

SABA SOFTWARE INC
Form 10-Q
January 06, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 30, 2011 November 30, 2011

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

For the transition period from to .

001-34372

(Commission File number)

SABA SOFTWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

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| | |
|---|--|
| Delaware (State or other jurisdiction of incorporation or organization) | 94-3267638 (I.R.S. Employer Identification No.) |
| 2400 Bridge Parkway Redwood Shores, California (Address of principal executive offices) | 94065-1166 (Zip Code) |
| (650) 581-2500 (Registrant's telephone number, including area code) | |

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

| | |
|--|---|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input checked="" type="checkbox"/> |
| Non-Accelerated filer <input type="checkbox"/> (do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

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

On December 30, 2011, 29,785,662 shares of the registrant's Common Stock, \$0.001 par value, were outstanding.

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SABA SOFTWARE, INC.

FORM 10-Q

QUARTER ENDED NOVEMBER 30, 2011

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share data)****(Unaudited)**

| | November 30, 2011 | May 31, 2011 |
|--|------------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 15,049 | \$ 25,940 |
| Accounts receivable, net of allowances for doubtful accounts of \$150 as of November 30, 2011 and May 31, 2011 | 31,311 | 27,676 |
| Prepaid expenses and other current assets | 3,388 | 3,411 |
| Total current assets | 49,748 | 57,027 |
| Property and equipment, net | 4,792 | 3,146 |
| Goodwill | 41,246 | 41,469 |
| Purchased intangible assets, net | 7,085 | 8,722 |
| Restricted cash | 430 | 437 |
| Other assets | 3,856 | 2,774 |
| Total assets | \$ 107,157 | \$ 113,575 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,386 | \$ 5,886 |
| Accrued compensation and related expenses | 10,047 | 8,008 |
| Accrued expenses | 5,888 | 5,330 |
| Deferred revenue | 43,698 | 42,513 |
| Current portion of lease obligations | 870 | 1,219 |
| Total current liabilities | 65,889 | 62,956 |
| Deferred revenue, less current portion | 3,566 | 3,270 |
| Other long-term liabilities | 3,017 | 3,926 |
| Total liabilities | 72,472 | 70,152 |
| Stockholders equity: | | |
| Preferred stock, issuable in series \$0.001 par value, 5,000,000 authorized shares at November 30, 2011 and May 31, 2011; none issued or outstanding | | |
| Common stock, \$0.001 par value, 50,000,000 authorized; 29,681,513 shares issued at November 30, 2011 and 29,186,633 shares issued at May 31, 2011 | 29 | 29 |
| Additional paid-in capital | 264,542 | 261,900 |
| Treasury stock: 920,288 shares at November 30, 2011 and 880,288 shares at May 31, 2011 | (5,986) | (5,701) |
| Accumulated deficit | (223,444) | (213,075) |

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| | | |
|--|------------|------------|
| Accumulated other comprehensive income | (456) | 270 |
| Total stockholders' equity | 34,685 | 43,423 |
| Total liabilities and stockholders' equity | \$ 107,157 | \$ 113,575 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share data)****(Unaudited)**

| | Three months ended November 30, 2011 | | Six months ended November 30, 2010 | |
|---|--------------------------------------|---------------|------------------------------------|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenues: | | | | |
| Subscription | \$ 19,134 | \$ 15,604 | \$ 37,681 | \$ 30,499 |
| Professional services | 9,930 | 8,774 | 19,259 | 16,623 |
| License | 1,332 | 4,814 | 4,097 | 9,264 |
| Total revenues | 30,396 | 29,192 | 61,037 | 56,386 |
| Cost of revenues: | | | | |
| Subscription | 4,433 | 3,891 | 8,772 | 7,811 |
| Professional services | 6,844 | 5,967 | 13,508 | 11,688 |
| License | 242 | 186 | 420 | 433 |
| Amortization of acquired developed technology | 75 | 295 | 150 | 590 |
| Total cost of revenues | 11,594 | 10,339 | 22,850 | 20,522 |
| Gross profit | 18,802 | 18,853 | 38,187 | 35,864 |
| Operating expenses: | | | | |
| Research and development | 5,714 | 4,436 | 11,766 | 8,859 |
| Sales and marketing | 12,565 | 11,052 | 25,661 | 20,898 |
| General and administrative | 5,118 | 3,419 | 10,056 | 6,831 |
| Amortization of purchased intangible assets | 743 | 634 | 1,486 | 1,268 |
| Total operating expenses | 24,140 | 19,541 | 48,969 | 37,856 |
| Loss from operations | (5,338) | (688) | (10,782) | (1,992) |
| Interest and other income (expense), net | 679 | 166 | 520 | (59) |
| Interest expense | (69) | (2) | (141) | (3) |
| Loss before provision for income taxes | (4,728) | (524) | (10,403) | (2,054) |
| Benefit (provision) for income taxes | 155 | (272) | 34 | (437) |
| Net loss | \$ (4,573) | \$ (796) | \$ (10,369) | \$ (2,491) |
| Basic and diluted net loss per share | \$ (0.16) | \$ (0.03) | \$ (0.36) | \$ (0.09) |
| Shares used in computing basic and diluted net loss per share | 28,586 | 28,197 | 28,486 | 28,174 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(Unaudited)**

| | Six months ended November 30, | |
|--|--|------------------|
| | 2011 | 2010(1) |
| Operating activities: | | |
| Net loss | \$ (10,369) | \$ (2,491) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 986 | 1,131 |
| Amortization of purchased intangible assets | 1,637 | 1,858 |
| Share-based compensation | 1,728 | 1,393 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (4,236) | 203 |
| Prepaid expenses and other current assets | (89) | (363) |
| Other assets | (882) | (244) |
| Accounts payable | (451) | 371 |
| Accrued compensation and related expenses | 2,457 | (1,733) |
| Accrued expenses | (725) | (627) |
| Deferred revenue | 2,180 | (1,790) |
| Restricted cash | (1) | (164) |
| Net cash used in operating activities | (7,765) | (2,456) |
| Investing activities: | | |
| Purchases of property and equipment | (2,697) | (844) |
| Net cash used in investing activities | (2,697) | (844) |
| Financing activities: | | |
| Proceeds from issuance of common stock under stock plans | 1,289 | 1,334 |
| Repurchase of common stock | (286) | (1,703) |
| Repurchase of stock to satisfy employee tax withholding obligations | (374) | (73) |
| Net cash provided by (used in) financing activities | 629 | (442) |
| Effect of exchange rate changes on cash and cash equivalents | (1,058) | 592 |
| Decrease in cash and equivalents | (10,891) | (3,150) |
| Cash and cash equivalents, beginning of period | 25,940 | 32,002 |
| Cash and cash equivalents, end of period | \$ 15,049 | \$ 28,852 |
| Supplemental disclosure of other cash flow information: | | |
| Cash paid for income taxes, net of refunds | \$ 340 | \$ 898 |
| Cash paid for interest | \$ | \$ |

(1) Certain amounts have been adjusted for the retrospective change in accounting principle for sales commissions. See Note 2 in the Notes to the Condensed Consolidated Financial Statements for the Company's Annual Form 10-K for the year ended May 31, 2011.

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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 condensed consolidated financial statements include the accounts of Saba Software, Inc. and its wholly owned subsidiaries (Saba or the Company). All intercompany balances and transactions have been eliminated.

The accompanying condensed consolidated balance sheet as of November 30, 2011, the condensed consolidated statements of operations for the three and six months ended November 30, 2011 and 2010 and the condensed consolidated statements of cash flows for the six months ended November 30, 2011 and 2010 are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (US GAAP). In the opinion of management, the unaudited interim condensed consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of the Company s financial position as of November 30, 2011, and the Company s results of operations for the three and six months ended November 30, 2011 and 2010 and cash flows for the six months ended November 30, 2011 and 2010. The condensed consolidated balance sheet as of May 31, 2011 is derived from the May 31, 2011 audited condensed consolidated financial statements.

These unaudited condensed consolidated financial statements should be read in conjunction with Saba s audited condensed consolidated financial statements included in Saba s Annual Report on Form 10-K for the fiscal year ended May 31, 2011 filed with the Securities and Exchange Commission (the SEC) on August 5, 2011. The results of operations for the three and six months ended November 30, 2011, are not necessarily indicative of results for the entire fiscal year ending May 31, 2012 or for any future period.

2. Summary of Significant Accounting Policies

Revenue Recognition

The Company generates revenues from the sale of subscription services, professional services and software licenses and recognizes revenues when all of the following conditions are met:

persuasive evidence of an agreement exists;

delivery has occurred;

the fee is fixed or determinable; and

collection is probable.

Subscription Services Arrangements

Subscription services arrangements generally include our products delivered via an internet-based cloud architecture, which includes related updates and support, and professional services. Subscription revenue includes revenue from cloud-based offerings and product updates and support related to licenses. Revenue from cloud-based offerings that are integrated offerings pursuant to which the customers ability to access the Company s software is not separable from the services necessary to operate the software and customers are not allowed to take possession of the Company s software are recognized ratably over the term of the arrangement as delivered or on an as-used basis if defined in the contract.

Saba does not grant its resellers the right of return and does not recognize revenue from resellers until an end-user has been identified and the other conditions of revenue recognition guidance are satisfied. Revenue from product updates, support and hosting services related to licenses

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are recognized ratably over the term of the arrangement as delivered or on an as-used basis if defined in the contract.

When subscription services arrangements involve multiple elements that qualify as separate units of accounting, the Company allocates arrangement consideration in multiple-deliverable revenue arrangements at the inception of an arrangement to all deliverables based on the relative selling price method in accordance with the selling price hierarchy, which includes: (i) vendor-specific objective evidence (VSOE) if available; (ii) third-party evidence (TPE) if VSOE is not available; and (iii) best estimate of selling price (BESP) if neither VSOE nor TPE is available.

The Company determines VSOE based on its historical pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, the Company requires that a substantial majority of the selling prices for these services fall within a reasonably narrow pricing range. The Company limits its assessment of VSOE for each element to either the price charged when the same element is sold separately or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

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SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

When VSOE cannot be established for deliverables in multiple element arrangements, the Company applies judgment with respect to whether it can establish a selling price based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, the Company's go-to-market strategy differs from that of its peers and its offerings contain a significant level of differentiation such that the comparable pricing of services with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitor services' selling prices are on a stand-alone basis. As a result, the Company has not been able to establish selling price based on TPE.

When it is unable to establish a selling price using VSOE or TPE, the Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. The Company determines BESP for deliverables by considering multiple factors including, but not limited to, prices it charges for similar offerings, market conditions, competitive landscape and pricing practices.

The Company does not have VSOE on its cloud-based offerings. As a result, the Company uses BESP in order to allocate the selling price to cloud-based deliverables. In general, the Company uses VSOE in order to allocate the selling price to professional service deliverables.

Certain cloud-based offerings include arrangements with customers that have separately licensed and taken possession of the Company's software. When these offerings are part of a multiple element arrangement involving licenses, the Company recognizes revenue in accordance with software revenue recognition guidance.

Professional Services

Professional services revenues are generally recognized as the services are performed. The Company provides professional services on a time-and-materials and fixed-fee basis. For services performed on a fixed-fee basis, revenues are generally recognized using the proportional performance method, with performance measured based on hours of work performed. For contracts that involve significant customization and implementation or consulting services that are essential to the functionality of the software, the license and services revenues are recognized using the percentage-of-completion method or, if Saba is unable to reliably estimate the costs to complete the services, Saba uses the completed-contract method of accounting in accordance with software revenue recognition guidance and relevant guidance of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605-35 *Construction-Type and Certain Production Type*. A contract is considered complete when all significant costs have been incurred or the item has been accepted by the customer.

If the requirements of software revenue recognition are not met when the Company bills a customer or a customer pays the Company, the billed or paid amount is recorded as deferred revenue, which is a liability account. As the revenue recognition criteria of software revenue recognition are satisfied, the requisite amounts are recognized as revenue.

The Company classifies deferred revenue and deferred costs on its consolidated balance sheet as current if the Company expects to recognize such revenue or cost within the following twelve months. When the revenue from professional services is recognized ratably over the subscription for transactions entered into prior to adoption of Accounting Standards Update 2009-13 *Revenue Recognition (Topic 605) Multiple Deliverable Revenue Arrangements (A Consensus of the FASB Emerging Issues Task Force)* (ASU 2009-13), the Company allocates the revenue to professional services revenue and to subscription revenue based on the VSOE of fair value for similar professional services that qualify as a separate element of the arrangement. The Company's judgment as to whether the consulting services qualify as a separate unit of accounting may materially affect the timing of the Company's revenue recognition and results of operations.

Software License Arrangements

Software license arrangements generally include a combination of the Company's software, license updates and product support and/or professional services. A significant amount of the Company's software license arrangements are for perpetual licenses.

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The Company recognizes revenue earned on perpetual software license arrangements in accordance with software revenue recognition guidance. When software arrangements involve multiple elements, the Company recognizes license revenue, using the residual method. Under the residual method revenue is allocated to undelivered elements based on VSOE of fair value of such undelivered elements and the residual amount of the arrangement is allocated to delivered elements. Accordingly, assuming all other revenue recognition criteria are met, revenues from perpetual licenses are recognized upon delivery using the residual method. The Company limits its assessment of VSOE for each element to either the price charged when the same element is sold separately or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

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License revenues from licenses with a term of three years or more are generally recognized on delivery if the other conditions of ASC 985-605 are satisfied. License revenues from licenses with a term of less than three years are generally recognized ratably over the term of the arrangement. In arrangements where term licenses are bundled with license updates and product support and such revenue is recognized ratably over the term of the arrangement, the Company allocates the revenue to license revenue and to license updates and product support revenue based on the VSOE of fair value for license updates and product support revenue on perpetual licenses of similar products. The Company does not grant its resellers the right of return and does not recognize revenue from resellers until an end-user has been identified and the other conditions of software revenue recognition are satisfied.

Fair Value Measurements

The Company performs fair value measurements in accordance with the guidance provided by ASC 820, *Fair Value Measurements and Disclosures*. ASC 820 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at their fair values, the Company considers the principal or most advantageous market in which it transacts and considers assumptions that market participants would use when pricing the assets or liabilities, such as inherent risk, transfer restrictions, and risk of nonperformance.

ASC 820 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. An asset's or liability's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. ASC 820 establishes three levels of inputs that may be used to measure fair value:

Level 1: quoted prices in active markets for identical assets or liabilities;

Level 2: inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or

Level 3: unobservable inputs that are supported by little or no market activity and that are significant to the fair values of the assets or liabilities.

The following table presents the liabilities carried at fair value as of November 30, 2011:

| Description | As of November 30, 2011 | Fair Value Measurements Using | | |
|--------------------------------------|-------------------------------|--|--|--|
| | | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Other Unobservable Inputs (Level 3) |
| Liabilities: | | | | |
| Acquisition contingent consideration | \$ 2,534 | \$ | \$ | \$ 2,534 |

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| | | | | | |
|-------------------|----------|----|----|----|-------|
| Total liabilities | \$ 2,534 | \$ | \$ | \$ | 2,534 |
|-------------------|----------|----|----|----|-------|

The Company estimates the fair value of acquisition-related liability-classified contingent consideration using the probability weighted expected pay-out model. The key assumptions in applying the approach is the probability of certain customer renewal weight targets and revenue booking targets. The contingent consideration liabilities are classified as Level 3 liabilities, because the Company uses unobservable inputs to value them, reflecting the Company's assessment of the assumptions market participants would use to value these liabilities.

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The following table presents the Company's liabilities that were measured at fair value using significant unobservable inputs (Level 3) during the six month period ended November 30, 2011. These consisted of the Company's contingent consideration liabilities related to acquisitions:

| (in thousands) | Contingent Consideration |
|-------------------------------------|-------------------------------------|
| Balance at May 31, 2011 | \$ 2,574 |
| Accretion and foreign exchange gain | (40) |
| Payments | |
| Balance at November 30, 2011 | \$ 2,534 |

Business Combinations

The Company allocates the purchase price of acquired companies to the assets acquired and liabilities assumed based on their estimated fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date fair value of the assets acquired and liabilities assumed. Management makes significant estimates and assumptions, especially with respect to intangible assets, to estimate the fair value of assets acquired and liabilities assumed. The estimates of fair value are based upon assumptions believed to be reasonable by management, but are inherently uncertain and unpredictable and, therefore, actual results may differ from estimates. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the fair value of assets acquired, liabilities assumed and contingent consideration, with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company's consolidated statements of operations.

The fair value of asset acquired and liabilities assumed are estimated using various valuation approaches, which include unobservable inputs that reflect the Company's assessment of the assumptions market participants would use to value such assets and liabilities. Significant inputs to estimate the fair value of assets acquired and liabilities assumed include, but are not limited to, discount rates, probability of future cash pay-outs related to contingent consideration, and future expected cash flows from customer contracts, customer lists, acquired developed technologies and patents and brand awareness and market position, as well as assumptions about the period of time the brand will continue to be used in the Company's product portfolio. The fair value of contingent consideration is remeasured at each reporting period with any changes to such fair value recorded to the Company's condensed consolidated statement of operations. Each reporting period the accretion of interest on contingent consideration is also calculated and recorded as interest expense in the Company's consolidated statement of operations.

In addition, uncertain tax positions and tax related valuation allowances assumed in connection with a business combination are initially estimated as of the acquisition date. The Company reevaluates these items quarterly and records any adjustments to the Company's preliminary estimates to goodwill provided that the Company is within the measurement period and the Company continues to collect information in order to determine their estimated fair values as of the date of acquisition. Subsequent to the measurement period or the Company's final determination of the tax allowance's or contingency's estimated value, changes to these uncertain tax positions and tax related valuation allowances will affect the Company's provision for income taxes in the Company's consolidated statement of operations.

3. Share-Based Compensation

The Company recognizes the fair value of its share-based payments to employees, including grants of employee stock options, restricted stock units (RSUs) and purchases under employee stock purchase plans, as an expense on a straight-line basis over the requisite service period of the awards in accordance with ASC 718-10 *Compensation - Stock Compensation*.

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The Company currently uses the Black-Scholes-Merton option pricing model to determine the fair value of stock options and employee stock purchase plan shares. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the expected term of the awards, the Company's expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, the risk-free interest rate and any expected dividends. The Company estimates the expected term of the share-based awards using its historical option activities, including option exercises, restricted stock units and holding patterns. The Company estimates the volatility using its historical stock price volatility over the length of the expected term of the options. The Company bases the risk-free interest rate that it uses in the option valuation model on U.S.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Treasury zero-coupon issues with remaining maturities similar to the expected term of the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model.

The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. The expected term of employee stock purchase plan shares is the average of the remaining purchase periods under each offering period.

The following assumptions have been used to value the options and awards granted during the three and six months ended November 30, 2011 and 2010, respectively, under the Company's stock incentive plans and stock purchased under the Company's employee stock purchase plan:

| | Three months ended November 30, | | Six months ended November 30, | |
|--------------------------------------|------------------------------------|---------|----------------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Stock Options: | | | | |
| Expected volatility | 57% | 55% | 56% | 56% |
| Risk-free interest rates | 0.92% | 1.65% | 1.11% | 1.86% |
| Expected term (years) | 4.84 | 5.69 | 4.84 | 5.69 |
| Expected dividend yield | 0% | 0% | 0% | 0% |
| Employee Stock Purchase Plan: | | | | |
| Expected volatility | 38% | 52% | 38% | 52% |
| Risk-free interest rates | 0.29% | 0.41% | 0.29% | 0.41% |
| Expected term (years) | 0.5 2.0 | 0.5 2.0 | 0.5 2.0 | 0.5 2.0 |
| Expected dividend yield | 0% | 0% | 0% | 0% |

The following table summarizes the stock-based compensation expense for stock options, restricted stock units and the Company's employee stock purchase plan shares that was recorded in the Company's condensed consolidated statements of operations for the three and six months ended November 30, 2011 and 2010, respectively:

| | Three months ended November 30, | | Six months ended November 30, | |
|---|------------------------------------|--------|----------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| (in thousands) | | | | |
| Cost of revenues | | | | |
| Subscription | \$ 34 | \$ 41 | \$ 70 | \$ 91 |
| Professional services | 47 | 43 | 108 | 100 |
| Research and development | 103 | 82 | 230 | 205 |
| Sales and marketing | 137 | 167 | 400 | 446 |
| General and administrative | 374 | 246 | 921 | 551 |
| Share-based compensation expense included in net loss | \$ 695 | \$ 579 | \$ 1,729 | \$ 1,393 |

The share-based compensation expense categorized by various equity components is summarized in the table below:

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| (in thousands) | Three months ended | | Six months ended | |
|--------------------------------|----------------------|--------|----------------------|----------|
| | November 30, 2011 | 2010 | November 30, 2011 | 2010 |
| Stock options | \$ 486 | \$ 463 | \$ 1,051 | \$ 1,121 |
| Restricted stock units | 143 | 108 | 556 | 255 |
| Employee stock purchase plan | 66 | 8 | 122 | 17 |
| Total share-based compensation | \$ 695 | \$ 579 | \$ 1,729 | \$ 1,393 |

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

RSUs granted by the Board of Directors have been awarded under the Company's 2000 Stock Incentive Plan (the "2000 Stock Plan") and the 2009 Stock Incentive Plan, as amended and restated (the "2009 Stock Plan"). The RSUs generally vest in four annual installments commencing on the one year anniversary of the date of the award. During the quarter ended November 30, 2011, 1,250 shares of the RSUs vested. In order to satisfy minimum tax withholding obligations that arose on the vesting of restricted stock units, 459 shares of common stock pursuant to our restricted stock units were repurchased for an aggregate price of approximately \$3,000.

The weighted average estimated fair value of options granted was \$2.62 and \$2.78 per share for the three months ended November 30, 2011 and 2010, respectively. The weighted average estimated fair value of options granted was \$3.45 and \$2.64 per share for the six months ended November 30, 2011 and 2010, respectively. The weighted average estimated fair value of RSUs granted was \$5.47 and \$5.39 per share for the three months ended November 30, 2011 and 2010, respectively. The weighted average estimated fair value of RSUs granted was \$8.84 and \$4.94 per share for the six months ended November 30, 2011 and 2010, respectively.

4. Basic and Diluted Net Loss Per Share

Basic and diluted net loss per share information for all periods is presented under the requirements of ASC 260-10 *Earnings per Share*. Basic loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Basic loss per share excludes the dilutive effects of options. Dilutive potential common shares consist of shares issuable upon the exercise of stock options and restricted stock unit awards under the treasury stock method. Potentially dilutive issuances have been excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive, which consist of common stock options, restricted stock unit awards and common stock subject to repurchase. The calculations of basic and diluted net loss per share are as follows:

| (in thousands, except per share data) | Three months ended November 30, | | Six months ended November 30, | |
|--|---------------------------------|-----------|-------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net loss | \$ (4,573) | \$ (796) | \$ (10,369) | \$ (2,491) |
| Weighted-average shares of common stock used in computing basic and diluted net loss per share | 28,586 | 28,197 | 28,486 | 28,174 |
| Basic and diluted net loss per share | \$ (0.16) | \$ (0.03) | \$ (0.36) | \$ (0.09) |

If the Company had generated net income for the three and six months ended November 30, 2011, 1.8 million and 2.3 million common equivalent shares, respectively, would have been added to the basic weighted-average shares outstanding for purposes of calculating the diluted weighted-average shares outstanding for the period. If the Company had generated net income for the three and six months ended November 30, 2010, 1.5 million common equivalent shares and 1.3 million common equivalent shares, respectively, would have been added to the basic weighted-average shares outstanding for purposes of calculating the diluted weighted-average shares outstanding.

Shares used in diluted net income per common share calculations exclude anti-dilutive common equivalent shares, consisting of all stock options and restricted stock units, if they have exercise prices that are higher than the average market price of the Company's common stock during the respective periods, under the treasury method. These anti-dilutive common equivalent shares totaled 2.6 million and 3.9 million shares for the three months ended November 30, 2011 and 2010, respectively. These anti-dilutive common equivalent shares totaled 2.0 million and 4.5 million shares for the six months ended November 30, 2011 and 2010, respectively. While these common equivalent shares are currently anti-dilutive, they could be dilutive in the future.

5. Comprehensive Loss

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The Company reports comprehensive loss in accordance with ASC 220-10 *Comprehensive Income*. The following table sets forth the calculation of comprehensive loss for all the periods presented:

| (in thousands) | Three months ended November 30, | | Six months ended November 30, | |
|--|--|-----------------|--------------------------------------|-------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net loss | \$ (4,573) | \$ (796) | \$ (10,369) | \$ (2,491) |
| Foreign currency translation gain (loss) | (668) | 169 | (726) | 243 |
| Comprehensive loss | \$ (5,241) | \$ (627) | \$ (11,095) | \$ (2,248) |

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****6. Goodwill and Purchased Intangible Assets**

The primary areas of the preliminary purchase price allocation for the acquisitions of Comartis Group Ltd. (Comartis) and Pedagogue Solutions (Pedagogue) in May 2011 that are not yet finalized relate to the fair value measurements of uncertain tax positions. The Company expects to continue to obtain information to assist it in determining the fair values of the uncertain tax positions at the acquisition dates during the measurement period. Adjustments to the amount recorded for uncertain tax positions during the remainder of the measurement period will be included in the purchase price allocation.

The following table summarizes the changes in goodwill during the three and six months ended November 30, 2011.

| | |
|-----------------------|-----------------|
| (in thousands) | Goodwill |
| August 31, 2011 | \$ 41,424 |
| Additions | |
| Adjustments | (178) |
| November 30, 2011 | \$ 41,246 |
| (in thousands) | Goodwill |
| May 31, 2011 | \$ 41,469 |
| Additions | |
| Adjustments | (223) |
| November 30, 2011 | \$ 41,246 |

Purchased intangible assets consist of acquired developed technology, customer relationships and trade names acquired as part of a purchase business combination. The intangible assets are stated at cost less accumulated amortization and are being amortized on a straight-line basis over their estimated useful lives ranging from two to ten years.

There were no additions to intangible assets during the three and six months ended November 30, 2011. The following tables provide a summary of the carrying amounts of purchased intangible assets that continue to be amortized:

| (in thousands) | November 30, 2011 | | | Weighted Average Useful Life |
|-------------------------------|------------------------------|---------------------------------|----------------------------|-------------------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | |
| Customer relationships | \$ 19,920 | \$ (14,619) | \$ 5,301 | 7.2 Years |
| Tradenames | 1,320 | (874) | 446 | 5.0 Years |
| Acquired developed technology | 7,390 | (6,052) | 1,338 | 5.0 Years |

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Total \$ 28,630 \$ (21,545) \$ 7,085

| (in thousands) | May 31, 2011 | | | Weighted Average Useful Life |
|-------------------------------|-----------------------------|-----------------------------|---------------------------|------------------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | |
| Customer relationships | \$ 19,920 | \$ (13,182) | \$ 6,738 | 7.2 Years |
| Tradenames | 1,320 | (824) | 496 | 5.0 Years |
| Acquired developed technology | 7,390 | (5,902) | 1,488 | 5.0 Years |
| Total | \$ 28,630 | \$ (19,908) | \$ 8,722 | |

The total expected future amortization related to acquired intangible assets will be approximately \$2.7 million for the year ended May 31, 2012 and \$0.9 million for each of the years ended May 31, 2013, 2014, 2015 and 2016. All intangible assets as of November 30, 2011 are expected to be fully amortized by May 31, 2021.

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SABA SOFTWARE, INC.

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7. Debt and Other Obligations

Credit Facility

On June 27, 2011, the Company entered into an Amended and Restated Credit Agreement with Wells Fargo (the "Amended Agreement"), which supersedes the Company's prior line of credit, increases the available revolving credit limit to \$40 million and extends the term of the line of credit to June 27, 2016.

Borrowings under the Amended Agreement bear interest based on the higher of the following calculated rates: (i) a fluctuating rate per annum of the applicable margin plus the base rate in effect (as defined in the Amended Agreement) or (ii) a fixed rate per annum determined by Wells Fargo to be the applicable margin plus the London Interbank Offer Rate ("LIBOR") in effect at the date of borrowing.

The line of credit is secured by all of the Company's personal property other than its intellectual property. The line of credit also is guaranteed by, and secured by the assets of, the Company's material domestic subsidiaries. The Amended Agreement includes certain covenants with which the Company must comply during the term of the Amended Agreement, including a minimum EBITDA covenant that applies only if liquidity (defined as cash plus available unused borrowings under the credit line) drops below \$15 million. The Amended Agreement also includes certain customary affirmative and negative covenants.

The Amended Agreement contains usual and customary events of default (subject to certain threshold amounts and grace periods). If an event of default occurs and is continuing, the Company may be required to repay the obligations under the line of credit prior to the stated maturity date, the Company's ability to borrow under the Amended Agreement may terminate, and the Bank may be able to foreclose on any or all collateral provided by the Company or the Company's subsidiaries.

No amounts have been borrowed under the Amended Agreement as of November 30, 2011; however, the Company was in compliance with the Amended Agreement's covenants and could have borrowed against the Amended Agreement as of November 30, 2011.

Other Obligations

During the quarter ended August 31, 2010, the Company entered into a non-cancelable three year contract for software services of which \$1.0 million remained as of November 30, 2011.

8. Guarantees

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

The Company'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, the Company has not incurred or accrued any material costs associated with these warranties.

Other guarantees include promises to indemnify, defend and hold harmless each of the Company's executive officers, non-employee directors and certain key employees from and against losses, damages and costs incurred by each such individual in administrative, legal or investigative proceedings arising from alleged wrongdoing by the individual while acting in good faith within the scope of his or her job duties on behalf of the Company. Historically, minimal costs have been incurred relating to such indemnifications and, as such, no accruals for these guarantees have been made.

9. Income Taxes

Income tax benefit for the three months ended November 30, 2011 was \$0.2 million compared to income tax provision for the three months ended November 30, 2010 of \$0.3 million. Income tax benefit was \$34,000 and for the six months ended November 30, 2011 compared to income tax provision of \$0.4 million for the six months ended November 30, 2010. Income tax benefit for the three and six months ended November 30, 2011 primarily resulted from a French tax audit settlement of \$0.2 million.

As of November 30, 2011 and May 31, 2011, the Company had a valuation allowance against the full amount of any U.S. net deferred tax assets. The Company currently provides a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all of its deferred tax assets, will not be realized.

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SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

10. Litigation

Litigation Relating to Initial Public Offering of Saba

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York (the District Court) against the Company, certain of its officers and directors, and certain underwriters of the Company's initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased the Company's common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by the Company and its officers and directors of Section 11 of the Securities Act of 1933, as amended (the Securities Act), Section 10(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and other related provisions in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the initial public 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 allege that the prospectus and the registration statement for the initial public offering failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some investors in the initial public offering agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of the Company's stock. The complaints were later consolidated into a single action. The complaint seeks unspecified damages, attorney and expert fees, and other unspecified litigation costs.

On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all of the actions, including the action involving the Company. On July 15, 2002, the Company, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On February 19, 2003, the District Court ruled on the motions. The District Court granted the Company's motion to dismiss the claims against the Company under Rule 10b-5, due to the insufficiency of the allegations against the Company. The District Court also granted the motion of the individual defendants, Bobby Yazdani and Terry Carlitz, the Company's Chief Executive Officer and Chairman of the Board and former Chief Financial Officer and a member of the Company's Board of Directors, to dismiss the claims against them under Rule 10b-5 and Section 20 of the Exchange Act. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including the Company.

In June 2003, a proposed collective partial settlement of this litigation was structured between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. In June 2004, an agreement of partial settlement was submitted to the District Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

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On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing was held on September 10, 2009. On October 5, 2009, the Court entered an opinion granting final approval to the settlement and directing that the Clerk of the Court close these actions. Appeals of the opinion granting final approval were filed, all of which were disposed of except certain appeals were remanded to the district court to determine standing to appeal. On August 25, 2011, the district court issued an order holding that the remaining objector had no standing to appeal. The August 25, 2011 order has been appealed.

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SABA SOFTWARE, INC.

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(Unaudited)

The Company intends to dispute these claims and defend the lawsuit vigorously. However, due to the inherent uncertainties of litigation and because the district court's August 25, 2011 order remains subject to appeal, the ultimate outcome of the litigation is uncertain.

Litigation Relating to Centra's Initial Public Offering

Centra, certain of its former officers and directors and the managing underwriters of Centra's initial public offering were named as defendants in an action filed in the District Court. The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve the Centra defendants on or about March 18, 2002. The original complaint has been superseded by an amended complaint filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, is purportedly brought on behalf of the class of persons who purchased Centra's common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act and Sections 10(b) and 20(a) of the Exchange Act. The complaint alleges that, in connection with Centra's initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the aftermarket at pre-determined prices. The complaint asserts that Centra's registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92.

On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all the actions, including the action involving Centra. On July 15, 2002, Centra, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On October 9, 2002, pursuant to agreements tolling the statute of limitations for claims related to the litigation, the plaintiffs dismissed, without prejudice, the claims against the named Centra officers and directors in the above-referenced action. Subsequent addenda to the agreements extended the tolling period through August 27, 2010. On February 19, 2003, the District Court issued an order denying the motion to dismiss the claims against Centra under Rule 10b-5. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including Centra.

In June 2003, a proposed collective partial settlement of this litigation was structured between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. In June 2004, an agreement of settlement was submitted to the District Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" rather than in all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

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On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing was held on September 10, 2009. On October 5, 2009, the Court entered an opinion granting final approval to the settlement and directing that the Clerk of the Court close these actions. On August 26, 2010, based on the expiration of the tolling period stated in the agreements between the plaintiffs and the named Centra officers and directors, the plaintiffs filed a notice to terminate the tolling agreement and recommence litigation against the named Centra officers and directors. The plaintiffs stated to the Court that they do not intend to take any further action against the named Centra

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(Unaudited)

officers and directors at this time. Appeals of the opinion granting final approval were filed, all of which were disposed of except certain appeals were remanded to the district court to determine standing to appeal. On August 25, 2011, the district court issued an order holding that the remaining objector had no standing to appeal. The August 25, 2011 order has been appealed.

The Company, on behalf of Centra, intends to dispute these claims and defend the lawsuit vigorously. However, due to the inherent uncertainties of litigation and because the district court's August 25, 2011 order remains subject to appeal, the ultimate outcome of the litigation is uncertain.

Litigation Relating to Claim of Patent Infringement by Centra

On August 19, 2003, a complaint was filed against Centra and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)) (the Colorado District Court). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. Centra filed an answer to the complaint denying all of the allegations. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred. Centra filed a request for reexamination of the patents at issue with the U.S. Patent and Trademark Office (the Patent Office). The Company's patent counsel is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the Colorado District Court approved the parties' motion to stay the court proceedings during the re-examination proceedings. A reexamination certificate has been issued for one of the patents that canceled all of the patent's claims, thereby rendering that patent of no further force or effect. The Patent Office issued a reexamination certificate for the other patent canceling all of the patent's original claims and allowing certain newly-added claims.

Centra subsequently filed a second reexamination request asking the Patent Office to reconsider the patentability of the newly-added claims in view of newly-discovered prior art and the Patent Office granted that request. The Colorado District Court again stayed the litigation pending the outcome of the second reexamination proceeding. On August 9, 2011, the Patent Office issued a Notice of Intent to Issue a Reexamination Certificate, indicating that a second reexamination certificate would issue in view of certain claim amendments and arguments EdiSync made to the Patent Office. On August 19, 2011, the Colorado District Court lifted the second stay. The second reexamination certificate issued on October 4, 2011. On October 17, 2011, EdiSync filed an amended complaint alleging infringement of only the one remaining patent and adding several additional parties as defendants, including Saba Software, Inc. and Centra Software, LLC. The amended complaint continues to seek permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. Saba Software, Inc., Centra Software, Inc., and Centra Software, LLC filed an answer to the amended complaint denying all of the allegations. The Company believes that it has meritorious defenses with respect to any future claims and intends to vigorously defend this action. However, due to the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of the litigation.

General Litigation Matters

The Company reviews the status of each litigation or other relevant claim and records a provision for a liability when it is considered both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions, if any, are reviewed quarterly and adjusted as additional information becomes available. If either or both of the criteria are not met, the Company assesses whether there is at least a reasonable possibility that a loss, or additional losses, may have been incurred. If there is a reasonable possibility that a loss may have been incurred, the Company discloses the estimate of the amount of loss or range of loss, discloses that the amount is immaterial, or discloses that an estimate of loss cannot be made, as applicable.

Based upon the Company's understanding of the asserted claims outstanding, including the matters disclosed above, its anticipated litigation defenses, and discussions to date with the claimants, the Company currently cannot make a reasonable estimate of the reasonably possible losses or range of losses, if any, arising from each litigation or other relevant claim. However, an unfavorable outcome in any specific litigation could materially and adversely affect the Company's business, financial condition or results of operations.

11. Recent Accounting Pronouncements

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* (ASU 2011-04), which provides guidance about fair value measurement and disclosure requirements. The new standard does not extend the use of fair value but rather, provides guidance about how fair value should be applied where it already is required or permitted under U.S. GAAP. A public entity is required to apply the ASU prospectively for interim and annual periods beginning after December 15, 2011, and early adoption is not permitted. The Company does not expect the adoption of ASU 2011-04 will have a material impact on the Company's condensed consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), to increase the prominence of other comprehensive income (loss) in financial statements. Under this ASU, an entity will have the option to present the components of net income and comprehensive income in either one or two consecutive financial statements. The ASU eliminates the option in U.S. GAAP to present other comprehensive income in the statement of changes in equity. An entity should apply the ASU retrospectively. For a public entity, the ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company plans to adopt the provisions of ASU 2011-05 beginning with its quarterly filing for the three months ending August 31, 2012. The adoption of this accounting update will only impact the presentation of comprehensive income on the Company's condensed consolidated financial statements.

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In September 2011, the FASB issued ASU No. 2011-08, *Intangibles - Goodwill and Other (Topic 350) Testing Goodwill for Impairment* (ASU 2011-08), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU 2011-08 is effective for the Company in fiscal 2013 and earlier adoption is permitted. The Company is currently evaluating the impact of the pending adoption of ASU 2011-08 on its condensed consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* (ASU 2011-12), to defer the changes in ASU 2011-05 that relate to the presentation of reclassification adjustments to other comprehensive income. These amendments are being delayed to allow the FASB time to redeliberate whether to present the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income on the face of the financial statements for all periods presented . While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, the Company is required to continue reporting reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No 2011-05.

12. Related Party Transactions

During the three and six months ended November 30, 2011 and 2010, the Company sold subscription services to Varian Medical Systems, Inc. An Executive Vice President of Varian serves as director on the Company s Board of Directors.

During the three and six months ended November 30, 2011 and 2010, the components of the related party transaction were as follows:

| (in thousands) | Sales to Related Party | | | |
|------------------------------|------------------------|----------------------|----------------------|----------------------|
| | Three months ended | | Six months ended | |
| | November 30, 2011 | November 30, 2010 | November 30, 2011 | November 30, 2010 |
| Varian Medical Systems, Inc. | \$ 144 | \$ 56 | \$ 256 | \$ 112 |
| Total | \$ 144 | \$ 56 | \$ 256 | \$ 112 |

| (in thousands) | Accounts Receivable | |
|----------------|------------------------------|-----------------|
| | November 30, 2011 | May 31, 2011 |
| | Varian Medical Systems, Inc. | \$ 110 |
| Total | \$ 110 | \$ 39 |

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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 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, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements in this Quarterly Report on Form 10-Q other than statements of historical fact are forward-looking statements. 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 the factors detailed under Part II, Item 1A: Risk Factors of this Quarterly Report on Form 10-Q. 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.

Forward-looking statements include statements regarding:

(i) in Part I, Item 1,

our belief that we are free from liability for past actions in connection with the litigation relating to the claim of patent infringement by Centra,

the merits of our litigation and our intent to dispute litigation claims and defend lawsuits vigorously,

the resolution and effect of pending litigation,

the effect of, and our adoption of, recent accounting pronouncements,

our estimate of future forfeiture rates in our stock-based compensation plans,

our anticipation that we will not pay any cash dividends in the foreseeable future, and

expected future amortization related to intangible assets.

(ii) in Part I, Item 2,

our belief that subscription revenue will grow in future periods,

our belief that the increased adoption of software as a service (SaaS) by our customers will lead to greater predictability in our quarterly revenue and our results of operations,

our anticipation that a substantial majority of our customers will renew their subscription agreements,

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our belief that our customers' preference for cloud-based subscription services over perpetual licenses will continue to grow,

our anticipation that we will continue to add new subscription customers,

the likelihood that our results of operations will vary significantly from quarter to quarter,

our anticipation that we will continue to experience long sales cycles,

the sufficiency of our available cash resources, combined with cash flows generated from revenues, to meet our presently anticipated working capital, capital expense and business expansion requirements, for at least the next 12 months.

(iii) in Part I, Item 3,

our exposure to interest rate risk and foreign currency risk, and

the effects of future changes in interest rates and foreign currency rates.

(iv) in Part II, Item 1A,

the possibility of future losses,

our expectation that we will continue to incur non-cash expenses relating to the amortization of purchased intangible assets,

our belief that quarter-to-quarter comparisons of our revenues and operating results are not necessarily meaningful and should not be relied upon as indicators of future performance,

maintaining and strengthening relationships with strategic partners,

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our anticipation that revenues from the Saba People Cloud Application, as well as related services will constitute substantially all of our revenue for the foreseeable future,

risks associated with our transition to the subscription model,

the likelihood significant fluctuations in our operating results,

our plan to expand sales coverage and marketing support,

our plan to continue to expand and ramp our direct sales force,

our intention to continue to expand our international presence,

the expectation that the intensity of competition and the pace of change will increase in the future, which is likely to result in price reductions, reduced gross margins and loss of market share,,

our belief and intention regarding litigation to which we are subject,

periodically acquiring complementary businesses or technologies, and

regularly releasing new products and new versions of existing products.

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 among others:

fluctuations in our quarterly results, including fluctuations that may result from any shift in customer preferences toward subscription services rather than software licenses,

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,

unanticipated need for capital for operations,

lack of demand for our products,

inability to introduce new products,

unanticipated difficulties relating to our products,

unanticipated decrease in demand for our products and services,

unanticipated changes in domestic and foreign tax regulations,

unanticipated adverse changes in the international markets,

requirements for increased spending in research and development,

lack of demand for our products,

negative effects of foreign exchange rates,

inability to accurately predict the impact of new accounting pronouncements,

unanticipated difficulties integrating and developing products acquired through acquisitions, and

the factors detailed under Part II, Item 1A: Risk Factors of this Quarterly Report on Form 10-Q.

OVERVIEW

General

Saba is the premier provider of a new class of learning and talent management solutions providing a unified set of People Cloud Applications that include: enterprise learning, talent management, testing and assessment and collaboration solutions delivered through the Saba People Cloud. Today's people-driven enterprises are using our solutions to mobilize and engage people around new strategies

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and initiatives, align and connect people to accelerate the flow of business, and cultivate, capture, and share individual and collective knowhow to effectively compete and succeed. We enable organizations to build a transformative workplace where they can leverage their people networks to become more competitive through innovation, speed, agility, and trust.

The Saba People Cloud consists of a full suite of integrated People Cloud Applications, an open, flexible, service-oriented architecture, a world-class multi-tenant people cloud infrastructure, and a vast people cloud community of human capital experts, partners, practitioners and thought leaders. The Saba People Cloud enables organizations to transform the way they develop, engage and inspire their people network of employees, partners and customers, to achieve sustainable competitive advantage and high impact performance. The Saba People Cloud does this by specifically providing solutions that help clients to:

MOBILIZE THEIR PEOPLE NETWORK to seize new opportunities through complete talent visibility, mobility and connection. The Saba People Cloud provides organizations with visibility into all of the skills, experience, competencies and connections of the people in their people network, the ability to quickly align them to new business initiatives and inspire them to greatness.

CULTIVATE A DEVELOPMENT CULTURE inside and outside their organization to arm their people network with the knowledge they need, when they need it to excel at their jobs, advance in their careers and drive higher performance.

ACCELERATE INNOVATION AND CREATIVITY by tapping into social and mobile capabilities to find and connect people and ideas throughout people networks to drive new ideas and faster time to market.

LEVERAGE A UNIFIED, FLEXIBLE, MULTI-TENANT CLOUD architecture and infrastructure that reduces costs, shortens time to benefit and provides the flexibility to scale globally and adapt locally to fit any organization's unique operational and financial needs.

Evolution of Our Market

Most of today's human capital management systems were built to support historic learning and talent management processes and strategies, top down management, and a culture focused on operational efficiency and automation rather than the collaboration, innovation and creativity of the networked economy. Sequential steps that were consistent and repeatable, such as formal training and rigid performance reviews were the keys to successful execution. Many systems were built to support these processes on highly rigid, linear, transactional frameworks, making them poorly suited for dynamic people-focused strategies and a networked work style. Even newer software as a service (SaaS) based talent management systems are typically assembled through multiple acquisitions to support individual processes such as recruiting, performance management or learning, and because they are not organically built and unified they cannot provide the type of complete talent visibility and process unification required of today's human capital management systems.

While business fundamentals have not changed, the environment in which organizations operate has changed dramatically and will continue to change at an accelerating pace. Business success now depends less on talented and knowledgeable individuals than on the power of the collective intelligence and influence of their personal and professional people networks. Much of this change is driven by technology such as the internet, mobile computing and the emergence of social networking technologies for business and commercial use. This continuous and dynamic change will continue to be highly disruptive to organizations that have not built a transformative workplace that is much more networked and agile. Organizations that have built this type of transformative workplace will be able to compete more effectively in the new networked economy, characterized by:

Globalization new opportunities and challenges are arising from developing countries in a world that is more interconnected where employees, suppliers, customers or partners cross borders.

Hyper-Competition the ubiquity of the internet means every competitor has global reach and can be a fast follower or has the ideas and means to invent new business models.

More Demanding Consumers are now the rule in the networked economy. Consumers can use the internet to learn anything and everything about a company, a product or a service and they can instantly compare products in the store on their smart phone or read public consumer ratings and reviews or get advice instantly from their personal network.

Closer Government Oversight in a highly networked and global environment, disasters and mistakes are no longer limited to local areas. In many cases, environmental issues like oil spills or the latest financial crisis have global implications. This has driven tighter government oversight and regulation in most industries.

Shorter Product Lifecycles the networked economy means that new ideas for products and services are crowd sourced every minute of every day and produced and adopted at blinding speed.

While these trends are changing organizations from the outside, the workforce is simultaneously evolving to change organizations from the inside. Organizations are adopting a modern and networked way of working, where the norms are transparency, concurrent projects with real-time updates, and continuously connected people, including customers, contractors and partners, who can operate successfully in a fluid and fast changing environment.

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Background

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 fiscal 2011, we experienced an accelerated shift toward increased customer adoption of SaaS transactions from perpetual licenses. In recognition of this trend, we announced a strategy in July 2011 to offer new customers primarily cloud-based subscriptions to our products, which we expect will further increase the shift in customer adoption of SaaS over perpetual licenses. Assuming this strategy is successful, we expect that the increased adoption of SaaS by our customers will lead to greater predictability in our quarterly revenue and our results of operations. However, the shift from software licenses has had an impact on our total revenue and results of operations during the last few quarters in part because we recognize revenues from SaaS over the term of the subscription agreement whereas revenue from a software license sale is generally recognized in the period in which the software arrangement is completed and the software is delivered to the customer.

Our corporate headquarters are located in Redwood Shores, California. We have an international presence in Australia, Brazil, Canada, France, Germany, India, Japan, Morocco, Switzerland and the United Kingdom through which we conduct various operating activities related to our business. In each of the non-U.S. jurisdictions in which we have subsidiaries, other than India, 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.

Sources of Revenue

We generate revenues from the sale of subscription services, professional services and software licenses.

Subscription Services

Subscription revenue includes revenue from delivery of our products in the cloud and revenue from license updates and product support. Customers that desire to access our products in the cloud generally sign subscription agreements with terms typically ranging from one to three years. License updates and product support include the right to receive future unspecified updates for the applicable software product and technical support. We typically sell license updates and product support for an initial period of one year concurrently with the sale of the related software license. After the initial period, license updates and product support is renewable on an annual basis at the option of the customer. Our subscription revenue depends upon both our sales of additional subscription services and renewals of existing agreements.

We believe that subscription revenue will grow steadily for the foreseeable future as we anticipate that the majority of our customers will renew their annual contracts and we will continue to add new subscription customers.

Professional Services

Our professional services business consists of consulting and education services. Consulting and education services are typically provided to customers that have purchased our products directly from us. These consulting and education services are generally provided over a period of three to nine months after the product purchase. Accordingly, our consulting and education services revenue varies directly with the levels of new product bookings generated from our direct sales organization in the preceding three to nine month period. In addition, our consulting and education services revenue varies following our commercial release of significant software updates as our license customers may engage our services to assist with the implementation of their software update. We provide consulting services on a time and materials basis and on a fixed fee basis. Generally, consulting services related to software implementation are not considered essential to the functionality of the software.

Software Licenses

Although we expect that our new customers will primarily purchase our products in the cloud on a software as a service basis, we will continue to license our products on a limited basis primarily to existing customers. When we license our software, it is included in multiple-element arrangement that includes a combination of our software, license updates and product support and/or professional services. A significant amount of our license sales are for perpetual licenses. Our license revenue is affected by, among other things, 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 typically six to 12 months. The timing of a few large software license transactions can substantially affect our quarterly license revenue.

Cost of Revenue

Our cost of revenue primarily consists of compensation, employee benefits and out-of-pocket travel-related expenses for our employees, and the fees of third-party subcontractors, who provide professional services. Cost of revenue also includes external hosting fees and depreciation and amortization charges related to the infrastructure required to deliver our products in the cloud, third-party license royalty costs, overhead allocated based on headcount and reimbursed expenses. The amortization of acquired developed technology,

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which is comprised of the ratable amortization of technological assets acquired in acquisitions, is also included in the cost of revenue. Many factors affect our cost of revenue, including changes in the mix of products and services, pricing trends and changes in the amount of reimbursed expenses. Because cost as a percentage of revenues is higher for services than for software licenses, an increase in services, including subscription services, as a percentage of our total revenue would reduce gross profit as a percentage of total revenue.

For contracts that were entered into prior to adoption of ASU 2009-13 and 2009-14, we classify deferred professional services revenue and the related deferred costs, when such services were related to subscription offerings, on our condensed consolidated balance sheet as current if we expect to recognize such revenue or cost within the following twelve months. As of November 30, 2011, the deferred professional services and deferred costs balances were \$2.2 million and \$1.3 million, respectively. Deferred revenue and deferred costs related to contracts that were entered into prior to adoption of ASU 2009-13 and 2009-14 continue to be recognized and amortized ratably over the subscription period, provided that such contracts were not subsequently materially modified.

Operating Expenses

We classify all operating expenses, except amortization of purchased intangible assets and restructuring, to the research and development, sales and marketing, and general and administrative expense categories based on the nature of the expenses. Each of these three categories includes commonly recurring expenses such as salaries (including stock-based compensation), employee benefits, travel and entertainment costs, and allocated communication, rent and depreciation costs. We allocate communication, rent and depreciation costs to each of the functional areas that derive a benefit from such costs based upon their respective headcounts. The sales and marketing category of operating expenses also includes sales commissions and expenses related to public relations and advertising, trade shows and marketing collateral materials. The general and administrative category of operating expenses also includes allowances for doubtful accounts, and administrative and professional services fees.

We capitalize sales commissions related to non-cancellable annual or multi-year SaaS contracts and amortize the sales commission in proportion to the revenue recognized over the non-cancellable term of the contract. All other sales commissions are generally expensed as they are earned per the terms of the sales compensations plans.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with United States Generally Accepted Accounting Principles (GAAP) as set forth in the Financial Accounting Standards Board's Accounting Standard Codification (the Codification) and consider the various staff accounting bulletins and other applicable guidance issued by the SEC. GAAP, as set forth within the Codification, requires us to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. While a number of accounting policies, methods and estimates affect our financial statements, areas that are particularly significant include revenue recognition policies, the assessment of recoverability of goodwill and purchased intangible assets, share-based payments, income taxes and business combinations. We have reviewed the critical accounting policies described in the following paragraphs with the Audit Committee of our Board of Directors.

Revenue recognition

The Company generates revenues from the sale of subscription services, professional services and software licenses and recognizes revenues when all of the following conditions are met:

persuasive evidence of an agreement exists;

delivery has occurred;

the fee is fixed or determinable; and

collection is probable.

Subscription Services Arrangements

Subscription services arrangements generally include a combination of our products delivered via an internet-based cloud architecture, product updates and support related to licenses and professional services. Subscription revenue includes revenue from cloud-based offerings and product updates and support related to licenses.

Revenue from cloud-based offerings that are integrated offerings pursuant to which the customers' ability to access the Company's software is not separable from the services necessary to operate the software and customers are not allowed to take possession of the Company's software are recognized ratably over the term of the arrangement as delivered or on an as-used basis if defined in the contract. Saba does not grant its resellers the right of return and does not recognize revenue from resellers until an end-user has been identified and the other conditions of software revenue recognition guidance are satisfied. Revenue from product updates, support and hosting services related to licenses are recognized ratably over the term of the arrangement as delivered or on an as-used basis if defined in the contract.

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When subscription services arrangements involve multiple elements that qualify as separate units of accounting, the Company allocates arrangement consideration in multiple-deliverable revenue arrangements at the inception of an arrangement to all deliverables based on the relative selling price method in accordance with the selling price hierarchy, which includes: (i) vendor-specific objective evidence (VSOE) if available; (ii) third-party evidence (TPE) if VSOE is not available; and (iii) best estimate of selling price (BESP) if neither VSOE nor TPE is available.

The Company determines VSOE based on its historical pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, the Company requires that a substantial majority of the selling prices for these services fall within a reasonably narrow pricing range. The Company limits its assessment of VSOE for each element to either the price charged when the same element is sold separately or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

When VSOE cannot be established for deliverables in multiple element arrangements, the Company applies judgment with respect to whether it can establish a selling price based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, the Company's go-to-market strategy differs from that of its peers and its offerings contain a significant level of differentiation such that the comparable pricing of services with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitor services' selling prices are on a stand-alone basis. As a result, the Company has not been able to establish selling price based on TPE.

When it is unable to establish a selling price using VSOE or TPE, the Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. The Company determines BESP for deliverables by considering multiple factors including, but not limited to, prices it charges for similar offerings, market conditions, competitive landscape and pricing practices.

The Company does not have VSOE on its cloud-based offerings. As a result, the Company uses BESP in order to allocate the selling price to cloud-based deliverables. In general, the Company uses VSOE in order to allocate the selling price to professional service deliverables.

Certain cloud-based offerings include arrangements with customers that have separately licensed and taken possession of the Company's software. When these offerings are part of a multiple element arrangement involving licenses, the Company recognizes revenue in accordance with software revenue recognition guidance.

Professional Services

Professional services revenues are generally recognized as the services are performed. Although the Company generally provides professional services on a time-and-materials basis, certain services agreements are provided on a fixed-fee basis. For services performed on a fixed-fee basis, revenues are generally recognized using the proportional performance method, with performance measured based on hours of work performed. For contracts that involve significant customization and implementation or consulting services that are essential to the functionality of the software, the license and services revenues are recognized using the percentage-of-completion method or, if Saba is unable to reliably estimate the costs to complete the services, Saba uses the completed-contract method of accounting in accordance with software revenue recognition guidance and relevant guidance of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605-35 *Construction-Type and Certain Production Type* . A contract is considered complete when all significant costs have been incurred or the item has been accepted by the customer.

If the requirements of software revenue recognition are not met when the Company bills a customer or a customer pays the Company, the billed or paid amount is recorded as deferred revenue, which is a liability account. As the revenue recognition criteria of software revenue recognition are satisfied, the requisite amounts are recognized as revenue.

The Company classifies deferred revenue and deferred costs on its consolidated balance sheet as current if the Company expects to recognize such revenue or cost within the following twelve months. When the revenue from professional services is recognized ratably over the subscription for transactions entered into prior to adoption of Accounting Standards Updated 2009-13 *Revenue Recognition (Topic 605) Multiple Deliverable Revenue Arrangements (A Consensus of the FASB Emerging Issues Task Force)* (ASU 2009-13), the Company allocates the revenue to professional services revenue and to subscription revenue based on the VSOE of fair value for similar professional services that qualify as a separate element of the arrangement. The Company's judgment as to whether the consulting services qualify as a separate unit of accounting may materially affect the timing of the Company's revenue recognition and results of operations.

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Software License Arrangements

Software license arrangements generally include a combination of the Company's software, license updates and product support and/or professional services. A significant amount of the Company's software license arrangements are for perpetual licenses.

The Company recognizes revenue earned on perpetual software license arrangements in accordance with software revenue recognition guidance. When software arrangements involve multiple elements, the Company recognizes license revenue, using the residual method. Under the residual method revenue is allocated to undelivered elements based on VSOE of fair value of such undelivered elements and the residual amount of the arrangement is allocated to delivered elements. Accordingly, assuming all other revenue recognition criteria are met, revenues from perpetual licenses are recognized upon delivery using the residual method. The Company limits its assessment of VSOE for each element to either the price charged when the same element is sold separately or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

License revenues from licenses with a term of three years or more are generally recognized on delivery if the other conditions of ASC 985-605 are satisfied. License revenues from licenses with a term of less than three years are generally recognized ratably over the term of the arrangement. In arrangements where term licenses are bundled with license updates and product support and such revenue is recognized ratably over the term of the arrangement, The Company allocates the revenue to license revenue and to license updates and product support revenue based on the VSOE of fair value for license updates and product support revenue on perpetual licenses of similar products. The Company does not grant its resellers the right of return and does not recognize revenue from resellers until an end-user has been identified and the other conditions of software revenue recognition are satisfied.

Recoverability of goodwill and purchased intangible assets

We account for goodwill under ASC 350-20 *Goodwill* (ASC 350-20). Our goodwill balance at November 30, 2011 was \$41.2 million. We account for purchased intangible assets under ASC 350-30 *General Intangibles Other than Goodwill*. Amortization of purchased intangible assets, including acquired developed technology, was \$0.8 million and \$0.9 million for the three months ended November 30, 2011 and 2010, respectively. Amortization of purchased intangible assets, including acquired developed technology, was \$1.6 million for the six months ended November 30, 2011 and \$1.9 million for the six months ended November 30, 2010. As of November 30, 2011, our purchased intangible assets balance was \$7.1 million, net of accumulated amortization. The total expected future amortization related to acquired intangible assets will be approximately \$2.7 million for the year ended May 31, 2012 and \$0.9 million for each of the years ended May 31, 2013, 2014, 2015 and 2016.

ASC 350-20 prescribes a two-phase process for impairment testing of goodwill. The first phase requires us to test for impairment, while the second phase, if necessary, requires us to measure and allocate for the impairment. We consider Saba to be a single reporting unit. Accordingly, all of our goodwill is associated with the entire company. We perform the required impairment analysis of goodwill annually or on a more frequent basis if indicators of impairment arise or circumstances otherwise dictate. A significant and extended reduction in our enterprise fair value to below the recorded amount of our stockholders' equity could indicate a change in our business climate and under ASC 350-20, we could be required to write down the carrying value of our goodwill and record an expense for an impairment loss.

Share-based compensation

Under ASC 718-10 *Compensation - Stock Compensation* (ASC 718-10), we are required to estimate the awards that we ultimately expect to vest and reduce share-based compensation expense for the effects of estimated forfeitures of awards over the expense recognition period. Although we estimate forfeitures based on historical experience, forfeitures in the future may differ. The forfeiture rate must be revised if actual forfeitures differ from our original estimates. We recognize awards granted under the straight-line amortization method. We estimate the fair value of employee stock options using the Black-Scholes-Merton pricing model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their stock options. The risk-free interest rate assumption is based upon United States treasury interest rates appropriate for the expected life of the awards. We estimate the volatility of our common stock based upon our historical stock price volatility over the length of the expected term of the stock option. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. Our expected dividend rate is zero since we do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future.

RSUs granted by the Board of Directors have been awarded under the Company's 2000 Stock Incentive Plan (the 2000 Stock Plan) and the 2009 Stock Incentive Plan, as amended and restated (the 2009 Stock Plan). The RSUs generally vest in four annual installments commencing on the one year anniversary of the date of the award.

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ASC 718-10 requires the benefits of tax deductions in excess of the tax-effected compensation that would have been recognized as if we had always accounted for our stock-based award activity under ASC 718-10 to be reported as a cash flow from financing activities, rather than as a cash flow from operating activities.

To the extent we change the terms of our employee stock-based compensation programs and refine different assumptions in future periods such as forfeiture rates that differ from our estimates, the stock-based compensation expense that we record in future periods may differ significantly from what we have recorded in the three and six months ended November 30, 2011.

Table of Contents***Income Taxes***

Significant judgment is required in determining our worldwide income tax provision. In the ordinary course of a global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of the process of identifying items of revenues and expenses that qualify for preferential tax treatment, segregating foreign and domestic earnings and expenses to avoid double taxation, and determining required intercompany revenue sharing, cost reimbursement and other transfer pricing arrangements among related entities. Although we believe that our estimates are reasonable, the final tax outcome of these matters could be different from that which is reflected in our historical income tax provisions and accruals. Such differences could have a material effect on our income tax provision and net income in the period in which such determination is made.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Our deferred tax assets consist primarily of net operating loss carry forwards and tax credit carryforwards. In order for us to realize our deferred tax assets, we must be able to generate sufficient taxable income in those jurisdictions where the deferred tax assets are located. We consider future growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies in determining the need for a valuation allowance. We maintain a full valuation allowance on our U.S. deferred tax assets. A portion of the valuation allowance pertains to deferred tax assets established in connection with prior acquisitions. The reversal of the valuation allowance pertaining to deferred tax assets established in connection with such prior acquisitions, would be credited to earnings. Although we believe that our tax estimates are reasonable, the ultimate tax determination involves significant judgment that could become subject to audit by tax authorities in the ordinary course of business. In the event that we were to determine that it is more likely than not that all or part of the net deferred tax assets would be realized, an adjustment to the deferred tax assets valuation allowance would be credited to earnings in the period in which we made such determination. If we later determine that we would not be able to realize all or part of the net deferred tax assets, an adjustment to the deferred tax assets valuation allowance would be charges to earnings at such time.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are generally recorded in the period when the tax returns are filed and the global tax implications are known. The amount of income tax we pay is subject to ongoing audits by federal, state and foreign tax authorities, which often result in proposed assessments. Our estimate of the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, audits are closed or when statutes of limitation on potential assessments expire. Additionally, the jurisdictions in which our earnings or deductions are realized may differ from our current estimates. As a result, our effective tax rate may fluctuate significantly on a quarterly basis.

Under ASC 740-10 *Income Taxes*, we recognize and measure uncertain tax positions taken or expected to be taken in a tax return based on a two-step approach. The first step is to determine if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained on tax audit assuming that all issues are audited and resolution of any related appeals or litigation processes are considered. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement. Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given with respect to the final outcome of such matters. We adjust reserves for our uncertain tax positions due to changing facts and circumstances, such as the closing of a tax audit, expiration of statutes of limitation on potential assessments or the refinement of an estimate. To the extent that the final outcome of these matters is different than the amounts recorded, such differences will impact our provision for income taxes in the period in which such a determination is made. Our provisions for income taxes include the impact of reserve provisions and changes to reserves that are considered appropriate and also include the related interest and penalties.

Business Combinations

We allocate the purchase price of acquired companies to the assets acquired and liabilities assumed based on their estimated fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date fair value of the assets acquired and liabilities assumed. We make significant estimates and assumptions, especially with respect to intangible assets, to estimate the fair value of assets acquired and liabilities assumed. The estimates of fair value are based upon assumptions believed to be reasonable by us, but are inherently uncertain and unpredictable and, therefore, actual results may differ from estimates. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to our consolidated statements of operations.

The fair value of asset acquired and liabilities assumed are estimated using various valuation approaches, which include unobservable inputs that reflect our assessment of the assumptions market participants would use to value such assets and liabilities. Significant inputs to estimate the fair

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value of assets acquired and liabilities assumed include, but are not limited to, discount rates, probability of future cash pay-outs related to contingent consideration, and future expected cash flows from customer contracts, customer lists, acquired developed technologies and patents and brand awareness and market position, as well as assumptions about the period of time the brand will continue to be used in our product portfolio.

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In addition, uncertain tax positions and tax related valuation allowances assumed in connection with a business combination are initially estimated as of the acquisition date. We reevaluate these items quarterly and record any adjustments to our preliminary estimates to goodwill provided that we are within the measurement period and we continue to collect information in order to determine their estimated fair values as of the date of acquisition. Subsequent to the measurement period or our final determination of the tax allowance s or contingency s estimated value, changes to these uncertain tax positions and tax related valuation allowances will affect our provision for income taxes in our consolidated statement of operations.

RESULTS OF OPERATIONS**THREE AND SIX MONTHS ENDED NOVEMBER 30, 2011 AND 2010****Revenues**

| (dollars in thousands) | Three months ended November 30, | | | |
|------------------------|---------------------------------|---------------------------|------------------|---------------------------|
| | 2011 | Percent of Total Revenues | 2010 | Percent of Total Revenues |
| Revenues: | | | | |
| Subscription | \$ 19,134 | 63% | \$ 15,604 | 53% |
| Professional services | 9,930 | 33% | 8,774 | 30% |
| License | 1,332 | 4% | 4,814 | 17% |
| Total revenues | \$ 30,396 | 100% | \$ 29,192 | 100% |

| (dollars in thousands) | Six months ended November 30, | | | |
|------------------------|-------------------------------|---------------------------|------------------|---------------------------|
| | 2011 | Percent of Total Revenues | 2010 | Percent of Total Revenues |
| Revenues: | | | | |
| Subscription | \$ 37,681 | 62% | \$ 30,499 | 54% |
| Professional services | 19,259 | 31% | 16,623 | 30% |
| License | 4,097 | 7% | 9,264 | 16% |
| Total revenues | \$ 61,037 | 100% | \$ 56,386 | 100% |

Total Revenues. Total revenues increased by \$1.2 million, or 4%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. Total revenues increased by \$4.7 million, or 8%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. As a percentage of total revenues, revenues from customers outside the United States represented 34% and 37% for the three months ended November 30, 2011 and 2010, respectively. As a percentage of total revenues, revenues from customers outside the United States represented 36% for both the six months ended November 30, 2011 and 2010. The only foreign country in which revenues represented more than 10% of total revenues was the United Kingdom, which represented 15% for both the three months ended November 30, 2011 and 2010, and 14% for both the six months ended November 30, 2011 and 2010.

Subscription Revenue. Subscription revenue increased by \$3.5 million, or 23%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. Subscription revenue increased by \$7.2 million, or 24%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The increases reflect an increase of subscription revenue from new customers, primarily related to our cloud offerings, an increase in subscription revenue as a result of the companies acquired in May 2011, as well as an increase in subscription revenue associated with subscription renewals.

Professional Services Revenue. Professional services revenue increased by \$1.2 million, or 13%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. Professional services revenue increased by \$2.6 million, or 16%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The increases were primarily due to an increased demand for

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our professional services from our expanded customer base including customers added as a result of the companies acquired in May 2011.

License Revenue. License revenue decreased by \$3.5 million, or 72%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. License revenue decreased by \$5.2 million, or 56%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The decreases in license revenue reflects the implementation of our strategy to primarily offer new cloud-based subscriptions to our products.

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| (dollars in thousands) | Three months ended November 30, | | | |
|---|---------------------------------|---------------------------|-----------|---------------------------|
| | 2011 | Percent of Total Revenues | 2010 | Percent of Total Revenues |
| Cost of revenues: | | | | |
| Subscription | \$ 4,433 | 15% | \$ 3,891 | 13% |
| Professional services | 6,844 | 23% | 5,967 | 20% |
| License | 242 | 1% | 186 | 1% |
| Amortization of acquired developed technology | 75 | < 1% | 295 | 1% |
| Total cost of revenues | \$ 11,594 | 40% | \$ 10,339 | 35% |

| (dollars in thousands) | Six months ended November 30, | | | |
|---|-------------------------------|---------------------------|-----------|---------------------------|
| | 2011 | Percent of Total Revenues | 2010 | Percent of Total Revenues |
| Cost of revenues: | | | | |
| Subscription | \$ 8,772 | 14% | \$ 7,811 | 14% |
| Professional services | 13,508 | 22% | 11,688 | 21% |
| License | 420 | 1% | 433 | 1% |
| Amortization of acquired developed technology | 150 | < 1% | 590 | 1% |
| Total cost of revenues | \$ 22,850 | 38% | \$ 20,522 | 37% |

The following table is a summary of gross margin:

| (dollars in thousands) | Three months ended November 30, | |
|---|---------------------------------|-----------|
| | 2011 | 2010 |
| Gross margin: | | |
| Subscription | \$ 14,701 | \$ 11,713 |
| <i>Percentage of subscription revenue</i> | 77% | 75% |
| Professional services | 3,086 | 2,807 |
| <i>Percentage of professional services revenue</i> | 31% | 32% |
| License (including amortization of acquired developed technology) | 1,015 | 4,333 |
| <i>Percentage of license revenue</i> | 76% | 90% |
| Total | \$ 18,802 | \$ 18,853 |
| <i>Percentage of total revenues</i> | 62% | 65% |

| (dollars in thousands) | Six months ended November 30, | |
|---|-------------------------------|-----------|
| | 2011 | 2010 |
| Gross margin: | | |
| Subscription | \$ 28,909 | \$ 22,688 |
| <i>Percentage of subscription revenue</i> | 77% | 74% |
| Professional services | 5,751 | 4,935 |

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| | | |
|---|---------------|---------------|
| <i>Percentage of professional services revenue</i> | <i>30%</i> | <i>30%</i> |
| License (including amortization of acquired developed technology) | 3,527 | 8,241 |
| <i>Percentage of license revenue</i> | <i>86%</i> | <i>89%</i> |
| Total | \$ 38,187 | \$ 35,864 |

| | | |
|-------------------------------------|------------|------------|
| <i>Percentage of total revenues</i> | <i>63%</i> | <i>64%</i> |
|-------------------------------------|------------|------------|

Cost of Subscription Revenue. Cost of subscription revenue increased by \$0.5 million, or 14%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. The subscription gross margin increased to 77% for the three months ended November 30, 2011 from 75% for the three months ended November 30, 2010. The increase in cost of subscription revenue was primarily the result of increases in third party data center service fees, license product costs and compensation costs associated with the increase in subscription revenue. The increase in subscription gross margin for the three months ended November 30, 2011 compared to the same period in the prior year was due to a 23% increase in subscription revenue with a corresponding increase in subscription revenue costs of only 14% for the three months ended November 30, 2011 compared to the same period in prior year. Cost of subscription revenue increased by \$1.0 million, or 12%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The subscription gross margin increased to 77% for the six months ended November 30, 2011 from 74% for the six months ended November 30, 2010. The increase in cost of subscription revenue was primarily the result of increases in third party hosting data center fees, license product costs and compensation costs associated with the increase in subscription revenue. The increase in subscription gross margin for the six months ended November 30, 2011 compared to the same period in the prior year was due a 24% increase in subscription revenue with a corresponding increase in subscription revenue costs of only 12% for the six months ended November 30, 2011 compared to the same period in prior year.

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Cost of Professional Services Revenue. For the three months ended November 30, 2011, cost of professional services revenue increased by \$0.9 million, or 15%, compared to the three months ended November 30, 2010. The increase in cost of professional services revenue was primarily the result of increases in compensation costs, third party billable labor and employee travel related expenses associated with the increase in subscription revenue. The professional services gross margin decreased slightly to 31% for the three months ended November 30, 2011, from 32% for the three months ended November 30, 2010. The decrease in gross margin is primarily due to an increase in professional services costs as compared to revenue. For the six months ended November 30, 2011, cost of professional services revenue increased by \$1.8 million, or 16%, compared to the six months ended November 30, 2010. The increase in cost of professional services revenue was primarily the result of increases in third party billable labor, compensation costs and billable travel related expenses associated with the increase in subscription revenue. The professional services gross margin remained constant at 30% for both the six months ended November 30, 2011 and 2010.

Cost of License Revenue. Cost of license revenue increased by \$56,000, or 30%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010, due to an increase in royalty expense. Gross margin on license revenue decreased to 76% for the three months ended November 30, 2011 from 90% for the three months ended November 30, 2010. The decrease in gross margin is primarily the result of a decrease in license revenue relative to the fixed cost of license revenue, including amortization of acquired technologies. Cost of license revenue decreased by \$13,000, or 3%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010, due to a reduction in royalty expense. Gross margin on license revenue decreased to 86% for the six months ended November 30, 2011 from 89% for the six months ended November 30, 2010. The decrease in gross margin is primarily the result of a decrease in license revenue relative to the fixed cost of license revenue, including amortization of acquired technologies.

Operating Expenses

| (dollars in thousands) | Three months ended November 30, | | | |
|---|---------------------------------|--------------------------|-----------|--------------------------|
| | 2011 | Percent of Total Revenue | 2010 | Percent of Total Revenue |
| Operating expenses: | | | | |
| Research and development | \$ 5,714 | 19% | \$ 4,436 | 15% |
| Sales and marketing | 12,565 | 41% | 11,052 | 38% |
| General and administrative | 5,118 | 17% | 3,419 | 12% |
| Amortization of purchased intangible assets | 743 | 2% | 634 | 2% |
| Total operating expenses | \$ 24,140 | 79% | \$ 19,541 | 67% |

| (dollars in thousands) | Six months ended November 30, | | | |
|---|-------------------------------|--------------------------|-----------|--------------------------|
| | 2011 | Percent of Total Revenue | 2010 | Percent of Total Revenue |
| Operating expenses: | | | | |
| Research and development | \$ 11,766 | 19% | \$ 8,859 | 16% |
| Sales and marketing | 25,661 | 42% | 20,898 | 37% |
| General and administrative | 10,056 | 17% | 6,831 | 12% |
| Amortization of purchased intangible assets | 1,486 | 2% | 1,268 | 2% |
| Total operating expenses | \$ 48,969 | 80% | \$ 37,856 | 67% |

Research and development. Research and development expenses increased by \$1.3 million, or 29%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. The increase was primarily attributable to an increase in compensation costs of \$1.4 million, partially offset by a decrease in employee travel related expenses of \$0.1 million. Research and development expenses increased by \$2.9 million, or 33%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The increase was primarily attributable to an increase in compensation costs of \$3.0 million partially offset by a decrease in employee travel related expenses of

\$0.1 million.

Sales and marketing. Sales and marketing expenses increased by \$1.5 million, or 14%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. The increase was primarily attributable to an increase in compensation costs of \$2.5 million, partially offset by decreases in marketing related expenses of \$0.6 million, employee-related operating expenses of \$0.3 million and employee travel costs of \$0.2 million. Sales and marketing expenses increased by \$4.8 million, or 23%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The increase was primarily attributable to increases in compensation costs of \$4.5 million, facilities related expenses of \$0.4 million, commissions of \$0.3 million and outside services of \$0.2 million. The increase was partially offset by a decrease in marketing related expenses of \$0.5 million.

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General and administrative. General and administrative expenses increased by \$1.7 million, or 50%, for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. The increase was primarily due to increases in compensation costs of \$1.1 million, equipment costs of \$0.3 million, outside services of \$0.2 million and stock compensation of \$0.1 million. General and administrative expenses increased by \$3.2 million, or 47%, for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The increase was due to increases in compensation costs of \$1.9 million, outside services of \$0.6 million, stock compensation of \$0.4 million and equipment costs of \$0.4 million.

Amortization of purchased intangible assets. Amortization of purchased intangible assets increased by \$0.1 million, or 17%, for three months ended November 30, 2011, compared to the three months ended November 30, 2010, primarily due to the acquisitions of Comartis and Pedagogue in May 2011. Amortization of purchased intangible assets increased by \$0.2 million, or 17%, for six months ended November 30, 2011, compared to the six months ended November 30, 2010, primarily due to the acquisitions of Comartis and Pedagogue in May 2011.

Other Income and Expenses, Net

Interest income and other, net consists of interest income and other non-operating expenses. Interest income and other, net increased by \$0.5 million for the three months ended November 30, 2011 compared to the three months ended November 30, 2010. The increase was attributable to a \$0.9 million net increase in foreign currency unrealized gains related to currency fluctuations in the Swiss Franc and other income of \$0.2 million related to the recovery of an investment previously written off. The increase was partially offset by a \$0.3 million net increase in realized foreign currency losses related to currency fluctuations in the Indian Rupee. Interest income and other, net increased by \$0.6 million for the six months ended November 30, 2011 compared to the six months ended November 30, 2010. The increase was attributable to a \$0.3 million net increase in foreign currency unrealized gains related to currency fluctuations in the British Pound and other income of \$0.2 million related to the recovery of an investment previously written off.

Benefit (provision) for income taxes

Income tax benefit for the three months ended November 30, 2011 was \$0.2 million compared to income tax provision for the three months ended November 30, 2010 of \$0.3 million. Income tax benefit was \$34,000 and for the six months ended November 30, 2011 compared to income tax provision of \$0.4 million for the six months ended November 30, 2010. Income tax benefit for the three and six months ended November 30, 2011 primarily resulted from a French tax audit settlement of \$0.2 million.

As of November 30, 2011 and May 31, 2011, we have a valuation allowance against the full amount of any U.S. net deferred tax assets. We currently provide a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all of our deferred tax assets, will not be realized.

DEFERRED REVENUES

Deferred revenues consisted of the following: