SABA SOFTWARE INC
Form 10-Q
April 14, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x	**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended February 28, 2005

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

For the transition period from ______ to ______

000-30221

(Commission File number)

SABA SOFTWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-3267638**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**
2400 Bridge Parkway,	
Redwood Shores, CA	**94065-1166**
(Address of principal executive offices)	**(Zip Code)**

(650) 696-3840

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

On April 12, 2005, 16,192,091 shares of the registrant s Common Stock, $.001 par value, were outstanding.

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SABA SOFTWARE, INC.

FORM 10-Q

QUARTER ENDED February 28, 2005

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PART 1: FINANCIAL INFORMATION

Item 1. Financial Statements

SABA SOFTWARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	February 28, 2005	May 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,362	$ 16,628
Short-term investments		150
Accounts receivable, net	9,058	6,648
Prepaid expenses and other current assets	1,136	1,030
Total current assets	25,556	24,456
Property and equipment, net	710	1,040
Goodwill, net	5,288	5,288
Purchased intangible assets, net		2
Other assets	909	955
Total assets	$ 32,463	$ 31,741
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 991	$ 1,625
Accrued compensation and related expenses	2,532	2,533
Accrued expenses	3,014	4,175
Deferred revenue	9,422	9,265
Borrowings under bank line of credit		3,500
Current portion of debt and lease obligations	780	752
Total current liabilities	16,739	21,850
Deferred revenue	83	179
Accrued rent	2,594	2,520
Debt and lease obligations, less current portion	357	671
Total liabilities	19,773	25,220
Stockholders equity:		
Preferred stock, issuable in series: $0.001 par value; 5,000,000 authorized shares at February 28, 2004; none issued or Outstanding		

Common stock: $0.001 par value; 50,000,000 authorized shares and 16,282,237 issued at February 28, 2005 and 200,000,000 authorized shares and 13,328,680 issued at May 31, 2004	56	54
Additional paid-in capital	200,887	191,925
Treasury stock: 102,997 shares held at February 28, 2005 and at May 31, 2004, at cost	(232)	(232)
Accumulated deficit	(187,856)	(185,012)
Accumulated other comprehensive loss	(165)	(214)
Total stockholders equity	12,690	6,521
Total liabilities and stockholders equity	$ 32,463	$ 31,741

See Accompanying Notes to Condensed Consolidated Financial Statements.

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SABA SOFTWARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three months ended		Nine months ended	
	February 28, 2005	February 29, 2004	February 28, 2005	February 29, 2004
Revenues:				
License	$ 3,758	$ 2,320	$ 9,598	$ 6,316
Services	6,780	5,515	20,590	17,940
Total revenues	10,538	7,835	30,188	24,256
Cost of revenues:				
Cost of license	43	27	219	178
Cost of services	2,895	2,845	9,054	9,188
Amortization of acquired developed technology		96	2	290
Total cost of revenues	2,938	2,968	9,275	9,656
Gross profit	7,600	4,867	20,913	14,600
Operating expenses:				
Research and development	2,417	2,310	7,197	7,516
Sales and marketing	4,309	3,933	12,775	12,405
General and administrative	1,228	872	3,544	3,188
Amortization of deferred stock compensation and other stock charges		4		45
Amortization of purchased intangible assets		41		125
Settlement of litigation				1,701
Total operating expenses	7,954	7,160	23,516	24,980
Loss from operations	(354)	(2,293)	(2,603)	(10,380)
Interest income (expense) and other, net	(73)	47	(101)	16
Loss before provision for income taxes	(427)	(2,246)	(2,704)	(10,364)
Provision for income taxes	(58)	(45)	(140)	(127)
Net loss	$ (485)	$ (2,291)	$ (2,844)	$ (10,491)
Basic and diluted net loss per share	$ (0.03)	$ (0.17)	$ (0.18)	$ (0.79)
Shares used in computing basic and diluted net loss per share	16,146	13,370	15,419	13,281

See Accompanying Notes to Condensed Consolidated Financial Statements.

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SABA SOFTWARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine months ended	
	February 28, 2005	February 29, 2004
Operating activities:		
Net loss	$ (2,844)	$ (10,491)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	710	1,346
Gain on sale of fixed assets	(1)	
Amortization of purchased intangible assets		125
Amortization of acquired developed technology	2	290
Amortization of deferred stock compensation		45
Changes in operating assets and liabilities:		
Accounts receivable	(2,361)	(476)
Prepaid expenses and other current assets	(106)	168
Other assets	46	(11)
Accounts payable	(634)	(405)
Accrued expenses	(1,162)	1
Accrued rent	74	(126)
Deferred revenue	61	1,611
Other liabilities		(61)
Net cash used in operating activities	(6,215)	(7,984)
Investing activities:		
Purchases of short-term investments		
Proceeds from redemptions and maturities of short-term investments	150	3,474
Proceeds from sale of property and equipment	1	
Purchases of property and equipment	(380)	(184)
Net cash (used in) provided by investing activities	(229)	3,290
Financing activities:		
Proceeds from issuance of common stock under stock plans	295	92
Proceeds from issuance of common stock in private placement, net of issuance costs	8,669	
Borrowings, net of issuance costs	304	10,523
Repayments on borrowings under the credit facility	(3,500)	(7,171)
Repayments on equipment term loan	(527)	
Repayments on note payable	(52)	(53)
Principal payments under capital lease obligations	(11)	(26)
Net cash provided by financing activities	5,178	3,365
Increase (decrease) in cash and cash equivalents	(1,266)	(1,329)
Cash and cash equivalents, beginning of period	16,628	17,566
Cash and cash equivalents, end of period	15,362	16,237

Short-term investments, end of period		152
Total cash, cash equivalents and short-term investments, end of period	$ 15,362	$ 16,389
Supplemental disclosure of non-cash transactions:		
Common stock issued for settlement of litigation	$	$ 576

See Accompanying Notes to Condensed Consolidated Financial Statements.

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SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Saba Software, Inc. and its subsidiaries (Saba) and, in the opinion of management, reflect all adjustments (consisting only of normal recurring adjustments) necessary to fairly state Saba s consolidated financial position, results of operations, and cash flows as of and for the dates and periods presented.

These unaudited condensed consolidated financial statements should be read in conjunction with Saba s audited consolidated financial statements included in Saba s Amended Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on October 27, 2004. The results of operations for the three and nine months ended February 28, 2005 are not necessarily indicative of results for the entire fiscal year ending May 31, 2005 or for any future period.

The condensed consolidated balance sheet at May 31, 2004 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

2. Basic and Diluted Net Loss Per Share

Basic and diluted net loss per share information for all periods is presented under the requirements of Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share. Basic earnings per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares that may be repurchased, and excludes any dilutive effects of options and warrants. Potentially dilutive issuances have been excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive. The calculations of basic and diluted net loss per share are as follows:

	Three months ended		Nine months ended	
	February 28, 2005	**February 29, 2004**	**February 28, 2005**	**February 29, 2004**
	(in thousands, except per share data)			
Net loss	$ (485)	$ (2,291)	$ (2,844)	$ (10,491)
Weighted-average shares of common stock outstanding	16,146	13,388	15,421	13,311

Weighted-average shares of common stock subject to repurchase		(18)	(2)	(30)
Weighted-average shares of common stock used in computing basic and diluted net loss per share	16,146	13,370	15,419	13,281
Basic and diluted net loss per share	$ (0.03)	$ (0.17)	$ (0.18)	$ (0.79)

3. Comprehensive Loss

Saba reports comprehensive loss in accordance with SFAS No. 130, Reporting Comprehensive Income. The following table sets forth the calculation of comprehensive loss for all periods presented:

	Three months ended		Nine months ended	
	February 28, 2005	**February 29, 2004**	**February 28, 2005**	**February 29, 2004**
		(in thousands)		
Net loss	$ (485)	$ (2,291)	$ (2,844)	$ (10,491)
Foreign currency translation (loss) gain	13	(12)	49	14
Unrealized (loss) gain on investments				(4)
Comprehensive loss	$ (472)	$ (2,303)	$ (2,795)	$ (10,481)

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4. Segment Information

Saba operates in a single operating segment, providing human capital software and services that enable global organizations to increase the productivity and competency of people across their extended enterprise.

Geographic Information

The following tables present revenue and long-lived assets information by geographic area:

	Total Revenue		Total Revenue	
	Three months ended		Nine months ended	
	February 28, 2005	February 29, 2004	February 28, 2005	February 29, 2004
	(in thousands)			
United States	$ 6,713	$ 4,624	$ 16,429	$ 14,869
United Kingdom	1,254	907	4,507	3,503
Rest of World	2,571	2,304	9,252	5,884
Total	$ 10,538	$ 7,835	$ 30,188	$ 24,256

	Long-Lived Assets	
	As of February 28, 2005	As of May 31, 2004
	(in thousands)	
United States	$ 5,810	$ 6,159
International	188	171
Total	$ 5,998	$ 6,330

Major Customers

For each of the three and nine months ended February 28, 2005 and February 29, 2004, no customer accounted for greater than 10% of revenues.

5. Credit Facility

In August 2004, Saba amended its credit facility to provide for a $5.0 million non-formula based revolving line of credit and an equipment term loan of up to $400,000. Under the revolving line of credit and equipment term loan, Saba may make draws through August 2005. Interest on borrowings under the revolving line of credit must be repaid monthly and outstanding principal must be repaid in August 2005. Borrowings under the equipment term loan must be repaid in 36 equal monthly installments of principal plus interest. Outstanding principal under the revolving line of credit bears interest at a rate equal to the bank s prime rate plus 1.50% and outstanding principal under equipment term loan bears interest at either a fluctuating rate equal to the bank s prime rate plus 1.75% or a fixed rate equal to the 36-month U.S. Treasury note plus 4.00%. Other terms of the credit facility remain unchanged. This amended credit facility requires us to satisfy certain covenants including a financial covenant to maintain a minimum balance of unrestricted cash and cash equivalents, net of borrowings, of $7.5 million on deposit with the bank at all times. The credit facility also restricts Saba s ability to pay cash dividends. As of February 28, 2005, Saba had not borrowed any amounts under the revolving line of credit and was in compliance with the covenants applicable to this facility.

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6. Restructuring

During each of fiscal 2004, fiscal 2003 and fiscal 2002, Saba implemented restructuring programs to reduce expenses to align its operations and cost structure with market conditions. The restructurings programs during fiscal 2004 were implemented under the provisions of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, while the restructuring programs during fiscal 2003 and fiscal 2002 were implemented under EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The restructuring programs included worldwide workforce reductions across all functions and consolidation of excess facilities. Workforce reduction charges consist primarily of severance and fringe benefits. A summary of the movements on the restructuring accrual during the nine months ended February 28, 2005 is outlined as follows:

	Workforce Reduction Charges	Facilities Related Charges	Total
		(in thousands)	
Accrual as of May 31, 2004	$ 72	$ 677	$ 749
Charges	2	12	14
Deductions cash payments	(51)	(312)	(363)
Accrual as of February 28, 2005	$ 23	$ 377	$ 400
Estimated remaining cash expenditures	$ 23	$ 377	$ 400

During the first quarter of fiscal 2004, Saba recorded net restructuring charges of $432,000. These charges were comprised of $80,000 for an excess facility that arose after default by a subtenant and $393,000 from the consolidation of an excess facility. These charges were partially offset by a $41,000 decrease to a workforce reduction accrual made in a prior period that resulted from severance payments that were less than previous estimates. The excess facilities charges were based on the present value of the sum of non-cancelable lease costs, less estimates for future sublease income, which will be paid over the estimated vacancy periods through fiscal 2006. As a result of this restructuring, Saba estimates that it will not recognize net lease expenses of approximately $218,000 in fiscal 2005 and $98,000 in fiscal 2006. There will not be any future cash savings from this restructuring.

During the second quarter of fiscal 2003, Saba recorded net restructuring charges of $922,000. These charges were comprised of $770,000 for employee severance payments and $152,000 from the consolidation of an excess facility. This restructuring included a worldwide workforce reduction of 24 employees across all business functions and geographies. As of February 28, 2005 all amounts relating this restructuring had been paid.

During the third quarter of fiscal 2003, Saba recorded net restructuring charges of $940,000. These charges were comprised of $416,000 for employee severance payments and $524,000 from the consolidation of excess facilities. This restructuring included a worldwide workforce reduction of 16 employees across all business functions and geographies. It is expected that the remaining workforce reduction payments will be made by the end of fiscal 2005. Amounts related to the excess facility charge will be paid over the remaining lease periods through the end of fiscal 2006.

7. Stock Options and Equity Instruments Exchanged for Services

Saba accounts for employee stock options using the intrinsic value method in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees while adhering to the disclosure requirements of SFAS No. 123, Accounting for Stock-Based Compensation and SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure. The fair value of options, warrants and restricted stock issued for services rendered by non-employees or assets acquired is determined using the Black-Scholes option-pricing model. To calculate the expense or asset value, Saba uses either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measured. The following table illustrates the effect on net loss and net loss per share had compensation cost for Saba s stock compensation plans been determined using the fair value method required by SFAS No. 123:

The value of stock-based awards on the date of grant using the Black-Scholes option pricing model was calculated using the assumptions in the following table:

	Three months ended		**Nine months ended**	
	February 28, 2005	**February 29, 2004**	**February 28, 2005**	**February 29, 2004**
	(in thousands, except per share amounts)			
Net loss as reported	$ (485)	$ (2,291)	$ (2,844)	$ (10,491)
Add: Total stock-based employee compensation expense included in net loss		4		46
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,724)	(2,840)	(6,390)	(9,319)
Adjusted net loss	$ (2,209)	$ (5,127)	$ (9,234)	$ (19,764)
Net loss per share as reported	$ (0.03)	$ (0.17)	$ (0.16)	$ (0.79)
Adjusted net loss per share	$ (0.14)	$ (0.38)	$ (0.60)	$ (1.48)

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Employee Options	Three months ended February 28, 2005	Three months ended February 29, 2004	Nine months ended February 28, 2005	Nine months ended February 29, 2004
Dividend Yield	0.0%	0.0%	0.0%	0.0%
Volatility	1.31	0.76	1.31 to 1.34	0.76 to 0.92
Risk Free rate of interest	3.91%	2.13%	2.88% to 3.91%	2.13% to 2.56%
Expected lives of options	2.24 years	3.0 years	2.24 to 2.35 years	3.0 years

Employee Stock Purchase Plan	Three months ended February 28, 2004	Three months ended February 29, 2004	Six months ended February 29, 2005	Six months ended February 29, 2004
Dividend Yield	0.0%	0.0%	0.0%	0.0%
Volatility	0.76	0.76	0.76	0.76
Risk Free rate of interest	2.13%	2.13%	2.13%	2.13%
Expected lives of purchase option	0.5 years	0.5 years	0.5 years	0.5 years

8. Guarantees

Saba enters into license agreements that generally provide indemnification for its customers against intellectual property claims. To date, Saba has not incurred any costs as a result of such indemnifications and has not accrued any liabilities related to such obligations in its consolidated financial statements.

Saba s license agreements also generally include a warranty that its software products will substantially operate as described in the applicable program documentation for a period of generally 90 days after delivery. To date, Saba has not incurred or accrued any material costs associated with these warranties.

9. Equity Funding

In August 2004, Saba entered into a common stock purchase agreement with Pequot Private Equity Fund III, L.P. and Pequot Offshore Private Equity Partners III, L.P. providing for the issuance of 2,674,500 shares of Saba s common stock at a price of $3.2841 per share. Total proceeds, net of issuance costs of $115,000, from the private placement were $8.7 million. Under the terms of the funding agreement, Saba filed a Registration Statement with the Securities and Exchange Commission for the common stock issued.

10. Legal Matters

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York against Saba, certain of its officers and directors, and certain underwriters of Saba s initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased Saba common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by Saba and its officers and directors of the Securities Act of 1933 in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints were later consolidated into a single action. On July 16, 2003, a committee of Saba s board of directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of Saba and of the individual defendants for the conduct alleged in the action to be wrongful in the amended complaint. Saba would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims Saba may have against its underwriters. Any direct financial impact of the proposed settlement is expected to be borne by Saba s insurers. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other issuer defendants in the proposed settlement, the consent of Saba s insurers to the settlement, and the completion of acceptable final settlement documentation. In June 2004, an agreement of settlement was submitted to the Court for preliminary approval. The court requested that any objections to preliminary approval of the settlement be submitted by July 14, 2004, and the underwriter defendants formally objected to the settlement. The plaintiffs and issuer defendants separately filed replies to the underwriter defendants objections to the settlement on August 4, 2004. The court granted preliminary approval motion on February 15, 2005, subject to certain modifications. If the parties are able to agree upon the required modifications, and such modifications are acceptable to the court, notice will be given to all class members of the settlement, a fairness hearing will be held and if the court determines that the settlement is fair to the class members, the settlement will be approved. There can be no assurance that this proposed settlement would be approved and implemented in its current form, or at all. If the settlement is not finalized, Saba intends to dispute these claims and defend the lawsuit vigorously. However, due to the inherent uncertainties of litigation, Saba cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect Saba s business, financial condition and results of operations.

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On March 12, 2004, Docent, Inc. filed a compliant against Saba and two employees in the Circuit Court of Cook County, Illinois. The complaint alleges, among other things, that Saba and the two employees gained an unfair competitive advantage by using Docent confidential employee information to solicit and hire certain Docent employees. In addition, the complaint alleges that Saba and the two employees used certain Docent proprietary information to interfere with Docent s client and prospective client relationships. On October 26, 2004 we entered into a settlement agreement with Docent. Under the terms of the settlement agreement, the litigation was dismissed. The settlement will have no material impact on our financial condition or operations.

Saba is also party to various legal disputes and proceedings arising from the ordinary course of general business activities. While, in the opinion of management, resolution of these matters is not expected to have a material adverse effect on Saba s consolidated financial position, results of operations or cash flows, the ultimate outcome of any litigation is uncertain. Were an unfavorable outcome to occur, the impact could be material to Saba.

11. Recent Accounting Pronouncements

On December 16, 2004 the Financial Accounting Standards Board or FASB issued Statement of Financial Accounting Standard (revised) Share Based Payment or SFAS123R. SFAS123R, which is effective for the first annual or interim period beginning after June 15, 2005 will require that any share based payment, including stock option, made to an employee be recognized in the financial statements based on their fair value. Under the terms of SFAS 123R the fair value of any equity award will be estimated at the grant date and this fair value will be recognized as compensation cost over the service period for all awards that are subject to a vesting period. SFAS123R requires that fair value be estimated using an option pricing model that takes into account at least the following items the exercise price, the expected term of the option, the current price of the underlying share, the expected volatility of the price of the underlying share, the expected dividends on the underlying share and the risk free rate of interest.

SFAS123R will be effective for the second quarter of fiscal 2006. The effects of the adoption of SFAS 123R on our results of operations and financial are dependent upon a number of factors, including the number of employee options which may be granted in the future, the future market value and volatility of our stock price, movements in the risk free rate of interest, stock option exercise and forfeiture patterns and the stock option valuation model used to estimate the fair value of each option. As a result of these variables it is not possible to estimate the effect of the adoption of SFAS123R on our results of operations and financial condition, however note 7 provides an indication of the effects of using the Black Scholes option pricing model using the assumptions detailed therein to estimate the fair value of employee stock options and employee stock purchase plan options upon the results of operations for the three and nine months ended February 28, 2005.

12. Subsequent Events

On March 24, 2005, Saba, entered into an Agreement and Plan of Merger (the Merger Agreement) providing for the acquisition of THINQ Learning Solutions, Inc., a privately held Delaware corporation (the Merger). The Boards of Directors of Saba and THINQ have unanimously approved the Merger and the Merger Agreement.

If the Merger is completed, THINQ will become a wholly-owned indirect subsidiary of Saba. The Merger will be a combined stock-for-stock and cash transaction and the aggregate consideration payable by Saba is up to 1,700,000 shares of Parent common stock and $500,000, subject to a post-closing balance sheet adjustment. In addition, up to an additional 100,000 shares of Saba common stock may be issued over a three-year period pursuant to an earn-out provision. As security for the Stockholders indemnification obligations set forth in the Merger Agreement, approximately 20% of the total merger consideration will be held in escrow until the date that Saba s Annual Report on Form 10-K for the fiscal year ended May 31, 2006 is required to be filed with the Securities and Exchange Commission.

The Merger is subject to customary conditions to closing, including (i) obtaining all required third party consents and approvals of governmental entities, (ii) the accuracy of representations and warranties and the absence of any material adverse change in THINQ (in each case, subject to certain exceptions), and (iii) the delivery of customary opinions from counsel to THINQ. Closing is expected to occur within 60 days of the date of the Merger Agreement.

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ITEM 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes contained herein and the information included in our annual report on Form 10-K for our fiscal year ended May 31, 2004 and in our other filings with the Securities and Exchange Commission. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the Securities Act) and Section 21E of the Securities and Exchange Act of 1934 (the Exchange Act). All statements in this Quarterly Report on Form 10-Q other than statements of historical fact are forward-looking statements for purposes of these provisions, including any statements of the plans and objectives for future operations and any statement of assumptions underlying any of the foregoing. Statements that include the use of terminology such as may, will, expects, believes, plans, estimates, potential, or continue, or the negative thereof or other comparable terminology are forward-looking statements. Forward-looking statements include (i) in Part I, Item 1, statements regarding estimates of recognition of net lease expenses and the absence of future cash savings from restructuring, expectations regarding workforce reduction payments and payments related to the excess facility charge, statements regarding the resolution and effect of pending litigation, statements regarding the adequacy of our tax provision and statements regarding the acquisition of THINQ, (ii) in Part I, Item 2, statements regarding the design of our products to increase organizational performance and help large enterprises, that the timing of a few large software license transactions can substantially affect quarterly revenue, our belief that support revenue will continue to grow, continued investment in areas that we believe accelerate growth, that business conditions may require us to adopt additional restructuring programs, that many of our customers have not resumed previous levels of expenditures on information technologies, our anticipation that the negative impact of seasonality on our first quarter will continue, our expectation that research and development expenses will remain relatively flat for the foreseeable future, our anticipation that we will continue to experience long sales cycles, the sufficiency of cash resources, credit facilities and cash flows to meet working capital, capital expense and business expansion requirements for at least the next 12 months, our expectation to derive substantially all of our revenues for the foreseeable future from the licensing of Saba Enterprise Learning and providing related services, our expectation to derive revenues from new products over the long term, our expectation to continue to incur non-cash expenses relating to the amortization of purchased intangible assets, along with any potential goodwill impairment, that our operating results will fluctuate significantly in the future, our expectation to increase our operating expenses, the impact of SFAS No. 123R and Statement of Position 97-2, our intention to expand our international presence in the future, our expectation to regularly release new products and new versions of existing products, our expectation of continued operating losses and negative cash flow from operations, our expectation to continue to acquire complementary businesses or technologies, that the acquisition of THINQ and any future acquisitions would result in the use of significant amounts of cash, potentially dilutive issuance of equity securities, and/or the incurrence of debt, (iii) in Part I, Item 3, that more of our contracts may be denominated in foreign currencies, and (iv) in Part II, Item 1, statements regarding the resolution and effect of pending litigation. These forward-looking statements involve known and unknown risks and uncertainties. Our actual results may differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are incorrect estimates or assumptions, unanticipated adverse results for pending litigation, contraction of the economy and world markets, lack of demand for information technologies from our customers, requirements for increased spending in research and development, unanticipated need for capital for operations, lack of demand for our products, inability to introduce new products and the factors detailed under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations Factors That May Impact Future Operating Results. All forward-looking statements and risk factors included in this document are made as of the date of this report, based on information available to us as of such date. We assume no obligation to update any forward-looking statement or risk factor.

OVERVIEW

Business, Principal Products, Revenue Models and Locations

We are a leading provider of human capital management solutions, which are designed to enable global organizations to increase the productivity and competency of people across their extended enterprise. Our solutions can help large enterprises to efficiently manage regulatory compliance, increase sales and channel readiness, accelerate time-to-competency of people across the extended enterprise, increase speed of customer acquisition, shorten time-to-market of new products and increase visibility into organizational performance. Our leadership position is supported by publicly available reports published by independent, third-party analysts that research vendors in our industry and rank them based on a number of factors, including product offerings, technology and customer base.

We commenced operations in April 1997 and, through March 1998, focused substantially all of our efforts on research activities, developing our products and building our business infrastructure. We shipped our first Saba Enterprise Learning products and began to generate revenues from software license fees, implementation and consulting services fees and support fees in April 1998. In August 2003, we shipped our generally available version of Saba Enterprise Performance.

Substantially all of our revenues are derived from perpetual licenses of our software products and related product-support and professional services. Specifically, we license our software solutions in multi-element arrangements that include a combination of our software, product support and/or professional services. To date, a substantial majority of our software license revenue has been derived from Saba Enterprise Learning. Our license revenue is affected by the strength of general economic and business conditions, as well as customers budgetary cycles and the competitive position of our software products. In addition, the sales cycle for our products is long, typically 6 to 12 months. The timing of a few large software license transactions can substantially affect our quarterly license revenue.

Product support includes technical support and future updates for the applicable software product. We typically sell support for an initial period of one year concurrently with the sale of the related software license. After the initial period, support is renewable on an annual basis at the option of the customer. Accordingly, our support revenue depends upon both our sale of additional software licenses and annual renewals of existing support agreements. The growth rate of support revenue does not necessarily correlate directly to the growth rate of license revenue as the support renewal rate has a greater impact on support revenue as our installed base of customers grows. For example, if license revenues remained constant, support revenue would continue to grow as a result of the incremental support revenue associated with new license sales, assuming renewal rates stayed relatively constant. We believe that support revenue will continue to grow as we anticipate that a substantial majority of our customers will renew their annual contracts and the sale of new software licenses will increase the number of customers that purchase support.

Our professional services offerings include (i) implementation services, (ii) education services for our customers regarding how to use our software, and (iii) hosting services that enable customers that separately purchase software licenses to access and use the software on computers operated by or for us. Our implementation and education services are typically initiated and provided to customers that license software directly from us over a period of three to nine months after licensing the software. Accordingly, our implementation and education services revenue varies directly with the levels of license revenue generated from our direct sales organization in the preceding three- to nine-month period. In addition, our implementation and education services revenue varies following our commercial release of significant software updates as our customers generally engage our services to assist with the implementation and education of their software upgrade. Although we primarily provide implementation services on a time and materials basis, a significant portion of these services is provided on a fixed fee basis. Hosting services are generally provided pursuant to annual agreements and the associated revenue is recognized ratably over the hosting term.

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Our corporate headquarters are located in Redwood Shores, California. In addition, we have seven non-U.S. subsidiaries through which we conduct various operating activities related to our business. In each of the non-U.S. jurisdictions in which we have subsidiaries, India, France, Japan, Germany, the United Kingdom, Canada and Australia, we have employees or consultants engaged in sales and services activities. In the case of our India subsidiary, our employees primarily engage in software development and quality assurance testing activities.

Significant Trends and Developments in Our Business

Since we began operations in 1997 and continuing throughout fiscal 2001, our business grew rapidly. During fiscal 2002 and continuing through the first three quarters of fiscal 2004, our revenues declined as a result of a