock options as one mechanism for recruiting and retaining highly skilled talent. Newly issued accounting regulations which will require us to expense stock options will impair our ability to provide these incentives without incurring compensation costs. If we are unable to compete successfully for talented employees, our business could suffer.

If we fail to manage our growth effectively, our business could be harmed.

Our success depends on our ability to effectively manage the growth of our operations. As a result of our acquisitions and increasing demand for our products and services, the scope of our operations has grown both domestically and internationally. Our management team will face challenges inherent in efficiently managing an increased number of employees over larger geographic distances. These challenges include implementing effective operational systems, procedures and controls, as well as training new personnel. Inability to successfully respond to these challenges could have a material adverse effect on the growth of our business.

Our websites could subject us to legal claims that could harm our business.

Some of our websites provide interactive information and services to our customers. To the extent that materials may be posted on and/or downloaded from these websites and distributed to others, we may be subject to claims for defamation, negligence, copyright or trademark infringement, personal injury, or other theories of liability based on the nature, content, publication or distribution of such materials. In addition, although we have attempted to limit our exposure by contract, we may also be subject to claims for indemnification by end users in the event that the security of our websites is compromised. As these websites are available on a worldwide basis, they could potentially be subject to a wide variety of international laws.

We could incur substantial costs protecting our intellectual property or defending against a claim of infringement.

Our ability to compete successfully and achieve future revenue growth depends, in part, on our ability to protect our proprietary technology and operate without infringing upon the intellectual property rights of others. We rely upon a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures, and contractual provisions, as well as required hardware components and security keys, to protect our proprietary technology. However, our means of protecting our proprietary rights may not be adequate. In addition, the laws of certain countries do not protect our proprietary technology to the same extent as do the laws of the United States. From time to time unauthorized parties have obtained, copied, and used information that we consider proprietary. Policing the unauthorized use of our proprietary technology is costly and time-consuming and we are unable to measure the extent to which piracy of our software exists. We expect software piracy to be a persistent problem.

We occasionally receive communications suggesting that our products may infringe the intellectual property rights of others. It is our practice to investigate the factual basis of such communications and negotiate licenses where appropriate. While it may be necessary or desirable in the future to obtain licenses relating to one or more products or relating to current or future technologies, we may be unable to do so on commercially reasonable terms. If we are unable to protect our proprietary technology or unable to negotiate licenses for the use of others' intellectual property, our business could be impaired.

We also may be liable to some of our customers for damages that they incur in connection with intellectual property claims. Although we attempt to limit our exposure to liability arising from infringement of third-party intellectual property rights in our agreements with customers, we may not always be successful. If we are required to pay damages to our customers, or indemnify our customers for damages they incur, our business could be harmed. Moreover, even if a particular claim falls outside of our indemnity or warranty obligations to our customers, our customers may be entitled to additional contractual remedies against us.

Our association with industry organizations could subject us to litigation.

We are members of several industry organizations, trade associations and standards consortia. Membership in these and similar groups could subject us to litigation as a result of the group's activities. For example, in connection with our anti-piracy program, designed to enforce copyright protection of our software, we are a member of the Business Software Alliance (BSA). From time to time the BSA undertakes litigation against suspected copyright infringers. These lawsuits could lead to counterclaims alleging improper use of litigation or violation of other local law. To date, none of these lawsuits or counterclaims have had an adverse effect on our results of operations, but should we become involved in material litigation, our cash flows or financial position could be adversely effected.

Compliance with rules and regulations concerning corporate governance has caused our operating expenses to increase and has put additional demands on our management.

The Sarbanes-Oxley Act of 2002 and the rules and regulations of the Securities and Exchange Commission and the NASDAQ stock market increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices. These laws, rules and regulations also may divert management's attention from business operations, increase the cost of obtaining director and officer liability insurance and make it more difficult for us to attract and retain qualified executive officers, key personnel and members of our board of directors.

If we experience problems with our third-party leasing program, our revenues could be adversely impacted.

We have an established leasing program with a third party that allows certain of our customers who choose to do so to finance their purchases. If this program ended abruptly or unexpectedly, some of our customers might be unable to purchase our products unless or until they were able to arrange for alternative financing, and this could adversely impact our revenues.

Our stock price may continue to be volatile.

The market price of our common stock has experienced volatility in the past and could continue to fluctuate substantially in the future based upon a number of factors, most of which are beyond our control. These factors include:

- changes in our quarterly operating results;
- shortfalls in revenues or earnings compared to securities analysts' expectations;
- changes in analysts' recommendations or projections;
- fluctuations in investors' perceptions of us or our competitors;
- shifts in the markets for our products;
- development and marketing of products by our competitors;
- changes in our relationships with suppliers, distributors, resellers, system integrators, or customers;
- a shift in financial markets; and
- global macroeconomic conditions.

Further, the stock market has experienced volatility with respect to the price of equity securities of high technology companies generally, and this volatility has, at times, appeared to be unrelated to or disproportionate to any of the factors above.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Market Risk

Our primary exposures to market risk are financial, including the effect of volatility in currencies on asset and liability positions and revenue and operating expenses of our international subsidiaries that are denominated in foreign currencies, and the effect of fluctuations in interest rates earned on our cash equivalents and marketable securities.

Foreign Currency Exchange Risk

We generally derive nearly half of our revenues from customers outside the United States. This business is, for the most part, transacted through international subsidiaries and generally in the currency of the end-user customers. Therefore, we are exposed to the risks that changes in foreign currency could adversely impact our revenues, net income (loss) and cash flow. To hedge against the foreign exchange exposure of certain forecasted receivables, payables and cash balances of our foreign subsidiaries, we enter into short-term foreign currency forward-exchange contracts. There are two objectives of our foreign currency forward-exchange contract program: (1) to offset any foreign exchange currency risk associated with cash receipts expected to be received from our customers over the next 30 day period and (2) to offset the impact of foreign currency exchange on the Company's net monetary assets denominated in currencies other than the U.S. dollar. These forward-exchange contracts typically mature within 30 days of purchase. We record gains and losses associated with currency rate changes on these contracts in results of operations, offsetting gains and losses on the related assets and liabilities. The success of this hedging program depends on forecasts of transaction activity in the various currencies, and contract rates versus financial statement rates. To the extent that these forecasts are over- or understated during the periods of currency volatility, we could experience unanticipated currency gains or losses.

At December 31, 2004, there were no forward-exchange contracts outstanding. For the year ended December 31, 2004, net losses of $4.7 million resulting from forward-exchange contracts were recorded, which offset net transaction and remeasurement gains of $3.0 million on the related assets and liabilities. A hypothetical 10% change in foreign currency rates would not have a material impact on our results of operations, assuming the above-mentioned forecast of foreign currency exposure is accurate, because the impact on the forward contracts as a result of a 10% change would at least partially offset the impact on the asset and liability positions of our foreign subsidiaries.

Interest Rate Risk

At December 31, 2004, we held $155.4 million in cash, cash equivalents and marketable securities, including short-term corporate obligations, asset-backed securities, commercial paper and U.S. and Canadian government and government agency obligations. Marketable securities are classified as “available for sale” and are recorded on the balance sheet at market value, with any unrealized gain or loss recorded in other comprehensive income (loss). A hypothetical 10% increase or decrease in interest rates would not have a material impact on the fair market value of these instruments due to their short maturity.

AVID TECHNOLOGY, INC.

ANNUAL REPORT ON FORM 10-K

YEAR ENDED DECEMBER 31, 2004

ITEM 8

FINANCIAL STATEMENTS AND SUPPLEMENTARY FINANCIAL INFORMATION

AVID TECHNOLOGY, INC.

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CONSOLIDATED FINANCIAL STATEMENTS INCLUDED IN ITEM 8:

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CONSOLIDATED FINANCIAL STATEMENT SCHEDULE INCLUDED IN ITEM 15(d):

Schedule II - Valuation and Qualifying Accounts for the years ended December 31, 2004, 2003 and 2002 F-1

Schedules other than that listed above have been omitted since the required information is not present, or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or the notes thereto.

Management's Report on Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Management's assessment of internal control over financial reporting excluded Midiman, Inc. (doing business as M-Audio) and its subsidiaries because M-Audio was acquired by the Company in a purchase business combination during 2004. M-Audio and its subsidiaries represented 33% and 4% of the Company's total assets and total revenues, respectively as of and for the year ended December 31, 2004. Excluding identifiable intangible assets and goodwill recorded in the business combination, M-Audio and its subsidiaries represented 5% of the Company's total assets as of December 31, 2004.

Based on our assessment, management has concluded that, as of December 31, 2004, the Company's internal control over financial reporting is effective based on the criteria set forth by the COSO.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page 38 of this Annual Report on Form 10-K.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Avid Technology, Inc.:

We have completed an integrated audit of Avid Technology, Inc.'s 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Avid Technology, Inc. and its subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in "Management's Report on Internal Control Over Financial Reporting" appearing under Item 8, that the Company maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in "Management's Report on Internal Control Over Financial Reporting," management has excluded M-Audio, Inc. and its subsidiaries from its assessment of internal control over financial reporting as of December 31, 2004 because the entity was acquired by the Company in a purchase business combination during 2004. We have also excluded M-Audio, Inc. and its subsidiaries from our audit of internal control over financial reporting. M-Audio, Inc. and its subsidiaries are wholly-owned subsidiaries whose total assets and total revenues represent 33% and 4%, respectively, of the related consolidated financial statement amounts of Avid Technology, Inc. as of and for the year ended December 31, 2004.

PricewaterhouseCoopers LLP

Boston, Massachusetts
March 15, 2005

AVID TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	For the Year Ended December 31,		
	2004	2003	2002
Net revenues:			
Product	$528,463	$425,403	$381,851
Services	61,142	46,509	36,868
Total net revenues	589,605	471,912	418,719
Cost of revenues:			
Product	220,246	183,304	185,293
Services	34,842	26,069	21,943
Amortization of intangible assets	408	–	–
Total cost of revenues	255,496	209,373	207,236
Gross profit	334,109	262,539	211,483
Operating expenses:			
Research and development	94,940	85,552	82,346
Marketing and selling	135,811	109,704	100,761
General and administrative	29,780	23,208	19,819
Restructuring and other costs, net	–	3,194	2,923
Amortization of intangible assets	3,641	1,316	1,153
Impairment of intangible assets	1,187	–	–
Total operating expenses	265,359	222,974	207,002
Operating income	68,750	39,565	4,481
Interest income	2,501	2,011	1,163
Interest expense	(342)	(318)	(203)
Other income (expense), net	(820)	181	(742)
Income before income taxes	70,089	41,439	4,699
Provision for (benefit from) income taxes	(1,612)	550	1,700
Net income	$71,701	$40,889	$2,999
Net income per common share – basic	$2.21	$1.40	$0.11
Net income per common share – diluted	$2.05	$1.25	$0.11
Weighted average common shares outstanding – basic	32,485	29,192	26,306
Weighted average common shares outstanding – diluted	35,003	32,653	26,860

The accompanying notes are an integral part of the consolidated financial statements.

AVID TECHNOLOGY, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)

	December 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$79,058	$77,124
Marketable securities	76,361	119,185
Accounts receivable, net of allowances of $9,334 and $9,161 at December 31, 2004 and 2003, respectively	97,536	69,230
Inventories	53,946	38,292
Deferred tax assets, net	653	1,032
Prepaid expenses	7,550	5,117
Other current assets	11,204	7,032
Total current assets	326,308	317,012
Property and equipment, net	29,092	23,223
Intangible assets, net	46,884	1,815
Goodwill	165,803	3,335
Long-term deferred tax assets, net	4,184	–
Other assets	3,963	2,734
Total assets	$576,234	$348,119
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$26,517	$15,755
Accrued compensation and benefits	30,468	23,753
Accrued expenses and other current liabilities	34,902	27,452
Income taxes payable	9,357	8,504
Deferred revenues	48,680	44,943
Total current liabilities	149,924	120,407
Long-term debt and other liabilities	1,689	607
Total liabilities	151,613	121,014
Commitments and contingencies (Notes F, H and I)		
Stockholders' equity:		
Preferred stock, $0.01 par value, 1,000 shares authorized; no shares issued or outstanding	–	–
Common stock, $0.01 par value, 50,000 shares authorized; 34,837 and 31,063 shares issued and outstanding at December 31, 2004 and 2003, respectively	348	311
Additional paid-in capital	546,849	419,981
Accumulated deficit	(122,775)	(194,476)
Deferred compensation	(4,392)	(30)
Accumulated other comprehensive income	4,591	1,319
Total stockholders' equity	424,621	227,105
Total liabilities and stockholders' equity	$576,234	$348,119

The accompanying notes are an integral part of the consolidated financial statements.

AVID TECHNOLOGY, INC.

Consolidated Statements of Stockholders' Equity

(in thousands)

	Shares of Common Stock Issued	Shares of Common Stock In Treasury	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances at December 31, 2001	26,591	(506)	$266	$357,446	($235,926)	($8,035)	($1,294)	($7,699)	$104,758
Stock issued pursuant to employee stock plans	677	510	7	7,085	(2,438)	8,035			12,689
Restricted stock grants canceled									
and compensation expense		(4)		(50)			1,078		1,028
Comprehensive income:									
Net income					2,999				2,999
Net change in unrealized gain (loss) on									
marketable securities								(20)	(20)
Translation adjustment								2,110	2,110
Other comprehensive income									2,090
Comprehensive income									5,089
Balances at December 31, 2002	27,268	–	273	364,481	(235,365)	–	(216)	(5,609)	123,564
Stock issued pursuant to employee stock plans	3,802		38	54,680					54,718
Restricted stock grants canceled									
and compensation expense	(7)			(5)			186		181
Tax benefits on stock options				825					825
Comprehensive income:									
Net income					40,889				40,889
Net change in unrealized gain (loss) on									
marketable securities								44	44
Translation adjustment								6,884	6,884
Other comprehensive income									6,928
Comprehensive income									47,817
Balances at December 31, 2003	31,063	–	311	419,981	(194,476)	–	(30)	1,319	227,105
Stock issued pursuant to employee stock plans	1,780		17	29,359					29,376
Issuance of common stock in connection									
with acquisition	1,974		20	96,459			(5,500)		90,979
Issuance of restricted stock	20			1,134			(1,134)		–
Amortization of and reversal									
of deferred compensation				(824)			2,272		1,448
Tax benefits on stock options				740					740
Comprehensive income:									
Net income					71,701				71,701
Net change in unrealized gain (loss) on									
marketable securities								(197)	(197)
Translation adjustment								3,469	3,469
Other comprehensive income									3,272
Comprehensive income									74,973
Balances at December 31, 2004	34,837	–	$348	$546,849	($122,775)	–	($4,392)	$4,591	$424,621

The accompanying notes are an integral part of the consolidated financial statements

AVID TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Year Ended December 31,		
	2004	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$71,701	$40,889	$2,999
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	16,292	12,391	12,974
Impairment of intangible assets	1,187	–	–
Provision for (recovery of) doubtful accounts and recourse obligations	(201)	624	1,073
Compensation expense from stock grants and options	1,448	181	1,028
Changes in deferred tax assets and liabilities, net of effects of acquisitions	(1,286)	(280)	104
Tax benefit of stock option exercises	740	603	–
Equity in income of non-consolidated company	(221)	(192)	(199)
Gain on sale of business	–	–	(327)
Write-down of investment in non-consolidated company	–	–	1,000
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(15,450)	(668)	13,370
Inventories	620	(209)	(16,170)
Prepaid expenses and other current assets	(4,804)	(358)	346
Accounts payable	3,300	(8,574)	4,969
Income taxes payable	141	(207)	(1,936)
Accrued expenses, compensation and benefits	8,634	5,016	(232)
Deferred revenues	(732)	9,429	6,399
NET CASH PROVIDED BY OPERATING ACTIVITIES	81,369	58,645	25,398
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(15,177)	(7,951)	(9,356)
Payments for other long-term assets	(656)	(300)	(196)
Dividend from non-consolidated company	–	196	59
Proceeds from sale of business	–	–	327
Payments for business acquisitions, net of cash acquired	(135,515)	(2,282)	(425)
Purchases of marketable securities	(61,407)	(121,038)	(58,900)
Proceeds from sales and maturities of marketable securities	105,644	57,461	34,027
NET CASH USED IN INVESTING ACTIVITIES	(107,111)	(73,914)	(34,464)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on capital lease obligations	(610)	(619)	–
Payments on debt	(1,203)	–	–
Payments on note issued in connection with acquisition	–	–	(13,020)
Proceeds from issuance of common stock under employee stock plans	29,376	54,718	12,689
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	27,563	54,099	(331)
Effects of exchange rate changes on cash and cash equivalents	113	1,545	533
Net increase (decrease) in cash and cash equivalents	1,934	40,375	(8,864)
Cash and cash equivalents at beginning of year	77,124	36,749	45,613
Cash and cash equivalents at end of year	$79,058	$77,124	$36,749

See Notes G, H and Q for supplemental disclosures.

The accompanying notes are an integral part of the consolidated financial statements.

AVID TECHNOLOGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. ORGANIZATION AND OPERATIONS

Avid Technology, Inc. ("Avid" or the "Company") develops, markets, sells and supports a wide range of software and hardware for digital media production, management and distribution. Digital media are video, audio or graphic elements in which the image, sound or picture is recorded and stored as digital values, as opposed to analog, or tape-based, signals. Our products are used worldwide in production and post-production facilities; film studios; network, affiliate, independent and cable television stations; recording studios; advertising agencies; government and educational institutions; corporate communication departments; and game developers and Internet professionals. Projects produced using our products include major motion pictures and prime-time television, music, video, and other recordings.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Company's significant accounting policies follows:

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Intercompany balances and transactions have been eliminated. Certain amounts in the prior years' financial statements have been reclassified to conform to the current year presentation.

The Company's preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. The most significant estimates reflected in these financial statements include revenue recognition, accounts receivable and sales allowances, inventory valuation and income tax valuation allowances. Actual results could differ from those estimates.

In connection with preparation of the accompanying financial statements, the Company concluded that it was appropriate to classify its investments in auction rate securities as marketable securities. Previously, such investments were classified as cash and cash equivalents. Accordingly, the Company has revised the classification to exclude from cash and cash equivalents $25.5 million and $25.4 million of auction rate securities at December 31, 2003, and 2002, respectively, and to include such amounts as marketable securities. In addition the Company has made corresponding adjustments to the accompanying statement of cash flows to reflect the gross purchases and sales of these securities as investing activities. As a result, cash used in investing activities increased by $0.1 million and $25.4 million in 2003 and 2002, respectively. This change in classification does not affect previously reported cash flows from operations or from financing activities.

Translation of Foreign Currencies

The functional currency of each of the Company's foreign subsidiaries is the local currency, except for the Irish manufacturing branch whose functional currency is the U.S. dollar. The assets and liabilities of the subsidiaries whose functional currencies are other than the U.S. dollar are translated into U.S. dollars at the current exchange rate in effect at the balance sheet date. Income and expense items for these entities are translated using the average exchange rate for the period. Cumulative translation adjustments are included in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity.

The Irish manufacturing branch and the U.S parent company, both of whose functional currency is the U.S. dollar, carry monetary assets and liabilities denominated in currencies other than the U.S. dollar. These assets and liabilities typically include cash, accounts receivable, and intercompany operating balances denominated in euros, pounds sterling, Japanese yen, Canadian dollars, Australian dollars, Swedish Krona, Danish Kroner, Norwegian Krone and Korean Won. These assets and liabilities are remeasured into the U.S dollar at the current exchange rate in effect at the balance sheet date. Foreign currency transaction and remeasurement gains and losses are included within marketing and selling expenses in the results of operations. For the year ended December 31, 2004, net losses of $4.7 million resulting from forward-exchange contracts were recorded, which offset net transaction and remeasurement gains of $3.0 million on the related assets and liabilities.

The U.S. parent company and various other wholly owned subsidiaries have long-term intercompany loan balances denominated in foreign currencies, which are remeasured into the US dollar at the current exchange rate in effect at the balance sheet date. Any gains and losses relating to these loans are included in the cumulative translation adjustment account in the balance sheet.

Cash, Cash Equivalents and Marketable Securities

Cash equivalents consist primarily of government and government agency obligations. The Company considers all debt instruments purchased with an original maturity of three months or less to be cash equivalents. Marketable securities consist of U.S. and Canadian government and government agency obligations, corporate obligations, municipal obligation, and asset-backed securities (see Note C). The Company generally invests in securities that mature within one year from the date of purchase. The Company classifies its cash equivalents and marketable securities as “available for sale” and reports them at fair value, with unrealized gains and losses excluded from earnings and reported as an adjustment to other comprehensive income (loss), which is reflected as a separate component of stockholders' equity. Amortization or accretion of premium or discount is included in interest income (expense) in the results of operations.

Concentration of Credit Risk and Fair Value of Financial Instruments

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash investments and trade receivables. The Company places its excess cash in marketable investment grade securities. There are no significant concentrations in any one issuer of debt securities. The Company places its cash, cash equivalents and investments with financial institutions with high credit standing. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the Company's customer base, and their dispersion across different regions. No individual customer comprised more than 10% of our net accounts receivable as of December 31, 2004 or 2003. The Company also maintains reserves for potential credit losses and such losses have been within management's expectations.

Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market value. Our management regularly reviews inventory quantities on hand and writes down inventory to its realizable value to reflect estimated obsolescence or unmarketability based upon assumptions about future inventory demand (generally for the following twelve months), and market conditions. Inventory in the digital media market, including the Company’s inventory, is subject to rapid technological change or obsolescence; therefore, utilization of existing inventory may differ from the Company’s estimates.

Property and Equipment

Property and equipment is recorded at cost and depreciated using the straight-line method over the estimated useful life of the asset. Leasehold improvements are amortized over the shorter of the useful life of the improvement or the remaining term of the lease. Property and equipment held under capital leases is stated at the lower of the fair market value of the related asset or the present value of the minimum lease payments at the inception of the lease and is amortized on a straight-line basis over the shorter of the life of the related asset or the term of the lease. Expenditures for maintenance and repairs are expensed as incurred. Upon retirement or other disposition of assets, the cost and related accumulated depreciation are eliminated from the accounts and the resulting gain or loss is reflected in other income (expense) in the results of operations. A significant portion of the property and equipment is subject to rapid technological obsolescence; as a result, the depreciation and amortization periods could ultimately be shortened to reflect changes in future technology.

Acquisition-related Intangible Assets and Goodwill

Acquisition-related intangible assets, which consists primarily of customer relationships and completed technology, result from the Company’s acquisitions of the following companies or their assets: M-Audio, NXN Software, Avid Nordic AB, The Motion Factory, iNews, iKnowledge, Rocket Network, Inc., and Bomb Factory Digital, Inc. (see Note F), which were accounted for under the purchase method. Acquisition-related intangible assets are reported at fair value, net of accumulated amortization. Identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives of two to twelve years. Straight-line amortization is used because no other pattern over which the economic benefits will be consumed can be reliably determined.

Goodwill is the amount by which the cost of acquired net assets exceeded the fair value of those net assets on the date of acquisition. The Company assesses goodwill for impairment on a reporting unit basis annually during the fourth quarter of each year, or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. If the book value of a reporting unit exceeds its fair value, which is estimated on a total-Company basis by reference to the quoted market price of the Company's stock and then allocated among reporting units based on the discounted expected future cash flows of the reporting unit, the implied fair value of goodwill is compared with the carrying amount of goodwill. If the carrying amount of goodwill exceeds the implied fair value, an impairment loss is recorded in an amount equal to that excess.

Long-Lived Assets

The Company periodically evaluates its long-lived assets, other than goodwill, for events and circumstances that indicate a potential impairment. A long-lived asset is assessed for impairment when the undiscounted expected future cash flows derived from that asset are less than its carrying value. The cash flows used for this analysis take into consideration a number of factors including past operating results, budgets and economic projections, market trends and product development cycles. The amount of any impairment would be equal to the difference between the estimated fair value of the asset, based on a discounted cash flow analysis, and its carrying value.

Revenue Recognition and Allowance for Doubtful Accounts

The Company recognizes revenue from sales of products upon receipt of a signed purchase order or contract and product shipment to distributors or end users, provided that collection is reasonably assured, the fee is fixed or determinable, and all other revenue recognition criteria of Statement of Position ("SOP") 97-2, "Software Revenue Recognition", as amended, and Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition", are met. Within the Video segment and a portion of the Audio segment, the Company follows the guidance of SOP 97-2 for revenue recognition on most of its products and services since they are software-related. However, for certain offerings in the Company's Audio segment, software is incidental to the delivered products and services. For these products, the Company records revenue based on satisfying the criteria in SAB No. 104.

In connection with many of the Company's product sale transactions, customers typically purchase a one-year maintenance and support agreement. The Company recognizes revenue from maintenance contracts on a ratable basis over their term. The Company recognizes revenue from training, installation or other services as the services are performed.

The Company uses the residual method to recognize revenues when an order includes one or more elements to be delivered at a future date and evidence of the fair value of all undelivered elements exists, including arrangements that include both products and maintenance contracts. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the total arrangement fee is recognized as revenues related to the delivered elements. If evidence of the fair value of one or more undelivered elements does not exist, revenues are deferred and recognized when delivery of those elements occurs or when fair value can be established. Fair value is typically based on the price charged when the same element is sold separately to customers. However, in certain transactions, fair value is based on the renewal price of the undelivered element that is granted as a contractual right to the customer. The Company's current pricing practices are influenced primarily by product type, purchase volume, term and customer location. Management reviews services revenues sold separately and corresponding renewal rates on a periodic basis and updates, when appropriate, the fair value for such services used for revenue recognition purposes to ensure that it reflects the Company's recent pricing experience.

In most cases the Company's products do not require significant production, modification or customization of software. Installation of the products is generally routine, requires minimal effort and is not typically performed by the Company. However, a growing number of transactions, those typically involving orders from end-users for a significant number of products for a single customer site, such as news broadcasters, may require that we perform an installation effort that we deem to be non-routine and complex. In these situations, the Company does not recognize revenue for either the products shipped or the installation services until the installation is complete. In addition, if such orders include a customer acceptance provision, no revenue is recognized until the customer's acceptance of the products and services has been received or the acceptance period has lapsed.

Telephone support, enhancements and unspecified upgrades typically are provided at no additional charge during the product's initial warranty period (generally between 30 days and twelve months), which precedes commencement of the maintenance contracts. The Company defers the fair value of this support period and recognizes the related revenue ratably over the initial warranty period. The Company also from time to time offers certain customers free upgrades or specified future products or enhancements. For each of these elements that are undelivered at the time of product shipment, the Company defers the fair value of the specified upgrade, product or enhancement and recognize that revenue only upon later delivery or at the time at which the remaining contractual terms relating to the upgrade have been satisfied.

A significant portion of the Company’s revenue is derived from indirect sales channels, including authorized resellers and distributors. Most of the Company’s resellers and distributors of Video and Film Editing and Effects products are not granted rights to return products after purchase, and actual product returns from them have been insignificant to date. However, the Company’s revenue from sales of Audio products is generally derived from transactions with distributors and authorized resellers that typically allow limited rights of return, inventory stock rotation and price protection. Accordingly, reserves for estimated returns, exchanges and credits for price protection are provided, as a reduction of revenues, upon shipment of the related products to such distributors and resellers, based upon the Company’s historical experience. To date, actual returns have not differed materially from management's estimates.

The Company from time to time offers rebates on purchases of certain products or rebates based on purchasing volume, which are accounted for as reductions to revenue upon shipment of related products or expected achievement of purchasing volumes. In accordance with Emerging Issues Task Force Issue 01-09, *Accounting for Consideration Given by a Vendor to a Customer (including a Reseller of the Vendor’s Products)*, consideration given to customers or resellers under the rebate program is recorded as a reduction to revenue because the Company does not receive an identifiable benefit that is sufficiently separable from the sale of the Company’s products.

At the time of a sale transaction, the Company makes an assessment of the collectibility of the amount due from the customer. Revenue is recognized only if the Company is reasonably assured that collection will occur. In making this assessment, the Company considers customer credit-worthiness and historical payment experience. If it is determined from the outset of the arrangement that collection is not reasonably assured based upon our credit review process, revenue is recognized on a cash-collected basis to the extent that the other criteria of SOP 97-2 and SAB 104 are satisfied. At the outset of the arrangement, the Company assesses whether the fee associated with the order is fixed or determinable and free of contingencies or significant uncertainties. In assessing whether the fee is fixed or determinable, the Company considers the payment terms of the transaction, collection experience in similar transactions without making concessions, and the Company’s involvement, if any, in third-party financing transactions, among other factors. If the fee is not fixed or determinable, revenue is recognized only as payments become due from the customer, provided that all other revenue recognition criteria are met. If a significant portion of the fee is due after our normal payment terms, which are generally 30, but can be up to 90, days after the invoice date, the Company evaluates whether there is sufficient history of successfully collecting past transactions with similar terms. If that collection history is successful, then revenue is recognized upon delivery of the products, assuming all other revenue recognition criteria are satisfied.

The Company maintains allowances for estimated bad debt losses resulting from the inability of its customers to make required payments for products or services. When evaluating the adequacy of the allowances, the Company analyzes accounts receivable balances, historical bad debt experience, customer concentrations, customer credit-worthiness and current economic trends. If the financial condition of certain customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

The Company records as revenue all amounts billed to customers for shipping and handling cost and records its actual shipping costs as a component of cost of revenues. The Company records reimbursements received from customers for out-of-pocket expenses as revenue, with related costs recorded as cost of revenues.

With respect to sales of “solutions”, the Company is able to invoice the customer under a billing plan in advance of providing products and services or maintenance and support. In these instances, the Company records invoiced amounts and cash payments received prior to revenue recognition as deferred revenue.

Advertising Expenses

All advertising costs are expensed as incurred and are classified as selling and marketing expenses. Advertising expenses during 2004, 2003 and 2002 were $8.1 million, $6.0 million and $6.9 million, respectively.

As part of its advertising initiatives, the Company maintains a cooperative marketing program for certain resellers in the Video and Film Editing and Effects segment. Under this program, participating resellers can earn reimbursement credits of up to 1% of qualified purchases from Avid. Consideration given to these resellers is included in selling and marketing expense in accordance with EITF 01-09, as the Company receives an identifiable benefit that is sufficiently separable from the sale of the Company's products, and can reasonably estimate the fair value of that benefit. The Company records the cooperative marketing credit earned by the reseller at the date the related revenue is recognized based on an estimate of claims to be made. To date, actual claims have not differed materially from management's estimates.

Research and Development Costs

Research and development costs are expensed as incurred, except for costs of internally developed or externally purchased software that qualify for capitalization. Development costs for software to be sold that are incurred subsequent to the establishment of technological feasibility, but prior to the general release of the product, are capitalized. Upon general release, these costs are amortized using the straight-line method over the expected life of the related products, generally 12 to 36 months. The straight-line method generally results in approximately the same amount of expense as that calculated using the ratio that current period gross product revenues bear to total anticipated gross product revenues. The Company evaluates the net realizable value of capitalized software at each balance sheet date, considering a number of business and economic factors. Unamortized capitalized software development costs were $0.8 million, $0.1 million and $0.1 million at December 31, 2004, 2003 and 2002, respectively.

Income taxes

The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The Company accounts for investment tax credits as a reduction of income taxes of the year in which the credit arises.

Computation of Net Income (Loss) Per Common Share

Net income (loss) per common share is presented for both basic earnings per share ("Basic EPS") and diluted earnings per share ("Diluted EPS"). Basic EPS is based upon the weighted average number of common shares outstanding during the period, excluding unvested restricted stock held by employees. Diluted EPS is based upon the weighted average number of common and potential common shares outstanding during the period. Potential common shares result from the assumed exercise of outstanding stock options and warrants as well as unvested restricted stock, the proceeds of which are then assumed to have been used to repurchase outstanding common stock using the treasury stock method. For periods that the Company reports a net loss, all potential common shares are considered anti-dilutive and are excluded from calculations of diluted net loss per common share. For periods when the Company reports net income, only potential common shares with purchase prices in excess of the Company's average common stock fair value for the related period are considered anti-dilutive and are excluded from calculations of diluted net income per common share (see Note P).

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss), which includes foreign currency translation adjustments and unrealized gains and losses on certain investments. For the purposes of comprehensive income (loss) disclosures, the Company does not record tax provisions or benefits for the net changes in the foreign currency translation adjustment, as the Company intends to permanently reinvest undistributed earnings in its foreign subsidiaries. Accumulated other comprehensive income at December 31, 2004 and 2003 is comprised of cumulative translation adjustments of $4.8 million and $1.3 million, respectively, and net unrealized gains (losses) on debt securities of ($0.2) million and $13,000, respectively.

Accounting for Stock-Based Compensation

The Company has several stock-based employee compensation plans, which are described more fully in Note K. The Company accounts for stock-based awards to employees using the intrinsic value method as prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no compensation expense is recorded for options issued to employees in fixed amounts and with fixed exercise prices at least equal to the fair market value of the Company's common stock at the date of grant. When the exercise price of stock options granted to employees is less than the fair market value of common stock at the date of grant, the Company records that difference multiplied by the number of shares under option as deferred compensation, which is then amortized over the vesting period of the options. Additionally, deferred compensation is recorded for restricted stock granted to employees based on the fair market value of the Company's stock at date of grant and is amortized over the period in which the restrictions lapse. The Company reverses deferred compensation associated with unvested options issued at below fair market value as well as unvested restricted stock upon the cancellation of such options or shares for terminated employees. The Company provides the disclosures required by Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure". All stock-based awards to non-employees are accounted for at their fair value in accordance with SFAS No. 123.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee awards. See Note K for additional disclosure.

	For the Year Ended December 31,		
	2004	2003	2002
Net income, as reported	$71,701	$40,889	$2,999
Add: Stock-based employee compensation expense included in reported net income, net of related tax effect	1,448	181	1,028
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effect	(15,881)	(11,876)	(12,209)
Pro forma net income (loss)	$57,268	$29,194	($8,182)
Income (loss) per common share:			
Basic-as reported	$2.21	$1.40	$0.11
Basic-pro forma	$1.76	$1.00	($0.31)
Diluted-as reported	$2.05	$1.25	$0.11
Diluted-pro forma	$1.65	$0.89	($0.31)

Recent Accounting Pronouncements

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs", an amendment of ARB No. 43, which is the result of its efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires idle facility expenses, freight, handling costs, and wasted material (spoilage) costs to be recognized as current-period charges. It also requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the impact of SFAS No. 151 on its consolidated financial statements.

On December 16, 2004, the FASB released SFAS No. 123R. This new accounting standard requires all forms of stock compensation, including stock options issued to employees, to be reflected as an expense in the Company's financial statements. Public companies must adopt the standard by their first fiscal period beginning after June 15, 2005. SFAS No. 123R allows three alternative methods of transitioning to the standard: modified prospective application (MPA), without restatement of prior interim periods in the year of adoption; MPA with restatement of prior interim periods in the year of adoption; or modified retrospective application. The Company intends to use the MPA without restatement alternative and to apply the revised standard beginning in the quarter ending September 30, 2005. Although the Company has not finalized its analysis, it expects that the adoption of the revised standard will result in higher operating expenses and lower earnings per share. See the above paragraph, Accounting for Stock-Based Compensation, for the pro forma impact on net income (loss) and income (loss) per common share as if the Company had historically applied the fair value recognition provisions of SFAS No. 123 to stock based employee awards.

On October 22, 2004, the President signed the American Jobs Creation Act of 2004 ("the Act"). The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends-received deduction for certain dividends from controlled foreign corporations. Although the deduction is subject to a number of limitations and significant uncertainty remains as to how to interpret numerous provisions in the Act, as of December 31, 2004, the Company believes that it has the information necessary to make an informed decision on the impact of the Act. Based on the information available, the Company has determined that its cash position in the U.S. is sufficient to fund anticipated needs. The Company also believes that the repatriation of income earned abroad would result in significant foreign withholding taxes that otherwise would not have been incurred as well as additional U.S. tax liabilities that may not be sufficiently offset by foreign tax credits. Therefore, the Company does not currently plan to repatriate any income earned abroad. These initial findings could change based on clarification of the rules and changes in facts and circumstances of the Company's operations and/or cash requirements in the U.S.

C. MARKETABLE SECURITIES

The cost (amortized cost of debt instruments) and fair value of marketable securities as of December 31, 2004 and 2003 are as follows (in thousands):

	Cost	Gross Unrealized Gains (Losses)	Fair Value
2004			
Government and government agency obligations	$22,964	($2)	$22,962
Corporate obligations	31,906	(146)	31,760
Municipal obligations	16,403	(14)	16,389
Asset-backed Securities	5,272	(22)	5,250
	$76,545	($184)	$76,361
2003			
Government and government agency obligations	$25,999	$9	$26,008
Corporate obligations	46,606	(30)	46,576
Municipal obligations	28,500	6	28,506
Asset-backed Securities	18,067	28	18,095
	$119,172	$13	$119,185

With the exception of auction rate securities, all federal, state and municipal obligations held at December 31, 2004 and 2003 mature within one year. As of December 31, 2004 and 2003, municipal obligations include auction rate securities of $12.0 million and $25.5 million, respectively. The Company's investments in auction rate securities are recorded at cost, which approximates fair value due to their variable interest rates. The interest rates generally reset every 28 days. Despite the long-term nature of their stated contractual maturities, the Company has the ability to quickly liquidate investments in auction rate securities. All income generated from these investments has been recorded as interest income. The Company calculates realized gains and losses on a specific identification basis. Realized gains and losses from the sale of marketable securities were immaterial for the years ended December 31, 2004, 2003 and 2002.

D. INVENTORIES

Inventories consist of the following (in thousands):

	December 31, 2004	December 31, 2003
Raw materials	$14,925	$12,086
Work in process	3,622	1,475
Finished goods	35,399	24,731
	$53,946	$38,292

As of December 31, 2004 and 2003, the finished goods inventory included deferred costs of $9.0 million and $14.0 million, respectively, associated with product shipped to customers for which revenue had not yet been recognized.

E. PROPERTY AND EQUIPMENT

Property and equipment consists of the following (in thousands):

	Depreciable Life	December 31, 2004	December 31, 2003
Computer and video equipment and software	2 to 5 years	$92,862	$82,813
Office equipment	3 years	6,872	7,004
Furniture and fixtures	3 years	7,101	6,458
Leasehold improvements	3 to 10 years	20,865	19,470
		127,700	115,745
Less accumulated depreciation and amortization		98,608	92,522
		$29,092	$23,223

Depreciation and amortization expense related to property and equipment was $12.0 million, $10.9 million and $11.6 million for the years ended December 31, 2004, 2003 and 2002, respectively. The Company wrote off fully depreciated assets with gross values of $6.2 million, $2.1 million and $42.4 million in 2004, 2003 and 2002, respectively.

Included in Computer and video equipment and software is equipment purchased under capital leases (see Note H) of approximately $1.9 million at December 31, 2004 and 2003, with accumulated amortization of $1.3 million and $0.7 million as of December 31, 2004 and 2003, respectively.

F. ACQUISITIONS

M-Audio

In August 2004, Avid completed the acquisition of M-Audio, a leading provider of digital audio and MIDI (Music Industry Digital Interface) solutions for electronic musicians and audio professionals. Avid paid cash of $79.6 million, net of cash acquired, of which $0.5 million will be paid out over a two year period, and issued stock and options with a fair value of $96.5 million. The market price of $42.72 used to value the Avid shares was based on the five-day average closing price of the stock during the period beginning two days before and ending two days after the date that the terms of the acquisition were agreed to and announced publicly. The weighted average fair value of $35.14 used to value the options was calculated using the same five-day average, less the weighted average exercise price of the options. Avid also incurred $3.3 million of transaction costs. The Company has integrated M-Audio into its Audio segment and will market its line of audio products alongside Digidesign's digital audio workstations for the professional and home/hobbyist markets. The goodwill of $122.0 million resulting from the purchase price allocation reflects the value of the underlying enterprise as well as synergies that Avid expects to realize, including incremental sales of Digidesign products. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Accounts receivable	$7,288
Inventories	13,420
Other current assets	903
Equipment and other long-term assets	1,520
Identifiable intangible assets:	
Customer relationships	28,000
Trade name	4,700
Non-compete covenant	1,200
Completed technology	4,500
Goodwill	122,022
Total assets acquired	183,553

Accounts payable	(4,626)
Other current liabilities	(5,066)
Deferred compensation related to stock options issued	5,500
Net assets acquired	$179,361

As part of the purchase agreement, Avid may be required to make additional payments to the former shareholders and option holders of M-Audio of up to $45.0 million, contingent upon the operating results of M-Audio through December 31, 2005. These payments, if required, will be made through the issuance of additional Avid shares or options based on the ten-day average closing price of the stock ending two days prior to the date the earn-out shares are distributed. Any additional Avid shares issued to the former shareholders of M-Audio will be recorded as additional purchase price allocated to goodwill. Any additional Avid options issued to former option holders of M-Audio will be recorded as stock-based compensation expense because future service is required for it to be earned.

The identifiable intangible assets are being amortized over their estimated useful lives of twelve years for customer relationships, six years for the trade name, four years for the developed technology and two years for the non-compete covenant. Amortization expense totaled $1.8 million for the year ended December 31, 2004 and accumulated amortization of these intangible assets was $1.8 million at December 31, 2004. The $122.0 million of goodwill was assigned to the Company's Audio segment and will not be amortized, in accordance with the requirements of SFAS No. 142, "Goodwill and Other Intangible Assets". This goodwill and the identifiable intangible assets are not deductible for tax purposes.

Avid Nordic AB

In September 2004, the Company acquired Avid Nordic AB, a Sweden-based reseller of Avid products operating in the Nordic and Benelux regions of Europe, for cash, net of cash acquired, of Euro 6.1 million ($7.4 million) plus transaction costs of $0.3 million. The Company previously had no ownership interest in Avid Nordic AB. The acquisition allows Avid to directly serve customers in this region. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed in the transaction (in thousands):

Accounts receivable	$3,702
Inventories	2,516
Other current assets	589
Equipment and other long-term assets	671
Identifiable intangible assets	4,700
Goodwill	1,955
Total assets acquired	14,133
Accounts payable	(2,571)
Note payable	(1,203)
Other current liabilities	(1,057)
Long term deferred tax liability	(1,645)
Net assets acquired	$7,657

As part of the purchase agreement, Avid may be required to make additional payments to the former shareholders of Avid Nordic AB of up to Euro 1.3 million ($1.8 million) contingent upon the operating results of Avid Nordic AB through August 31, 2005. Any such payments will be recorded as additional purchase consideration, allocated to goodwill.

The identifiable intangible asset represents customer relationships developed in the region by Avid Nordic AB. This asset will be amortized over its estimated useful life of five years. Amortization expense totaled $0.3 million for the year ended December 31, 2004 and accumulated amortization of this asset was $0.3 million at December 31, 2004. The goodwill of $2.0 million resulting from the purchase price allocation reflects the value of the assembled workforce and existing infrastructure in the region. This goodwill was assigned to the Video and Film Editing and Effects segment and will not be amortized in accordance with the requirements of SFAS No. 142. This goodwill and the customer relationships intangible asset are not deductible for tax purposes. During the quarter ended December 31, 2004, the goodwill was increased by $0.4 million to $2.4 million due to a reduction in the estimated fair value of inventory and other current assets acquired from Avid Nordic AB. The note payable represented an overdraft facility with a bank, which was paid in full in December 2004.

NXN Software GmbH

In January 2004, Avid acquired Munich, Germany-based NXN Software GmbH ("NXN"), a leading provider of asset and production management systems specifically targeted for the entertainment and computer graphics industries, for cash of Euro 35 million ($43.7 million) net of cash acquired of $0.8 million. The Company also incurred $1.3 million of transaction costs. The acquisition expands Avid's offering in digital asset management by enabling the Company's film and video post-production, broadcast, audio and 3D animation customers to leverage the workflow capabilities of the NXN Alienbrain® product line. NXN is reported within Avid's Video and Film Editing and Effects segment. The goodwill resulting from the purchase price allocation reflects the synergies the Company expects to realize by integrating the NXN technology with its other products. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Current assets	$2,049
Equipment and other long-term assets	584
Identifiable intangible assets	7,200
Deferred tax assets, net	2,480
Goodwill	38,813
Total assets acquired	51,126
Current liabilities assumed	(6,169)
Net assets acquired	$44,957

The identifiable intangible assets include completed technology valued at $4.3 million, customer relationships valued at $2.1 million, and a trade name valued at $0.8 million, which are being amortized over their estimated useful lives of four to six years, three to six years, and six years, respectively. The weighted average amortization period is 5.6 years for both completed technology and customer relationships. Amortization expense relating to these intangibles was $1.2 million for the year ended December 31, 2004 and accumulated amortization of these assets was $1.2 million at December 31, 2004. In December 2004, the Company reviewed the identifiable intangible assets acquired in the NXN transaction and found the customer relationships intangible assets and the trade name to be impaired. The impairment of the customer relationships intangible assets was the result of the need to renegotiate contracts with certain customers, which also had an impact on the fair value of the Alienbrain trade name asset. The Company recalculated the fair values of these intangible assets based on revised expected future cash flows reflecting the contract renegotiations and recorded a charge of $1.2 million in December 2004 to write them down to their revised fair values. This charge is included in the statement of operations caption "Impairment of intangible assets" and was charged to the Video segment. During the year ended December 31, 2004, the $38.8 million of goodwill was reduced by $0.7 million to $38.1 million due to finalizing the estimated fair value of deferred revenue acquired from NXN. This goodwill was assigned to the Video and Film Editing and Effects segment and, in accordance with the requirements of SFAS No. 142, will not be amortized. This goodwill and the identifiable intangible assets are not deductible for tax purposes.

Bomb Factory Digital, Inc.

In December 2003, the Company acquired Bomb Factory Digital, Inc., a manufacturer of real-time audio effects for the Digidesign Pro Tools platform for approximately $3.3 million in cash, of which $2.0 million was paid in 2003 and $1.3 million was accrued at December 31, 2003 as contingent consideration. This amount was paid in 2004. The Company allocated $1.1 million of the purchase price to completed technology and recorded goodwill of $2.2 million. The goodwill has been allocated to the Company's Audio segment. The completed technology is being amortized on a straight-line basis over a three-year period. The Company recorded amortization expense of $0.3 million in 2004 and accumulated amortization of this asset was $0.3 million at December 31, 2004.

Other Acquisitions

The Company also recorded intangible assets associated with acquiring the following businesses: Rocket Network, Inc. in 2003; iKnowledge, Inc. in 2002; iNews LLC in 2001; and The Motion Factory, Inc. ("TMF") in 2000. In connection with these acquisitions, the Company allocated $4.8 million to identifiable intangible assets, which have been or are being amortized over periods ranging from 3 to 5 years. Included in the operating results for 2004, 2003 and 2002 is amortization of these intangible assets of $0.4 million, $1.3 million and $1.2 million, respectively. In connection with the iNews acquisition, the Company recorded $1.8 million for assembled workforce. As of January 1, 2002, the remaining balance of workforce of $1.1 million was reclassified to goodwill in connection with the Company's adoption of SFAS 142 and is not subject to further periodic amortization.

As part of the TMF purchase agreement, the Company may have been required to make certain contingent cash payments, limited in the aggregate up to an additional $10.0 million, dependent upon future revenues and/or gross margin levels through December 2004 of products including technologies acquired from TMF. No such contingent payments were required. As part of the iKnowledge purchase agreement, the Company was required to make certain contingent cash payments, dependent upon the future revenues of the products acquired from iKnowledge through December 2004. Contingent payments required to be made under this agreement were immaterial.

Pro Forma Financial Information for Acquisitions (Unaudited)

The results of operations of M-Audio, Avid Nordic and NXN have been included in the results of operations of the Company since the respective date of each acquisition. The following unaudited pro forma financial information presents the results of operations for the years ended December 31, 2004 and 2003 as if the acquisitions of both M-Audio and NXN had occurred at the beginning of 2003. The Company's pro forma results of operations giving effect to the Avid Nordic AB, Bomb Factory Digital and Rocket Network acquisitions as if they had occurred at the beginning of 2003 is not included as it would not differ materially from the reported results. The pro forma financial information for the combined entities has been prepared for comparative purposes only and is not indicative of what actual results would have been if the acquisitions had taken place at the beginning of fiscal 2003, or of future results.

	Years Ended December 31,	
	2004	2003
(In thousands, except per share data)		
Net revenues	$631,889	$528,963
Net income	$70,285	$33,474
Net income per share:		
Basic	$2.04	$1.07
Diluted	$1.90	$0.97

Identifiable Intangible Assets

As a result of all of the acquisitions described above, identifiable intangible assets consisted of the following (in thousands) at December 31:

	2004			2003		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Completed technologies	$12,113	($3,405)	$8,708	$5,318	($3,503)	$1,815
Customer relationships	33,800	(1,315)	32,485	–	–	–
Trade name	5,046	(337)	4,709	–	–	–
Non-compete covenant	1,200	(218)	982	–	–	–
	$52,159	($5,275)	$46,884	$5,318	($3,503)	$1,815

The Company expects amortization of these intangible assets to be approximately $7.5 million in 2005, $7.0 million in 2006, $6.2 million in 2007, $5.6 million in 2008, $4.6 million in 2009, and $16.0 million thereafter through 2016 at which point they will be fully amortized.

G. INCOME TAXES

Income before income taxes and the components of the income tax provision (benefit) for the years ended December 31, 2004, 2003 and 2002 are as follows (in thousands):

	2004	2003	2002
Income before income taxes:			
United States	$55,811	$27,105	$7,288
Foreign	14,278	14,334	(2,589)
Total income before income taxes	$70,089	$41,439	$4,699

Provisions for (benefit from) income taxes:			
Current tax expense (benefit):			
Federal	$630	$250	($459)
State	125	200	200
Foreign benefit of net operating losses	(1,541)	–	–
Other Foreign	488	381	1,927
Total current tax expense (benefit)	(298)	831	1,668
Deferred tax expense (benefit):			
Federal	–	–	–
State	–	–	–
Foreign benefit of net operating losses	(2,269)	–	–
Other Foreign	955	(281)	32
Total deferred tax expense (benefit)	(1,314)	(281)	32
Total provision for (benefit from) income taxes	($1,612)	$550	$1,700

Net cash payments for (refunds of) income taxes in 2004, 2003 and 2002 were approximately ($1.3 million), $0.2 million and $3.9 million respectively.

The cumulative amount of undistributed earnings of subsidiaries, which is intended to be permanently reinvested and for which U.S. income taxes have not been provided, totaled approximately $50.8 million at December 31, 2004.

Net deferred tax assets are comprised of the following (in thousands):

	December 31,	
	2004	2003
Deferred tax assets:		
Tax credit and net operating loss carryforwards	$86,918	$78,138
Allowances for bad debts	614	752
Difference in accounting for:		
Revenue	6,186	4,651
Costs and expenses	17,793	17,352
Inventories	3,701	3,876
Acquired intangible assets	49,355	55,099
Other	74	–
Gross deferred tax assets	164,641	159,868
Valuation allowance	(140,785)	(153,220)
Deferred tax assets after valuation allowance	23,856	6,648
Deferred tax liabilities:		
Difference in accounting for:		
Revenue	(414)	(414)
Costs and expenses	(2,673)	(1,103)
Inventories	(340)	(465)
Acquired intangible assets	(14,508)	–
Other	(2,624)	(3,634)
Gross deferred tax liabilities	(20,559)	(5,616)
Net deferred tax assets	$3,297	$1,032

Deferred tax assets reflect the net tax effects of the tax credits, operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The ultimate realization of the net deferred tax assets is dependent upon the generation of sufficient future taxable income in the applicable tax jurisdictions.

For U.S. Federal income tax purposes at December 31, 2004, the Company has tax credit carryforwards of approximately $28.1 million, which will expire between 2005 and 2024, and net operating loss carryforwards of approximately $143.7 million, which will expire between 2018 and 2024. Based on the level of the deferred tax assets as of December 31, 2004, the level of historical U.S. taxable losses after deductions for stock compensation, and the future tax deductions anticipated related to outstanding stock options, management has determined that the uncertainty regarding the realization of these assets warrants a full valuation allowance at December 31, 2004.

The Company's assessment of the valuation allowance on the U.S. deferred tax assets could change in the future based upon its levels of pre-tax income and other tax related adjustments. Removal of the valuation allowance in whole or in part would result in a non-cash reduction in income tax expense during the period of removal. In addition, because a portion of the valuation allowance as of December 31, 2004 was established to reserve against certain deferred tax assets resulting from the exercise of employee stock options, in accordance with SFAS No. 109, removal of the valuation allowance related to these assets would result in a credit to additional paid-in capital within stockholders' equity rather than the provision for income taxes. If the valuation allowance of $140.8 million as of December 31, 2004 were to be removed in its entirety, an $84.9 million non-cash reduction in income tax expense and a $55.9 million credit to additional paid-in capital would be recorded in the period of removal.

For foreign income tax purposes at December 31, 2004, the Company has net operating loss carryforwards relating to the Irish manufacturing branch of approximately $18.9 million, which can be carried forward indefinitely. In the past, due to the uncertainty regarding the realization of this asset, the Company had established a valuation allowance related to the entire carryforwards amount. Since the Irish operations have generated sufficient profits in recent years and future profitability is anticipated, as of December 31, 2004, the Company believes it is more likely than not that it will realize the benefit related to the $18.9 million net operating loss carryforward; therefore, the Company has removed the $2.1 million valuation allowance against this deferred tax asset. The net deferred tax assets of $3.3 million and $1.0 million at December 31, 2004 and 2003 are related to foreign deferred tax assets deemed realizable in certain jurisdictions.

A reconciliation of the Company's income tax provision (benefit) to the statutory federal tax rate follows:

	2004	2003	2002
Statutory rate	35%	35%	35%
Tax credits	(3)	(3)	(69)
Foreign operations	(6)	(8)	65
State taxes, net of federal benefit	2	2	12
Effective tax rate before valuation allowance	28	26	43
Tax provision increase (decrease) in valuation allowance	(30)	(25)	(7)
Effective tax rate	(2)%	1%	36%

H. LONG-TERM DEBT AND OTHER LIABILITIES

Subordinated Note

In connection with the acquisition of Softimage from Microsoft Corporation ("Microsoft") in 1998, Avid issued a $5.0 million subordinated note (the "Note") to Microsoft. The principal amount of the Note, including any adjustments relative to Avid stock options forfeited by Softimage employees plus all unpaid accrued interest, was due on June 15, 2003. The Note bore interest at 9.5% per year, payable quarterly. Through December 31, 2001, the Note had been increased by approximately $16.0 million for forfeited Avid stock options. During 1999, Avid made a principal payment of $8.0 million. In February 2002, Avid made a payment of approximately $13.0 million in full satisfaction of the outstanding Note to Microsoft.

Capital Leases

During 2002 and 2001, the Company entered into vendor-financed equipment leases at various interest rates (ranging from 5.3% to 8.7%) for certain information system purchases, which were assessed as operating leases for accounting purposes. In 2002, due to changes in certain of the agreements' terms, including consolidation of various lease schedules and an extension of the term, certain of these arrangements were determined to be capital leases for accounting purposes. As of December 31, 2004, future minimum lease payments under capital leases are due as follows (in thousands):

	Year	
	2005	$502
	2006	112
	2007	53
Total minimum lease payments		667
Less amount representing interest		29
Present value of minimum lease payments		638
Less current portion		489
Long-term portion of capital lease obligations		$149

The current portion of these capital lease obligations is recorded in accrued expenses and other current liabilities at December 31, 2004.

I. COMMITMENTS AND CONTINGENCIES

Operating Lease Commitments

The Company leases its office space and certain equipment under non-cancelable operating leases. The future minimum lease commitments under these non-cancelable leases at December 31, 2004 are as follows (in thousands):

Year	
2005	$20,582
2006	19,429
2007	16,421
2008	15,348
2009	12,550
Thereafter	10,714
Total	$95,044

The total of future minimum rentals to be received by the Company under non-cancelable subleases related to the above leases is $10.2 million as of December 31, 2004. Such sublease income amounts are not reflected in the schedule of minimum lease payments above. Included in our operating lease commitments above are obligations under leases for which we have vacated the underlying facilities as part of various restructuring plans. These leases expire at various dates through 2010, and represent an aggregate obligation of $18.6 million through 2010. The Company has a restructuring accrual of $3.5 million at December 31, 2004 which represents the difference between this aggregate future obligation and expected future sublease income under actual or estimated potential sublease agreements, on a net present value basis. See Note M.

The Company's two leases for corporate office space in Tewksbury, Massachusetts, expiring in June 2010, contain renewal options to extend the respective terms of each lease for an additional 60 months. The Company has other leases for office space that have termination options, which if exercised by the Company, would result in a penalty of approximately $0.5 million in the aggregate. The future minimum lease commitments above include the Company's obligations through the original lease terms and do not include these penalties.

The Company has a standby letter of credit at a bank that is used as a security deposit in connection with the Company's Daly City, California office space lease. In the event of default on this lease, the landlord would, as of December 31, 2004, be eligible to draw against this letter of credit to a maximum of $4.3 million, subject to an annual reduction of approximately $0.8 million but not below $2.0 million. The letter of credit will remain in effect at $2.0 million throughout the remaining lease period, which extends to September 2009. As of December 31, 2004, the Company was not in default of this lease.

The accompanying consolidated results of operations reflect rent expense on a straight-line basis over the term of the leases. Total rent expense under operating leases, net of operating subleases, was approximately $16.7 million, $14.2 million and $14.3 million for the years ended December 31, 2004, 2003 and 2002, respectively. Total rent received from our operating subleases was approximately $3.6 million, $3.2 million and $3.3 million for the years ended December 31, 2004, 2003 and 2002, respectively.

Purchase Commitments

As of December 31, 2004, the Company has entered into non-cancelable purchase commitments for certain inventory components used in its normal operations. The purchase commitments covered by these agreements are generally less than one year and aggregate approximately $25.0 million.

Transactions with Recourse

The Company, through a third party, provides lease financing options to its customers, including primarily end-users, and occasionally distributors. During the terms of these leases, which are generally three years, the Company remains liable for any unpaid principal balance upon default by the end-user, but such liability is limited in the aggregate based on a percentage of initial amounts funded or, in certain cases, amounts of unpaid balances. At December 31, 2004 and 2003, Avid's maximum recourse exposure totaled approximately $17.2 million and $14.8 million, respectively. The Company records revenue from these transactions upon the shipment of products, provided that all other revenue recognition criteria are met. Because the Company has been providing these financing options to its customers for many years, the Company has a substantial history of collecting under these arrangements without providing refunds or concessions to the end user or financing party. To date, the payment default rate has consistently been between 2% and 4% per year of the original funded amount. The Company maintains a reserve for estimated losses under this recourse lease program based on these historical default rates. At December 31, 2004, the Company's accrual for estimated losses was $2.2 million.

Contingencies

On March 11, 1996, Avid was named as a defendant in a patent infringement suit filed in the United States District Court for the Western District of Texas by Combined Logic Company, a California partnership located in Beverly Hills, California. On May 16, 1996, upon Avid's motion, the suit was transferred to the United States District Court for the Southern District of New York. The complaint alleged infringement by Avid of U.S. patent number 4,258,385, and sought injunctive relief, treble damages, costs, and attorneys' fees. In its answer to the complaint, Avid asserted that it did not infringe the patent and that the patent was invalid. In August 2004, Avid filed a Motion To Dismiss based on Combined Logic's failure to prosecute. An oral hearing on Avid's Motion was held on November 5, 2004 and the District Court granted the Motion on November 22, 2004. The District Court entered Judgment in favor of Avid on December 10, 2004, dismissing the suit with prejudice. Combined Logic Company filed a Notice Of Appeal to the Court of Appeals for the Second Circuit on January 6, 2005. On February 14, 2005, Avid filed a Motion To Dismiss For Lack of Jurisdiction. On February 15, 2005, Combined Logic, by letter to the Second Circuit, indicated that it did not object to the dismissal of its appeal and did not object to the relief sought in Avid's Motion. Because of the foregoing facts, Avid considers this matter terminated.

Avid receives inquiries from time to time with regard to possible patent infringement claims. If any infringement is determined to exist, the Company may seek licenses or settlements. In addition, as a normal incidence of the nature of the Company's business, various claims, charges, and litigation have been asserted or commenced against the Company arising from or related to contractual or employee relations, intellectual property rights or product performance. Management does not believe these claims will have a material adverse effect on the financial position or results of operations of the Company.

From time to time, the Company provides indemnification provisions in agreements with customers covering potential claims by third parties that Avid products infringe their intellectual property rights. Pursuant to these indemnification provisions, the Company agrees to indemnify customers for losses that they suffer or incur in connection with any valid U.S. patent or copyright infringement claim brought by a third party with respect to Avid products. These indemnification provisions generally offer perpetual coverage for infringement claims based upon the products covered by the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is theoretically unlimited; however, to date, the Company has not received any claims under these indemnification provisions. As a result, the Company believes the estimated fair value of these indemnification provisions is minimal.

As permitted under Delaware law, Avid has agreements whereby the Company indemnifies its officers and directors for certain events or occurrences while the officer or director is or was serving at Avid's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, Avid has mitigated the exposure through the purchase of directors and officers insurance, which is intended to limit the risk and, in most cases, enable the Company to recover all or a portion of any future amounts paid. As a result of this insurance policy coverage and Avid's related payment experience to date, the Company believes the estimated fair value of these indemnification agreements is minimal.

Avid provides warranty on hardware sold through its Video and Film Editing and Effects segment which generally mirrors the manufacturers' warranties. The Company charges the related material, labor and freight expense to cost of revenues in the period incurred. With respect to the Audio business, Avid provides warranty on externally sourced and internally developed hardware and records an accrual for the related liability based on historical trends and actual material and labor costs. The warranty period for all of the Company's products is generally 90 days to one year but can extend up to five years depending on the manufacturer's warranty.

The following table sets forth the activity in the product warranty accrual account for the year ended December 31, 2004 (in thousands):

Accrual balance at December 31, 2002	$925
Accruals for product warranties	2,332
Cost of warranty claims	(1,902)
Accrual balance at December 31, 2003	1,355
Accruals for product warranties	3,605
Cost of warranty claims	(2,699)
Accrual balance at December 31, 2004	$2,261

J. CAPITAL STOCK

Preferred Stock

The Company has authorized up to one million shares of preferred stock, $0.01 par value per share for issuance. Each series of preferred stock shall have such rights, preferences, privileges and restrictions, including voting rights, dividend rights, conversion rights, redemption privileges, and liquidation preferences, as shall be determined by the Board of Directors.

Shareholder Rights Plan

In February 1996, the Board of Directors approved a Shareholder Rights Plan. The rights were distributed in March 1996 as a dividend at the rate of one right for each share of common stock outstanding. No value was assigned to these rights. The rights may be exercised to purchase shares of a new series of $0.01 par value, junior participating preferred stock or to purchase a number of shares of the Company's common stock which equals the exercise price of the right, $115, divided by one-half of the then-current market price, upon occurrence of certain events, including the purchase of 20% or more of the Company's common stock by a person or group of affiliated or associated persons. The rights expire on February 28, 2006 and may be redeemed by the Company for $0.01 each at any time prior to the tenth day following a change in control and in certain other circumstances.

Common Stock

In 2004 and 2000, the Company granted 20,000 and 260,000 shares, respectively, of restricted common stock to certain employees under Company stock option and award plans. During 2000, the Company also completed a Stock Option Exchange Program whereby employees could request that certain outstanding stock options be exchanged for shares of restricted common stock according to specified exchange ratios. The Company granted 118,115 shares of restricted common stock in exchange for stock options to purchase 431,836 shares of common stock with exercise prices ranging from $9.44 to $45.25 per share under this program.

The shares under the 2004 awards vest annually in 25% increments over the next four years. The shares under the 2000 awards vested 40% on the first anniversary and 60% on the second anniversary of the awards. The awards under the Stock Option Exchange program vested annually over three years from the date of grant. Unvested restricted shares may not be sold, transferred or assigned and are subject to forfeiture in the event that an employee ceases to be employed by the Company.

The Company initially recorded, as a separate component of stockholders' equity, deferred compensation of approximately $1.1 million and $4.6 million in 2004 and 2000, respectively, with respect to the restricted stock under these programs. The deferred compensation amounts for all restricted stock awards represent the fair value of the Company's common stock at the date of the award less par value, which represents the purchase price paid by the holders, and are recorded as compensation expense ratably as the shares vest. For the years ended December 31, 2004, 2003 and 2002, $0.1 million, $0.2 million and $1.0 million, respectively, was recorded as compensation expense related to these restricted stock arrangements.

The Company generally allows employees to satisfy any withholding tax obligation under certain award plans by tendering to the Company a portion of the common stock received under the award. During the year ended December 31, 2004, the Company did not receive any shares to satisfy tax withholding obligations. During the years ended December 31, 2003 and 2002, the Company received approximately 6,332 shares and 53,000 shares, respectively, of its common stock for $0.2 million and $0.5 million, respectively, in connection with these non-cash transactions.

Warrant

In connection with the acquisition of Softimage Inc., the Company issued to Microsoft a ten-year warrant to purchase 1,155,235 shares of the Company's common stock, valued at $26.2 million. The warrant became exercisable on August 3, 2000, at a price of $47.65 per share, and expires on August 3, 2008.

K. STOCK PLANS

Employee Stock Purchase Plan

The Company's 1996 Employee Stock Purchase Plan, as amended through May 25, 2003, authorizes the issuance of a maximum of 1,700,000 shares of common stock in quarterly offerings to employees at a price equal to 95% of the closing price on the applicable offering termination date. As of December 31, 2004, 353,432 shares remain available for issuance under this plan.

Stock Option and Award Plans

The Company has several stock-based compensation plans under which employees, officers, directors and consultants may be granted stock awards or options to purchase the Company's common stock generally at the fair market value on the date of grant. Certain plans allow for options to be granted at below fair market value under certain circumstances. Options become exercisable over various periods, typically two to four years for employees and immediately to four years for officers and directors. The options have a maximum term of ten years. As of December 31, 2004, a maximum of 15,219,606 shares of common stock have been authorized for issuance under the Company's stock-based compensation plans, of which 1,474,151 shares remain available for future grants. Shares available for future grants at December 31, 2004 include 597,741 shares that can be issued as grants of restricted stock.

Information with respect to options granted under all stock option plans is as follows:

	2004		2003		2002	
	Shares	Weighted Average Price Per Share	Shares	Weighted Average Price Per Share	Shares	Weighted Average Price Per Share
Options outstanding at January 1,	4,233,477	$17.58	6,842,557	$14.46	7,093,183	$14.34
Granted, at fair value	869,786	$45.31	1,263,413	$25.43	1,289,187	$13.31
Granted, below fair value	345,202	$9.21	–	–	–	–
Exercised	(1,749,768)	$16.04	(3,614,122)	$14.41	(1,008,860)	$11.19

Canceled	(114,508)	$19.55	(258,371)	$16.27	(530,953)	$16.47
Options outstanding at December 31,	3,584,189	$24.19	4,233,477	$17.58	6,842,557	$14.46
Options exercisable at December 31,	1,592,944	$18.74	1,943,057	$16.27	4,308,706	$15.18
Options available for future grant at December 31,	1,474,151		2,188,769		3,213,214	

The below-fair-value options were granted in connection with the purchase of M-Audio (see Note F).

The following table summarizes information about stock options outstanding at December 31, 2004:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.01 to $9.96	290,600	6.86	$6.65	106,298	$5.35
$9.98 to $12.80	663,742	6.37	$12.01	459,707	$12.13
$12.81 to $14.12	75,735	5.24	$13.46	64,489	$13.45
$14.13 to $20.25	630,240	5.93	$15.11	384,447	$15.65
$20.50 to $22.01	804,978	7.38	$21.89	310,076	$21.74
$23.01 to $62.03	1,118,894	8.35	$43.47	267,927	$37.60
$0.01 to $62.03	3,584,189	7.15	$24.19	1,592,944	$18.74

Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for the awards under these plans consistent with the methodology prescribed under SFAS No. 123, the Company's net income (loss) and earnings (loss) per share would have been adjusted to the pro forma amounts shown in Note B – "Summary of Significant Accounting Policies," as required under SFAS No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure."

Under SFAS 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions and results:

	Stock Options			Stock Purchase Plan		
	2004	2003	2002	2004	2003	2002
Expected dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	2.2%	2.0%	3.8%	1.9%	1.1%	3.8%
Expected volatility	61%	69%	73%	38%	71%	73%
Expected life (in years)	3.40	3.51	3.44	0.25	0.43	0.5
Fair value of options granted at fair value	$19.66	$12.30	$6.94	$5.89	$7.97	$3.79
Fair value of options granted below fair value	$35.14	–	–	–	–	–

L. EMPLOYEE BENEFIT PLANS

Employee Benefit Plans

The Company has a defined contribution employee benefit plan under section 401(k) of the Internal Revenue Code covering substantially all U.S. employees. The 401(k) plan allows employees to make contributions up to a specified percentage of their compensation. The Company may, upon resolution by the Board of Directors, make discretionary contributions to the plan. The Company's contribution to the plan is 50% of up to the first 6% of an employee's salary contributed to the plan by the employee. The Company's contributions to this plan totaled $2.4 million, $2.1 million, and $1.5 million in 2004, 2003 and 2002, respectively.

In addition, the Company has various retirement and post-employment plans covering certain international employees. Certain of the plans require the Company to match employee contributions up to a specified percentage as defined by the plans. The Company made related contributions of $1.9 million, $1.4 million, and $1.1 million in 2004, 2003 and 2002, respectively.

Nonqualified Deferred Compensation Plan

The Board of Directors has approved a nonqualified deferred compensation plan (the "Deferred Plan"). The Deferred Plan covers senior management and members of the Board of Directors as approved by the Company's Compensation Committee. The plan provides for a trust to which participants can contribute varying percentages or amounts of eligible compensation for deferred payment. Payouts are generally made upon termination of employment with the Company. The benefit payable under the Deferred Plan represents an unfunded and unsecured contractual obligation of the Company to pay the value of the deferred compensation in the future, adjusted to reflect the trust's investment performance. The assets of the trust, as well as the corresponding obligations, were approximately $1.0 million and $0.8 million as of December 31, 2004 and 2003, respectively, and were recorded in other current assets and accrued compensation and benefits at those dates.

M. RESTRUCTURING AND OTHER COSTS, NET

The Company’s restructuring charges during 2004 consisted of $0.2 million to reflect the decrease in rent to be received from one of the Company’s subtenants, offset by a reversal of $0.2 million associated with unutilized space in Tewksbury, Massachusetts.

In December 2002, the Company recorded a charge of $3.3 million in connection with vacating excess space in its Tewksbury, Massachusetts; Daly City, California; and Montreal, Canada facilities. The portion of the charge related to Tewksbury ($0.5 million) resulted from a revision of the Company’s estimate of the timing and amount of future sublease income associated with that facility for which a charge had previously been included in the 2001 restructuring. The remaining portion of the charge for Daly City and Montreal was a result of the Company’s ceasing to use a portion of each facility in December 2002 and hiring real estate brokers to assist in finding subtenants.

In March 2003, the Company implemented a restructuring program under which 48 employees worldwide were terminated, and a leased facility in California was vacated. In connection with these actions, the Company recorded a charge of $1.2 million for employee terminations and $0.6 million for unutilized space in Santa Monica that included a write-off of leasehold improvements of $0.4 million. Also during 2003, the Company recorded charges of $1.5 million related to a revision of the company’s estimate of the timing and amount of future sublease income associated with the Daly City facility discussed above.

The Company recorded the 2003 and 2002 charges in accordance with the guidance of SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities”. SFAS 146 requires that a liability be recognized for an operating lease that is not terminated based on the remaining lease rental costs, measured at its fair value on a discounted cash flow basis, when the entity ceases using the rights conveyed by the operating lease. That amount is reduced by any estimated sublease rentals, regardless of whether the entity intends to enter into a sublease. Future changes in the fair value of the Company’s obligations are recorded through operating expenses.

The following table sets forth the activity in the restructuring and other costs accrual, which is included in accrued expenses and other current liabilities, in 2002, 2003 and 2004 (in thousands):

	Employee Related	Facilities Related	Total
Accrual balance at December 31, 2001	$1,471	$3,619	$5,090
Charge for vacated facilities	–	2,812	2,812
Cash payments made	(1,201)	(743)	(1,944)
Non-cash disposals	–	(1,030)	(1,030)
Revisions of estimated liabilities	163	276	439
Accrual balance at December 31, 2002	433	4,934	5,367
Restructuring charge	1,177	641	1,818
Cash payments made	(1,483)	(1,773)	(3,256)

Non-cash disposals	–	(412)	(412)
Revisions of estimated liabilities	(77)	1,453	1,376
Accrual balance at December 31, 2003	50	4,843	4,893
Restructuring charge	–	241	241
Cash payments made	–	(1,359)	(1,359)
Revisions of estimated liabilities	(50)	(191)	(241)
Accrual balance at December 31, 2004	–	$3,534	$3,534

The majority of the facilities-related accrual at December 31, 2004 represents estimated losses on subleases of space vacated as part of the Company's restructuring actions. The leases, and payment on the amount accrued, extend through 2010 unless the Company is able to negotiate an earlier termination. The 2003 non-cash disposal of $0.4 million related to the write-off of certain leasehold improvements on property included in the 2003 restructuring and abandoned in the first quarter of 2003. The 2002 non-cash disposal of $1.0 million related to the write-off of certain leasehold improvements on property included in the 2001 restructuring and abandoned in the first quarter of 2002.

N. SEGMENT INFORMATION

The Company's organizational structure is based on strategic business units that offer various products to the principal markets in which the Company's products are sold. In SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company evaluated the discrete financial information that is regularly reviewed by the chief operating decision-makers and determined that these business units equate to two reportable segments: Video and Film Editing and Effects, and Audio.

The Video and Film Editing and Effects segment produces non-linear video and film editing systems to improve the productivity of video and film editors and broadcasters by enabling them to edit moving pictures and sound in a faster, easier, more creative, and more cost-effective manner than by use of traditional analog tape-based systems. The products in this operating segment are designed to provide capabilities for editing and finishing feature films, television shows, broadcast news programs, commercials, music videos, and corporate and home videos. This segment includes the Media Composer family of products, which accounted for approximately 17%, 16% and 19% of our consolidated net revenues in 2004, 2003 and 2002, respectively. Also within this segment are Storage and Workgroup products that provide complete network, storage, and database solutions based on our Avid Unity MediaNetwork technology, and enable users to simultaneously share and manage media assets throughout a project or organization. This product family accounted for 18%, 19% and 15% of our consolidated net revenues in 2004, 2003 and 2002, respectively. The Audio segment produces digital audio systems for the audio market. This operating segment includes products developed to provide audio recording, editing, signal processing, and automated mixing. This segment includes the Pro Tools product family, which accounted for approximately 24%, 25% and 27% of our consolidated net revenues in 2004, 2003 and 2002, respectively.

The accounting policies of each of the segments are the same as those described in the summary of significant accounting policies (see Note B). The Company evaluates performance based on profit and loss from operations before income taxes, interest income, interest expenses and other income, excluding the effects of restructuring and other costs, amortization or impairment of intangible assets associated with acquisitions, and stock-based compensation. Common costs not directly attributable to a particular segment are allocated between segments based on management's best estimates.

The following is a summary of the Company's operations by reportable segment (in thousands):

	For the Year Ended December 31,		
	2004	2003	2002
Video and Film Editing and Effects:			
Net revenues	$391,143	$330,859	$282,864
Depreciation	9,529	8,419	9,006
Operating income (loss)	46,153	28,357	(6,804)
Assets at December 31,	142,105	111,682	107,221
Capital expenditures	12,477	7,195	6,563

Audio:			
Net revenues	$198,462	$141,053	$135,855
Depreciation	2,502	2,484	2,610
Operating income	29,251	15,718	15,361
Assets at December 31,	66,023	34,978	36,948
Capital expenditures	2,700	756	2,793
Combined Segments:			
Net revenues	$589,605	$471,912	$418,719
Depreciation	12,031	10,903	11,616
Operating income	75,404	44,075	8,557
Assets at December 31,	208,128	146,660	144,169
Capital expenditures	15,177	7,951	9,356

The following table reconciles operating income for reportable segments to total consolidated amounts for the years ended December 31, 2004, 2003 and 2002 (in thousands):

	2004	2003	2002
Total operating income for reportable segments	$75,404	$44,075	$8,557
Unallocated amounts:			
Restructuring and other costs, net	–	(3,194)	(2,923)
Amortization of acquisition-related intangible assets	(4,049)	(1,316)	(1,153)
Stock-based compensation	(1,418)	–	–
Impairment of intangible assets	(1,187)	–	–
Consolidated operating income	$68,750	$39,565	$4,481

Certain assets are not included in the assets of the reportable segment because management does not consider them in evaluating operating results of the segments. The following table reconciles assets for reportable segments to total consolidated amounts as of December 31, 2004, 2003 and 2002 (in thousands):

	2004	2003	2002
Total assets for reportable segments	$208,128	$146,660	$144,169
Unallocated amounts:			
Cash, cash equivalents and marketable securities	155,419	196,309	89,034
Acquisition-related intangible assets	212,687	5,150	2,600
Total assets	$576,234	$348,119	$235,803

The following table summarizes the Company's revenues by country (in thousands). The categorization of revenue is based on the country in which the sales originate:

	For the Year Ended December 31,		
	2004	2003	2002
Revenues:			
United States	$287,182	$238,340	$210,599
Other countries	302,423	233,572	208,120
Total revenues	$589,605	$471,912	$418,719

The following table summarizes the Company's long-lived assets, by country (in thousands):

	December 31, 2004	December 31, 2003
Long-lived assets:		
United States	$25,025	$20,722
Other countries	8,030	5,235
Total long-lived assets	$33,055	$25,957

O. FINANCIAL INSTRUMENTS

Forward-Exchange Contracts

As of December 31, 2004, there were no forward-exchange contracts outstanding. At December 31, 2003, the Company had approximately $25.3 million of foreign currency forward-exchange contracts outstanding, denominated in euros, Japanese yen, British pounds, Singapore dollars, Canadian dollars and Australian dollars, as a hedge against the foreign exchange exposure of certain forecasted third-party and intercompany receivables, payables and cash balances.

There are two objectives of the Company's foreign currency forward-exchange contract program: (1) to offset any foreign exchange currency risk associated with cash receipts expected to be received from our customers over the next 30 day period and (2) to offset the impact of foreign currency exchange on the Company's net monetary assets denominated in currencies other than the U.S. dollar. These forward-exchange contracts typically mature within 30 days of purchase.

The changes in fair value of the forward-exchange contracts intended to offset foreign currency exchange risk on forecasted cash flows are recorded as gains or losses in the Company's statement of operations in the period of change, because they do not meet the criterion of SFAS No.133, *Accounting for Derivative Instruments and Hedging Activities*, to be treated as hedges for accounting purposes.

The forward-exchange contracts associated with offsetting the impact of foreign currency exchange risk on the Company's net monetary assets are accounted for as fair value hedges under SFAS No. 133. Specifically, the forward-exchange contracts are recorded at fair value at the origination date, and gains or losses on the contracts are recognized in earnings; the changes in fair value of the net monetary assets attributable to changes in foreign currency are an adjustment to the carrying amount and are recognized in earnings in the period of change.

Net realized and unrealized gains (losses) of ($1.7) million, ($0.6) million and $0.5 million resulting from foreign currency transactions, remeasurement, and forward-exchange contracts were included in results of operations for the years ended December 31, 2004, 2003 and 2002, respectively.

P. NET INCOME PER COMMON SHARE

Basic and diluted net income per share were as follows (in thousands, except per share data):

	For the Year Ended December 31, 2004	2003	2002
Net income	$71,701	$40,889	$2,999
Weighted average common shares outstanding – basic	32,485	29,192	26,306
Weighted average potential common stock:			
Options	2,483	3,461	554
Warrant	35	–	–
Weighted average common shares outstanding – diluted	35,003	32,653	26,860
Net income per common share – basic	$2.21	$1.40	$0.11
Net income per common share – diluted	$2.05	$1.25	$0.11

Common stock options, restricted shares and a warrant that were considered anti-dilutive securities and excluded from the diluted net income per share calculations were as follows, on a weighted-average basis:

	For the Year Ended December 31,		
	2004	2003	2002
Options	137	32	5,170
Warrant	–	1,155	1,155
Restricted shares	20	–	–
Total anti-dilutive securities	157	1,187	6,325

Q. SUPPLEMENTAL CASH FLOW INFORMATION

The following table reflects supplemental cash flow investing activities related to the acquisitions of NXN Software GmbH, M-Audio, and Avid Nordic AB in 2004, Rocket Network, Inc. and Bomb Factory Digital, Inc. in 2003, and iKnowledge in 2002 (in thousands):

	Year Ended December 31,		
	2004	2003	2002
Fair value of:			
Assets acquired and goodwill	$249,924	$3,866	$425
Accrual for contingent payments made in 2004	–	(1,369)	–
Payment for contingency	1,310	–	–
Liabilities assumed	(22,337)	(215)	–
Deferred compensation for stock options issued	5,500	–	–
Total consideration	234,397	2,282	425
Less: cash acquired	(1,875)	–	–
Less: equity consideration and accrued payments	(97,007)	–	–
Net cash paid for acquisitions	$135,515	$2,282	$425

During 2004, the Company paid $1.3 million of the contingent payments related to Bomb Factory, after resolution of the contingencies as specified in the purchase agreement.

R. QUARTERLY RESULTS (UNAUDITED)

The following information has been derived from unaudited consolidated financial statements that, in the opinion of management, include all normal recurring adjustments necessary for a fair presentation of such information.

In thousands, except per share data:

	Quarters Ended							
	2004				2003			
	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Net revenues	$174,971	$147,374	$139,886	$127,374	$127,328	$119,090	$113,317	$112,177
Cost of revenues	77,145	62,845	60,995	54,103	53,754	52,784	50,608	52,227
Amortization of intangible assets	281	127	–	–	–	–	–	–
Gross profit	97,545	84,402	78,891	73,271	73,574	66,306	62,709	59,950
Operating expenses:								
Research & development	25,845	23,879	22,924	22,292	21,719	20,706	21,428	21,699
Marketing & selling	38,712	33,589	33,656	29,854	28,733	27,959	27,748	25,264
General & administrative	10,024	7,686	6,184	5,886	6,576	5,670	5,617	5,345
Restructuring and other costs, net	–	–	–	–	1,335	76	–	1,783
Amortization of intangible assets	1,665	988	549	439	341	341	341	293
Impairment of intangible assets	1,187	–	–	–	–	–	–	–
Total operating expenses	77,433	66,142	63,313	58,471	58,704	54,752	55,134	54,384
Operating income	20,112	18,260	15,578	14,800	14,870	11,554	7,575	5,566
Other income (expense), net	653	651	595	(560)	544	592	507	231
Income before income taxes	20,765	18,911	16,173	14,240	15,414	12,146	8,082	5,797
Provision (benefit) for income taxes	(1,749)	(63)	700	(500)	(350)	300	300	300
Net income	$22,514	$18,974	$15,473	$14,740	$15,764	$11,846	$7,782	$5,497

Net income	$22,514	$18,974	$15,473	$14,740	$15,764	$11,846	$7,782	$5,497
Net income per share - basic	$0.66	$0.58	$0.49	$0.47	$0.51	$0.40	$0.27	$0.20
Net income per share - diluted	$0.61	$0.54	$0.45	$0.44	$0.47	$0.35	$0.25	$0.18
Weighted average common shares outstanding – basic	34,355	32,737	31,623	31,202	30,764	29,865	28,494	27,604
Weighted average common shares outstanding – diluted	36,751	35,033	34,134	33,740	33,864	33,380	31,673	29,860
High common stock price	$62.57	$54.66	$61.68	$55.42	$59.77	$57.95	$38.15	$24.15
Low common stock price	$46.48	$40.90	$44.11	$38.43	$44.65	$33.96	$21.86	$16.76

The Company's quarterly operating results fluctuate as a result of a number of factors including, without limitation, the timing of new product introductions, the timing of, and costs incurred in association with, the recognition of “solutions” sales to customers, marketing expenditures, promotional programs, and periodic discounting due to competitive factors. The Company's operating results may fluctuate in the future as a result of these and other factors, including the Company's success in developing and introducing new products, its products and customer mix and the level of competition which it experiences. Quarterly sales and operating results generally depend on the volume and timing of orders received and recognized as revenue during the quarter. The Company's expense levels are based in part on its forecasts of future revenues. If revenues are below expectations, the Company's operating results may be adversely affected. Accordingly, there can be no assurance that the Company will be profitable in any particular quarter.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2004. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of December 31, 2004, our chief executive officer and chief financial officer concluded that, as of such date, the Company’s disclosure controls and procedures were effective at the reasonable assurance level.

Management’s report on our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) and the independent registered public accounting firm’s related audit report are included in Item 8 of this Form 10-K and are incorporated herein by reference.

No change in our internal control over financial reporting occurred during the fiscal quarter ended December 31, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

We have adopted a Code of Business Conduct and Ethics applicable to all our employees, including our principal executive officer, principal financial officer and principal accounting officer. We will provide any person, without charge, with a copy of our Code of Business Conduct and Ethics upon written request to Avid Technology, Inc., Avid Technology Park, One Park West, Tewksbury, MA 01876, Attention: Corporate Secretary.

The remainder of the response to this item is contained under the caption "EXECUTIVE OFFICERS OF THE COMPANY" in Part I hereof, and in our Proxy Statement for our 2005 Annual Meeting of Stockholders (the "2005 Proxy Statement") under the captions "Election of Directors" and “Section 16(a) Beneficial Ownership Reporting Compliance” all of which is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The response to this item is contained in the 2005 Proxy Statement under the captions "Election of Directors - Directors’ Compensation" and "Executive Compensation" and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The response to this item is contained in the 2005 Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management" and is incorporated herein by reference.

The disclosures required for securities authorized for issuance under equity compensation plans are contained in the 2005 Proxy Statement under the caption “Equity Compensation Plan Information” and are incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The response to this item is contained in the Company's 2005 Proxy Statement under the caption "Independent Registered Public Accounting Firm Fees and Other Matters" and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. FINANCIAL STATEMENTS

The following consolidated financial statements are included in Item 8:

- Management's Report on Internal Control Over Financial Reporting
- Report of Independent Registered Public Accounting Firm
- Consolidated Statements of Operations for the years ended December 31, 2004, 2003 and 2002
- Consolidated Balance Sheets as of December 31, 2004 and 2003
- Consolidated Statements of Stockholders' Equity for the years ended December 31, 2004, 2003 and 2002
- Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003 and 2002
- Notes to Consolidated Financial Statements

(a) 2. FINANCIAL STATEMENT SCHEDULE

The following consolidated financial statement schedule is included in Item 15(d):

Schedule II - Valuation and Qualifying Accounts

Schedules other than that listed above have been omitted since the required information is not present, or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or the notes thereto.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AVID TECHNOLOGY, INC.
(Registrant)

By: /s/ David A. Krall
David A. Krall
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 15, 2005

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ David A. Krall David A. Krall President and Chief Executive Officer (Principal Executive Officer)	By: /s/ Paul J. Milbury Paul J. Milbury Chief Financial Officer (Principal Financial Officer)	By: /s/ Carol L. Reid Carol L. Reid Vice President and Corporate Controller (Principal Accounting Officer)
Date: March 15, 2005	Date: March 15, 2005	Date: March 15, 2005

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

NAME	TITLE	DATE
/s/ David A. Krall David A. Krall	Director	March 15, 2005
/s/ George Billings George Billings	Director	March 15, 2005
/s/ Elizabeth M. Daley Elizabeth M. Daley	Director	March 15, 2005
/s/ John Guttag John Guttag	Director	March 15, 2005
/s/ Nancy Hawthorne Nancy Hawthorne	Director	March 15, 2005
/s/ Pamela F. Lenehan Pamela F. Lenehan	Director	March 15, 2005
/s/ William J. Warner William J. Warner	Director	March 15, 2005

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corporate information

Independent Registered Public Accountants
PricewaterhouseCoopers LLP
Boston, Massachusetts

Transfer Agent and Registrar
EquiServe Trust Company, N.A.
P.O. Box 219045
Kansas City, MO 64121-9045
tel 816 843 4299
web www.equiserve.com

Shareholder Inquiries
Inquiries related to the Company, its activities, or its securities should be addressed to:

Dean Ridlon
Director of Investor Relations
Avid Technology, Inc.
One Park West
Tewksbury, MA 01876
tel 978 640 5309
fax 978 640 3116
email Investor_Relations@avid.com
web www.avid.com

Common Shares
Traded on The Nasdaq National Market under the symbol "AVID"

Annual Meeting of Shareholders
The Annual Meeting of Shareholders will take place on a date and at a location to be set forth in the Company's definitive proxy statement.

Chairman of the Board
Nancy Hawthorne
Chair and
Chief Executive Officer
Clerestory, LLC.

Board of Directors
George H. Billings
President
Billings & Co.

Elizabeth M. Daley
Dean,
University of Southern California
School of Cinema-Television

Dr. John V. Guttag
Professor,
Department of Electrical Engineering and Computer Science,
Massachusetts Institute of Technology

David A. Krall
President and
Chief Executive Officer
Avid Technology, Inc.

Pamela F. Lenehan
President
Ridge Hill Consulting, LLC.

William J. Warner
President, Warner Research, LLC.
Founder, Avid Technology, Inc.

Corporate Management
David A. Krall
President and
Chief Executive Officer

Paul J. Milbury
Vice President and
Chief Financial Officer

Patricia A. Baker
Vice President of
Human Resources

Joseph Bentivegna
Vice President and
Chief Operating Officer,
Avid Video

Ethan E. Jacks
Vice President of
Business Development
and Chief Legal Officer

David M. Lebolt
Vice President and
General Manager,
Digidesign

Carol L. Reid
Vice President and
Corporate Controller

Michael J. Rockwell
Vice President and
Chief Technology Officer

Charles L. Smith
Vice President and
General Manager,
Avid Video

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Chicago	Orlando
Dublin	Osaka
Edmonton	Paris
Hong Kong	Tokyo
Iver Heath	Toronto
London	Washington, D.C.

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