

SABA SOFTWARE INC  
Form 10-Q  
October 06, 2011  
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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 August 31, 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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<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>94-3267638</b> (I.R.S. Employer Identification No.)
<b>2400 Bridge Parkway</b>  <b>Redwood Shores, California</b> (Address of principal executive offices)	<b>94065-1166</b> (Zip Code)
<b>(650) 581-2500</b> (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 September 30, 2011, 29,397,919 shares of the registrant's Common Stock, \$0.001 par value, were outstanding.

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**FORM 10-Q**

**QUARTER ENDED AUGUST 31, 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)

	August 31, 2011	May 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 20,814	\$ 25,940
Accounts receivable, net of allowances for doubtful accounts of \$150 as of August 31, 2011 and May 31, 2011	25,125	27,676
Prepaid expenses and other current assets	3,345	3,411
Total current assets	49,284	57,027
Property and equipment, net	4,069	3,146
Goodwill	41,424	41,469
Purchased intangible assets, net	7,904	8,722
Restricted cash	437	437
Other assets	3,473	2,774
Total assets	\$ 106,591	\$ 113,575
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 5,299	\$ 5,886
Accrued compensation and related expenses	8,528	8,008
Accrued expenses	5,892	5,330
Deferred revenue	40,083	42,513
Current portion of lease obligations	924	1,219
Total current liabilities	60,726	62,956
Deferred revenue, less current portion	3,763	3,270
Other long-term liabilities	3,746	3,926
Total liabilities	68,235	70,152
Stockholders' equity:		
Preferred stock, issuable in series \$0.001 par value, 5,000,000 authorized shares at August 31, 2011 and May 31, 2011; none issued or outstanding		
Common stock, \$0.001 par value, 50,000,000 authorized; 29,371,909 shares issued at August 31, 2011 and 29,186,633 shares issued at May 31, 2011	29	29
Additional paid-in capital	262,973	261,900
Treasury stock: 920,288 shares at August 31, 2011 and 880,288 shares at May 31, 2011	(5,986)	(5,701)
Accumulated deficit	(218,872)	(213,075)
Accumulated other comprehensive income	212	270

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Total stockholders' equity	38,356	43,423
Total liabilities and stockholders' equity	\$ 106,591	\$ 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)**

	<b>Three months ended August 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Revenues:</b>		
Subscription	\$ 18,547	\$ 14,895
Professional services	9,329	7,849
License	2,765	4,450
<b>Total revenues</b>	<b>30,641</b>	<b>27,194</b>
<b>Cost of revenues:</b>		
Subscription	4,339	3,920
Professional services	6,664	5,721
License	178	247
Amortization of acquired developed technology	75	295
<b>Total cost of revenues</b>	<b>11,256</b>	<b>10,183</b>
<b>Gross profit</b>	<b>19,385</b>	<b>17,011</b>
<b>Operating expenses:</b>		
Research and development	6,052	4,423
Sales and marketing	13,096	9,846
General and administrative	4,938	3,412
Amortization of purchased intangible assets	743	634
<b>Total operating expenses</b>	<b>24,829</b>	<b>18,315</b>
<b>Loss from operations</b>	<b>(5,444)</b>	<b>(1,304)</b>
Interest and other expense, net	(159)	(225)
Interest expense	(72)	(1)
<b>Loss before provision for income taxes</b>	<b>(5,675)</b>	<b>(1,530)</b>
Provision for income taxes	(121)	(165)
<b>Net loss</b>	<b>\$ (5,796)</b>	<b>\$ (1,695)</b>
<b>Basic and diluted net loss per share</b>	<b>\$ (0.20)</b>	<b>\$ (0.06)</b>
Shares used in computing basic and diluted net loss per share	28,387	28,151

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	<b>Three months ended August 31,</b>	
	<b>2011</b>	<b>2010(1)</b>
<b>Operating activities:</b>		
Net loss	\$ (5,796)	\$ (1,695)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	511	558
Amortization of purchased intangible assets	818	929
Share-based compensation	1,034	814
Changes in operating assets and liabilities:		
Accounts receivable	2,516	6,886
Prepaid expenses and other current assets	33	(1,140)
Other assets	(755)	(121)
Accounts payable	(585)	109
Accrued compensation and related expenses	767	(1,442)
Accrued expenses	472	217
Deferred revenue	(1,882)	(3,337)
Accrued rent	(490)	(279)
Net cash provided by (used in) operating activities	(3,357)	1,499
<b>Investing activities:</b>		
Purchases of property and equipment	(1,446)	(288)
Net cash used in investing activities	(1,446)	(288)
<b>Financing activities:</b>		
Proceeds from issuance of common stock under stock plans	412	392
Repurchase of common stock	(286)	(747)
Repurchase of stock to satisfy employee tax withholding obligations	(372)	
Net cash used in financing activities	(246)	(355)
Effect of exchange rate changes on cash and cash equivalents	(77)	334
Increase (decrease) in cash and equivalents	(5,126)	1,190
Cash and cash equivalents, beginning of period	25,940	32,002
Cash and cash equivalents, end of period	\$ 20,814	\$ 33,192
<b>Supplemental disclosure of other cash flow information:</b>		
Cash paid for income taxes, net of refunds	\$ 40	\$ 819
Cash paid for interest	\$	\$ 3

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- (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.  
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 August 31, 2011, the condensed consolidated statements of operations and the condensed consolidated statements of cash flows for the three months ended August 31, 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 August 31, 2011, and the Company s results of operations and cash flows for the three months ended August 31, 2011 and 2010. The condensed consolidated balance sheet as of August 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 months ended August 31, 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 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.

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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.

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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**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 has not historically priced its cloud-based offerings within a narrow range and limited historical renewal rate information is available based on the life cycle of these 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 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 August 31, 2011:

Description	As of August 31, 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	\$ 2,715	\$	\$	\$ 2,715

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Total liabilities	\$ 2,715	\$	\$	\$ 2,715
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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.

The following table presents the Company's liabilities that were measured at fair value using significant unobservable inputs (Level 3) during the three month period ended August 31, 2011. These consisted of the Company's contingent consideration liabilities related to acquisitions:

(in thousands)	<b>Contingent Consideration</b>
Balance at May 31, 2011	\$ 2,574
Accretion and foreign exchange loss	141
Payments	
Balance at August 31, 2011	\$ 2,715

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

***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*.

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. 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.





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The following assumptions have been used to value the options and awards granted during the three months ended August 31, 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 August 31,	
	2011	2010
<b>Stock Options:</b>		
Expected volatility	56%	57%
Risk-free interest rates	1.34%	2.08%
Expected term (years)	4.8	5.7
Expected dividend yield	0%	0%
<b>Employee Stock Purchase Plan:</b>		
Expected volatility	38%	51%
Risk-free interest rates	0.29%	0.40%
Expected term (years)	0.5 2.0	0.5 2.0
Expected dividend yield	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 months ended August 31, 2011 and 2010, respectively:

	Three months ended August 31,	
	2011	2010
<b>(in thousands)</b>		
<b>Cost of revenues:</b>		
Subscription	\$ 36	\$ 49
Professional services	61	58
Research and development	127	123
Sales and marketing	263	279
General and administrative	547	305
<b>Share-based compensation expense included in net loss</b>	<b>\$ 1,034</b>	<b>\$ 814</b>

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

	Three months ended August 31,	
	2011	2010
<b>(in thousands)</b>		
Stock options	\$ 565	\$ 658
Restricted stock units	413	147
Employee stock purchase plan	56	9

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Total share-based compensation	\$ 1,034	\$ 814
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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 August 31, 2011, 116,250 shares of the RSUs vested. In order to satisfy minimum tax withholding obligations that arose on the vesting of restricted stock units, 41,852 shares of common stock pursuant to our restricted stock units were repurchased for an aggregate price of approximately \$372,000.

The weighted average estimated fair value of options granted was \$4.44 and \$2.60 per share for the three months ended August 31, 2011 and 2010, respectively. The weighted average estimated fair value of RSUs granted was \$9.31 and \$4.90 per share for the three months ended August 31, 2011 and 2010, respectively.

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

<b>(in thousands, except per share data)</b>	<b>Three months ended August 31,</b>	
	<b>2011</b>	<b>2010</b>
Net loss	\$ (5,796)	\$ (1,695)
Weighted-average shares of common stock used in computing basic and diluted net loss per share	28,387	28,151
Basic and diluted net loss per share	\$ (0.20)	\$ (0.06)

If the Company had generated net income for the three months ended August 31, 2011 and 2010, 2.8 million and 1.2 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.

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 1.3 million and 3.7 million shares for the three months ended August 31, 2011 and 2010, respectively. While these common equivalent shares are currently anti-dilutive, they could be dilutive in the future.

**5. Comprehensive Loss**

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:

<b>(in thousands)</b>	<b>Three months ended August 31,</b>	
	<b>2011</b>	<b>2010</b>
Net loss	\$ (5,796)	\$ (1,695)
Foreign currency translation gain (loss)	(58)	74
Comprehensive loss	\$ (5,854)	\$ (1,621)

**6. Goodwill and Purchased Intangible Assets**

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The primary areas of the preliminary purchase price allocation for the acquisitions of Comartis Group Ltd. ( Comartis ) and Pedagogue Solutions ( Pedagogue ) 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 adjustments to goodwill during the three months ended August 31, 2011.

	May 31, 2011	Additions (in thousands)	Adjustments	August 31, 2011
Goodwill	\$ 41,469	\$	\$ (45)	\$ 41,424

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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 months ended August 31, 2011. The following tables provide a summary of the carrying amounts of purchased intangible assets that continue to be amortized:

(in thousands)	Gross Carrying Amount	August 31, 2011		Weighted Average Useful Life
		Accumulated Amortization	Net Carrying Amount	
Customer relationships	\$ 19,920	\$ (13,900)	\$ 6,020	7.2 Years
Tradenames	1,320	(849)	471	5.0 Years
Acquired developed technology	7,390	(5,977)	1,413	5.0 Years
Total	\$ 28,630	\$ (20,726)	\$ 7,904	

(in thousands)	Gross Carrying Amount	May 31, 2011		Weighted Average Useful Life
		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 August 31, 2011 are expected to be fully amortized by May 31, 2021.

**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.

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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 August 31, 2011; however, the Company was in compliance with the Amended Agreement's covenants and could have borrowed against the Amended Agreement as of August 31, 2011.

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During the quarter ended August 31, 2010, the Company entered into a non-cancelable three year contract for software services of which \$1.2 million remained as of August 31, 2011.

The following table summarizes the Company's future minimum lease payments and contract obligations as of August 31, 2011.

	Total	Payments due by fiscal year					Thereafter
		FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	
(in thousands)							
<b>Contractual obligations:</b>							
Long-term contract commitment	\$ 1,185	\$ 462	\$ 667	\$ 56	\$	\$	\$
Operating lease obligations	14,782	2,899	3,583	2,096	1,199	1,196	3,809
Total	\$ 15,967	\$ 3,361	\$ 4,250	\$ 2,152	\$ 1,199	\$ 1,196	\$ 3,809

**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 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 provision for the three months ended August 31, 2011 and 2010 was \$0.1 million and \$0.2 million, respectively. Income tax provision for both of the three months ended August 31, 2011 and 2010 consisted primarily of state taxes as well as foreign tax expense incurred as a result of local country profits.

As of August 31, 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.

**10. Litigation**

*Litigation Relating to Initial Public Offering of Saba*

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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.



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**SABA SOFTWARE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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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.

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 the appeals filed by one objector were remanded to the district court to determine standing to appeal. On August 25, 2011, the district court issued an order holding that the final objector had no standing to appeal. The objector has appealed that decision.

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. An unfavorable outcome in litigation could materially and adversely affect the Company's business, financial condition and results of operations.

*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

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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

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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.

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

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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. An unfavorable outcome in litigation could materially and adversely affect the Company's business, financial condition and results of operations.

### *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,

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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 has 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. 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. An unfavorable outcome of the litigation could materially and adversely affect the Company's business, financial condition and results of operations.

**11. Recent Accounting Pronouncements**

In December 2010, the FASB issued Accounting Standards Update No. 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (Topic 350) Intangibles - Goodwill and Other* (ASU 2010-28). ASU 2010-28 amends the criteria for performing Step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts and requires performing Step 2 if qualitative factors indicate that it is more likely than not that a goodwill impairment exists. The Company will adopt ASU 2010-28 in fiscal 2013 and any impairment to be recorded upon adoption will be recognized as an adjustment to the Company's beginning retained earnings. The Company is currently evaluating the impact of the pending adoption of ASU 2010-28 on its condensed consolidated financial statements.

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 have no impact on the Company's condensed consolidated financial statements.

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

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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.

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During the three months ended August 31, 2011 and 2010, the Company licensed software and sold related support and 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 months ended August 31, 2011 and 2010, the components of the related party transaction were as follows:

(in thousands)	Sales to Related Party Three months ended August 31,		Accounts Receivable	
	2011	2010	August 31, 2011	May 31, 2011
Varian Medical Systems, Inc.	\$ 112	\$ 56	\$ 17	\$ 39
Total	\$ 112	\$ 56	\$ 17	\$ 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,*

*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,*

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*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 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.

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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.

***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

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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 and SaaS 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, 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,

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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

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current if we expect to recognize such revenue or cost within the following twelve months. As of August 31, 2011, the deferred professional services and deferred costs balances were \$1.5 million and \$1.0 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.

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

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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 has not historically priced its cloud-based offerings within a narrow range and limited historical renewal rate information is available based on the life cycle of these 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.

### *Software License Arrangements*

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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

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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*. Our goodwill balance at August 31, 2011 was \$41.4 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 August 31, 2011 and 2010, respectively. As of August 31, 2011, our purchased intangible assets balance was \$7.9 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*, 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.

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 months ended August 31, 2011.

### ***Income Taxes***

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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.

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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 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.

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.

**Table of Contents****RESULTS OF OPERATIONS****THREE MONTHS ENDED AUGUST 31, 2011 AND 2010****Revenues**

(dollars in thousands)	Three months ended August 31,			
	2011	Percent of Total Revenues	2010	Percent of Total Revenues
Revenues:				
Subscription	\$ 18,547	61%	\$ 14,895	55%
Professional services	9,329	30%	7,849	29%
License	2,765	9%	4,450	16%
<b>Total revenues</b>	<b>\$ 30,641</b>	<b>100%</b>	<b>\$ 27,194</b>	<b>100%</b>

*Total Revenues.* Total revenues increased by \$3.4 million, or 13%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The only foreign country in which revenues represented more than 10% of total revenues was the United Kingdom, which represented 13% for the three months ended August 31, 2011 and 2010.

*Subscription Revenue.* Subscription revenue increased by \$3.7 million (including \$0.9 million for testing and assessment offerings as a result of our May 2011 acquisition of Comartis Group Ltd. ( Comartis ) and Pedagogue Solutions ( Pedagogue ), or 25%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The increase reflects an increase of subscription revenue from new customers, primarily related to our cloud offerings, as well as an increase in subscription revenue associated with subscription renewals.

*Professional Services Revenue.* Professional services revenue increased by \$1.5 million (including \$0.5 million for testing and assessment offerings), or 19%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The increase was primarily due to an increased demand for our professional services from our expanded customer base.

*License Revenue.* License revenue decreased by \$1.7 million (including \$0.2 million for testing and assessment offerings), or 38%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The decrease in license revenue reflects the implementation of our strategy to primarily offer new cloud-based subscriptions to our products.

**Cost of Revenues**

(dollars in thousands)	Three months ended August 31,			
	2011	Percent of Total Revenues	2010	Percent of Total Revenues
Cost of revenues				
Subscription	\$ 4,339	14%	\$ 3,920	14%
Professional services	6,664	22%	5,721	21%
License	178	1%	247	1%
Amortization of acquired developed technology	75	0%	295	1%
<b>Total cost of revenues</b>	<b>\$ 11,256</b>	<b>37%</b>	<b>\$ 10,183</b>	<b>37%</b>

The following table is a summary of gross margin:



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(dollars in thousands)	Three months ended	
	August 31,	
	2011	2010
Gross margin:		
Subscription	\$ 14,208	\$ 10,975
<i>Percentage of subscription revenue</i>	<i>77%</i>	<i>74%</i>
Professional services	2,665	2,128
<i>Percentage of professional services revenue</i>	<i>29%</i>	<i>27%</i>
License (including amortization of acquired developed technology)	2,512	3,908
<i>Percentage of license revenue</i>	<i>91%</i>	<i>88%</i>
Total	\$ 19,385	\$ 17,011
<i>Percentage of total revenues</i>	<i>63%</i>	<i>63%</i>

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*Cost of Subscription Revenue.* Cost of subscription revenue increased by \$0.4 million, or 11%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The increase in cost of subscription revenue was primarily due to compensation costs of \$0.2 million and external hosting costs of \$0.2 million. Subscription gross margin increased to 77% for the three months ended August 31, 2011 from 74% for the three months ended August 31, 2010.

*Cost of Professional Services Revenue.* For the three months ended August 31, 2011, cost of professional services revenue increased by \$0.9 million, or 17%, compared to the three months ended August 31, 2010. The increase in cost of professional services revenue was primarily the result of an increase in compensation costs. The professional services gross margin increased slightly to 29% for the three months ended August 31, 2011, from 27% for the three months ended August 31, 2010.

*Cost of License Revenue.* Cost of license revenue decreased by \$69,000, or 28%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010, due to a decrease in royalty expense. Gross margin on license revenue increased to 91% for the three months ended August 31, 2011 from 88% for the three months ended August 31, 2010.

**Operating Expenses**

	Three months ended August 31,		Percent of Total Revenue	
	2011	2010		
<b>(dollars in thousands)</b>				
<b>Operating expenses:</b>				
Research and development	\$ 6,052	20%	\$ 4,423	16%
Sales and marketing	13,096	43%	9,846	36%
General and administrative	4,938	16%	3,412	13%
Amortization of purchased intangible assets	743	2%	634	2%
<b>Total operating expenses</b>	<b>\$ 24,829</b>	<b>81%</b>	<b>\$ 18,315</b>	<b>67%</b>

*Research and development.* Research and development expenses increased by \$1.6 million (including \$0.6 million as a result of the Comartis and Pedagogue acquisitions), or 37%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The increase was primarily attributable to an increase in compensation costs of \$1.6 million primarily related to increased headcount.

*Sales and marketing.* Sales and marketing expenses increased by \$3.3 million (including \$0.5 million as a result of the Comartis and Pedagogue acquisitions), or 33%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The increase was primarily attributable to increases in compensation costs of \$2.6 million primarily related to increased headcount, marketing related expenses of \$0.3 million and facilities and telecommunications charges of \$0.2 million.

*General and administrative.* General and administrative expenses increased by \$1.5 million (including \$0.2 million as a result of the Comartis and Pedagogue acquisitions), or 45%, for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The increase was primarily attributable to an increase in compensation costs of \$0.8 million, professional services fees of \$0.3 million, stock-based compensation expense of \$0.2 million and administrative expenses of \$0.2 million.

*Amortization of purchased intangible assets.* Amortization of purchased intangible assets increased slightly for three months ended August 31, 2011, compared to the three months ended August 31, 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 decreased by \$66,000 for the three months ended August 31, 2011 compared to the three months ended August 31, 2010. The decrease was attributable to a \$0.2 million net decrease in foreign currency unrealized loss primarily related to currency fluctuations of the Swiss Franc.

**Provision for income taxes**

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Income tax provision for the three months ended August 31, 2011 and 2010 was \$0.1 million and \$0.2 million, respectively. Income tax provision for the three months ended August 31, 2011 and 2010 consisted primarily of state taxes as well as foreign tax expense incurred as a result of local country profits. The decrease in provision expense for the three months ended August 31, 2011 compared to the three months ended August 31, 2010 was primarily related to the lower local country profits during the three months ended August 31, 2011.

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As of August 31, 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:

(in thousands)	August 31, 2011	May 31, 2011	August 31, 2010
Subscription	\$ 39,818	\$ 42,688	\$ 29,804
Professional services	3,640	3,046	3,883
License	388	49	365
 Total deferred revenues	 \$ 43,846	 \$ 45,783	 \$ 34,052
 Deferred revenues, current	 \$ 40,083	 \$ 42,513	 \$ 31,476
Deferred revenues, non-current	3,763	3,270	2,576
 Total deferred revenues	 \$ 43,846	 \$ 45,783	 \$ 34,052

Deferred subscription revenue includes deferred software license updates and product support revenues as well as deferred revenues from products delivered in the cloud. Deferred subscription revenue represents contracts for which cash has been received plus billings for which the service has started but cash has not been received. Subscription contracts are typically billed on a per annum basis in advance and revenues are recognized ratably over the subscription period. Deferred professional services revenues include amounts invoiced for consulting and educational services, which have not yet been delivered. In addition, deferred professional services revenue includes amounts invoiced for services that have been delivered, but are not separable from services subscriptions. Revenues for services that are not separable from services subscriptions are deferred until performance has been completed and then recognized ratably over the longest period of the arrangement. Deferred revenues from new software licenses typically result from undelivered products or specified enhancements, term license agreements that are recognized over the related term, customer specific acceptance provisions, and software license transactions that cannot be segmented from consulting services or certain extended payment term arrangements. Our deferred revenue is generally at its lowest annual level at the end of the first and second fiscal quarters, as we have higher levels of subscription renewal business in our fiscal third and fourth quarters.

**KEY OPERATING METRICS*****Billings***

With the increasing adoption of our SaaS offerings, we believe that billings, which are total revenues plus the change in deferred revenue, are a key operating metric. The prevailing trend among SaaS companies is to provide billings information. For the three months ended August 31, 2011, billings were \$28.7 million, or an increase of 18%, compared to \$24.2 million for the three months ended August 31, 2010. We also track our renewal rate on subscription services on a dollar basis, which for the three months ended August 31, 2011 was 94% compared to 91% for the three months ended August 31, 2010.

**FLUCTUATIONS OF QUARTERLY RESULTS AND OTHER TRENDS**

Our results of operations have in the past and will likely in the future vary significantly from quarter to quarter. If revenues fall below our expectations in a particular quarter, we will likely not be able to reduce our spending rapidly in response to the shortfall and our quarterly operating results are likely to be adversely affected. We anticipate that we will continue to experience long sales cycles. Therefore, the timing of future customer contracts could be difficult to predict, making it difficult to predict the levels of revenues from quarter to quarter.

In addition, revenues from the sale of software licenses are generally recognized at the time of the sale transaction whereas revenues from the sale of subscription services are generally recognized over the life of the subscription contract. As a result, of the implementation in July 2011 of our strategy to offer new customers primarily cloud-based subscriptions to our products, rather than a software license, we expect to recognize less revenue in a quarter from transactions that occur in such quarter. The increased customer adoption of our cloud-based subscriptions may

have an impact on our revenues and results of operation.

Further, we are not always able to predict the form that a particular customer transaction previously identified in the sales pipeline will ultimately take. Therefore, because this shift of some customer transactions away from software licenses to cloud-based subscriptions affects the amount of revenue we recognize in the quarter in which the transaction occurs, the timing of future customer contracts as well as the ultimate form of those contracts could be difficult to predict, thereby making it difficult to predict revenue between quarters. Over the longer term, assuming this trend continues, we expect that the increased adoption of cloud-based subscriptions by our customers will lead to greater predictability in our quarterly revenue and our results of operation. Over time, we expect that the growing shift toward subscription revenue will have a positive impact on our results of operations.

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Other factors that could affect our quarterly operating results are described in the risk factor entitled "Fluctuations in our quarterly results could cause our stock price to experience significant fluctuations or declines" under Part II, Item: 1A *Risk Factors* of this Quarterly Report on Form 10-Q.

**LIQUIDITY AND CAPITAL RESOURCES**

(in thousands)	Three months ended August 31,	
	2011	2010
Net cash provided by (used in) operating activities	\$ (3,357)	\$ 1,499
Net cash used in investing activities	(1,446)	(288)
Net cash used in financing activities	(246)	(355)

We have funded our operations through financing activities and our operations. Our most significant source of operating cash flows stems from customer purchases of our subscription, license and professional services offerings. Our primary uses of cash from operating activities are for personnel and facilities related expenditures. As of August 31, 2011, we had \$20.8 million in available cash and cash equivalents.

***Net Cash Provided By (Used In) Operating Activities***

Net cash used in operating activities for the three months ended August 31, 2011 increased by \$4.9 million to \$3.4 million from \$1.5 million in net cash provided by operating activities for the three months ended August 31, 2010. The increase was primarily attributable to a \$4.1 million increase in net loss for the three months ended August 31, 2011 and a reduction in accounts receivable of \$4.4 million, offset by an increase of \$2.2 million in compensation and other accruals and deferred revenue of \$1.2 million and a decrease in prepaid expenses of \$1.2 million.

Total accounts receivable billing days outstanding ( BDO ) was 79 days at August 31, 2011 and 73 days at May 31, 2011. The increase in BDO is due to lower collections in the three months ended August 31, 2011 compared to the three months ended May 31, 2011. BDO is calculated using the current quarter total billings and calculating average daily billings per day. The accounts receivable aging balance at the end of the period is then divided by the average billing amount to determine the BDO at the end of the period.

Total accounts receivable days sales outstanding ( DSO ) was 79 days at August 31, 2011 and 86 days at May 31, 2011. Changes in accounts receivable have a significant impact on our cash flow. Items that can affect our accounts receivable DSO and BDO include: timing of license revenue and the proportion of that license revenue relative to our other types of revenue, timing of billing of our professional services revenue, contractual payment terms, client payment patterns (including approval or processing delays and cash management) and the effectiveness of our collection efforts.

***Net Cash Used In Investing Activities***

Net cash used in investing activities was \$1.4 million for the three months ended August 31, 2011 compared to \$0.3 million for the three months ended August 31, 2010. The net cash used in investing activities was primarily attributable to the purchases of equipment, to enhance our infrastructure necessary to deliver our cloud-based offerings and leasehold improvements for the remodel of our headquarter facility.

***Net Cash Used In Financing Activities***

Net cash used in financing activities of \$0.2 million for the three months ended August 31, 2011 was primarily attributable to \$0.4 million in repurchase of stock to satisfy employee minimum tax withholding obligations for vesting of restricted stock units and \$0.3 million in repurchases of common stock, partially offset by an increase of proceeds from the exercise of options to purchase of common stock of \$0.4 million. Net cash used in financing activities of \$0.4 million for the three months ended August 31, 2010 was primarily attributable to \$0.7 million in repurchases of common stock, partially offset by an increase of proceeds the exercise of options to purchase common stock of \$0.4 million.

***Contractual Obligations and Commitments***

We currently anticipate that our available cash resources, combined with cash flows generated from revenues will be sufficient to meet our presently anticipated working capital, capital expense and business expansion requirements, for at least the next 12 months. However, we may be required, or seek, to raise additional funds in the future. Our future liquidity and capital requirements will depend on numerous factors,

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including our future revenues, the timing and extent of spending to support product development efforts and expansion of sales and marketing and related general and administrative activities, the success of our existing and new product and service offerings and competing technological and market developments. There can be no assurance that additional funding, if needed, will be available on terms acceptable to us, if at all. In addition, any raising of additional funds could dilute our current stockholders' ownership interests.

On September 7, 2010, we entered into a Third Amendment to Lease with Westport Office Park, LLC (the Landlord), which amended

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the Lease Agreement dated as of March 16, 1999, as amended, between us and the Landlord relating to the lease of the office space comprising our corporate headquarters. The Third Amendment to Lease, which became effective as of August 31, 2010, extended the lease termination date from May 31, 2014 to May 31, 2019. The amended lease modification also resulted in a reduction of straight-line rent expense beginning in the second quarter of fiscal 2011.

On June 27, 2011, we entered into an Amended and Restated Credit Agreement with Wells Fargo (the Amended Agreement), which supersedes our 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 our personal property other than our intellectual property. The line of credit also is guaranteed by, and secured by the assets of, our material domestic subsidiaries. The Amended Agreement includes certain covenants with which we 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, we may be required to repay the obligations under the line of credit prior to the stated maturity date, our ability to continue to borrow under the Amended Agreement may terminate, and the Bank may be able to foreclose on any or all collateral provided by us or our subsidiaries.

No amounts have been borrowed under the Amended Agreement as of August 31, 2011; however, the Company was in compliance with the Amended Agreement's covenants and could have borrowed against the Amended Agreement as of August 31, 2011.

During the quarter ended August 31, 2010, the Company entered into a non-cancelable three year contract for software services of which \$1.2 million remained as of August 31, 2011.

The following table summarizes the Company's future minimum lease payments and contract obligations as of August 31, 2011.

	Total	FY 2012	Payments due by fiscal year				Thereafter
			FY 2013	FY 2014	FY 2015	FY 2016	
(in thousands)							
<b>Contractual obligations:</b>							
Long-term contract commitment	\$ 1,185	\$ 462	\$ 667	\$ 56	\$	\$	\$
Operating lease obligations	14,782	2,899	3,583	2,096	1,199	1,196	3,809
Total	\$ 15,967	\$ 3,361	\$ 4,250	\$ 2,152	\$ 1,199	\$ 1,196	\$ 3,809

As of August 31, 2011, other than the renewal of the non-cancelable three year contract for software services, the new amended lease, and the Amended and Restated Credit Agreement with Wells Fargo, there were no material changes in capital leases, operating lease obligations, purchase obligations or any other long-term liabilities reflected on our condensed consolidated balance sheets compared to such obligations and liabilities as of May 31, 2011.

**Off-Balance Sheet Arrangements**

As of August 31, 2011, we did not have any off-balance sheet arrangements, as defined in Item 303(a) (4) (ii) of SEC Regulation S-K.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Interest Rate Risk**



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Our exposure to market risk for changes in interest rates relates primarily to our borrowings and investments.

We do not believe that we currently have any material exposure to interest rate risk resulting from our investments. At August 31, 2011, we had available cash and cash equivalents totaling \$20.8 million. Of this amount, approximately \$5.2 million was invested in money market accounts bearing variable interest rates of between 0.04% and 7.75%. The remainder of our cash and cash equivalents is held in non-interest bearing accounts at several banks. Variable interest rate securities may produce less income than expected if interest rates fall. A 0.5% change in interest rates would not have a material impact on our financial statements.

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***Foreign Currency Risk***

We provide our products and services to customers in the United States, Europe and elsewhere throughout the world. Sales are primarily made in U.S. dollars, and to a lesser but increasing extent, British pounds and Euros; however, as we continue to expand our operations, more of our contracts may be denominated in Australian dollars, Canadian dollars, Japanese yen or other foreign currencies. A strengthening of the U.S. dollar could make our products less competitive in foreign markets.

Our exposure to foreign exchange rate fluctuations also arises in part from intercompany accounts with our foreign subsidiaries. These intercompany accounts are typically denominated in the functional currency of the foreign subsidiary, and, when translated into U.S. dollars, have an impact on our operating results depending upon the movement in foreign currency rates. For the three months ended August 31, 2011, our total change of realized and unrealized losses compared to the prior year, due to movements in foreign currencies, primarily related to currency fluctuations of the Swiss Franc. As exchange rates vary, these foreign exchange results may vary and adversely or favorably impact operating results. An unfavorable change of 10% in foreign currency rates would not have a material impact on our condensed consolidated financial statements.

**ITEM 4. CONTROLS AND PROCEDURES**

***(a) Evaluation of disclosure controls and procedures.***

Saba maintains disclosure controls and procedures, as such term is defined under Exchange Act Rule 13a-15(e), that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our chief executive officer and chief financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective at the reasonable assurance level.

***(b) Changes in internal control over financial reporting.***

We regularly review our system of internal control over financial reporting to ensure we maintain an effective internal control environment. As we grow geographically and with new product offerings, we continue to create new processes and controls as well as improve our existing environment to increase efficiencies. Improvements may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Note 11 of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

**ITEM 1A: RISK FACTORS**

*Set forth below and elsewhere in this Quarterly Report on Form 10-Q and in other documents we file with the SEC, are risks and uncertainties that could cause actual results to differ materially from the results expressed or implied by the forward-looking statements contained in this Quarterly Report. The fact that some of the risk factors may be the same or similar to our past filings means only that the risks are present in multiple periods. We believe that many of the risks detailed here and in our other SEC filings are part of doing business in our industry and will likely be present in all periods reported. The fact that certain risks are endemic to our industry does not lessen the significance of the risk. There are no material changes to the risk factors set forth under the title Risk Factors in our Annual Report on Form 10-K for the fiscal year ended May 31, 2011, except for changes to the risk factors entitled We may incur future losses and cannot assure you that we will sustain profitability on a consistent basis in the future, if at all ; The recent recession and global economic crisis may impact our business, operating results or financial condition, including our revenue growth and profitability, which in turn could adversely affect our stock price ; Our subscription business depends substantially on our customers renewing their agreements with us. Any decline in our customer renewals would harm our future operating results ; Currency exchange rate fluctuations could lower our revenue and net income ; and Our stock price may fluctuate substantially .*

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***We may incur future losses and cannot assure you that we will sustain profitability on a consistent basis in the future, if at all.***

We incurred losses during fiscal 2011 and we cannot be certain as to when we will have sufficient revenues to regain profitability on a quarterly or annual basis, especially as we continue to shift our business away from license sales toward recurring SaaS subscription transactions. In addition, we expect to continue to incur non-cash expenses in the future relating to the amortization of purchased intangible assets and stock-based compensation, which will impact our operating results. Also, any impairment of our goodwill would result in additional non-cash charges that would further negatively impact our operating results. As of August 31, 2011, we had \$7.9 million of purchased intangible assets to be amortized as a result of our May 2011 acquisitions of Pedagogue and Comartis, January 2006 acquisition of Centra Software, Inc. ( Centra ) and May 2005 acquisition of THINQ Learning Solutions, Inc. ( THINQ ) and our goodwill balance was \$41.4 million. These non-cash expenses have made it and will continue to make it significantly more difficult for us to achieve profitability. We may not be able to regain profitability on a consistent basis, if at all.

***The recent recession, global economic crisis and disruptions in the global credit and financial markets may impact our business, operating results or financial condition, including our revenue growth and profitability, which in turn could adversely affect our stock price.***

The recent recession and global economic crisis caused a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, public sector deficits and extreme volatility in credit, equity and fixed income markets, which have contributed to diminished expectations for the global economy. These macroeconomic developments have negatively affected, and continued or further weakness in the global economy in the future could negatively affect, our business, operating results or financial condition which, in turn, could adversely affect our stock price. A general weakening of, and related declining corporate confidence in, the global economy or the curtailment in government or corporate spending could cause current or potential customers to reduce their IT budgets or be unable to fund software or services purchases, which could cause customers to delay, decrease or cancel purchases of our products and services or cause customers not to pay us or to delay paying us for previously-purchased products and services. In addition, there is significant uncertainty about the stability of global credit and financial markets and the continuing debt crisis in certain European countries could cause the value of the Euro to deteriorate, thus reducing the purchasing power of our European customers. The recent downgrade of the U.S. credit rating and the ongoing European debt crisis have contributed to the instability in global credit markets. We are unable to predict the impact of these events, and if economic conditions deteriorate, operations our business and results of operations could be materially and adversely affected.

***Fluctuations in our quarterly results could cause our stock price to experience significant fluctuations or declines.***

Our operating results have varied significantly in the past and will likely fluctuate significantly in the future. If revenues fall below our expectations in a particular quarter, we will likely not be able to reduce our spending rapidly in response to the shortfall and our quarterly operating results are likely to be adversely affected.

In addition, we anticipate that we will continue to experience long sales cycles. Further, we are not always able to predict the form that a particular customer transaction previously identified in the sales pipeline will ultimately take. For example, in recent quarters we have experienced a shift of some customer transactions away from software licenses to software as service subscription agreement transactions. This shift significantly affects the amount of revenue we recognize in the quarter in which the transaction occurs. Therefore, the timing of future customer contracts as well as the ultimate form of those contracts could be difficult to predict, making it difficult to predict revenues between quarters.

We also have limited visibility into our future revenue, especially license revenue, which often has been heavily concentrated in the third month of each quarter. As a result, if we were to fail to close a sufficient number of transactions by the end of our quarter, particularly large license transactions, we would miss our revenue projections. If our plan to expand sales coverage and marketing support to align with key growth initiatives is not successful, we could miss our revenue and profit projections. In addition, our operating expenses are based in part on future revenue projections and are relatively fixed in the short-term. If we cannot meet our revenue projections, our business will be seriously harmed.

Other factors that could affect our quarterly operating results include:

The demand for our products and professional services and our efficiency in rendering our professional services;

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The variability in the mix of the type of services delivered in any quarter and the extent to which third party contractors are used to provide such services;

The size and complexity of our license transactions and potential delays in recognizing revenue from license transactions;

The amount and timing of our operating expenses and capital expenditures;

The performance of our international business, which accounts for a substantial part of our condensed consolidated revenues; and

Fluctuations in foreign currency exchange rates.

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Due to these and other factors, we believe that quarter-to-quarter comparisons of our revenues and operating results should not be relied upon as indicators of future performance. It is possible that in some future quarter our operating results may be below the expectations of public market analysts or investors, which could cause the market price of our common stock to fall.

*Our cloud strategy carries a number of risks which may be harmful to our business.*

We derive a substantial portion of our revenues from subscriptions to our cloud-based offerings. To accelerate a transition of our business, in July 2011, we announced a strategy to offer new customers primarily cloud-based subscriptions to our products. Our transition to a subscription model entails both a change to how we charge for our products as well as how we deliver them. These changes reflect a shift from perpetual license sales and delivery of our software in favor of purchasing the right to access the software for a specified subscription period. As customers increasingly move away from purchasing a perpetual license toward purchasing a subscription, we will experience a deferral of revenues and cash payments from customers. In addition to a change in license and delivery model, our transition to a subscription model requires significant investment in product development and cloud operations.

Additional risks associated with our transition to the subscription model include the following:

we may experience a delay in recognizing revenue due to the combination of multiple element arrangements and longer subscription terms;

we may not successfully achieve market penetration in newly targeted markets, including target customers we characterize as middle-market companies;

our relationships with existing partners that require or prefer the ability to resell perpetual licenses may be negatively impacted;

we may not be successful in selling subscriptions to new customers that desire perpetual licenses;

although we intend to support existing perpetual license customers, our transition to a subscription model may raise concerns among our installed base of customers;

we may fail to achieve our target pricing;

we may have a short-term and/or long-term adverse impact on total revenues as a result of the transition; and

we may incur costs at a higher than forecasted rate as we expand our cloud operations.

*We expect competition from a variety of companies.*

Many of our competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do, enabling them to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Such resources also enable our competitors to make substantial investments in the marketing and promotion of their products and services, and to withstand prolonged periods of negative cash flows and unfavorable economic, political and market conditions. Competition could seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products and services obsolete, unmarketable or less competitive. Our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other partners, thereby increasing the availability of their services to address the needs of our current and prospective customers. We may not be able to compete successfully against our current and future competitors, and competitive pressures that we encounter may seriously harm our

business.

***The success of our recently announced Saba People Cloud could be adversely impacted by deployment problems, security breaches, or system or telecommunication disruptions.***

The Saba People Cloud could encounter unexpected problems. These problems could be attributable to our products, third party software, telecommunications failures, security breaches, or the cloud technology from web services provider or other hosting providers. Industry acceptance of cloud computing is still forming. Since cloud technology is new and requires that customer data reside outside of a customer's firewall of protection, many prospective customers could reject or delay adoption, thereby limiting the potential for this new offering. If the Saba People Cloud fails to keep pace with sales, customers may experience delays as we seek to obtain additional capacity, which could harm our reputation and adversely affect our revenue growth. Any disruption of service from the Saba People Cloud, or loss or compromise of customer data, would adversely affect our adoption and renewal rates for Saba People Cloud Applications and adversely impact our ability to achieve our business plan and forecasted financial results.

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***If we are unable to accurately forecast revenues, we may fail to meet stock analysts' and investors' expectations of our quarterly operating results, which could cause our stock price to decline.***

We use a pipeline system, a common industry practice, to forecast sales and trends in our business. Our sales personnel monitor the status of all proposals, including the date when they estimate that a customer will make a purchase decision and the potential dollar amount of the sale. We aggregate these estimates periodically in order to generate a sales pipeline. We assess the pipeline at various points in time to look for trends in our business. While this pipeline analysis may provide us with some guidance in business planning and budgeting, these pipeline estimates are necessarily speculative and may not consistently correlate to revenues in a particular quarter or over a longer period of time, particularly during the recent weakness in the global macroeconomic environment. Further, we are not always able to predict the form that a particular customer transaction previously identified in the sales pipeline will ultimately take, particularly as we shift customer transactions away from software licenses to software as a service subscription transactions. This shift significantly affects the amount of revenue we recognize in the quarter in which the transaction occurs. Therefore, the timing of future customer contracts as well as the ultimate form of those contracts could be difficult to predict, making it difficult to forecast quarterly revenues.

Additionally, because we have historically recognized a substantial portion of our license revenues in the last month of each quarter and sometimes in the last few weeks of each quarter, we may not be able to adjust our cost structure in a timely manner in response to variations in the conversion of the sales pipeline into license revenues. Any change in the conversion rate of the pipeline into customer sales or in the pipeline itself could cause us to improperly budget for future expenses that are in line with our expected future revenues, which would adversely affect our operating margins and results of operations and could cause the price of our common stock to decline.

***Intense competition in our target market could impair our ability to grow and achieve profitability on a consistent basis.***

The market for our products and services is intensely competitive, dynamic and subject to rapid technological change. The intensity of the competition and the pace of change are expected to increase in the future. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business. Competitors vary in size and in the scope and breadth of the products and services offered. We encounter competition with respect to different aspects of our solution from a variety of sources including:

companies that offer human capital management solutions that provide one or more applications within the HCM market, such as leaning management, performance management, talent management, compensation and recruiting, including SumTotal, Cornerstone OnDemand, Success Factors and Taleo;

companies that offer collaboration solutions, such as Microsoft, Adobe, Citrix and Cisco;

enterprise software vendors that offer human resources information systems and employee relationship management systems with training and performance modules, such as SAP and Oracle; and

potential customers' internal development efforts.

***Our growth depends on our ability to adequately expand and ramp our direct sales force.***

We need to continue to increase and develop our sales and marketing infrastructure in order to grow our customer base and our business. We plan to continue to expand and ramp our direct sales force both domestically and internationally. Identifying and recruiting these people and training them in the use of our products require significant time, expense and attention. This expansion will require us to invest significant financial and other resources. Our business will be seriously harmed if our efforts to expand and ramp our direct sales force do not generate a corresponding significant increase in revenue. In particular, if we are unable to hire, develop and retain talented sales personnel or if new direct sales personnel are unable to achieve desired productivity levels in a reasonable period of time, whether due to the global economic slowdown or for other reasons, we may not be able to significantly increase our revenue and grow our business.

***Our subscription business depends substantially on customers renewing their agreements with us. Any decline in our customer renewals would harm our future operating results.***



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In order for us to improve our operating results, it is important that our customers renew their agreements with us when the contract term expires. Our subscription customers have no obligation to renew their contracts, and we cannot assure you that customers will renew subscriptions at the same or higher level of service, if at all. During the three months ended August 31, 2011, 94% of our subscription services on a total annual contract dollar basis were renewed. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our product offerings, pricing, the prices of competing products or services, completion of customer initiatives, mergers and acquisitions affecting our customer base, or reductions in our customers' spending levels. If our subscription customers do not renew their contracts or renew on less favorable terms, our revenue may decline.

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***A significant amount of our revenue is revenue from the sale of subscription solutions, including SaaS transactions, which may affect our results in a number of different ways.***

We generally recognize subscription revenue over the terms of our customer agreements, which typically range from one to three years. As a result, most of our quarterly subscription revenue results from agreements entered into during previous quarters. A decline in new or renewed subscriptions in any one quarter may not impact our financial performance in that quarter, but will negatively affect our revenue in future quarters. If a number of contracts expire and are not renewed in the same quarter, our revenue could decline significantly in that quarter and in subsequent quarters. Accordingly, the effect of significant declines in sales and market acceptance of our solutions may not be reflected in our short-term results of operations, making our results less indicative of our future prospects. It is also difficult for us to rapidly increase our subscription revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

***If our efforts to attract new customers or to sell additional solutions to our existing customers are not successful, our revenue growth will be adversely affected.***

To increase our revenue, we must continually add new customers and sell additional solutions to existing customers. If our existing and prospective customers do not perceive our solutions to be of sufficiently high value and quality, we may not be able to attract new customers or to increase sales to existing customers. Our ability to attract new customers and to sell new solutions to existing customers will depend in large part on the success of our sales and marketing efforts. However, our existing and prospective customers may not be familiar with some of our solutions, or may have traditionally used other products and services for some of their people management requirements. Our existing and prospective customers may develop their own solutions to address their people management requirements, purchase competitive product offerings or engage third-party providers of outsourced people management services.

***A decline in the price of, or demand for, our products or our related services offerings, would seriously harm our revenues and operating margins.***

We anticipate that revenues from the Saba People Cloud Applications as well as related services will constitute substantially all of our revenue for the foreseeable future. Consequently, a decline in the price of, or demand for, the Saba People Cloud Applications or failure to achieve broad market acceptance would seriously harm our business.

***Our products have a long sales cycle, which increases the cost of completing sales and renders completion of sales less predictable.***

Due to the expense, broad functionality, and company-wide deployment of our products, the period between our initial contact with a potential customer and the purchase of our products and services is often long. To successfully sell our products and services, we generally must educate our potential customers regarding the use and benefits of our products and services. We may commit a substantial amount of time and resources to potential customers without assurance that any sales will be completed or revenues generated. Many of our potential customers are large enterprises that generally take longer to make significant business decisions. Our public sector customers, in particular, are subject to extensive procurement procedures that require many reviews and approvals. Our typical sales cycle has been approximately six to 12 months, making it difficult to predict the quarter in which we may recognize revenue. The delay or failure to complete sales in a particular quarter could reduce our revenues in that quarter. If our sales cycle were to unexpectedly lengthen in general or for one or more large orders, it would adversely affect the timing of our revenues. If we were to experience a delay on a large license order, it could harm our ability to meet our forecasts for a given quarter.

***We experience seasonality in our sales and expense, which could cause our operating results to fluctuate from quarter to quarter.***

We experience quarterly seasonality in the demand for our products and services. For example, revenue has historically been lower in our first fiscal quarter while expenses have been higher than in the immediately preceding fourth fiscal quarter. Contributing to this seasonality is the timing of our first fiscal quarter that occurs during the summer months when general business activities slow down in a number of territories where we conduct our operations, particularly Europe. Our commission structure and other sales incentives also tend to result in fewer sales in the first fiscal quarter than in the fourth fiscal quarter. These seasonal variations in our revenue are likely to lead to fluctuations in our quarterly operating results.

***Reductions in information technology spending could limit our ability to grow our business.***

Our operating results may vary based on changes in the information technology spending of our clients. The revenue growth and profitability of our business depend on the overall demand for enterprise applications and services. We sell our solutions primarily to large organizations whose

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businesses fluctuate with general economic and business conditions. As a result, decreased demand for enterprise applications and services, and in particular people systems, caused by factors affecting the global economy may cause a decline in our revenue. Historically, economic downturns have resulted in overall reductions in corporate information technology spending. In particular, people software may be viewed by some of our existing and potential clients as a lower priority and may be among the first expenditures reduced as a result of unfavorable economic conditions. In the future, potential clients may decide to reduce their information technology budgets by deferring or reconsidering product purchases, which would negatively impact our operating results.

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***We rely on our relationships with our strategic partners. If we do not maintain and strengthen these relationships, our ability to generate revenue and control expenses could be adversely affected, which could cause a decline in the price of our common stock.***

We believe that our ability to increase the sales of our products depends in part upon maintaining and strengthening relationships with our current strategic partners and any future strategic partners. In addition to our direct sales force, we rely on established relationships with a variety of strategic partners, such as systems integrators, resellers, business process outsourcing partners (BPOs), human resource outsourcing partners (HROs) and distributors, for marketing, selling, implementing, and supporting our products in the United States and internationally.

Our strategic partners offer products from several different companies, including, in some cases, products that compete with our products. We have limited control, if any, as to whether these strategic partners devote adequate resources to promoting, selling, and implementing our products as compared to our competitors' products. We cannot guarantee that we will be able to strengthen our relationships with our strategic partners or that such relationships will be successful in generating additional revenue.

We may not be able to maintain our strategic partnerships or attract sufficient additional strategic partners, who have the ability to market our products effectively, are qualified to provide timely and cost-effective customer support and service, or have the technical expertise and personnel resources necessary to implement our products for our customers. In particular, if our strategic partners do not devote sufficient resources to implement our products, we may incur substantial additional costs associated with hiring and training additional qualified technical personnel to implement solutions for our customers in a timely manner. Furthermore, our relationships with our strategic partners may not generate enough revenue to offset the significant resources used to develop these relationships. If we are unable to leverage the strength of our strategic partnerships to generate additional revenues, our revenues and the price of our common stock could decline.

***Implementation of accounting regulations and related interpretations and policies, particularly those related to revenue recognition, could cause us to defer recognition of revenue or recognize lower revenue or to report lower earnings per share.***

While we believe that we are in compliance with ASC 985-605 *Software Revenue Recognition*, additional implementation guidelines, and changes in interpretations of such guidelines, could lead to unanticipated changes in our current revenue accounting practices that could cause us to defer the recognition of revenue to future periods or to recognize lower revenue. In addition, policies, guidelines and interpretations related to accounting for acquisitions, income taxes, facilities consolidation charges, allowance for doubtful accounts and other financial reporting matters require different judgments on complex matters that are often subject to multiple sources of authoritative guidance. To the extent that management's judgment is incorrect, it could result in an adverse impact on our financial statements. Further, the factual complexities of applying these policies, guidelines and interpretations to specific transactions can lead to unanticipated changes in revenue recognition with respect to such transactions, which may affect our revenue and results of operations.

***If we fail to retain key employees and recruit qualified technical and sales personnel, our business could be harmed.***

We believe that our success depends on the continued employment of our senior management and other key employees, the loss of any of which could materially harm our business. In addition, because our future success is dependent on our ability to continue to enhance and introduce new software and services, we are heavily dependent on our ability to attract and retain qualified engineers with the requisite education, background and industry experience. As we expand our business, our continued success will also depend, in part, on our ability to attract and retain qualified sales, marketing and operational personnel capable of supporting a larger and more diverse client base. The loss of the services of a significant number of our engineers or sales people could be disruptive to our development efforts or business relationships.

***The consolidation or acquisition of our competitors or other similar strategic alliances could weaken our competitive position or reduce our revenue.***

There has been consolidation among companies offering software products and services in the market in which we operate. Additional consolidation within our industry may change the competitive landscape in ways that adversely affect our ability to compete effectively. Our competitors may also establish or strengthen cooperative relationships with our current or future BPO partners, HRO partners, systems integrators, third-party consulting firms or other parties with whom we have relationships, thereby limiting our ability to promote our products and limiting the number of consultants available to implement our solutions. Disruptions in our business caused by these events could reduce our revenue.

***If we are unable to manage the complexity of conducting business globally, our international revenues may suffer.***

International revenues accounted for 38% and 34% of our revenues for the three months ended August 31, 2011 and 2010, respectively. Although we intend to continue to expand our international presence, in the future we may not be able to successfully market, sell or distribute

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our products and services in foreign markets. Factors that could materially adversely affect our international operations, and our business and future growth include:

exposure to geopolitical instability, natural disasters and acts of war or terrorism;

difficulties in staffing and managing foreign operations, including language barriers;

seasonal fluctuations in purchasing patterns in other countries, particularly depressed sales during July and August in European markets;

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difficulties in collecting accounts receivable in foreign countries, particularly European countries in which collections take considerably more time than the United States and collections are more difficult to effect;

currency exchange rate fluctuations, particularly in countries where we sell our products in denominations other than U.S. dollars, such as in the United Kingdom, the Euro zone, Switzerland, Brazil, Australia and Japan, or have exposures in intercompany accounts denominated in foreign currencies;

exposure to tax regimes of multiple countries and potential increased tax exposure relating to in-country profits as well as audits and assessments relating to transfer pricing matters and other tax matters;

costs attributable to development of internationalized versions of our products and marketing and sales materials;

increases in our cost of doing business in foreign jurisdictions in order to comply with international and U.S. laws and regulations that apply to our international operations (including the Foreign Corrupt Practices Act in the U.S. and local laws in foreign jurisdictions which prohibit corrupt payments to governmental officials, data privacy requirements, labor relations laws, tax laws, anti-competition regulations, import and trader restrictions, and export requirements);

the reduced protection for intellectual property rights in some countries;

greater difficulties in maintaining and enforcing U.S. accounting and public reporting standards, including in staffing and managing foreign operations with personnel sufficiently experienced in U.S. accounting and public reporting standards; and

tariffs, export controls and other trade barriers and unexpected changes thereto.

In addition, the reallocation of certain design, development and testing functions from the United States to our lower-cost development centers in India intensifies our exposure to international uncertainties. In recent years, increased growth and development of the technology market in general, and in India specifically, has made it more difficult for us to hire and retain qualified technical employees and other personnel. In addition to the risks inherent in conducting international operations as described above, certain risks are particularly acute in India, such as employee turnover, increasing salaries and less reliable infrastructure.

### ***A portion of our revenue is generated by sales to government entities, which are subject to a number of challenges and risks.***

We derive a portion of our revenues from sales to U.S. and foreign federal, state and local governments and their respective agencies. Sales into government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that we will successfully sell our products and services to such governmental entity. Government entities may not embrace our transition to cloud offerings and may require contract terms that differ from our standard arrangements. In addition, government demand and payment for our products may be affected by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our products. Most of our sales to government entities have been made indirectly through third-party prime contractors that resell our solutions. Government entities may have contractual or other legal rights to terminate contracts with our resellers for convenience or due to a default, and any such termination may adversely impact our future results of operations. Additionally, government contracts are generally subject to audits and investigations which could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, refund of a portion of fees received, forfeiture of profits, suspension of payments, fines and suspensions or debarment from future government business.

***Because a number of our products collect, store and report personal information of employees, privacy concerns could result in liability to us or inhibit sales of our products.***

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Many federal, state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information. Because many of our products collect, store and report on personal information, any inability to adequately address privacy concerns, even if unfounded, or comply with applicable privacy laws, regulations and policies, could result in liability to us, damage our reputation, inhibit sales and harm our business.

Furthermore, the costs of compliance with, and other burdens imposed by, such laws, regulations and policies that are applicable to the businesses of our customers may limit the use and adoption of our products and reduce overall demand for them. Privacy concerns, whether or not valid, may inhibit market adoption of our products in certain industries.

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***The enactment of legislation implementing changes in U.S. taxation of international business activities or the adoption of other tax reform policies could materially impact our financial position and results of operations.***

Recently several tax bills have been introduced to reform U.S. taxation of international business activities. The current Administration has made public statements indicating that it has made the issue a priority and key members of the U.S. Congress have conducted hearings and proposed legislation. Accordingly, depending on the final form of legislation enacted, if any, these consequences may be significant for us due to the large scale of our international business activities. If any of these proposals are enacted into legislation, they could have material adverse consequences on the amount of tax we pay and thereby on our financial position and results of operations.

***Currency exchange rate fluctuations could lower our revenue and net income.***

During the three months ended August 31, 2011, we recognized approximately 38% of our revenue in markets outside the United States. Sales are primarily denominated in U.S. dollars, and to an increasing extent, British pounds and Euros. As we continue to expand our operations, more of our contracts may be denominated in foreign currencies. In preparing our financial statements, we translate revenues and expenses in foreign countries from their local currencies into U.S. dollars using average exchange rates (during their respective fiscal periods average monthly exchange rate). Because an increasing portion of our sales is in foreign countries, exchange rate fluctuations may have a significant effect on our sales and earnings. Our reported net earnings may be significantly affected by fluctuations in currency exchange rates, with earnings generally increasing with a weaker U.S. dollar and decreasing with a strengthening U.S. dollar. As sales expand in countries where foreign currency transactions may be made, our operating results will increasingly be subject to the risks of exchange rate fluctuations and we may not be able to accurately estimate the impact that these changes may have on our future results of operations or financial condition. We may from time to time enter into foreign currency hedging contracts, which may create foreign currency losses. Our currency exposures typically arise from intercompany loans and other intercompany transactions that are expected to be cash settled in the near term. Our ultimate realized gain or loss with respect to foreign currency fluctuations will generally depend on the size and type of cross-currency transactions that are entered into, the currency exchange rates associated with these exposures and changes in those rates, whether we have entered into foreign currency forward contracts to offset these exposures, the effectiveness of these forward contracts or other hedging activities and other factors.

***Future acquisitions and growth initiatives may be difficult to integrate, disrupt our business, dilute stockholder value or divert management's attention.***

As part of our overall business strategy, we have acquired and may continue to acquire complementary businesses or technologies and we expect to pursue other growth initiatives that will provide additional products or services offerings, additional industry expertise or an expanded geographic presence.

The pursuit of acquisitions involves a number of uncertainties, including selecting the appropriate products, technologies or companies to acquire, negotiating successful acquisition terms at appropriate prices, and successfully completing the targeted transaction. An element of our growth strategy depends on the availability of suitable acquisition candidates at reasonable prices. We may face competition for acquisition opportunities from other companies, including larger companies with greater financial resources. We also may incur substantial expenses in identifying and negotiating acquisition opportunities, whether or not completed.

In addition, no assurance can be given that the benefits or synergies we may expect from the acquisition of companies or businesses will be realized to the extent or in the time frame we anticipate, if at all. Any acquisitions that we complete could expose us to numerous risks, including:

difficulties in the assimilation of the operations, technologies, products and personnel of the acquired company;

the diversion of management's attention from other business concerns;

risks of entering markets in which we have no or limited prior experience;

the potential loss of key employees, significant customers and strategic partners of the acquired company; and



exposure to claims by terminated employees, stockholders of the acquired company or other third parties arising out of an acquisition (and the indemnification and other contractual protections we have may be inadequate to protect against these claims).

These challenges can be magnified as the size of the acquisition increases. Any delays or unexpected costs incurred in connection with the integration of acquired companies or otherwise related to the acquisitions could have a material adverse effect on our business, financial condition and results of operations.

An acquisition or other growth initiative also could absorb substantial cash resources, require us to incur or assume debt obligations, or involve our issuance of additional equity securities. If we issue equity securities in connection with an acquisition or growth initiative, we may dilute our existing common stockholders with securities that have an equal or a senior interest in our company. If we incur additional debt to pay for or fund an acquisition or growth initiative, it may significantly increase our interest expense. Acquired entities also may be highly leveraged or dilutive to our earnings per share, or may have unknown liabilities. In addition, the combined entity may have lower

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revenues or higher expenses and therefore may not achieve the anticipated results. If additional financing is required but not available, we may be unable to take advantage of growth opportunities such as acquisitions or we may have to implement measures to conserve cash and reduce costs. Any of these factors could have a material adverse impact on our business, financial condition and results of operations.

***Our business is subject to changing regulations regarding corporate governance and public disclosure that will increase both our costs and the risk of noncompliance.***

As a public company, we incur significant legal, accounting and other expenses associated with compliance with applicable laws, rules, regulations and listing requirements. In addition, the Sarbanes-Oxley Act, the Dodd-Frank Act, and rules subsequently implemented by the SEC and The NASDAQ Stock Market, have imposed a variety of compliance requirements on public companies, including requiring changes in corporate governance practices. In addition, the SEC and the U.S. Congress may continue to increase the scope of applicable disclosure and corporate governance-related rules. Our management and other personnel will need to devote a substantial amount of time to the compliance requirements associated with being a public company. Moreover, these laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices.

***We may incur impairments to goodwill or long-lived assets.***

We are required to test goodwill for impairment annually or if a triggering event occurs in accordance with the provisions of ASC 350-20 *Goodwill and Other Intangible Assets*. We are also required to test long-lived assets for impairment if a triggering event occurs with the provisions of ASC 350-30 *General Intangibles other than Goodwill* and ASC 360-10 *Property, Plant and Equipment*. Such impairment could be caused by internal factors as well as external factors beyond our control.

Significant negative industry or economic trends, reduced estimates of future cash flows, disruptions to our business, slower growth rates or lack of growth in the areas in which we generate revenues could lead to an impairment charge for any of our intangible assets or goodwill. If, in any period, our stock price decreases to the point where the fair value of the Company, as determined by our market capitalization, is less than our book value, this could indicate a potential impairment and we may be required to record an impairment charge in our statement of operations in that period which would cause our profits to decline.

We operate in highly competitive environments and projections of future operating results and cash flows may vary significantly from actual results. Additionally, if a significant decline in our stock price and/or market capitalization result in impairment to our goodwill, we may be required to record a charge to earnings in our financial statements during a period in which such impairment is determined to exist, which may negatively impact our results of operations. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely, heavily, on projections of future operating performance.

***Delays in releasing new products or enhanced versions of our existing products could adversely affect our competitive position.***

As part of our strategy, we expect to regularly release new products and new versions of our existing products. Even if our new products or new versions of our existing products contain the features and functionality our customers want; in the event we are unable to timely introduce these new products or product releases, our competitive position may be harmed. We cannot assure you that we will be able to successfully complete the development of currently planned or future products or product releases in a timely and efficient manner. Due to the complexity of our products, internal quality assurance testing and customer testing of pre-commercial releases may reveal product performance issues or desirable feature enhancements that could lead us to postpone the release of these products. In addition, the reallocation of resources associated with any postponement would likely cause delays in the development and release of other future products or enhancements to our currently available products. The reallocation of certain design, development and testing functions to our lower-cost development center heightens risks relating to product design, development, testing and introduction. Any delay in releasing future products or enhancements of our products could harm our business.

***If we release products containing defects, we may need to halt further shipments, service levels may be reduced and our business and reputation would be harmed.***

Products as complex as ours, often contain unknown and undetected errors or performance problems. Serious defects are frequently found during the period immediately following introduction and initial shipment of new products or enhancements to existing products, even though our products are subject to rigorous testing and quality control processes. Although we attempt to resolve all errors that we believe would be considered serious by our customers before shipment to them, our products are not error-free. These errors or performance problems could result in lost revenues, reduced service levels, delays in customer acceptance on professional services products and would be detrimental to our business and reputation. As is typical in the software industry, with each release we have discovered errors in our products after introduction.

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We will not be able to detect and correct all errors before releasing our products commercially and these undetected errors could be significant. We cannot assure you that undetected errors or performance problems in our existing or future products will not be discovered in the future or that known errors considered minor by us will not be considered serious by our customers, resulting in cancellation of orders, loss of customers, difficulties in achieving our sales goals, increased demands on our support services, a decrease in our revenues and service credits or refunds. To correct such errors, we may expend considerable time and resources to develop and release modifications to our software.

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As a result of such errors, we may be subject to warranty and product liability claims that are costly or difficult to settle. Our products and services enable customers to manage critical business information. If product errors are alleged to cause or contribute to security and privacy breaches or misappropriation of confidential information, we may also be subject to significant liability. Although our license agreements contain provisions intended to limit our exposure to liability, we cannot assure you that these limits will be adequate, that they will be enforceable or, if enforceable, that they will be interpreted favorably by a court.

### ***We face risks related to claims by third parties that we infringe their intellectual property rights and other litigation.***

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights, particularly in the software and Internet-related industries. We have, in the past, been and are presently subject to intellectual property actions. For example, on August 19, 2003, EdiSync Systems, LLC filed a complaint against Centra in federal court in Denver, Colorado, alleging infringement of two patents for a remote multiple user editing system and method and seeking to enjoin us from continuing to sell our products, as well as unspecified compensatory damages. Centra filed an answer to the complaint denying all of the allegations, and instituted reexamination proceedings for the patents at issue with the Patent Office. Centra filed a request for reexamination of the patents at issue with the Patent Office. Our 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, thus 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. We believe we are free from liability for past actions, as we believe the newly-added claims would be enforceable only prospectively as of the issue date of the reexamination certificate. Centra has since 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 has granted that request. The Colorado District Court again stayed the litigation pending the outcome of the second reexamination proceeding. On March 21, 2011, the Patent Office issued a final office action indicating that all but two of the twenty eight claims in the reexamination certificate are unpatentable and that one claim added during this reexamination proceeding is patentable. On March 25, 2011, the plaintiff filed a motion to lift the stay on the court proceedings. Although we believe that we have meritorious defenses and intend to vigorously defend this action, we can give no assurance that we will be able to achieve a satisfactory outcome. We could become subject to additional intellectual property infringement claims as the number of our competitors grows and our products and services overlap with competitive offerings. Any of these claims, even if not meritorious, could be expensive to defend and could divert management's attention from operating our company. If we become liable to third parties for infringing their intellectual property rights, we could be required to pay a substantial award of damages and to develop non-infringing technology, obtain a license or cease selling the products that contain the infringing intellectual property. We may be unable to develop non-infringing technology or obtain a license on commercially reasonable terms, if at all. We also may face other forms of litigation or claims as part of our business, which may expose us to additional costs and risks.

### ***Our products include third party technology, the loss of which could materially harm our business.***

We use licensed third party technology components in our products. Future licenses to this technology may not be available to us on commercially reasonable terms, or at all. The loss of or inability to obtain or maintain any of these technology licenses could result in delays in the introduction of new products or could force us to discontinue offering portions of our solutions until equivalent technology, if available, is identified, licensed and integrated.

### ***Our use of open source technology could impose limitations on our ability to commercialize our products.***

We use open source software in our application suite. Although we monitor our use of open source software closely, the terms of many open source licenses have not been interpreted by United States courts, and there is risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to re-engineer our technology or to discontinue offering all or a portion of our products in the event re-engineering cannot be accomplished on a timely basis, any of which could adversely affect our business, operating results and financial condition.

### ***We may not be able to adequately protect our proprietary technology, and our competitors may be able to offer similar products and services that would harm our competitive position.***

Our success depends upon our proprietary technology. We rely primarily on copyright, trademark and trade secret laws, confidentiality procedures and contractual provisions to establish and protect our proprietary rights. As part of our confidentiality procedures, we enter into non-disclosure agreements with our employees. Despite these precautions, third parties could copy or otherwise obtain and use our technology without authorization, which may represent potential sales and revenue losses that are difficult to quantify. Policing unauthorized use of our technology is difficult, time-consuming and costly. Were we to discover instances of unauthorized use, there can be no assurance that we would be able to enforce our proprietary rights or obtain adequate recovery for our losses. In addition, we have seven patents issued in the United States

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and seven patent applications pending in the United States. We cannot assure you that any patents will be issued for any of the pending patent applications. Even for the issued patents, or any patent issued to us in the future, there can be no assurance that such patent will protect our intellectual property, or will not be challenged by third parties. Furthermore, effective protection of intellectual property rights is unavailable or limited in certain foreign countries. We cannot assure you that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our products and services or design around any patents or other intellectual property rights we hold.

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### ***Natural disasters and other events beyond our control could materially adversely affect us.***

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control. Although we maintain crisis management and disaster response plans, such events could make it difficult or impossible for us to deliver our services to our customers, and could decrease demand for our services. Our corporate headquarters, information technology systems and other critical business operations are located near major seismic faults in the San Francisco Bay Area. Because we do not carry earthquake insurance for direct quake-related losses, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

### ***If we fail to manage our datacenter operations satisfactorily, our existing customers may experience service outages and data loss, and our new customers may experience delays in the deployment of our solution.***

Our hosting infrastructure is a critical part of our business operations. Our customers access our cloud solutions through a standard web browser via the internet and depend on us to enable fast and reliable access to our applications. We have experienced, and may in the future experience, disruptions within our hosting infrastructure, some of which have been significant, which have prevented customers from using our solutions from time to time. Factors that may cause such disruptions include:

software errors or defects;

equipment failures or defects;

human error;

physical or electronic security breaches;

telecommunications outages from third-party providers;

computer viruses or other malicious code;

acts of terrorism or sabotage;

fire, earthquake, flood and other natural disasters; and

power loss.

Although we back up customer data stored on our systems on a near real-time basis, our infrastructure does not currently include real-time mirroring of data storage and production capacity in more than one geographically distinct location. Thus, in the event of a physical disaster, or certain other failures of our computing infrastructure, customer data from recent transactions may be permanently lost.

We currently deliver our cloud solutions from datacenter facilities operated and controlled by third parties. Accordingly, we rely on these third parties to provide the physical security, facilities management and communications infrastructure services to ensure the reliable and consistent delivery of our solutions to our customers. Although we believe we would be able to enter into similar relationships with another third party

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vendors should one of these relationships fail or terminate for any reason, we believe our reliance on any third-party vendor exposes us to risks outside of our control. If these third-party vendors fail to secure adequately and maintain their hosting facilities or provide the required data communications capacity, our customers may experience interruptions in our service or the loss or theft of important customer data.

If, as a result of our datacenter operations, our customers experience service interruptions or the loss or theft of their data caused by us, we may be required to issue credits pursuant to the terms of our contracts and may also be subject to financial liability or customer losses. Such credits could reduce our revenues below the levels that we have indicated we expect to achieve and adversely affect our margins and operating results.

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Our insurance policies may not adequately compensate us for any losses that may occur due to any failures or interruptions in our systems.

***If our security measures are breached and unauthorized access is obtained to client data, clients may curtail or stop their use of our subscription solutions, which would harm our business, operating results and financial condition.***

A portion of our subscription business involves the storage and transmission of confidential information of clients and their existing and potential employees, and security breaches could expose us to a risk of loss of, or unauthorized access to, this information, resulting in possible litigation and possible liability. If our security measures are ever breached as a result of third party action, employee error, malfeasance or otherwise, and, as a result, an unauthorized party obtained access to this confidential data, our reputation could be damaged, our business may suffer and we could incur significant liability. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not discovered until launched against a target. As a result, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of our security measures could be harmed and we could lose sales and clients.

***Our stock price may fluctuate substantially.***

From the beginning of fiscal year 2010 through August 31, 2011, the market price for our common stock has fluctuated between \$3.05 per share and \$10.62 per share. The market price for our common stock may be affected by a number of factors, including those described above and the following:

the announcement of new products and services or product and service enhancements by us or our competitors;

actual or anticipated quarterly variations in our results of operations or those of our competitors;

changes in earnings estimates or recommendations by securities analysts that may follow our stock;

developments in our industry, including announcements of significant acquisitions or strategic partnerships; and

general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

In addition, the stock market in general, and The NASDAQ Stock Market technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies. Broad market and industry trends may also materially and adversely affect the market price of our common stock, regardless of our actual operating performance. Volatility in the market price and trading volume of our common stock may prevent our stockholders from selling their shares at a favorable price. In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been initiated against that company. Class-action litigation could result in substantial costs and a diversion of management's attention and resources.

***The anti-takeover provisions in our charter and bylaws and our rights plan could delay or prevent a change in control.***

Our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws contain provisions that could make it more difficult for a third party to acquire us without the consent of our Board of Directors.

For example, if a potential acquirer were to make a hostile bid for us, the acquirer would not be able to call a special meeting of stockholders to remove our Board of Directors or act by written consent without a meeting. In addition, our Board of Directors has staggered terms that make it difficult to remove all directors at once. The acquirer would also be required to provide advance notice of its proposal to remove directors at an annual meeting. The acquirer will not be able to cumulate votes at a meeting, which will require the acquirer to hold more shares to gain representation on the Board of Directors than if cumulative voting were permitted.



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Our Board of Directors also has the ability to issue preferred stock that would significantly dilute the ownership of a hostile acquirer. In addition, Section 203 of the Delaware General Corporation Law limits business combination transactions with 15% stockholders that have not been approved by the Board of Directors. These provisions and other similar provisions make it more difficult for a third party to acquire us without negotiation. These provisions may apply even if the offer may be considered beneficial by some stockholders. In addition, on June 2, 2009, our Board of Directors authorized and declared a dividend of one right for each outstanding share of our common stock to stockholders of record at the close of business on June 15, 2009. Each right entitles the registered holder, subject to the terms of the rights agreement between us and the rights agent, to purchase from us one one-thousandth of a share (a Unit ) of Series A Preferred Stock, par value \$0.001 per share, at a purchase price of \$12.50 per Unit, under circumstances described in the rights agreement.

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The purchase price, the number of units of preferred stock and the type of securities issuable upon exercise of the rights are subject to adjustment. The rights will expire at the close of business June 2, 2012 unless earlier redeemed or exchanged. Until a right is exercised, the holder thereof, as such, will have no rights as one of our stockholders, including the right to vote or to receive dividends. The rights are not immediately exercisable. Subject to the terms and conditions of the rights agreement, they will become exercisable ten business days after a person or group acquires, or commences a tender or exchange offer which would lead to the acquisition of, beneficial ownership of 15% or more of our outstanding common stock. Once a person or group acquires beneficial ownership of 15% or more of our outstanding common stock, subject to the terms of the rights agreement, each right not owned by that person or group or certain related parties will entitle its holder to purchase, at the right's then-current purchase price, Units of Series A Preferred Stock or, at our option, shares of common stock or cash, property or other securities of our Company having a market value equal to twice the then-current purchase price.

The anti-takeover provisions in our charter and bylaws and under Delaware law, as well as our rights agreement could have the effect of discouraging a third party from making a tender offer or otherwise attempting to gain control of us, even though the transactions could be profitable for our stockholders. If the acquirer was discouraged from offering to acquire us or prevented from successfully completing a hostile acquisition by our anti-takeover measures, our stockholders could lose the opportunity to sell their shares at a favorable price.

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

a.) None.

b.) None

c.) The following table provides monthly detail regarding our share repurchases during the three months ended August 31, 2011:

Period	Total Number of Shares Purchased	Average Price Paid per Share (in thousands, except share and per share amounts)	Total Cost for Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Cost for Number of Shares That May Yet Be Purchased Under the Plans or Programs
June 1 30, 2011		\$	\$	\$ 4,503
July 1 31, 2011				4,503
August 1 31, 2011	81,852 <sup>(1)</sup>	7.14	287	4,217
Total	81,852		\$ 287	\$ 4,217

(1) Includes 41,852 shares of common stock pursuant to our restricted stock units program for an aggregate price of approximately \$372,000 to satisfy tax withholding obligations that arose on the vesting of restricted stock units.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. (REMOVED AND RESERVED)****ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

a. Exhibits

See Exhibit Index following the signature page, which is incorporated herein by reference.

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**SIGNATURES**

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

SABA SOFTWARE, INC.

Dated: October 6, 2011

By: /s/ **BOBBY YAZDANI**  
**Bobby Yazdani**

**Chief Executive Officer and**

**Chairman of the Board**

**(Principal Executive Officer)**

By: /s/ **WILLIAM SLATER**  
**William Slater**

**Chief Financial Officer**

**(Principal Financial and Accounting Officer)**

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**EXHIBIT INDEX**

<b>Exhibit</b>	
<b>Number</b>	<b>Document</b>
3.1(1)	Amended and Restated Certificate of Incorporation of the Company effective as of April 12, 2000.
3.2(2)	Amendment to Amended and Restated Certificate of Incorporation of the Company effective as of May 12, 2003.
3.3(3)	Amendment to Amended and Restated Certificate of Incorporation of the Company effective as of November 19, 2004.
3.4(4)	Certificate of Designation of the Series A Preferred Stock, as filed with the Secretary of Delaware on June 2, 2009.
3.5(5)	Amended and Restated Bylaws of the Company.
4.1	Reference is made to Exhibits 3.1, 3.2, 3.3, 3.4 and 3.5.
10.1(6)	Amended and Restated Credit Agreement dated June 27, 2011 by and among Saba Software, Inc. and Wells Fargo Bank, National Association.
18.1(7)	Preferability Letter from Independent Registered Public Accounting Firm Regarding Change in Accounting Principle.
31.1	Certification of Bobby Yazdani, Chief Executive Officer and Chairman of the Board, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated October 6, 2011.
31.2	Certification of William Slater, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated October 6, 2011.
32.1	Certification of Bobby Yazdani, Chief Executive Officer and Chairman of the Board, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated October 6, 2011.
32.2	Certification of William Slater, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated October 6, 2011.
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of August 31, 2011 and May 31, 2011, (ii) Condensed Consolidated Statements of Operations for the three months ended August 31, 2011 and 2010, (iii) Condensed Consolidated Statements of Cash Flows for the three months ended August 31, 2011 and 2010 and (iv) Notes to Condensed Consolidated Financial Statements
(1)	Incorporated by reference to Exhibit 3.2 previously filed with the Company's Registration Statement on Form S-1/A (Registration No. 333-95761) filed on March 3, 2000.
(2)	Incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 2003.
(3)	Incorporated by reference to Exhibit 3.4 to the Company's Quarterly Report on Form 10-Q for the period ended November 30, 2004.
(4)	Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on June 2, 2009.
(5)	Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on September 23, 2011.
(6)	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 1, 2011.
(7)	Incorporated by reference to Exhibit 18.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 2011.