ANDREA ELECTRONICS CORP
Form 10QSB
August 14, 2007

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

FORM 10-QSB

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended June 30, 2007

OR

o 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 1-4324

ANDREA ELECTRONICS CORPORATION

(Exact name of small business issuer as specified in its charter)

New York (State or other jurisdiction of incorporation or organization)	11-0482020 (I.R.S. employer identification no.)
65 Orville Drive, Bohemia, New York (Address of principal executive offices)	11716 (Zip Code)

Issuer's telephone number, including area code: 631-719-1800

Check whether the issuer (1) filed all reports required to by filed by Section 13 or 15(d) of the Exchange Act during the past months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of August 9, 2007, there are 59,679,373 common shares outstanding.

Transitional Small Business Disclosure format (check one) Yes o No x

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 983,385	$ 303,678
Accounts receivable, net of allowance for doubtful accounts of $16,591 and $16,704, respectively	491,462	839,599
Inventories, net	763,139	1,088,778
Prepaid expenses and other current assets	111,649	367,421
Total current assets	2,349,635	2,599,476
Property and equipment, net	31,540	39,243
Intangible assets, net	3,207,705	3,437,432
Other assets, net	12,864	12,864
Total assets	$ 5,601,744	$ 6,089,015
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 283,504	$ 619,159
Short-term portion of capital lease	1,527	5,068
Other current liabilities	238,831	413,166
Total liabilities	523,862	1,037,393
Series B Redeemable Convertible Preferred Stock, $.01 par value; authorized: 1,000 shares; none issued and outstanding	-	-
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $.01 par value; authorized: 2,497,500 shares; none issued and outstanding	-	-
Series C Convertible Preferred Stock, net, $.01 par value; authorized: 1,500 shares; issued and outstanding: 90.7 and 100.7 shares, respectively; liquidation value: $907,015 and $100,701, respectively	1	1
Series D Convertible Preferred Stock, net, $.01 par value; authorized: 2,500,000 shares; issued and outstanding: 1,192,858 and 1,242,858 shares, respectively; liquidation value: $1,192,858 and $1,242,858, respectively	11,929	12,429
Common stock, $.01 par value; authorized: 200,000,000 shares; issued and outstanding: 59,679,373 and 59,021,857 shares, respectively	596,794	590,219

Additional paid-in capital	76,491,237	76,352,407
Accumulated deficit	(72,022,079)	(71,903,434)
Total shareholders’ equity	5,077,882	5,051,622
Total liabilities and shareholders’ equity	$ 5,601,744	$ 6,089,015

See Notes to Condensed Consolidated Financial Statements.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Revenues				
Net Product revenues	$ 862,293	$ 1,239,675	$ 2,167,115	$ 2,166,342
License revenues	140,171	144,901	407,901	271,559
Revenues	1,002,464	1,384,576	2,575,016	2,437,901
Cost of revenues	467,750	778,396	1,256,919	1,275,753
Gross margin	534,714	606,180	1,318,097	1,162,148
Research and development expenses	156,101	134,858	328,860	268,393
General, administrative and selling expenses	491,071	460,895	1,079,832	936,972
(Loss) income from operations	(112,458)	10,427	(90,595)	(43,217)
Interest income (expense), net	1,576	(168)	404	(310)
(Loss) income before provision for income taxes	(110,882)	10,259	(90,191)	(43,527)
Provision for income taxes	8,252	20,496	28,454	20,496
Net loss	$ (119,134)	$ (10,237)	$ (118,645)	$ (64,023)
Basic and diluted weighted average shares	59,611,981	58,376,586	59,327,389	58,330,338
Basic and diluted net loss per share	$ (.00)	$ (.00)	$ (.00)	$ (.00)

See Notes to Condensed Consolidated Financial Statements.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2007
(UNAUDITED)

	Series C Convertible Preferred Stock Outstanding	Series C Convertible Preferred Stock	Series D Convertible Preferred Stock Outstanding	Series D Convertible Preferred Stock	Common Stock Shares Outstanding	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Total Shareholders' Equity
Balance, January 1, 2007	100.701477	$ 1	1,242,858	$ 12,429	59,021,857	$ 590,219	$ 76,352,407	$ (71,903,434)	$ 5,051,622
Conversions of Series D Convertible Preferred Stock	-	-	(50,000)	(500)	200,000	2,000	(1,500)	-	-
Conversions of Series C Convertible Preferred Stock	(10.000000)	-	-	-	457,516	4,575	12,137	-	16,712
Stock Grant to Outside Directors and related amortization	-	-	-	-	-	-	10,000	-	10,000
Amortization of Stock Option Grants	-	-	-	-	-	-	118,193	-	118,193
Net loss	-	-	-	-	-	-	-	(118,645)	(118,645)
Balance, June 30, 2007	90.701477	$ 1	1,192,858	$ 11,929	59,679,373	$ 596,794	$ 76,491,237	$ (72,022,079)	$ 5,077,882

See Notes to Condensed Consolidated Financial Statements.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Six Months Ended	
	June 30, 2007	June 30, 2006
Cash flows from operating activities:		
Net loss	$ (118,645)	$ (64,023)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	243,700	245,062
Stock compensation expense	128,193	14,743
Provision for bad debt	(113)	(291)
Inventory reserve	2,234	(38,016)
Changes in operating assets and liabilities:		
Accounts receivable	348,250	(130,191)
Inventories	323,405	(151,636)
Prepaid expenses and other current assets	255,772	91,030
Trade accounts payable	(335,655)	16,407
Other current liabilities	(157,623)	(42,085)
Net cash provided by (used in) operating activities	689,518	(59,000)
Cash flows from investing activities:		
Purchases of Patents and trademarks	(6,270)	(9,832)
Net cash used in investing activities	(6,270)	(9,832)
Cash flows from financing activities:		
Payments under capital lease	(3,541)	(6,095)
Net cash used in financing activities	(3,541)	(6,095)
Net increase (decrease) in cash and cash equivalents	679,707	(74,927)
Cash and cash equivalents, beginning of period	303,678	418,597
Cash and cash equivalents, end of period	$ 983,385	$ 343,670
Supplemental disclosures of cash flow information:		
Non-cash investing and financing activities:		
Conversion of Series C Convertible Preferred Stock into common stock	$ 16,712	$ 8,356
Cash paid for:		
Interest	$ 1,628	$ 746
Income Taxes	$ 63,759	$ 14,164

See Notes to Condensed Consolidated Financial Statements.

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ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Note 1. Basis of Presentation and Management's Liquidity Plans

Basis of Presentation - The accompanying unaudited condensed consolidated interim financial statements include the accounts of Andrea Electronics Corporation and its subsidiaries ("Andrea" or the "Company"). All intercompany balances and transactions have been eliminated in consolidation.

These unaudited, condensed consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements. In addition, the December 31, 2006 balance sheet data was derived from the audited consolidated financial statements, but does not include all disclosures required by GAAP. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for any other interim period or for the fiscal year.

These unaudited condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2006 included in the Company's Form 10-KSB for the fiscal year ended December 31, 2006, filed on March 23, 2007. The accounting policies used in preparing these unaudited condensed consolidated interim financial statements are consistent with those described in the December 31, 2006 audited consolidated financial statements except for the adoption of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), which is discussed in Note 9.

Management's Liquidity Plans - As of June 30, 2007, Andrea had working capital of $1,825,773 and cash on hand of $983,385. Andrea's loss from operations was $112,458 and $90,595 for the quarter and six months ended June 30, 2007, respectively. Andrea plans to continue to improve its cash flows during 2007 by placing heightened emphasis on its sales and marketing efforts.

As of August 9, 2007, Andrea has approximately $740,000 (unaudited) of cash. Management believes that Andrea has sufficient liquidity available to operate through at least June 2008. While Andrea continues to explore opportunities to increase sales in new business areas, the Company is also examining additional opportunities for cost reduction, production efficiencies and further diversification of its business. In 2005, Andrea made significant changes in its facilities to improve overall cash expenditures. In 2006, Andrea increased sales whereas they reached profitability and became cash flow positive. Although these steps are encouraging, if Andrea fails to develop additional revenues from sales of its products or to generate adequate funding from operations, or if Andrea fails to obtain additional financing through a capital transaction or other type of financing, Andrea will be required to continue to significantly reduce its operating expenses and/or operations or Andrea may have to relinquish its products, technologies or markets which could have a materially adverse effect on revenue and operations. Andrea has no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all.

Note 2. Summary of Significant Accounting Policies

Loss Per Share - Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share adjusts basic loss per share for the effects of

convertible securities, stock options and other potentially dilutive financial instruments, only in the periods in which such effect is dilutive. Securities that could potentially dilute basic earnings per share ("EPS") in the future that were not included in the computation of the diluted EPS because to do so would have been anti-dilutive for the periods presented, consist of the following for the three months and six months end June 30, 2007 and 2006:

Total potential common shares as of:	June 30, 2007	June 30, 2006
Options to purchase common stock (Note 7)	7,440,001	4,442,500
Series C Convertible Preferred Stock and related accrued dividends (Note 3)	4,149,736	4,607,252
Series D Convertible Preferred Stock and related warrants (Note 4)	9,929,776	10,472,632
Total potential common shares	21,519,513	19,522,384

Cash and Cash Equivalents - Cash and cash equivalents include cash and highly liquid investments with original maturities of three months or less. Andrea has cash deposits in excess of the maximum amounts insured by FDIC at June 30, 2007 and December, 31 2006. The Company mitigates its risk by investing in or through major financial institutions.

Concentration of Credit Risk - Andrea is a manufacturer of audio communications equipment for several industries. Revenues of superbeam array microphone products were significant to one customer and its affiliates, accounting for approximately 17% and 22% of the total net revenues for the three months ended June 30, 2007 and 2006, respectively and accounted for 35% and 24% of total accounts receivable at June 30, 2007 and December 31, 2006, respectively. Revenues of superbeam array microphone products were significant to one customer and its affiliates, accounting for approximately 14% and 12% of the total net revenues for the six months ended June 30, 2007 and 2006, respectively. Revenues of noise canceling and active noise canceling products were significant to one customer and its affiliates, accounting for approximately 0% and 9% of the total net revenues for the three months ended June 30 2007 and 2006, respectively, and accounted for 0% and 3% of total accounts receivable at June 30, 2007 and December 31, 2006, respectively. Revenues of noise canceling and active noise canceling products were significant to one customer and its affiliates, accounting for approximately 5% and 14% of the total net revenues for the six months ended June 30 2007 and 2006, respectively. Licensing revenues and other revenues of noise canceling and active noise canceling products were significant to one customer and its affiliates, accounting for approximately 6% and 13% of the total net revenues for the three months ended June 30, 2007 and 2006, respectively, and accounted for 12% and 41% of total accounts receivable at June 30, 2007 and December 31, 2006, respectively. Licensing revenues and other revenues of noise canceling and active noise canceling products were significant to one customer and its affiliates, accounting for approximately 17% and 11% of the total net revenues for the six months ended June 30, 2007 and 2006, respectively. Licensing revenues and other service related revenues to one customer were approximately 14% and 6% of the total net revenues for the three months ended June 30, 2007 and 2006, respectively and accounted for 17% and 8% of total accounts receivable at June 30, 2007 and December 31, 2006, respectively. Licensing revenues and other service related revenues to one customer were approximately 11% and 8% of the total net revenues for the six months ended June 30, 2007 and 2006, respectively.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Andrea purchases a substantial portion of its finished goods from two suppliers. Purchases from these two suppliers amounted to 40% and 47% of total purchases for the three months ended June 30, 2007 and 86% and 0% for the three months ended June 30, 2006. Purchases from these two suppliers amounted to 77% and 9% of total purchases for the six months ended June 30, 2007 and 76% and 0% for the six months ended June 30, 2006. At June 30, 2007, the amounts due to these suppliers in accounts payable was $86,290 and 67,603, respectively. At December 31, 2006, the amounts due to these suppliers in accounts payable were 377,019 and $0, respectively.

Allowance for Doubtful Accounts - The Company performs on-going credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by the review of their current credit information. Collections and payments from customers are continuously monitored. The Company maintains an allowance for doubtful accounts, which is based upon historical experience as well as specific customer collection issues that have been identified. While such bad debt expenses have historically been within expectations and allowances established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories - Inventories are stated at the lower of cost (on a first-in, first-out) or market basis. The cost elements of inventories include materials, labor and overhead. Andrea reviews its inventory reserve for obsolescence on a quarterly basis and establishes reserves on inventories when the cost of the inventory is not expected to be recovered. Andrea's policy is to reserve for inventory that shows slow movement over the preceding six consecutive quarters. Andrea records changes in inventory reserves as part of cost of revenues.

	June 30, 2007	December 31, 2006
Raw materials	$ 32,366	$ 40,237
Finished goods	1,324,987	1,640,521
	1,357,353	1,680,758
Less: reserve for obsolescence	(594,214)	(591,980)
	$ 763,139	$ 1,088,778

Intangible and Long-Lived Assets - Andrea accounts for its long-lived assets in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 , "Accounting for the Impairment or Disposal of Long-Lived Assets" for purposes of determining and measuring impairment of its long-lived assets (primarily intangible assets) other than goodwill. Andrea's policy is to periodically review the value assigned to its long-lived assets to determine if they have been permanently impaired by adverse conditions which may affect Andrea. If Andrea identifies a permanent impairment such that the carrying amount of Andrea's long lived assets are not recoverable using the sum of an undiscounted cash flow projection (gross margin dollars from product sales), a new cost basis for the impaired asset will be established. This new cost basis will be net of any recorded impairment.

At June 30, 2007, management compared the sum of Andrea's undiscounted cash flow projections (gross margin dollars from product sales) of the Andrea DSP Microphone and Audio Software core technology to the carrying value of that technology. The results of this test indicated that there was no impairment. However, this process utilized probability weighted undiscounted cash flow projections which include a significant amount of management's judgment and estimates as to future revenue. If these probability weighted projections do not come to fruition, the

Company could be required to record an impairment charge in the near term and such impairment could be material. Andrea amortizes its core technology, patents and trademarks on a straight-line basis over the estimated useful lives of its intangible assets that range from 15 to 17 years. For the three-month periods ended June 30, 2007 and 2006, amortization expense was $118,043 and $117,744, respectively. For the six-month periods ended June 30, 2007 and 2006, amortization expense was $235,997 and $235,366, respectively.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Revenue Recognition - Non software-related revenue, which is generally comprised of microphones and microphone connectivity product revenues, is recognized when title and risk of loss pass to the customer, which is generally upon shipment. With respect to licensing revenues, Andrea recognizes revenue in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended, and Staff Accounting Bulletin Topic 13 "Revenue Recognition in Financial Statement." License revenue is recognized based on the terms and conditions of individual contracts (see Note 5). In addition, fee based services, which are short-term in nature, are generally performed on a time-and-material basis under separate service arrangements and the corresponding revenue is generally recognized as the services are performed.

Income Taxes - The provision for income taxes is a result of certain licensing revenues that are subject to withholding of income tax as mandated by the foreign jurisdiction in which the revenues are earned. For all other income taxes, Andrea accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 requires an asset and liability approach for financial accounting and reporting for income taxes. The provision for income taxes is based upon income or loss after adjustment for those permanent items that are not considered in the determination of taxable income. Deferred income taxes represent the tax effects of differences between the financial reporting and tax bases of the Company's assets and liabilities at the enacted tax rates in effect for the years in which the differences are expected to reverse. The Company evaluates the recoverability of deferred tax assets and establishes a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. If it becomes more likely than not that a tax asset will be used, the related valuation allowance on such assets would be reversed. Management makes judgments as to the interpretation of the tax laws that might be challenged upon an audit and cause changes to previous estimates of tax liability. In management's opinion, adequate provisions for income taxes have been made for all years. If actual taxable income by tax jurisdiction varies from estimates, additional allowances or reversals of reserves may be necessary. Income tax expense consists of the tax payable for the period and the change during the period in deferred tax assets and liabilities. Effective January 1, 2007, the Company adopted the provisions of FIN 48. FIN 48 establishes for all entities a minimum threshold for financial statement recognition of the benefit of tax positions, and requires certain expanded disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006, and is to be applied to all open tax years as of the date of effectiveness. The adoption of FASB Interpretation No. 48 did not have a material effect on the Company's condensed consolidated financial position or results of operations or cash flows (Note 9).

Stock-Based Compensation - At June 30, 2007, Andrea had three stock-based employee compensation plans, which are described more fully in Note 7. Effective, January 1, 2006, the Company adopted the provisions of SFAS No. 123R, "Share-Based Payment." SFAS No. 123R establishes accounting for stock-based awards exchanged for employee services. Under the provisions of SFAS No. 123R, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the employee's requisite service period (generally the vesting period of the equity grant). The Company amortizes stock-based compensation by using the straight-line method.

Recently Issued Accounting Pronouncements

Effective January 1, 2007, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences" ("EITF Issue No. 06-2"). EITF Issue No. 06-2 requires that compensation expense associated with a sabbatical leave, or other similar benefit arrangements, be accrued over the requisite service period during which an employee earns the benefit. The adoption of EITF Issue No. 06-2 did not have a material impact on our condensed consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement No. 157, “Fair Value Measurements” (“Statement No. 157”) which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. Statement No. 157 is effective for fiscal years beginning after November 15, 2007, and should be applied prospectively, except for the provisions for certain financial instruments that should be applied retrospectively as of the beginning of the year of adoption. The transition adjustment of the difference between the carrying amounts and the fair values of those financial instruments should be recognized as a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. The Company is currently evaluating the impact of adopting the provisions of Statement No. 157.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

In November 2006, the EITF reached a final consensus in EITF Issue 06-6 "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments" ("EITF 06-6"). EITF 06-6 addresses the modification of a convertible debt instrument that changes the fair value of an embedded conversion option and the subsequent recognition of interest expense for the associated debt instrument when the modification does not result in a debt extinguishment pursuant to EITF 96-19 , "Debtor's Accounting for a Modification or Exchange of Debt Instruments,". The consensus should be applied to modifications or exchanges of debt instruments occurring in interim or annual periods beginning after November 29, 2006. The adoption of EITF 06-6 did not have a material impact on the Company's condensed consolidated financial position, results of operations or cash flows.

In November 2006, the FASB ratified EITF Issue No. 06-7, "Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities" ("EITF 06-7"). At the time of issuance, an embedded conversion option in a convertible debt instrument may be required to be bifurcated from the debt instrument and accounted for separately by the issuer as a derivative under FAS 133, based on the application of EITF 00-19. Subsequent to the issuance of the convertible debt, facts may change and cause the embedded conversion option to no longer meet the conditions for separate accounting as a derivative instrument, such as when the bifurcated instrument meets the conditions of Issue 00-19 to be classified in stockholders' equity. Under EITF 06-7, when an embedded conversion option previously accounted for as a derivative under FAS 133 no longer meets the bifurcation criteria under that standard, an issuer shall disclose a description of the principal changes causing the embedded conversion option to no longer require bifurcation under FAS 133 and the amount of the liability for the conversion option reclassified to stockholders' equity. EITF 06-7 should be applied to all previously bifurcated conversion options in convertible debt instruments that no longer meet the bifurcation criteria in FAS 133 in interim or annual periods beginning after December 15, 2006, regardless of whether the debt instrument was entered into prior or subsequent to the effective date of EITF 06-7. Earlier application of EITF 06-7 is permitted in periods for which financial statements have not yet been issued. The adoption of EITF 06-7 did not have a material impact on the Company's condensed consolidated financial position, results of operations or cash flows.

In December 2006, the FASB issued FASB Staff Position ("FSP") EITF 00-19-2 "Accounting for Registration Payment Arrangements" ("FSP EITF 00-19-2") which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with SFAS No. 5, "Accounting for Contingencies." Adoption of FSP EITF 00-19-02 is required for fiscal years beginning after December 15, 2006. The adoption of FSP EITF 00-19-02 did not have a material impact on the Company's condensed consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS No. 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Adoption is required for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 159. The Company is currently evaluating the expected effect of SFAS 159 on its condensed consolidated financial statements and is currently not yet in a position to determine such effects.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. The most significant estimates, among other things, are used in accounting for allowances for bad debts, inventory valuation and obsolescence, product warranty, depreciation, deferred income taxes, expected realizable values for assets (primarily intangible assets), contingencies, revenue recognition as well as the recording and presentation of our convertible preferred stock. Estimates and assumptions are periodically reviewed and the effects of any material revisions are reflected in the condensed consolidated financial statements in the period that they are determined to be necessary. Actual results could differ from those estimates and assumptions.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Note 3. Series C Redeemable Convertible Preferred Stock

On October 10, 2000, Andrea issued and sold in a private placement $7,500,000 of Series C Redeemable Convertible Preferred Stock (the "Series C Preferred Stock"). Each of these shares of Series C Preferred Stock had a stated value of $10,000 plus $671.23 increase in the stated value, which sum is convertible into Common Stock at a conversion price of $0.2551. The Series C Preferred Stock currently has no dividends. Prior to the amendment there was a dividend of 5% per annum on the stated value. The additional amount of $671.23 represents the 5% per annum from October 10, 2000 through the amendment.

On April 11, 2007, 10 shares of Series C Preferred Stock, together with related accrued dividends, were converted into 457,516 shares of Common Stock at a conversion price of $0.2551.

As of June 30, 2007, there were 90.701477 shares of Series C Preferred Stock outstanding, which were convertible into 4,149,736 shares of Common Stock and remaining accrued dividends of $151,583, which is included in other current liabilities in the accompany unaudited condensed consolidated balance sheet.

Note 4. Series D Redeemable Convertible Preferred Stock

On February 17, 2004, Andrea entered into a Securities Purchase Agreement with certain holders of the Series C Preferred Stock and other investors (collectively, the "Buyers") pursuant to which the Buyers agreed to invest a total of $2,500,000. In connection with this agreement, on February 23, 2004, the Buyers purchased, for a purchase price of $1,250,000, an aggregate of 1,250,000 shares of a new class of preferred stock, the Series D Preferred Stock, convertible into 5,000,000 shares of Common Stock (an effective conversion price of $0.25 per share) and Common Stock warrants exercisable for an aggregate of 2,500,000 shares of Common Stock. The warrants are exercisable at any time after August 17, 2004 and before February 23, 2009 at an exercise price of $0.38 per share.

In addition, on June 4, 2004, the Buyers purchased for an additional $1,250,000, an additional 1,250,000 shares of Series D Preferred Stock convertible into 5,000,000 shares of Common Stock (an effective conversion price of $0.25 per share) and Common Stock warrants exercisable for an aggregate of 2,500,000 shares of Common Stock. The warrants are exercisable at any time after December 4, 2004 and before June 4, 2009 at an exercise price of $0.17 per share.

Knightsbridge Capital served as a financial advisor to Andrea in connection with the aforementioned transactions and the initial issuance of the Series D Preferred Stock and related warrants. In connection with these transactions, Andrea agreed to pay Knightsbridge Capital $300,000 in cash and to issue warrants exercisable for an aggregate of 377,094 shares of Common Stock. The warrants are exercisable at any time after August 17, 2004 and before February 23, 2009 at an exercise price of $0.38 per share.

From the time of issuance through June 4, 2009, the Company is required to maintain effective registration statements. Prior to 2007, there were 281,250 exercises of Series D Preferred Stock Warrants. On March 16, 2007, 25,000 shares of Series D Preferred Stock were converted into 100,000 shares of Common Stock at a conversion price of $0.25. On April 11, 2007, 25,000 shares of Series D Preferred Stock were converted into 100,000 shares of Common Stock at a conversion price of $0.25. As of June 30, 2007, there are 1,192,858 shares of Series D Preferred Stock and 5,158,344 related warrants outstanding, which are convertible and exercisable into 9,929,776 shares of Common Stock. There were no Series D Preferred Stock Warrant exercises during the quarter or six months ended June 30, 2007.

Note 5. Licensing Agreements

Analog

In November 2004, Andrea entered into a license agreement with Analog to integrate its EchoStop technology with certain Analog products for one of Analog's customers ("EchoStop Licensed Products"). As consideration of this license, Analog will pay Andrea a royalty for each EchoStop Licensed Product shipped. During the first year of the agreement, Analog will pay Andrea a minimum of $100,000 in royalty payments, payable in payments of $25,000 per quarter. During the three months ended June 30, 2006 Andrea received the final $25,000 of the minimum royalty payment due under this agreement. Andrea will continue to receive royalty payments based on the number of EchoStop Licensed Products shipped until either party terminates the agreement per the terms of the agreement. During the three months ended June 30, 2007 and June 30, 2006, Andrea has recognized $26,486 and $0, respectively of licensing revenues related to this agreement. During the six months ended June 30, 2007 and June 30, 2006, Andrea has recognized $67,999 and $25,000, respectively of licensing revenues related to this agreement.

In January 2006, Andrea entered into a license agreement with Analog to integrate its DSDA and EchoStop technologies with certain of Analog products for specific Analog PC Original Equipment Manufacturer ("OEM") customers ("DSDA/EchoStop Licensed Product"). In consideration of this license, Analog will pay Andrea a royalty for each DSDA/EchoStop Licensed Product shipped. During the three months ended June 30, 2007 and June 30, 2006, Andrea has recognized $37,004 and $12,500, respectively, of revenues under this agreement. During the six months ended June 30, 2007 and June 30, 2006, Andrea has recognized $63,945 and $12,500, respectively, of revenues under this agreement. When the royalties paid to Andrea from DSDA/EchoStop Licensed Products amount to $500,000, no further payments will be required under this agreement.

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Marconi
In December 2002, Andrea entered into a license agreement with Marconi Communications to provide and integrate a number of its proprietary audio software technologies into the Marconi ViPr Virtual Presence System ("ViPr"™). The ViPr conference system is a new network appliance developed by Marconi that enables secure, high resolution, real-time, multimedia communications between people in geographically dispersed locations. The addition of our hands-free audio system includes an advanced stereo version of Andrea's patented EchoStop, as well as its patented Digital Super Directional Array ("DSDAâ") and PureAudio noise canceling algorithms, among others. The implementation of Andrea's microphone array, which is embedded in the monitor of the ViPr system allows users to carry on discussions at normal conversation levels, even in a noisy environment. In 2006, Ericsson Inc. purchased certain assets and liabilities of Marconi Communication Inc. In conjunction with this purchase, Andrea, Marconi Communications Inc. and Ericsson Inc. executed a Novation Agreement in which the 2002 license agreement is now between Ericsson and Andrea. During the three months ended June 30, 2007 and 2006 $3,000 and $14,280, respectively, of license revenues were recognized in the accompanying unaudited condensed consolidated statements of operations. During the six months ended June 30, 2007 and 2006 $9,080 and $23,520, respectively, of licensing revenues were recognized related to this agreement.

Creative
In October 2004 Andrea entered into a Production and Distribution Agreement with Creative Technology Ltd. ("Creative"). This agreement was modified in January 2005 to incorporate additional license rights. This agreement grants Creative a non-exclusive license to VoiceCenter, PureAudio and DSDA as well as the right to purchase and resell certain of its other products. VoiceCenter will be distributed with Creative's Sound Blaster Live! ADVANCED MB, a simple online upgrade allowing PC users with motherboard audio produced by Dell to upgrade to Sound Blaster audio quality. The Sound Blaster Live! ADVANCED MB audio solution is available for PCs equipped with this configuration. The features of PureAudio and DSDA will be distributed in certain of Creative's other products to enable optimized far-field voice input. In consideration of this agreement, Creative pays Andrea a royalty for each VoiceCenter license shipped with the Soundblaster Live and each webcam shipped with Andrea's licensed technologies. During the three months ended June 30, 2007 and 2006, Andrea recorded $59,321 and $114,252, respectively of licensing revenues related to this agreement. During the six months ended June 30, 2007 and 2006, Andrea recorded $238,629 and $204,353, respectively of licensing revenues related to this agreement.

Samsung
In October 2005, Andrea entered into a license agreement with Samsung Electronics Co., LTD ("Samsung") to integrate our DSDA and EchoStop technologies with certain notebook/laptop PC products incorporating directional microphone and speaker phone functions for use in conjunction with PC software voice driven applications. During the three months ended June 30, 2007 and 2006, Andrea recorded $14,061 and $3,869 of licensing revenue related to this agreement, respectively. During the six months ended June 30, 2007 and 2006, Andrea recorded $27,491 and $3,869 of licensing revenue related to this agreement, respectively.

Note 6. Commitments And Contingencies

Leases

In March 2005, Andrea entered into a lease for its corporate headquarters located in Bohemia, New York, where Andrea leases space for warehousing, sales and executive offices from an unrelated party. The lease is for approximately 11,000 square feet and expires in October 2008. Rent expense under this operating lease was $20,469 and $40,516 for the three and six-month periods ended June 30, 2007, respectively. Rent expense under this operating

lease was $19,873 and $39,166 for the three and six-month periods ended June 30, 2006.

As of June 30, 2007, the future minimum annual lease payments under this lease and all non-cancelable operating leases are as follows:

2007 (July to December 31)	$	52,104
2008		102,326
2009		93,541
2010		29,171
Total	$	277,142

Employment Agreements

In June 2004, the Company entered into a one-year employment contract with the Chairman of the Board, Douglas J. Andrea, which automatically renewed for one additional one-year term and expired June 2006. Pursuant to this employment agreement, Mr. Andrea received an annual base salary of $225,000 per annum, a minimum annual prorated bonus of $50,000. Mr. Andrea was also entitled to a change in control payment equal to one time his base salary with continuation of health and medical benefits for one year in the event of a change in control and subsequent termination of employment other than for cause. In accordance with Amendment 1 of Mr. Andrea’s employment agreement, Mr. Andrea did not receive a $50,000 bonus for the periods ended December 31, 2005 and 2004, and instead is entitled to $100,000 bonus when the Company has positive cash flows. This bonus was paid during the three-month period ended June 30, 2007. At December 31, 2006, the future minimum cash commitments under this agreement aggregate $100,000, (including the unpaid portion of Mr. Andrea’s 2005 and 2004 bonuses), and is included in other liabilities in the Company’s accompanying condensed balance sheet.

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In November 2006, the Company entered into a new employment agreement with Mr. Andrea. The employment agreement expires July 31, 2008 and is subject to renewal as approved by the Compensation Committee of the Board of Directors. Pursuant to his employment agreement, Mr. Andrea will receive an annual base salary of $300,000 per annum. In addition, upon execution of the employment agreement, Mr. Andrea is entitled to a salary adjustment from August 1, 2006 through the date of the employment agreement. The employment agreement provides for quarterly bonuses equal to 25% of the Company’s pre-bonus net after tax quarterly earnings in excess of $25,000 for a total quarterly bonus amount not to exceed $12,500; and annual bonuses equal to 10% of the Company’s annual pre-bonus net after tax earnings in excess of $300,000. All bonuses shall be payable as soon as the Company's cash flow permits. All bonus determinations or any additional bonus in excess of the above will be made in the sole discretion of the Compensation Committee. On November 2, 2006, in accordance with his employment agreement, Mr. Andrea was granted 1,000,000 stock options. This grant provides for a three year vesting period, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. On November 16, 2006, in accordance with his employment agreement, Mr. Andrea was granted 1,000,000 stock options. This grant provides for a three year vesting period, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. Mr. Andrea is also entitled to a change in control payment equal to two times his salary with continuation of health and medical benefits for two years in the event of a change in control. At June 30, 2007, the future minimum cash commitments under this agreement aggregate $325,000. At December 31, 2006, the future minimum cash commitments under this agreement aggregate $481,349, of which $6,349 is included in other liabilities at December 31, 2006.

Legal Proceedings

Andrea is involved in routine litigation incidental to the normal course of business. While it is not feasible to predict or determine the final outcome of claims, Andrea believes the resolution of these matters will not have a material adverse effect on Andrea’s financial position, results of operations or liquidity.

Note 7. Stock Plans and Stock Based Compensation

In 1991, the Board of Directors of Andrea (the “Board”) adopted the 1991 Performance Equity Plan (“1991 Plan”), which was approved by the shareholders. The 1991 Plan, as amended, authorizes the granting of awards, the exercise of which would allow up to an aggregate of 4,000,000 shares of Andrea’s Common Stock to be acquired by the holders of those awards. Stock options granted to employees and directors under the 1991 Plan were granted for terms of up to 10 years at an exercise price equal to the market value at the date of grant. No further awards will be granted under the 1991 Plan.

In 1998, the Board adopted the 1998 Stock Option Plan (“1998 Plan”), which was subsequently approved by the shareholders. The 1998 Plan, as amended, authorizes the granting of awards, the exercise of which would allow up to an aggregate of 6,375,000 shares of Andrea’s Common Stock to be acquired by the holders of those awards. The awards can take the form of stock options, stock appreciation rights, restricted stock, deferred stock, stock reload options or other stock-based awards. Awards may be granted to key employees, officers, directors and consultants. At June 30, 2007, there were 9,984 shares available for further issuance under the 1998 Plan.

In October 2006, the Board adopted the Andrea Electronics Corporation 2006 Equity Compensation Plan (“2006 Plan”), which was subsequently approved by the shareholders. The 2006 Plan authorizes the granting of awards, the exercise of which would allow up to an aggregate of 10,000,000 shares of Andrea’s Common Stock to be acquired by the holders of those awards. The awards can take the form of stock options, stock appreciation rights, restricted stock or

other stock-based awards. Awards may be granted to key employees, officers, directors and consultants. At June 30, 2007, there were 8,070,000 shares available for further issuance under the 2006 Plan.

On August 4, 2005, in accordance with his employment agreement, Mr. Andrea was granted 250,000 stock options. This grant provides for a six month vesting period, an exercise price of $0.04 per share, which was fair market value at the date of grant, and a term of 10 years. There was no compensation expense related to the award for the three and six-month periods ended June 30, 2007. The compensation expense related to the award was $0 and $1,333 for the three and six-month periods ended June 30, 2006, respectively.

On November 1, 2005, the Board granted 40,000 stock options to each chairperson on the Nominating and Audit Committees. The grants provide for a six-month vesting period, an exercise price of $0.05 per share, which was fair market value at the date of grant, and a term of 10 years. There was no compensation expense related to the award for the three and six-month periods ended June 30, 2007. Compensation expense related to these awards was $667 and $2,667 for the three and six-month period ended June 30, 2006, respectively.

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In November 2006, in accordance with his employment agreement, Mr. Andrea was granted 2,000,000 stock options. These grants provide for three year vesting, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. Compensation expense related to these awards was $36,648 and $73,296 for the three and six-month period ended June 30, 2007, respectively. There was no compensation expense related to the award for the three and six-month periods ended June 30, 2006.

During 2006, the Board granted 400,000 stock options to the Vice President and Chief Financial Officer and 755,000 stock options to employees of the Company. Each option grant provides for vesting periods of up to three years, a weighted average exercise price of $0.12 per share, the exercise price of each option grant was equal to the fair market value at the date of grant, and a term of 10 years. Compensation expense related to these awards was $20,097 and $40,399 for the three and six-month period ended June 30, 2007, respectively. Compensation expense related to these awards was $349 and $741 for the three and six-month period ended June 30, 2006, respectively.

On November 16, 2006, the Board granted 16,667 stock options to each chairperson on the Nominating and Compensation Committees and 41,667 stock options to the chairperson on the Audit Committee. The grants provide for an eighteen-month vesting period, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. Compensation expense related to these awards was $1,749 and $4,498 for the three and six-month period ended June 30, 2007, respectively. There was no compensation expense related to the award for the three and six-month periods ended June 30, 2006.

Total compensation expense recognized related to stock option awards was $58,494 and $118,193 for the three and six-month periods ended June 30, 2007, respectively. For the three month period ended June 30, 2007, $48,108 is included in general, administrative and selling expenses, $9,927 is included in research and development expenses and $459 is included in cost of revenues in the accompanying condensed consolidated statement of operations. For the six month period ended June 30, 2007, $97,256 is included in general, administrative and selling expenses, $20,004 is included in research and development expenses and $933 is included in cost of revenues in the accompanying condensed consolidated statement of operations. Total compensation expense recognized related to stock option awards was $1,016 and $4,741 for the three and six-month periods ended June 30, 2006, respectively. These 2006 expenses are included in general, administrative and selling expenses in the accompanying condensed consolidated statement of operations.

The fair values of the stock options granted were estimated on the date of grant using the Black-Scholes option-pricing model that uses the following weighted-average assumptions for the three and six-month periods ended June 30, 2006:

	Three months ended June 30, 2006	Six months ended June 30, 2006
Expected life in years	7	7
Risk-free interest rates	5.02%	4.57%
Volatility	220.6%	219.8%
Dividend yield	0%	0%

There were no options granted during the three or six-month periods ended June 30, 2007.

Option activity during 2007 and 2006 is summarized as follows:

	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Options Exercisable	Weighted Average Exercise Price
At January 1, 2006	4,512,500	1.71	7.74 years	4,182,500	$ 1.84
Granted	3,230,001	0.12			
Cancelled	(152,500)	0.98			
At December 31, 2006	7,590,001	1.05	8.01 years	4,397,500	$ 1.72
Cancelled	(150,000)	5.38			
At June 30, 2007	7,440,001	0.96	7.72 years	4,309,975	$ 1.57

The weighted average fair value of options at the date of grant using the Black-Scholes fair value based method for the three and six-month periods ended June 30, 2006 is estimated at $0.08 and $0.05, respectively. There was no total intrinsic value for these options for the three and six months ended June 30, 2006.

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The following table is the summary of the Company's nonvested shares as of June 30, 2007 and 2006:

	Options Outstanding and Nonvested	Weighted Average Exercise Price	Weighted Average Fair Value
Nonvested at January 1, 2006	330,000	0.04	0.04
Granted	3,230,001	0.12	0.12
Vested	(367,500)	0.04	0.04
Nonvested at December 31, 2006	3,192,501	0.12	0.12
Vested	(62,475)	0.08	0.08
Nonvested at June 30, 2007	3,130,026	0.12	0.12

The following table summarizes information about stock options outstanding at June 30, 2007:

	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
$0.04 to $0.06	2,345,000	8.14	$ 0.05	2,345,000	$ 0.05
0.07 to 0.11	265,000	7.20	0.10	265,000	0.10
0.12 to 0.17	3,580,001	9.09	0.12	449,975	0.13
0.28 to 0.43	35,000	5.87	0.34	35,000	0.34
0.44 to 0.65	70,000	5.45	0.57	70,000	0.57
0.66 to 1.00	342,500	4.59	0.69	342,500	0.69
1.52 to 2.28	75,000	3.78	1.75	75,000	1.75
2.29 to 3.43	10,000	3.43	3.30	10,000	3.30
5.17 to 7.75	482,500	2.43	6.24	482,500	6.24
7.76 to 11.65	40,000	2.11	8.25	40,000	8.25
11.66 to 17.49	195,000	0.86	14.28	195,000	14.28
$0.04 to $17.49	7,440,001	7.72	$ 0.96	4,309,975	$ 1.57

As of June 30, 2007, there was $186,300 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the 1998 and 2006 Plans. This unrecognized compensation cost is expected to be recognized over the next 3 years ($74,888 during the remaining period in 2007, $83,602 in 2008 and $27,810 in 2009).

During 2006 and 2005, pursuant to Andrea's compensation policy for outside directors, Andrea granted 166,668 shares of Common Stock with a fair market value of $0.12 and 400,000 shares of Common stock with a fair market value of $0.05. Compensation expense related to these awards was $5,000 and $5,001 for the three period ended June 30, 2007 and 2006, respectively.

Compensation expense related to these awards was $10,000 and $10,002 for the six month period ended June 30, 2007 and 2006, respectively.

Note 8. Segment Information

Andrea follows the provisions of SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information.” Reportable operating segments are determined based on Andrea’s management approach. The management approach, as defined by SFAS No. 131, is based on the way that the chief operating decision-maker organizes the segments within an enterprise for making operating decisions and assessing performance. While Andrea’s results of operations are primarily reviewed on a consolidated basis, the chief operating decision-maker also manages the enterprise in two segments: (i) Andrea DSP Microphone and Audio Software Products and (ii) Andrea Anti-Noise Products. Andrea DSP Microphone and Audio Software Products primarily include products based on the use of some, or all, of the following technologies: Andrea Digital Super Directional Array microphone technology (DSDA), Andrea Direction Finding and Tracking Array microphone technology (DFTA), Andrea PureAudio noise filtering technology, and Andrea EchoStop, an advanced acoustic echo cancellation technology. Andrea Anti-Noise Products include noise cancellation and active noise cancellation computer headset products and related computer peripheral products.

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The following represents selected condensed consolidated financial information for Andrea's segments for the three-month periods ended June 30, 2007 and 2006:

2007 Three Month Segment Data	Andrea DSP Microphone and Audio Software Products	Andrea Anti-Noise Products	Total 2007 Three Month Segment Data
Net revenues from external customers	$ 328,601	$ 533,692	$ 862,293
License Revenues	140,171	-	140,171
Loss from operations	(108,048)	(4,410)	(112,458)
Depreciation and amortization	117,166	4,729	121,895
Purchases of patents and trademarks	510	5,760	6,270
Assets	4,139,502	1,462,242	5,601,744
Total long lived assets	3,065,282	173,963	3,239,245

2006 Three Month Segment Data	Andrea DSP Microphone and Audio Software Products	Andrea Anti-Noise Products	Total 2006 Three Month Segment Data
Net revenues from external customers	$ 502,694	$ 736,981	$ 1,239,675
License Revenues	144,901	-	144,901
(Loss) income from operations	(81,733)	92,160	10,427
Depreciation and amortization	116,176	4,987	121,163
Purchases of patents and trademarks	2,698	6,909	9,607

The following represents selected condensed consolidated financial information for Andrea's segments for the six-month periods ended June 30, 2007 and 2006:

2007 Six Month Segment Data	Andrea DSP Microphone and Audio Software Products	Andrea Anti-Noise Products	Total 2007 Six Month Segment Data
Net revenues from external customers	$ 796,085	$ 1,371,030	$ 2,167,115
License Revenues	407,901	-	407,901
(Loss) income from operations	(110,304)	19,709	(90,595)
Depreciation and amortization	234,325	9,375	243,700
Purchases of patents and trademarks	510	5,760	6,270

	Andrea DSP Microphone	Andrea Anti-	Total 2006 Six Month

2006 Six Month Segment Data	and Audio Software Products	Noise Products	Segment Data
Net revenues from external customers	$ 693,243	$ 1,473,099	$ 2,166,342
License Revenues	271,559	-	271,559
(Loss) income from operations	(231,175)	187,958	(43,217)
Depreciation and amortization	233,750	11,312	245,062

The following represents selected condensed consolidated financial information for Andrea's segments as of December 31, 2006.

2006 Year End Segment Data	Andrea DSP Microphone and Audio Software Products	Andrea Anti-Noise Products	Total December 31, 2006
Assets	4,329,036	1,759,979	6,089,015
Total long lived assets	3,297,304	179,371	3,476,675

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Management assesses non-operating income statement data on a consolidated basis only. International revenues are based on the country in which the end-user is located. For the three-month periods ended June 30, 2007 and 2006, and as of each respective period-end, net revenues and accounts receivable by geographic area are as follows:

Geographic Data	June 30, 2007	June 30, 2006
Net revenues:		
United States	$ 724,567	$ 739,887
Foreign[(1)]	277,897	644,689
	$ 1,002,464	$ 1,384,576

(1) Net revenue to the People's Republic of China and Singapore represented 17% and 4%, respectively of total net revenues for three months ended June 30, 2007. Net revenues to any one foreign country did not exceed 10% of total net revenues for the three months ended June 30, 2006.

For the six-month periods ended June 30, 2007 and 2006, by geographic area, net revenues are as follows:

Geographic Data	June 30, 2007	June 30, 2006
Net revenues:		
United States	$ 1,837,746	$ 1,570,885
Foreign[(2)]	737,270	867,016
	$ 2,575,016	$ 2,437,901

(2) Net revenue to the People's Republic of China and Singapore represented 15% and 9%, respectively of total net revenues for six months ended June 30, 2007. Net revenues to any one foreign country did not exceed 10% of total net revenues for the six months ended June 30, 2006.

As of June 30, 2007 and December 31, 2006, account receivable by geographic area is as follows:

Geographic Data	June 30, 2007	December 31, 2006
Accounts receivable:		
United States	$ 253,443	$ 231,416
Foreign	238,019	608,183
	$ 491,462	$ 839,599

Note 9. Accounting for the Uncertainty in Income Taxes

The Company has adopted the provisions of FIN 48, on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also

provides guidance on derecognition, classification, interest and penalties, accounting in interim period, disclosure and transition. There were no unrecognized tax benefits as of January 1, 2007.

The Company has identified its federal tax return and its state tax return in New York as "major" tax jurisdictions, as defined in FIN 48. Based on the Company's evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements. The Company's evaluation was performed for tax years ended 2003 through 2006, the only periods subject to examination. The Company believes that its income tax positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income tax expense. There were no amounts accrued for penalties or interest as of or during the three or six months ended June 30, 2007. The Company does not expect its unrecognized tax benefit position to change during the next twelve months. Management is currently unaware of any issues under review that could result in significant payments, accruals or material deviations from its position.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Overview

Our mission is to provide the emerging “voice interface” markets with state-of-the-art communications products that facilitate natural language, human/machine interfaces.

Examples of the applications and interfaces for which Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products provide benefit include: Internet and other computer-based speech; telephony communications; multi-point conferencing; speech recognition; multimedia; multi-player Internet and CD ROM interactive games; and other applications and interfaces that incorporate natural language processing. We believe that end users of these applications and interfaces will require high quality microphone and earphone products that enhance voice transmission, particularly in noisy environments, for use with personal computers, mobile personal computing devises, cellular and other wireless communication devices and automotive communication systems. Our Andrea DSP Microphone and Audio Software Products use “far-field” digital signal processing technology to provide high quality transmission of voice where the user is at a distance from the microphone. High quality audio communication technologies will be required for emerging far-field voice applications, ranging from continuous speech dictation, to Internet telephony and multiparty video teleconferencing and collaboration, to natural language-driven interfaces for automobiles, home and office automation and other machines and devices into which voice-controlled microprocessors are expected to be introduced during the next several years.

We outsource to Asia high volume assembly for most of our products from purchased components. We assemble some low volume Andrea DSP Microphone and Audio Software Products from purchased components. As sales of any particular Andrea DSP Microphone and Audio Software Product increases, assembly operations are transferred to a subcontractor in Asia.

Our Critical Accounting Policies

Our unaudited condensed consolidated financial statements and the notes to our unaudited condensed consolidated financial statements contain information that is pertinent to management's discussion and analysis. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions 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 that are not readily apparent from other sources. On a continual basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results may vary from these estimates and assumptions under different and/or future circumstances. Our significant accounting policies are described in Note 2 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-KSB for the year ended December 31, 2006. A discussion of our critical accounting policies and estimates are included in Management’s Discussion and Analysis or Plan of Operation in our Annual Report on Form 10-KSB for the year ended December 31, 2006. Management has discussed the development and selection of these policies with the Audit Committee of the Company’s Board of Directors, and the Audit Committee of the Board of Directors has reviewed the Company’s disclosures of these policies. There have been no material changes to the critical accounting policies or estimates reported in the Management’s Discussion and Analysis section of the audited financial statements for the year ended December 31, 2006 as filed with the Securities and Exchange Commission.

Cautionary Statement Regarding Forward-Looking Statements

Certain information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations for the three months ended June 30, 2007 compared to the three months ended June 30, 2006 and for the six months ended June 30, 2007 compared to the six months ended June 30, 2006 are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words "anticipates," "believes," "estimates," "expects," "intends," "plans," "seeks," variations of such words, and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements on our current expectations, estimates and projections about our business and industry, our beliefs and certain assumptions made by our management. Investors are cautioned that matters subject to forward-looking statements involve risks and uncertainties including economic, competitive, governmental, technological and other factors that may affect our business and prospects. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. In order to obtain the benefits of these "safe harbor" provisions for any such forward-looking statements, we wish to caution investors and prospective investors about the following significant factors, which, among others, have in some cases affected our actual results and are in the future likely to affect our actual results and could cause them to differ materially from those expressed in any such forward-looking statements. These factors include the following:

Our operating results are subject to significant fluctuation, period-to-period comparisons of our operating results may not necessarily be meaningful and you should not rely on them as indications of our future performance.

Our results of operations have historically been and are subject to continued substantial annual and quarterly fluctuations. The causes of these fluctuations include, among other things:

– the volume of sales of our products under our collaborative marketing arrangements;

– the cost of development of our products;

– the mix of products we sell;

– the mix of distribution channels we use;

– the timing of our new product releases and those of our competitors;

– fluctuations in the computer and communications hardware and software marketplace; and

– general economic conditions.

We cannot assure that the level of revenues and gross profit, if any, that we achieve in any particular fiscal period will not be significantly lower than in other fiscal periods. Our revenues for the three months ended June 30, 2007 were $1,002,464 versus $1,384,576 for the three months ended June 30, 2006. Net loss for the three months ended June 30, 2007 was $119,134, or $.00 loss per share on a basic and diluted basis, versus net loss of $10,237, or $.00 loss per share on a basic and diluted basis for the three months ended June 30, 2006. Our revenues for the six months ended June 30, 2007 were $2,575,016 versus $2,437,901 for the six months ended June 30, 2006. Net loss for the six months ended June 30, 2007 was $118,645, or $.00 loss per share on a basic and diluted basis, versus net loss of $64,023, or $.00 loss per share on a basic and diluted basis for the six months ended June 30, 2006. We continue to explore opportunities to grow sales in other business areas, we are also examining additional opportunities for cost reduction, production efficiencies and further diversification of our business. Although we have improved cash flows by reducing overall expenses and increasing sales, if our revenues decline we may not continue to generate positive cash flows and our net income or loss may be affected.

If we fail to obtain additional capital or maintain access to funds sufficient to meet our operating needs, we may be required to significantly reduce, sell, or refocus our operations and our business, results of operations and financial condition could be materially and adversely effected.

In order to be a viable entity we need to maintain and increase profitable operations. To continue to achieve profitable operations we need to maintain/increase current net revenues and continue to look for ways to control expenses. We might also need to sell additional assets or raise capital as a means of funding continued operations. In recent years, we have sustained significant operating losses. Since 1997, we have been unable to generate sufficient cash flow from operations to meet our operating needs and, correspondingly, from time to time during the past several years, we have raised additional capital from external sources. We may have to continue to raise additional capital from external sources. These sources may include private or public financings through the issuance of debt, convertible debt or equity, or collaborative arrangements. Such additional capital and funding may not be available on favorable terms, if at all. Additionally, we may only be able to obtain additional capital or funds through arrangements that require us to relinquish rights to our products, technologies or potential markets, in whole or in part, or result in our sale. As a result of past few years of performance, we believe that we have sufficient liquidity to continue our operations at least through June 2008, provided our net revenues do not decline and our operating expenses do not increase. Although

we have revised our business strategies to reduce our expenses and capital expenditures, we cannot assure you that we will be successful in generating positive cash flows or obtaining access to additional sources of funding in amounts necessary to continue our operations. Failure to maintain sufficient access to funding may also result in our inability to continue operations.

Shares Eligible For Future Sale May Have An Adverse Effect On Market Price and Andrea Shareholders May Experience Substantial Dilution.

Sales of a substantial number of shares of our common stock in the public market could have the effect of depressing the prevailing market price of our common stock. Of the 200,000,000 shares of common stock presently authorized, 59,679,373 were outstanding as of August 9, 2007. The number of shares outstanding does not include an aggregate of 29,599,497 shares of common stock that are issuable. This number of issuable common shares is equal to approximately 50% of the 59,679,373 outstanding shares. These issuable common shares are comprised of: a) 7,440,001 shares of our common stock reserved for issuance upon exercise of outstanding awards granted under our 1991 Performance Equity Plan, 1998 Stock Plan and 2006 Stock Plan; b) 9,984 shares reserved for future grants under our 1998 Stock Plan; c) 8,070,000 shares reserved for future grants under our 2006 Stock Plan; d) 4,149,736 shares of common stock that are issuable upon conversion of the Series C Preferred Stock; e) 4,771,432 shares of common stock issuable upon conversion of the Series D Preferred Stock; and f) 5,158,344 of common stock issuable upon exercise of warrants relating to the Series D Preferred stock.

Conversions of our Series C Preferred Stock, Series D Preferred Stock and related Warrants may result in substantial dilution to other holders of our common stock.

As of August 9, 2007, we had 90.701477 shares of Series C Preferred Stock, 1,192,858 shares of Series D Preferred Stock and 5,158,344 Common Stock warrants outstanding. The issuance of shares of common stock upon conversion of the Series C Preferred Stock is limited to that amount which, after given effect to the conversion, would cause the holder not to beneficially own in excess of 4.99% or, together with other shares beneficially own during the 60 day period prior to such conversion, not to beneficially own in excess of 9.99% of the outstanding shares of common stock. The issuance of common stock upon conversion of the Series D Preferred Stock and the related warrants also are limited to that amount which, after given effect to the conversion, would cause the holder not to beneficially own an excess of 4.99% of then outstanding shares of our common stock, except that each holder has a right to terminate such limitation upon 61 days notice to us. Beneficial ownership for purposes of calculation of such percentage limitations does not include shares whose acquisition is subject to similar limitations. If all shares of the Series C and Series D Preferred Stock and warrants, which are outstanding to be issued, are assumed to be converted into or exercised for shares of common stock, the number of new shares of common stock required to be issued as a result would aggregate 14,079,512 shares, which would represent 24% of the then outstanding shares of common stock.

Short sales of our common stock may be attracted by or accompany conversions of Series C Preferred Stock and Series D Preferred Stock, which sales may cause downward pressure upon the price of our common stock.

Short sales of our common stock may be attracted by or accompany the sale of converted common stock, which in the aggregate could cause downward pressure upon the price of the common stock, regardless of our operating results, thereby attracting additional short sales of the common stock.

If we fail to commercialize and fully market our Andrea DSP Microphone and Audio Software products, or continue to develop, and not fully market, Andrea Anti-Noise Headset products, our revenues may not increase at a high enough rate to improve our results of operations or may not increase at all.

Our business, results of operations and financial condition depend on the successful commercialization of our Andrea DSP Microphone and Audio Software products and technologies. We introduced our first Andrea DSP Microphone products in 1998 and we continued to introduce complementary products and technologies over the last several years. We are primarily targeting these products at the desktop computer market, the audio and video conferencing markets and the market for in-vehicle computing, among others. The success of these products is subject to the risks frequently encountered by companies in an early stage of product commercialization, particularly companies in the computing and communications industries.

If we are unable to obtain market acceptance of Andrea DSP Microphone and Audio Software products and technologies or if market acceptance of these products and technologies occurs at a slow rate, then our business, results of operations and financial condition will be materially and adversely affected.

We, and our competitors, are focused on developing and commercializing products and technologies that enhance the use of voice, particularly in noisy environments, for a broad range of computer and communications applications. These products and technologies have been rapidly evolving and the number of our competitors has grown, but the markets for these products and technologies are subject to a high level of uncertainty and have been developing slowly. We, alone or together with our industry, may be unsuccessful in obtaining market acceptance of these products and technologies.

If we fail to develop and successfully introduce new products and technologies in response to competition and evolving technology, we may not be able to attract new customers or retain current customers.

The markets in which we sell our Andrea DSP Microphone and Audio Software and Andrea Anti-Noise Headset products are highly competitive. We may not compete successfully with any of our competitors. Most of our current and potential competitors have significantly greater financial, technology development, marketing, technical support and other resources than we do. Consequently, these competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, marketing, and sale of their products than we can. One or more of these competitors may independently develop technologies that are substantially equivalent or superior to our technology. The introduction of products incorporating new technologies could render our products obsolete and unmarketable and could exert price pressures on existing products.

We are currently engaged in the development of digital signal processing products and technologies for the voice, speech and natural language interface markets. We may not succeed in developing these new digital signal processing products and technologies, and any of these new digital signal processing products or technologies may not gain market acceptance.

Further, the markets for our products and technologies are characterized by evolving industry and government standards and specifications that may require us to devote substantial time and expense to adapt our products and technologies. For example, certain of our Andrea DSP Microphone and Audio Software and Andrea Anti-Noise Headset products are subject to the Federal Communications Commission requirements. We may not successfully anticipate and adapt our products and technologies in a cost effective and timely manner to changes in technology and industry standards or to introductions of new products and technologies by others that render our then existing products and technologies obsolete.

If our marketing collaborators do not effectively market their products with which our products are included or incorporated, our sales growth will be adversely affected.

We have entered into collaborative and distribution arrangements with software publishers and computer hardware manufacturers relating to the marketing and sale of Andrea DSP Microphone and Audio Software products through inclusion or incorporation with the products of our collaborators. Our success will therefore be dependent to a substantial degree on the efforts of these collaborators to market their products with which our products are included or incorporated. Our collaborators may not successfully market these products. In addition, our collaborators generally are not contractually obligated to any minimum level of sales of our products or technologies, and we have no control over their marketing efforts. Furthermore, our collaborators may develop their own microphone, earphone or headset products that may replace our products or technologies or to which they may give higher priority.

Shortages of, or interruptions in, the supply of more specialized components for our products could have a material adverse effect on our sales of these products.

The majority of our assembly operations are fulfilled by subcontractors (primarily in the Far East) using purchased components. Some specialized components for the Andrea DSP Microphone and Audio Software products and Andrea Anti-Noise products, such as microphones and digital signal processing boards, are available from a limited number of suppliers (in some cases foreign) and subject to long lead times. We may not be able to continue to obtain sufficient supplies of these more specialized components, particularly if the sales of our products increase substantially or market demand for these components otherwise increases. If our subcontractors fail to meet our production and shipment schedules, our business, results of operations and financial condition would be materially and adversely affected.

Our ability to compete may be limited by our failure to adequately protect our intellectual property or by patents granted to third parties.

We rely on a combination of patents, patent applications, trade secrets, copyrights, trademarks, and nondisclosure agreements with our employees, independent contractors, licensees and potential licensees, limited access to and dissemination of our proprietary information, and other measures to protect our intellectual property and proprietary rights. However, the steps that we have taken to protect our intellectual property may not prevent its misappropriation or circumvention. In addition, numerous patents have been granted to other parties in the fields of noise cancellation, noise reduction, computer voice recognition, digital signal processing and related subject matter. We expect that products in these fields will increasingly be subject to claims under these patents as the numbers of products and competitors in these fields grow and the functionality of products overlap. Claims of this type could have an adverse effect on our ability to manufacture and market our products or to develop new products and technologies, because the parties holding these patents may refuse to grant licenses or only grant licenses with onerous royalty requirements. Moreover, the laws of other countries do not protect our proprietary rights to our technologies to the same extent as the laws of the United States.

An unfavorable ruling in any current litigation proceeding or future proceeding may adversely affect our business, results of operations and financial condition.

From time to time we are subject to litigation incidental to our business. For example, we are subject to the risk of adverse claims, interference proceedings before the U.S. Patent and Trademark Office, oppositions to patent applications outside the United States, and litigation alleging infringement of the proprietary rights of others. Litigation to establish the validity of patents, to assert infringement claims against others, and to defend against patent infringement claims can be expensive and time-consuming, even if the outcome is in our favor.

Changes in economic and political conditions outside the United States could adversely affect our business, results of operations and financial condition.

We generate revenues to regions outside the United States, particularly in Asia. For the three-month period ended June 30, 2007, and 2006, net revenues to customers outside the United States accounted for approximately 27% and 46% of our net revenues. For the six-month period ended June 30, 2007, and 2006, net revenues to customers outside the United States accounted for approximately 29% and 36%, respectively, of our net revenues. International revenues and operations are subject to a number of risks, including:

- trade restrictions in the form of license requirements;
- restrictions on exports and imports and other government controls;
- changes in tariffs and taxes;
- difficulties in staffing and managing international operations;
- problems in establishing and managing distributor relationships;
- general economic conditions; and
- political and economic instability or conflict.

To date, we have invoiced our international revenues in U.S. dollars, and have not engaged in any foreign exchange or hedging transactions. We may not be able to continue to invoice all of our revenues in U.S. dollars in order to avoid engaging in foreign exchange or hedging transactions. If we are required to invoice any material amount of international revenues in non-U.S. currencies, fluctuations in the value of non-U.S. currencies relative to the U.S. dollar may adversely affect our business, results of operations and financial condition or require us to incur hedging costs to counter such fluctuations.

If we are unable to attract and retain the necessary managerial, technical and other personnel necessary for our business, then our business, results of operations and financial condition will be harmed.

Our performance is substantially dependent on the performance of our executive officers and key employees. The loss of the services of any of these executive officers or key employees could have a material adverse effect on our business, results of operations and financial condition. Our future success depends on our continuing ability to attract and retain highly qualified managers and technical personnel. Competition for qualified personnel is intense and we may not be able to attract, assimilate or retain qualified personnel in the future.

Compliance with the Sarbanes-Oxley Act of 2002 will require substantial financial and management resources and may result in additional expenses, which as a smaller public company many be disproportionately high.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we evaluate and report on our system of internal controls as of December 31, 2007 and requires that we have such system of internal controls audited beginning with our Annual Report on 10-KSB for the year ending December 31, 2008. If we fail to maintain the adequacy of our internal controls, we could be subject to regulatory scrutiny, civil or criminal penalties and/or stockholder litigation. Any inability to provide reliable financial reports could harm our business. Section 404 of the Sarbanes-Oxley Act of 2002 also requires that our independent registered public accounting firm report on management's evaluation of our system of internal controls. The development of the internal controls of any such entity to achieve compliance with the Sarbanes-Oxley Act may increase the time and costs necessary to complete any such acquisition. Furthermore, any failure to implement required new or improved controls, or difficulties encountered in the implementation of adequate controls over our financial processes and reporting in the future, could harm our operating results or cause us to fail to meet our reporting obligations. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock.

Results Of Operations

Quarter ended June 30, 2007 compared to Quarter ended June 30, 2006 and Six Months Ended June 30, 2007 compared to the Six Months Ended June 30, 2006.

Net Revenues

Net Revenues for the three months ended June 30, 2007, were $1,002,464, a decrease of 28% from sales of $1,384,576 for the three months ended June 30, 2006. Net Revenues for the six months ended June 30, 2007 were $2,575,016, an increase of 6% from the six months ended June 30, 2006 net revenues of $2,437,901. The decrease in net revenues for the three months ended June 30, 2007 reflects a decrease of 28% in net revenues of Andrea Anti-Noise Products, to $533,692, from $736,981 for the three months ended June 30, 2006, or 53% of net revenues and a 28% decrease in net revenues of Andrea DSP Microphone and Software Products to $468,772 from $647,595 for the three months ended June 30, 2006, or 47% of total net revenues. The increase in net revenues for the six months ended June 30, 2007 reflects a 25% increase in net revenues of Andrea DSP Microphone to $1,203,986, from $964,802 from the six months ended June 30, 2006 or 47% of net revenues partially offset by a decrease of 7% in net revenues of Andrea Anti-Noise Products and Software Products to $1,371,030, from $1,473,099 from the six months ended June 30, 2006 or 53% of net revenues. The decrease in revenues for the three months ended June 30, 2007 is a result of decreased shipments of noise canceling products to one of our OEM customers, decreased shipments of low

margin microphone array product shipments to another one of our OEM customers and decreased licensing revenues related to one of our licensing agreements. The increase in revenues for the six months ended 2007 is the result on increased shipments of low margin microphone array product shipments to one of our OEM customers, increases in certain licensing revenues offset in part decreased shipments of noise canceling products to one of OEM customers.

Cost of Revenues

Cost of revenues as a percentage of sales for the three months ended June 30, 2007 decreased to 47% from 56% for the three months ended June 30, 2006. Cost of revenues as a percentage of sales for the six months ended June 30, 2007 decreased to 49% from 52% for the six months ended June 30, 2006. These decreases primarily reflect the impact of the changes in the composition of our revenues as described under “Revenues” above.

Research and Development

Research and development expenses for the three months ended June 30, 2007 increased 16% to $156,101 from $134,858 for the three months ended June 30, 2006. Research and development expenses for the six months ended June 30, 2007 were $328,860, an increase of 23% from the six months ended 2006 research and development expenses of $268,393. These increases relate to the adoption of the provisions of SFAS No. 123R as well employee compensation and related benefit costs related to a dedicated employee focused on product development. The substantial level of research and development is a reflection of our efforts to develop and commercialize DSP Microphone and Audio Software technologies, coupled with, to a lesser extent, Andrea Anti-Noise headset products. For the three months ended June 30, 2007, the Andrea DSP Microphone and Audio Software Technology efforts were $113,698, or 73% of total research and development expenses and Andrea Anti-Noise Headset Product efforts were $42,403, or 27% of total research and development expenses. For the three months ended June 30, 2006, the Andrea DSP Microphone and Audio Software Technology efforts were $106,068, or 79% of total research and development expenses and Andrea Anti-Noise Headset Product efforts were $28,790, or 21% of total research and development expenses. For the six months ended June 30, 2007, the Andrea DSP Microphone and Audio Software Technology efforts were $236,870, or 72% of total research and development expenses and Andrea Anti-Noise Headset Product efforts were $91,990, or 28% of total research and development expenses. For the six months ended June 30, 2006, the Andrea DSP Microphone and Audio Software Technology efforts were $209,605, or 78% of total research and development expenses and Andrea Anti-Noise Headset Product efforts were $58,788, or 22% of total research and development expenses. With respect to DSP Microphone and Audio Software technologies, research efforts are primarily focused on the pursuit of commercializing a natural language-driven human/machine interface by developing optimal far-field microphone solutions for various voice-driven interfaces, incorporating Andrea’s digital super directional array microphone technology, and certain other related technologies such as noise suppression and stereo acoustic echo cancellation. We believe that continued research and development spending should provide Andrea with a competitive advantage.

General, Administrative and Selling Expenses

General, administrative and selling expenses increased approximately 7% to $491,071 for the three months ended June 30, 2007 from $460,895 for the three months ended June 30, 2006. General, administrative and selling expenses for the six months ended June 30, 2007 were $1,079,832, an increase of 15% from the six months ended June 30, 2006 general, administrative and selling expenses of $936,972. This increase is a primarily the result of amortization of stock based compensation issued in 2006 as well as the new employment agreement entered into with the Company's President and Chief Executive Officer in November 2006. For the three months ended June 30, 2007, the increase reflects a 2% increase in our Andrea DSP Microphone and Audio Software Technology efforts to $288,449, or 59% of total general, administrative and selling expenses and a 14% increase in our Andrea Anti-Noise Headset Product efforts to $202,622, or 41% of total general, administrative and selling expenses.

Interest Income (Expense), net

Interest income, net for the three months ended June 30, 2007 was $1,576 compared to interest expense, net of $168 for the three months ended June 30, 2006. Interest income, net for the six months ended June 30, 2007 was $404 compared to interest expense of $310 for the six months ended June 30, 2006. The increase in net interest income (expense) is a result of higher cash balances during 2007.

Provision for Income Taxes

The provision for income taxes is a result of certain licensing revenues that are subject to withholding of income tax as mandated by the foreign jurisdiction in which the revenues are earned. Amounts are based on net revenues and are therefore subject to change. Effective January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 establishes for all entities a minimum threshold for financial statement recognition of the benefit of tax positions, and requires certain expanded disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006, and is to be applied to all open tax years as of the date of effectiveness. The adoption of FASB Interpretation No. 48 did not have a material effect on the Company's condensed consolidated financial position or results of operations or cash flows (Note 9).

Net Loss

Net loss for three months ended June 30, 2007 was $119,134 compared to net loss of $10,237 for the three months ended June 30, 2006. Net loss for the six months ended June 30, 2007 was $118,645 compared to net loss of $64,023 for the six months ended June 30, 2006. The net loss for three and six months ended June 30, 2007 principally reflects the factors described above.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Liquidity And Capital Resources

Andrea's principal sources of funds have historically been, and are expected to continue to be, gross cash flows from operations and proceeds from the sale of convertible notes, preferred stock or other securities to certain financial institutions, investors and potential industry partners. At June 30, 2007, we had cash and cash equivalents of $983,385 compared with $303,678 at December 31, 2006. The balance of cash and cash equivalents at June 30, 2007

is primarily a result of our cash provided from operations during the six months ended June 30, 2007.

Working capital balance at June 30, 2007 was $1,825,773 compared to a working capital balance of $1,562,083 at December 31, 2006. The increase in working capital reflects a decrease in total current assets of $249,841 coupled with a decrease in total current liabilities of $513,531. The decrease in total current assets reflects an increase in cash and cash equivalents of $679,707, a decrease in accounts receivable of $348,137, a decrease in inventory of $325,639, and a decrease in prepaid expenses and other current assets of $255,772. The decrease in total current liabilities reflects a decrease in trade accounts payable of $335,655, a decrease in the current portion of capital lease of $3,541, and a decrease of $174,335 in other current liabilities. The increase in cash and cash equivalents of $679,707 reflects $689,518 of net cash provided by operating activities, $6,270 of net cash used in investing activities, and $3,541 of net cash used in financing activities.

The cash provided by operating activities of $689,518, excluding non-cash charges for the quarter ended June 30, 2007, is attributable to a $348,250 decrease in accounts receivable, a $323,405 decrease in inventory, a $255,772 decrease in prepaid expenses and other current assets, a $335,655 decrease in accounts payable, and a $157,623 decrease in other current and long-term liabilities. The changes in receivables, inventory, prepaid expenses and accounts payable primarily reflect differences in the timing related to both the payments for and the acquisition of inventory as well as for other services in connection with ongoing efforts related to Andrea's various product lines.

The cash used in investing activities reflects patents and trademarks expenditures of $6,270 associated with intellectual property.
The net cash used in financing activities of $3,541 reflects payment of our capital leases associated with communication related equipment.

We plan to continue to improve our cash flows during 2007 by aggressively pursuing 1) existing sales opportunities in our Andrea Anti-Noise Headset Products market, 2) existing and prospective opportunities to sell our Superbeam Array Microphone generated through our co-marketing efforts with Analog Devices in the personal computing market, 3) opportunities in the video and audio conferencing market and 4) the automotive (in-vehicle computing) market. However, there can be no assurance that we will be able to successfully execute the aforementioned plans. As of August 9, 2007, Andrea has approximately $740,000 (unaudited) of cash and cash equivalents. We believe that we have sufficient liquidity available to continue in operation through at least June 2008. To the extent that we do not generate sufficient cash flows from our operations in the next twelve months, additional financing might be required. Although we have improved cash flows by reducing overall expenses, if our revenues decline, these reductions may impede our ability to be cash flow positive and our net income or loss may be disproportionately affected. We have no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all. Any financing we obtain may contain covenants that restrict our freedom to operate our business or may have rights, preferences or privileges senior to our common stock and may dilute our current shareholders' ownership interest in Andrea. We cannot assure that demand will continue for any of our products, including future products related to our Andrea DSP Microphone and Audio Software technologies, or, that if such demand does exist, that we will be able to obtain the necessary working capital to increase production and provide marketing resources to meet such demand on favorable terms, or at all.

Recently Issued Accounting Pronouncements

Effective January 1, 2007, we adopted Emerging Issues Task Force ("EITF") Issue No. 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences" ("EITF Issue No. 06-2"). EITF Issue No. 06-2 requires that compensation expense associated with a sabbatical leave, or other similar benefit arrangements, be accrued over the requisite service period during which an employee earns the benefit. The adoption of EITF Issue No. 06-2 did not have a material impact on our condensed consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("Statement No. 157") which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. Statement No. 157 is effective for fiscal years beginning after November 15, 2007, and should be applied prospectively, except for the provisions for certain financial instruments that should be applied retrospectively as of the beginning of the year of adoption. The transition adjustment of the difference between the carrying amounts and the fair values of those financial instruments should be recognized as a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. We are currently evaluating the impact of adopting the provisions of Statement No. 157.

In November 2006, the EITF reached a final consensus in EITF Issue 06-6 "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments" ("EITF 06-6"). EITF 06-6 addresses the modification of a convertible debt instrument that changes the fair value of an embedded conversion option and the subsequent recognition of interest expense for the associated debt instrument when the modification does not result in a debt extinguishment pursuant to EITF 96-19 , "Debtor's Accounting for a Modification or Exchange of Debt Instruments,". The consensus should be applied to modifications or exchanges of debt instruments occurring in interim or annual periods beginning after November 29, 2006. The adoption of EITF 06-6 did not have a material impact on our condensed consolidated financial position, results of operations or cash flows.

In November 2006, the FASB ratified EITF Issue No. 06-7, "Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities" ("EITF 06-7"). At the time of issuance, an embedded conversion option in a convertible debt instrument may be required to be bifurcated from the debt instrument and accounted for separately by the issuer as a derivative under FAS 133, based on the application of EITF 00-19. Subsequent to the issuance of the convertible debt, facts may change and cause the embedded conversion option to no longer meet the conditions for separate accounting as a derivative instrument, such as when the bifurcated instrument meets the conditions of Issue 00-19 to be classified in stockholders' equity. Under EITF 06-7, when an embedded conversion option previously accounted for as a derivative under FAS 133 no longer meets the bifurcation criteria under that standard, an issuer shall disclose a description of the principal changes causing the embedded conversion option to no longer require bifurcation under FAS 133 and the amount of the liability for the conversion option reclassified to stockholders' equity. EITF 06-7 should be applied to all previously bifurcated conversion options in convertible debt instruments that no longer meet the bifurcation criteria in FAS 133 in interim or annual periods beginning after December 15, 2006, regardless of whether the debt instrument was entered into prior or subsequent to the effective date of EITF 06-7. Earlier application of EITF 06-7 is permitted in periods for which financial statements have not yet been issued. The adoption of EITF 06-7 did not a material impact on our condensed consolidated financial position, results of operations or cash flows.

In December 2006, the FASB issued FASB Staff Position ("FSP") EITF 00-19-2 "Accounting for Registration Payment Arrangements" ("FSP EITF 00-19-2") which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with SFAS No. 5, "Accounting for Contingencies." Adoption of FSP EITF 00-19-02 is required for fiscal years beginning after December 15, 2006. The adoption of FSP EITF 00-19-02 did not have a material impact on our condensed consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS No. 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Adoption is required for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 159. We are currently evaluating the expected effect of SFAS 159 on our condensed consolidated financial statements and is currently not yet in a position to determine such effects.

ITEM 3. CONTROLS AND PROCEDURES

Andrea's management, including its principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, Andrea's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that it files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Andrea's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Limitations on the Effectiveness of Controls

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that all control issues and instance of fraud, if any, within a company have been detected. Andrea's disclosure controls and procedures are designed to provide reasonable assurance of achieving its objectives.

There have been no changes in the Company's internal controls over financial reporting that have materially affected, or is reasonable likely to materially affect the Company's internal controls over financial reporting during the period covered by this Quarterly Report.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Andrea is involved in routine litigation incidental through the normal course of business. While it is not feasible to predict or determine the final outcome of the claims, Andrea believes the resolution of these matters will not have a material adverse effect on Andrea's financial position, results of operations or liquidity.

See "Part I Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations--Cautionary Statement Regarding Forward-Looking Statements--An unfavorable ruling in any current litigation proceeding or future proceeding may adversely affect our business, results of operations and financial condition" and Note 6 to the unaudited condensed consolidated financial statements in this quarterly report for a discussion of the legal proceedings of Andrea.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

a) Exhibits

Exhibit 31 – Rule 13a-14(a)/15d-14(a) Certifications*
Exhibit 32 – Section 1350 Certifications*

* Filed herewith

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ANDREA ELECTRONICS CORPORATION

By: /s/ DOUGLAS J. ANDREA
Name: **Douglas J. Andrea**
Title: **Chairman of the Board, President, Chief Executive Officer and Corporate Secretary**

Date: August 14, 2007

/s/ DOUGLAS J. ANDREA **Douglas J. Andrea**	Chairman of the Board, President, Chief Executive Officer and Corporate Secretary	August 14, 2007
/s/ CORISA L. GUIFFRE **Corisa L. Guiffre**	Vice President, Chief Financial Officer and Assistant Corporate Secretary	August 14, 2007