

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2010

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 1-13550

HAUPPAUGE DIGITAL INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

11-3227864
(I.R.S. Employer
Identification No.)

91 Cabot Court, Hauppauge, New York 11788
(Address of principal executive offices)

(631) 434-1600
(Registrant's telephone number, including area code)

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

YES NO

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

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. (See definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act).

LARGE ACCELERATED FILER

ACCELERATED FILER

NON-ACCELERATED FILER

SMALLER REPORTING COMPANY

(Do not check if a smaller reporting company)

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

YES

NO

As of January 31, 2011, 10,084,795 shares of .01 par value Common Stock of the issuer were outstanding.

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements	<u>Page no.</u>
Consolidated Balance Sheets – December 31, 2010 (unaudited) and September 30, 2010	5
Consolidated Statements of Operations - Three Months ended December 31, 2010 (unaudited) and 2009 (unaudited)	6
Consolidated Statements of Other Comprehensive Loss Three Months ended December 31, 2010 (unaudited) and 2009 (unaudited)	7
Consolidated Statements of Cash Flows - Three Months ended December 31, 2010 (unaudited) and 2009 (unaudited)	8
Notes to Consolidated Financial Statements	9-14
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	15-19
Item 3. Quantitative and Qualitative Disclosures about Market Risks	20
Item 4. Controls and Procedures	20

PART II. OTHER INFORMATION

Item 6. Exhibits

21-22

Signatures

23

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

	December 31, 2010 (unaudited)	September 30, 2010
Assets:		
Cash and cash equivalents	\$7,286,019	\$7,057,904
Trade receivables, net of various allowances	3,623,630	4,403,194
Other non trade receivables	1,829,872	2,355,834
Inventories	12,214,733	11,450,565
Deferred tax asset-current	1,271,988	1,310,204
Prepaid expenses and other current assets	1,070,173	980,087
Total current assets	<u>27,296,415</u>	<u>27,557,788</u>
Intangible assets, net	3,752,557	3,941,266
Property, plant and equipment, net	505,835	544,959
Security deposits and other non current assets	106,241	106,241
Deferred tax asset-non current	449,224	610,734
Total assets	<u>\$32,110,272</u>	<u>\$32,760,988</u>
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Accounts payable	\$7,015,036	\$7,306,221
Accrued expenses fees	4,917,267	4,955,540
Accrued expenses	10,416,263	10,266,495
Income taxes payable	276,717	252,090
Total current liabilities	<u>22,625,283</u>	<u>22,780,346</u>
Stockholders' Equity:		
Common stock, \$.01 par value; 25,000,000 shares authorized, 10,845,368 and 10,842,274 issued, respectively	108,454	108,423
Additional paid-in capital	17,843,446	17,739,330
Retained deficit	(1,789,106)	(1,050,886)
Accumulated other comprehensive loss	(4,272,257)	(4,410,677)
Treasury Stock, at cost, 760,479 shares	(2,405,548)	(2,405,548)
Total stockholders' equity	<u>9,484,989</u>	<u>9,980,642</u>
Total liabilities and stockholders' equity	<u>\$32,110,272</u>	<u>\$32,760,988</u>

See accompanying notes to consolidated financial statements

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three months ended December 31,	
	2010	2009
Net sales	\$12,862,946	\$17,878,358
Cost of sales	8,515,708	12,655,961
Gross profit	4,347,238	5,222,397
Selling, general and administrative expenses	3,774,704	4,332,523
Research and development expenses	1,096,779	1,170,071
Loss from operations	(524,245)	(280,197)
Other income (expense):		
Interest income	1,559	1,452
Interest expense	-	(4,340)
Foreign currency gain (loss)	31,523	(240)
Total other income (expense)	33,082	(3,128)
Loss before tax provision	(491,163)	(283,325)
Deferred tax expense	199,726	-
Current tax expense	47,331	51,226
Net loss	(\$738,220)	(\$334,551)
Net loss per share:		
Basic and diluted	(\$0.07)	(\$0.03)

See accompanying notes to consolidated financial statements

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE LOSS
(UNAUDITED)

	Three months ended December 31,	
	2010	2009
Net loss	(\$738,220)	(\$334,551)
Foreign currency translation gain (loss)	161,219	(122,240)
Forward exchange contracts marked to market loss	(22,798)	(2,424)
Other comprehensive loss	(\$599,799)	(\$459,215)

See accompanying notes to consolidated financial statements

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three months ended December 31,	
	2010	2009
Net loss	(\$738,220)	(\$334,551)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	59,931	69,521
Amortization of intangible assets	188,709	188,709
Stock compensation expense	100,470	106,251
Deferred tax expense	199,726	-
Sales reserve, net	(110,569)	78,300
Bad debt reserve	-	20,000
Other items	54,429	18
Changes in current assets and liabilities, net of effects of acquisition:		
Accounts receivable	1,696,257	251,123
Inventories	(1,032,798)	146,083
Prepaid expenses and other current assets	(86,338)	103,248
Accounts payable	(301,340)	(151,918)
Accrued expenses and other current liabilities	238,624	1,971,997
Total adjustments	1,007,101	2,783,332
Net cash provided by operating activities	268,881	2,448,781
Cash Flows From Investing Activities:		
PCTV acquisition	-	(511,332)
Purchases of property, plant and equipment	(20,807)	(2,773)
Net cash used in investing activities	(20,807)	(514,105)
Cash Flows From Financing Activities:		
Proceeds from the exercise of stock options and employee stock purchases	3,677	5,237
Net cash provided by financing activities	3,677	5,237
Effect of exchange rates on cash	(23,636)	(124,664)
Net increase in cash and cash equivalents	228,115	1,815,249
Cash and cash equivalents, beginning of period	7,057,904	8,368,342
Cash and cash equivalents, end of period	\$7,286,019	\$10,183,591
Supplemental disclosures:		
Interest paid	-	\$ 4,340
Income taxes paid	\$33,416	\$ 61,171

See accompanying notes to consolidated financial statements

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements for Hauppauge Digital Inc. and subsidiaries (collectively, the “Company”) included herein have been prepared in accordance with generally accepted accounting principles for interim period reporting in conjunction with the instructions to Form 10-Q. Accordingly, these statements do not include all of the information required by generally accepted accounting principles for annual financial statements. In the opinion of management, all known adjustments (consisting of normal recurring accruals and reserves) necessary to present fairly the Company’s consolidated financial position, results of operations and cash flows as of and for the interim periods have been included. It is suggested that these interim statements be read in conjunction with the financial statements and related notes included in the Company's September 30, 2010 Form 10-K.

The operating results for the three months ended December 31, 2010 are not necessarily indicative of the results to be expected for the September 30, 2011 year end.

Management has evaluated subsequent events after the balance sheet date through the issuance of the financial statements for appropriate accounting and disclosure.

Note 2. Trade Accounts and Other Non-Trade Receivables

Trade receivables consist of:

- Trade receivables from sales to customers
- Allowances, consisting of sales and bad debt

Other non trade receivables consist of:

- Receivables pertaining to component parts purchased from the Company at cost by the Company’s contract manufacturers which are excluded from sales
- General services tax (GST) and value added tax (VAT) reclaimable on goods purchased by the Company’s Asian and European locations
- Other minor non-trade receivables

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Trade receivables and other non-trade receivables as of December 31, 2010 and September 30, 2010 consisted of:

	December 31, <u>2010</u>	September 30, <u>2010</u>
Trade receivables	\$7,975,599	\$9,123,726
Allowance for doubtful accounts	(383,773)	(383,773)
Sales reserve	<u>(3,968,196)</u>	<u>(4,336,759)</u>
Net trade receivables	<u>\$3,623,630</u>	<u>\$4,403,194</u>
Receivable from contract manufacturers	\$1,276,732	\$1,846,949
GST and VAT taxes receivables	477,161	439,745
Other	<u>75,979</u>	<u>69,140</u>
Total other non trade receivables	<u>\$1,829,872</u>	<u>\$2,355,834</u>

Note 3. Inventories

Inventories have been valued at the lower of average cost or market on a first in first out basis. The components of inventory consist of:

	December 31, <u>2010</u>	September 30, <u>2010</u>
Component parts	\$ 4,455,874	\$ 3,565,643
Finished goods	<u>7,758,859</u>	<u>7,884,922</u>
	<u>\$ 12,214,733</u>	<u>\$ 11,450,565</u>

Note 4. Net Loss Per Share

Basic net loss per share includes no dilution and is computed by dividing net loss by the weighted average number of shares of common stock outstanding for the period. Diluted net loss per share reflects, in the periods in which they have a dilutive effect, the dilution which would occur upon the exercise of stock options. A reconciliation of the shares used in calculating basic and diluted net income per share is as follows:

	Three months ended <u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
-		
Weighted average shares outstanding-basic	10,083,417	10,059,808
Number of shares issued on the assumed exercise of stock options	<u>-</u>	<u>-</u>
Weighted average shares outstanding-diluted	<u>10,083,417</u>	<u>10,059,808</u>

Options to purchase 1,537,442 and 1,522,394 shares of common stock, at prices from \$0.89 to \$7.45 and from \$1.05 to \$8.75, were outstanding for the three months ended December 31, 2010 and 2009, respectively, but were not included in the computation of diluted earnings per share because they were anti-dilutive.

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 5. Foreign Currency Translations and Transactions

The Company's Asian subsidiary reports its financial position and results of operations in the reporting currency of the Company.

The financial position and results of operations of the Company's European subsidiaries are determined using Euros as the functional currency. Assets and liabilities of these subsidiaries are translated at the exchange rate in effect at each period end. Income statement accounts are translated at the average rate during the year. Translation adjustments arising from the translation to U.S. Dollars at differing exchange rates are included in the accumulated other comprehensive income (loss) account in stockholders' equity. Gains and losses resulting from transactions that are denominated in currencies other than Euros are included in earnings as a component of other income. The Company had a translation loss of \$4,410,677 recorded on the balance sheet as of September 30, 2010. For the three months ended December 31, 2010 the Company recorded on the balance sheet translation gains of \$161,219, resulting in an accumulated translation loss of \$4,249,458 recorded as a component of accumulated other comprehensive loss as of December 31 2010.

Note 6. Product segment and geographic information

The Company operates in one business segment, which is the development, marketing and manufacturing of analog and digital TV tuner products for the personal computer market. The products are similar in function and share commonality of component parts and manufacturing processes. The Company's products are either sold, or can be sold, by the same retailers and distributors in the Company's marketing channel. The Company also sells product directly to PC manufacturers. The Company evaluates its product lines under the functional categories of analog TV tuners, digital TV tuners and other non-TV tuner products.

The Company's products fall under three product categories:

- Analog TV tuner products
- Digital TV tuner, and combination analog and digital TV tuner, products
- Other non-TV tuner products

The Company's Analog TV tuner products are TV tuner modules which can be added to a PC and enable a PC user, among other things, to watch and record analog cable TV in a resizable window on a PC.

The Company's digital TV and combination analog and digital tuner products are TV tuner modules which enable a PC user, among other things, to watch and record analog cable TV and digital TV in a resizable window on a PC.

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company's other non-TV tuner products enable a PC user, among other things, to video conference, watch and listen to PC based videos, music and pictures on a TV set through a home network, and record TV and other types of video on a PC for playback on portable video players.

Sales by functional category are as follows:

<u>Product line sales</u>	Three months ended December 31,	
	<u>2010</u>	<u>2009</u>
Analog TV tuner products	\$ 530,576	\$ 277,870
Digital and combination analog and digital TV tuner products	8,195,740	15,805,316
Other non-TV tuner products	<u>4,136,630</u>	<u>1,795,172</u>
Total sales	<u>\$ 12,862,946</u>	<u>\$ 17,878,358</u>

The Company sells its products through a North American and international network of distributors and retailers. It maintains sales offices in Europe and Asia. Sales percentages by geographic region are as follows:

<u>Geographic region</u>	Three months ended December 31,	
	<u>2010</u>	<u>2009</u>
The Americas	61%	43%
Europe	37%	55%
Asia	<u>2%</u>	<u>2%</u>
Total	<u>100%</u>	<u>100%</u>

Note 7. Tax provision

The Company's tax provision for the three months ended December 31, 2010 and 2009 is as follows:

	Three months ended December 31,	
	<u>2010</u>	<u>2009</u>
Tax expense on international operations	\$ 37,331	\$ 41,226
State taxes	10,000	10,000
Deferred tax expense	<u>199,726</u>	<u>-</u>
Tax provision	<u>\$247,057</u>	<u>\$ 51,226</u>

Note 8. Accrued expense- fees

The Company uses software and technology purchased or licensed from third parties in certain of the Company's products. The Company enters into agreements for these technologies, and incurs a fee for each product sold that includes the technology. The Company recognizes and estimates the amount of fees owed to third parties based on products sold that include software and technology purchased or licensed from these third parties. The Company uses all available applicable information in determining

HAUPPAUGE DIGITAL INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

these estimates and thus the accrued amounts are subject to change as new information is made available to the Company. The Accrued expense fees are accounted for as a component of product cost and are charged to cost of sales. As of December 31, 2010 and September 30, 2010 the amount of Accrued expense fees amounted to \$4,917,267 and \$4,955,540, respectively.

Note 9, Accrued Expenses

Accrued expenses are for costs incurred for goods and services which are based on estimates, charged as incurred to operations as period costs and for which no invoice has been rendered. Accrued expenses as of December 31, 2010 and September 30, 2010 were \$10,416,263 and \$10,266,495, respectively. Included in accrued expenses are accruals for product costs, accruals for sales costs relating to a sales rebate program, accruals for freight and duty expenses, accruals for compensation, accruals for warranty repair costs and accruals for advertising and marketing costs. During the quarter ended December 31, 2011 the Company reduced its warranty repair accrual by \$150,787 as the actual warranty costs appear to have decreased compared to original estimates.

Note 10. Fair Value Measurements

ASC Topic 820, "Fair Value Measurements and Disclosures", establishes a framework for measuring fair value, and expands the related disclosure requirements. The ASC indicates, among other things, that a fair value measurement assumes a transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The Company also adopted the provisions of ASC 820-10 with respect to its non-financial assets and liabilities during the first quarter of fiscal 2010. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a hierarchy for observable and unobservable inputs used to measure fair value into three broad Levels, which are described below:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.
- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

As of December 31, 2010, the Company had foreign currency contracts outstanding of approximately \$1,319,000 with a fair market value of \$1,341,798 against the delivery of the Euro. These contracts expire each month through March 31, 2011. The Company had no forward exchange contracts outstanding as of September 30, 2010.

Additionally, on a nonrecurring basis, the Company uses fair value measures when analyzing asset impairment. Long-lived assets and certain identifiable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If it is determined such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization periods, their carrying values are reduced to estimated fair value. Measurements based on undiscounted cash flows are considered to be Level 3 inputs.

The carrying amount of cash, accounts receivables and accounts payables and other short-term financial instruments approximate their fair value due to their short-term nature.

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

**THREE MONTH PERIOD ENDED DECEMBER 31, 2010 COMPARED TO THE THREE
MONTH PERIOD ENDED DECEMBER 31, 2009**

Results of operations for the three months ended December 31, 2010 compared to the three months ended December 31, 2009 is as follows:

	Three	Three	Variance	Percentage of sales		
	Months	Months				
	Ended	Ended		2010	2009	Variance
	<u>12/31/10</u>	<u>12/31/09</u>	\$			
Net Sales	\$12,862,946	\$17,878,358	(\$5,015,412)	100.00%	100.00%	-
Cost of sales	<u>8,515,708</u>	<u>12,655,961</u>	<u>(4,140,253)</u>	<u>66.20%</u>	<u>70.79%</u>	<u>-4.59%</u>
Gross Profit	4,347,238	5,222,397	(875,159)	33.80%	29.21%	4.59%
Gross Profit %	33.80%	29.21%	4.59%			
Expenses:						
Sales & marketing	2,510,330	2,900,815	(390,485)	19.52%	16.23%	3.29%
Sales & marketing-PCTV	97,398	124,713	(27,315)	0.76%	0.70%	0.06%
Technical support	110,718	121,173	(10,455)	0.86%	0.68%	0.18%
General & administrative	747,422	835,677	(88,255)	5.81%	4.67%	1.14%
General & administrative-PCTV	56,184	92,980	(36,796)	0.44%	0.52%	-0.08%
Amortization of intangible assets	188,709	188,709	-	1.47%	1.06%	0.41%
Selling, general and administrative stock compensation expense	<u>63,943</u>	<u>68,456</u>	<u>(4,513)</u>	<u>0.50%</u>	<u>0.38%</u>	<u>0.12%</u>
Total selling, general and administrative expense	3,774,704	4,332,523	(557,819)	29.36%	24.24%	5.12%
Research and development	655,950	627,757	28,193	5.10%	3.51%	1.59%
Research and development-PCTV	404,302	504,519	(100,217)	3.14%	2.82%	0.32%
Research and development stock compensation expense	<u>36,527</u>	<u>37,795</u>	<u>(1,268)</u>	<u>0.28%</u>	<u>0.21%</u>	<u>0.07%</u>
Total expenses	<u>4,871,483</u>	<u>5,502,594</u>	<u>(631,111)</u>	<u>37.88%</u>	<u>30.78%</u>	<u>7.10%</u>
Loss from operations	(524,245)	(280,197)	(244,048)	-4.08%	-1.57%	-2.51%
Other income (expense) :						
Interest income	1,559	1,452	107	0.01%	0.01%	0.00%
Interest (expense)	-	(4,340)	4,340	0.00%	-0.02%	0.02%
Foreign currency	<u>31,523</u>	<u>(240)</u>	<u>31,763</u>	<u>0.25%</u>	<u>0.00%</u>	<u>0.25%</u>
Total other income (expense)	<u>33,082</u>	<u>(3,128)</u>	<u>36,210</u>	<u>0.26%</u>	<u>-0.02%</u>	<u>0.27%</u>
Loss before tax provision	(491,163)	(283,325)	(207,838)	-3.82%	-1.58%	-2.24%
Deferred tax expense	199,726	-	199,726	1.55%	0.00%	1.55%
Current tax expense	<u>47,331</u>	<u>51,226</u>	<u>(3,895)</u>	<u>0.37%</u>	<u>0.29%</u>	<u>0.08%</u>
Net loss	<u>(\$738,220)</u>	<u>(\$334,551)</u>	<u>(\$403,669)</u>	<u>-5.74%</u>	<u>-1.87%</u>	<u>-3.87%</u>

Net sales for the three months ended December 31, 2010 decreased \$5,015,412 compared to the three months ended December 31, 2009 as shown in the table below.

	Three Months ended 12/31/10	Three Months ended 12/31/09	Increase	Increase	Percentage of sales by geographic region	
			(decrease) Dollar Variance	(decrease) dollar variance %	2010	2009
The Americas	\$ 7,893,888	\$ 7,663,098	\$ 230,790	3%	61%	43%
Europe	4,706,131	9,812,426	(5,106,295)	-52%	37%	55%
Asia	<u>262,927</u>	<u>402,834</u>	<u>(139,907)</u>	<u>-35%</u>	<u>2%</u>	<u>2%</u>
Total	<u>\$ 12,862,946</u>	<u>\$ 17,878,358</u>	<u>\$ (5,015,412)</u>	<u>-28%</u>	<u>100%</u>	<u>100%</u>

European sales were impacted by lower consumer demand due to weak economic conditions and a weaker Euro exchange rate against the U.S. dollar for the quarter ended December 31, 2010. A sales mix of higher priced product contributed to a 25.68% increase in the average unit sales price while unit sales declined by 42.75%.

Gross profit

Gross profit decreased \$875,159 for the three months ended December 31, 2010 compared to the same period in the prior year.

The decrease in the gross profit is detailed below:

	<u>Increase (decrease)</u>
Decreased sales	\$ (2,002,306)
Decrease due weaker Euro to USD exchange rate	(344,281)
Higher gross profit on sales mix	568,118
Change in warranty repair reserve	150,787
Lower production and production related costs	<u>752,523</u>
Total decrease in gross profit	<u>\$ (875,159)</u>

Gross profit percentage for the three months ended December 31, 2010 was 33.80% compared to 29.21% for the three months ended December 31, 2009, resulting in a gross profit percentage increase of 4.59%.

The increase in gross profit percentage is detailed below:

	<u>Increase (decrease)</u>
Higher gross profit on sales mix	4.60%
Decrease due weaker Euro to USD exchange rate	-1.68%
Change in warranty repair reserve	1.17%
Lower production and production related costs	<u>0.50%</u>
Total increase in gross profit percentage	<u>4.59%</u>

The factors contributing to the gross profit percent increase of 4.59% for the three months ended December 31, 2010 were primarily:

- Shift in sales to products with a higher average unit sales price resulted in a gross profit percentage increase of 4.60%.
- A decrease in the Euro to USD exchange rate from 1.4773 for the three months ended December 31, 2010 to 1.3591 for the three months ended December 31, 2010 resulted in a gross profit decrease of 1.68%.
- Change in warranty repair reserve to reflect changes in estimate based on actual experience resulted in gross profit increase of 1.17%
- Lower production and production related costs such as building overhead, packaging costs, freight costs and labor costs at a third party facility resulted in a gross profit increase of 0.50%.

Selling, general and administrative expenses

The chart below illustrates the components of selling, general and administrative expense.

	<u>Three months ended December 31,</u>					
	<u>Dollar Costs</u>			<u>Percentage of Sales</u>		
	<u>2010</u>	<u>2009</u>	<u>Increase (Decrease)</u>	<u>2010</u>	<u>2009</u>	<u>Increase (Decrease)</u>
Sales and marketing-HCW	\$2,510,330	\$2,900,815	\$(390,485)	19.52%	16.23%	3.29%
Sales and marketing-PCTV	97,398	124,713	(27,315)	0.76%	0.70%	0.06%
Technical support	110,718	121,173	(10,455)	0.86%	0.68%	0.18%
General and administrative-HCW	747,422	835,677	(88,255)	5.81%	4.67%	1.14%
General and administrative-PCTV	56,184	92,980	(36,796)	0.44%	0.52%	-0.08%
Amortization of intangible assets	188,709	188,709	-	1.47%	1.06%	0.41%
Stock compensation	<u>63,943</u>	<u>68,456</u>	<u>(4,513)</u>	<u>0.50%</u>	<u>0.38%</u>	<u>0.12%</u>
Total	<u>\$3,774,704</u>	<u>\$4,332,523</u>	<u>\$(557,819)</u>	<u>29.36%</u>	<u>24.24%</u>	<u>5.12%</u>

Selling, general and administrative expense for the first quarter of fiscal 2011 decreased \$557,819 from the same period as last year as follows.

Sales and marketing expenses for HCW and PCTV decreased \$417,800, driven primarily by a \$140,198 decrease in expenses attributable to the decrease in the Euro exchange rate compared to the U.S. dollar, \$317,670 decrease in sales related expenses, mainly commission and co-op advertising expenses, offset by an increase of \$77,822 in sales offices expenses.

The decrease in Technical Support was primarily due to lower personnel costs. The decrease in HCW and PCTV general and administrative expenses of \$125,051 was due primarily to lower professional fees for legal and accounting services of \$73,121 and lower PCTV general and administrative expenses of \$36,796, mainly for termination of service related contracts and lower communication and professional fees.

Research and development expenses

Research and development expense for the three months ended December 31, 2010 decreased \$73,292 from the three months ended December 31, 2009 as follows:

	<u>HCW</u>	<u>PCTV</u>	<u>Total</u>
Research and development expense-HCW	\$28,193	\$0	\$28,193
Research and development expense-PCTV	0	(100,217)	(100,217)
Stock compensation expense	<u>(1,268)</u>	<u>0</u>	<u>(1,268)</u>
Total research and development expense	<u>\$26,925</u>	<u>(\$100,217)</u>	<u>(\$73,292)</u>

The PCTV decrease in research and development expenses was due to lower personnel costs and lower program costs. The increase in HCW research and development costs was due to higher personnel costs.

Tax provision

Our tax provision for the three months ended December 31, 2010 and 2009 is as follows:

	<u>Three months ended December 31,</u>	
	<u>2010</u>	<u>2009</u>
Tax expense on international operations	\$ 37,331	\$ 41,226
State taxes	10,000	10,000
Deferred tax expense	<u>199,726</u>	<u>-</u>
Tax provision	<u>\$247,057</u>	<u>\$ 51,226</u>

Summary of operations

We recorded a net loss of \$738,220 for the three months ended December 31, 2010, which resulted in basic and diluted net income per share of \$0.07 on weighted average basic and diluted shares of 10,083,417, compared to a net loss of \$334,551 for the three months ended December 31, 2009, which resulted in basic and diluted net loss per share of \$0.03 on weighted average basic and diluted shares of 10,059,808.

Options to purchase 1,537,442 and 1,522,394 shares of common stock, at prices from \$0.89 to \$7.45 and from \$1.05 to \$8.75, were outstanding for the three months ended December 31, 2010 and 2009, respectively, but were not included in the computation of diluted earnings per share because they were anti-dilutive.

Seasonality

As our sales are primarily to the consumer market, we have experienced certain seasonal revenue trends. Historically, our peak sales quarter due to holiday season sales is our first fiscal quarter (October to December), followed by our second fiscal quarter (January to March). In addition, our international sales, mostly in the European market, were 54% of sales for fiscal year ended September 30, 2010 and 52% for the fiscal year ended September 30, 2009. Part of our third and fourth quarters (April through June and July to September) can be potentially impacted by the reduction of activity experienced in Europe during the summer holiday period.

We target a wide range of customer types to attempt to moderate the seasonal nature of our retail sales.

Liquidity and capital resources

Our cash, working capital and stockholders' equity position as of December 31, 2010 and September 30, 2010 is set forth below:

	<u>December 31, 2010</u>	<u>September 30, 2010</u>
Cash	\$ 7,286,019	\$ 7,057,904
Working Capital	4,671,132	4,777,442
Stockholders' Equity	9,484,989	9,980,642

The Company had cash and cash equivalents as of December 31, 2010 of \$7,286,019, an increase of \$228,115 from September 30, 2010.

The increase in cash was due to was:

	Operating	Investing	Financing	
<u>Sources of cash:</u>	<u>Activities</u>	<u>Activities</u>	<u>Activities</u>	<u>Total</u>
Decrease in accounts receivable	\$1,696,257	\$0	\$0	\$1,696,257
Proceeds from employee stock purchases	<u>-</u>	<u>-</u>	<u>3,677</u>	<u>3,677</u>
Total sources of cash	1,696,257	\$0	3,677	1,699,934
<u>Less cash used for:</u>				
Increase in inventory	(\$1,032,798)	\$-	\$-	(\$1,032,798)
Net loss adjusted for non cash items	(245,524)	-	-	(245,524)
Increase in prepaid expenses and other current assets	(86,338)	-	-	(86,338)
Decrease in accounts payable and accrued expenses	(62,716)	-	-	(62,716)
Effect of exchange rates on cash	(23,636)	-	-	(23,636)
Capital equipment purchases	<u>-</u>	<u>(20,807)</u>	<u>-</u>	<u>(20,807)</u>
Total cash usage	<u>(1,451,012)</u>	<u>(20,807)</u>	<u>-</u>	<u>(1,471,819)</u>
Net cash increase	<u>\$245,245</u>	<u>(\$20,807)</u>	<u>\$3,677</u>	<u>\$228,115</u>

Net cash provided by operating activities was due to a decrease in accounts receivable of \$1,696,257. The decrease in accounts receivable was primarily due to timing of sales. Offsetting the cash increase were increases in inventory of \$1,032,798, the net loss adjusted for non cash items of \$245,524, increases in prepaid expenses of \$86,338 and a decrease in accounts payable and accrued expenses of \$62,716. The increase in inventory was for parts purchased for products that are expected to be built in the second fiscal quarter.

Cash of \$20,807 was used in investing activities for the purchase of fixed assets. Cash of \$3,677 from financing activities came from exercise of incentive stock options.

Our cash requirements for the next twelve months will include, among other things, the cash needed to fund our operating and working capital needs. With the proper execution of our business and operating plan, we believe that our cash and cash equivalents as of December 31, 2010 and our internally generated cash will provide us with sufficient liquidity to meet our capital needs for the next twelve months. Failure to meet the business and operating plan could require the need for additional sources of capital. In light of the current economic and credit conditions there can be no assurances that we will be able to find external sources of financing to fund our additional capital needs. In addition, if we are able to obtain financing, there can be no assurances that it will be on financially reasonable terms.

Future contractual obligations

The following table shows our contractual obligations related to lease obligations as of December 31, 2010:

	<u>Total</u>	<u>Payments due by period</u>		
	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>3 to 5 years</u>
Operating lease obligations	<u>\$901,735</u>	<u>\$591,826</u>	<u>\$280,440</u>	<u>\$29,469</u>

Inflation

While inflation has not had a material effect on our operations in the past, there can be no assurance that we will be able to continue to offset the effects of inflation on the costs of our products or services

through price increases to our customers without experiencing a reduction in the demand for our products; or that inflation will not have an overall effect on the computer equipment market that would have a material effect on us.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 305 of Regulation S-K “Quantitative and Qualitative Disclosures About Market Risk” is not required for Smaller Reporting Companies.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

As required by Exchange Act Rule 13a-15(b), as of the end of the period covered by this Quarterly Report, with the participation of our principal executive officer and principal financial officer, we evaluated the effectiveness of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2010.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting, identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 of the Exchange Act, that occurred during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Special note regarding forward-looking statements

This Quarterly Report on Form 10-Q contains forward-looking statements as that term is defined in the federal securities laws. The events described in forward-looking statements contained in this Quarterly Report on Form 10-Q may not occur. Generally these statements relate to business plans or strategies, projected or anticipated benefits or other consequences of our plans or strategies, financing plans, projected or anticipated benefits from acquisitions that we may make, or projections involving anticipated revenues, earnings or other aspects of our operating results or financial position, and the outcome of any contingencies. Any such forward-looking statements are based on current expectations, estimates and projections of management. We intend for these forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements. Words such as “may,” “will,” “expect,” “believe,” “anticipate,” “project,” “plan,” “intend,” “estimate,” and “continue,” and their opposites and similar expressions are intended to identify forward-looking statements. We caution you that these statements are not guarantees of future performance or events and are subject to a number of uncertainties, risks and other influences, many of which are beyond our control, that may influence the

accuracy of the statements and the projections upon which the statements are based. Any one or more of these uncertainties, risks and other influences could materially affect our results of operations and whether forward-looking statements made by us ultimately prove to be accurate. Our actual results, performance and achievements could differ materially from those expressed or implied in these forward-looking statements. All cautionary statements made in this Quarterly Report on Form 10-Q should be read as being applicable to all related forward-looking statements wherever they appear. We undertake no obligation to publicly update or revise any forward-looking statements, whether from new information, future events or otherwise. Factors that could cause actual results to differ materially from those set forth or implied by any forward-looking statement include, but are not limited to, the mix of products sold and the profit margins thereon, order cancellation or a reduction in orders from customers, the availability and pricing of key raw materials, competitive product offerings and pricing actions, dependence on key members of management, the availability of financing, successful integration of acquisitions, economic conditions in the United States and abroad, history of operating losses as well as other risks and uncertainties discussed in our reports filed with the Securities and Exchange Commission, including, but not limited to, our Annual Report on Form 10-K for the fiscal year ended September 30, 2010 and this Form 10-Q for the three months ended December 31, 2010. Copies of these filings are available at www.sec.gov.

PART II. OTHER INFORMATION

Item 6. Exhibits

- 3.1 Certificate of Incorporation (1)
- 3.1.1 Certificate of Amendment of the Certificate of Incorporation, dated July 14, 2000 (2)
- 3.2 By-laws, as amended to date (3)
- 4.1 Form of Common Stock Certificate (1)
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Denotes document filed as an Exhibit to our Registration Statement on Form SB-2 (No. 33-85426), as amended, effective January 10, 1995 and incorporated herein by reference.
 - (2) Denotes document filed as an Exhibit to our Form 10-K for the period ended September 30, 2006, and incorporated herein by reference.

- (3) Denotes document filed as an Exhibit to our Form 8-K dated December 26, 2007 and incorporated herein by reference.

SIGNATURES

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

HAUPPAUGE DIGITAL INC.

Date: February 11, 2011

By /s/Kenneth Plotkin
KENNETH PLOTKIN
Chief Executive Officer, Chairman of the
Board, President (Principal Executive Officer)

Date: February 11, 2011

By /s/Gerald Tucciarone
GERALD TUCCIARONE
Treasurer, Chief Financial Officer,
(Principal Financial Officer and Principal
Accounting Officer) and Secretary

CERTIFICATION

Exhibit 31.1

I, Kenneth Plotkin, certify that:

1. I have reviewed this Form 10-Q of Hauppauge Digital Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 11, 2011

/s/Kenneth Plotkin

Kenneth Plotkin

Principal Executive Officer

CERTIFICATION

I, Gerald Tucciarone, certify that:

1. I have reviewed this Form 10-Q of Hauppauge Digital Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 11, 2011

/s/Gerald Tucciarone
Gerald Tucciarone
Principal Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned hereby certifies, pursuant to, and as required by, 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Hauppauge Digital Inc. (the "Company") on Form 10-Q for the period ended December 31, 2010 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 11, 2011

/s/ Kenneth Plotkin
Kenneth Plotkin
Chief Executive Officer

/s/ Gerald Tucciarone
Gerald Tucciarone
Chief Financial Officer, Treasurer
and Secretary