

SABA SOFTWARE INC
Form 10-Q
January 12, 2007
[Table of Contents](#)

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

FORM 10-Q

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

For the quarterly period ended November 30, 2006

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

For the transition period from to .

000-30221

(Commission File number)

SABA SOFTWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

94-3267638
(I.R.S. Employer

Identification No.)

2400 Bridge Parkway

94065-1166

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Redwood Shores, California
(Address of principal executive offices)

(650) 581-2500

(Zip Code)

(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-Accelerated filer ☒

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

On December 31, 2006, 28,597,938 shares of the registrant's Common Stock, \$.001 par value, were outstanding.

Table of Contents

SABA SOFTWARE, INC.

FORM 10-Q

QUARTER ENDED NOVEMBER 30, 2006

INDEX

	Page
Part I. <u>FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of November 30, 2006 and May 31, 2006</u>	3
<u>Condensed Consolidated Statements of Operations for the three and six months ended November 30, 2006 and November 30, 2005</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the six months ended November 30, 2006 and November 30, 2005</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	32
Item 4. <u>Controls and Procedures</u>	33
Part II. <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	34
Item 1A. <u>Risk Factors</u>	36
Item 2. <u>Unregistered Sales of Equity Securities and Use Of Proceeds</u>	44
Item 3. <u>Defaults Upon Senior Securities</u>	44
Item 4. <u>Submission of Matters to a Vote of Securities Holders</u>	44
Item 5. <u>Other Information</u>	45
Item 6. <u>Exhibits</u>	45
<u>Signatures</u>	46

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

	November 30, 2006 (Unaudited)	May 31, 2006*
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 18,749	\$ 23,029
Restricted cash	500	500
Accounts receivable, net	22,497	18,334
Prepaid expenses and other current assets	2,025	2,709
Total current assets	43,771	44,572
Property and equipment, net	2,513	2,172
Goodwill	38,337	38,164
Purchased intangible assets, net	18,432	20,449
Other assets	939	1,018
Total assets	\$ 103,992	\$ 106,375
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 5,872	\$ 8,782
Accrued compensation and related expenses	6,288	6,259
Accrued expenses	5,462	6,265
Deferred revenue	25,544	23,571
Current portion of debt and lease obligations	2,551	2,330
Total current liabilities	45,717	47,207
Deferred revenue	2,099	526
Accrued rent	2,791	2,833
Debt and lease obligations, less current portion	3,362	3,962
Total liabilities	53,969	54,528
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, issuable in series: \$0.001 par value:		
5,000,000 authorized shares at November 30, 2006 and May 31, 2006; none issued or outstanding		
Common stock, \$0.001 par value:		
50,000,000 authorized; 28,650,343 issued and outstanding at November 30, 2006 and 28,509,483 shares issued and outstanding at May 31, 2006	29	29
Additional paid-in capital	249,300	247,716

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Treasury stock: 102,997 shares at November 30, 2006 and May 31, 2006, at cost	(232)	(232)
Accumulated deficit	(198,957)	(195,359)
Accumulated other comprehensive loss	(117)	(307)
Total stockholders' equity	50,023	51,847
Total liabilities and stockholders' equity	\$ 103,992	\$ 106,375

* Derived from audited financial statements included in Form 10-K filed with the Securities and Exchange Commission for the year ended May 31, 2006.

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

(Unaudited)

	Three months ended November 30,		Six months ended November 30,	
	2006	2005	2006	2005
Revenues:				
License	\$ 6,916	\$ 5,080	\$ 13,104	\$ 8,430
License updates and product support	7,699	4,644	14,706	9,007
OnDemand	3,784	804	7,333	1,642
Professional services	7,798	5,704	14,213	10,781
 Total revenues	 26,197	 16,232	 49,356	 29,860
Cost of revenues:				
Cost of license	562	34	777	293
Cost of license updates and product support	2,016	981	3,900	1,888
Cost of OnDemand	1,090	491	2,232	817
Cost of professional services	5,074	4,033	10,048	7,842
Amortization of acquired developed technology	295		589	
 Total cost of revenues	 9,037	 5,539	 17,546	 10,840
 Gross profit	 17,160	 10,693	 31,810	 19,020
Operating expenses:				
Research and development	4,253	2,787	8,270	5,515
Sales and marketing	9,883	5,926	19,247	11,223
General and administrative	3,144	1,542	6,136	3,178
Amortization of purchased intangible assets	634	170	1,269	339
 Total operating expenses	 17,914	 10,425	 34,922	 20,255
 Income (loss) from operations	 (754)	 268	 (3,112)	 (1,234)
Interest income and other, net	(15)	(32)	51	(35)
Interest expense	(102)	(79)	(237)	(187)
 Income (loss) before provision for income taxes	 (871)	 157	 (3,298)	 (1,457)
Provision for income taxes	135	26	300	34
 Net income (loss)	 \$ (1,006)	 \$ 131	 \$ (3,598)	 \$ (1,491)
 Basic net income (loss) per share	 \$ (0.03)	 \$ 0.01	 \$ (0.13)	 \$ (0.09)
 Diluted net income (loss) per share	 \$ (0.03)	 \$ 0.01	 \$ (0.13)	 \$ (0.09)
 Shares used in computing basic net income (loss) per share	 28,517	 17,523	 28,363	 17,407

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Shares used in computing diluted net income (loss) per share	28,517	18,082	28,363	17,407
--	--------	--------	--------	--------

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six months ended	
	November 30,	November 30,
	2006	2005
Operating activities:		
Net loss	\$ (3,598)	\$ (1,491)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	716	300
Amortization of purchased intangible assets	2,018	389
Stock-based compensation expense	1,007	
Loss on disposal of property and equipment	16	6
Changes in operating assets and liabilities:		
Accounts receivable	(4,028)	1,259
Prepaid expenses and other current assets	764	(393)
Other assets	91	113
Accounts payable	(2,880)	695
Accrued compensation and related expenses	(19)	426
Accrued expenses	(1,077)	(2,270)
Accrued rent	(42)	(24)
Deferred revenue	3,465	634
Net cash used in operating activities	(3,567)	(356)
Investing activities:		
Purchases of property and equipment	(1,065)	(405)
Proceeds from sale of property and equipment		24
Net cash used in investing activities	(1,065)	(381)
Financing activities:		
Proceeds from issuance of common stock under employee stock plans	577	187
Borrowings, under credit facility, net of issuance costs	4,794	124
Repayments on borrowings under credit facility	(5,083)	(1,114)
Repayments on note payable	(90)	(65)
Net cash provided by (used in) financing activities	198	(868)
Effect of exchange rate changes on cash	154	(89)
Decrease in cash and cash equivalents	(4,280)	(1,694)
Cash and cash equivalents, beginning of period	23,029	15,408
Cash and cash equivalents, end of period	\$ 18,749	\$ 13,714

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

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

These unaudited condensed consolidated financial statements should be read in conjunction with Saba's audited condensed consolidated financial statements included in Saba's Annual Report on Form 10-K filed with the Securities and Exchange Commission on August 18, 2006, as amended by the Form 10-K/A filed on September 28, 2006. The results of operations for the three and six months ended November 30, 2006 are not necessarily indicative of results for the entire fiscal year ending May 31, 2007 or for any future period.

The condensed consolidated balance sheet at May 31, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

Certain previously reported amounts on the balance sheet and the statement of operations have been reclassified to conform to the current presentation, none of which affected gross margin, net loss or net loss per share. Specifically, the Company has reclassified certain amounts between accounts receivables and deferred revenues. Additionally, the Company has reclassified revenues and cost of revenues by type and made certain reclassifications between operating expense accounts.

Related Party Transaction

During the quarter ended November 30, 2006, Saba licensed its software and sold related support and services to Varian Medical Systems, Inc. in the aggregate amount of \$325,000. At November 30, 2006, Saba's accounts receivable included \$195,000 payable by Varian Medical Systems, Inc. The Executive Vice President of Varian Medical Systems, Inc. serves as a director on Saba's Board of Directors.

2. Stock-Based Compensation

The Company currently grants stock options under its 2000 Stock Incentive Plan and its 1997 Stock Option Plan and maintains an employee stock purchase plan. Beginning with its first quarter of fiscal 2007, the Company adopted the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 123 revised 2004 (SFAS 123R), *Share-Based Payment* which replaced Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation* and supersedes Accounting Principles Board (APB) Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The Company adopted SFAS 123R using the modified prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding prior to the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the SFAS 123 pro forma disclosures.

The adoption of SFAS 123R had and will have a material impact on the Company's consolidated results of operations.

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

Prior to June 1, 2006, the Company applied the intrinsic value recognition and measurement principles of APB 25, in accounting for stock-based incentives. Accordingly, the Company was not required to record compensation expense when stock options were granted to eligible participants as long as the exercise price was not less than the fair market value of the stock when the option was granted. The Company was also not required to record compensation expense in connection with its 2000 Employee Stock Purchase Plan (ESPP) as long as the purchase price of the stock was not less than 85% of the lower of the fair market value of the stock at the beginning of each offering period or at the end of each purchase period. Effective June 1, 2006, the Company's adoption of the fair value recognition provisions of SFAS 123R, as interpreted by the Securities and Exchange Commission's Staff Accounting Bulletin No. 107 (SAB 107), *Share-Based Payment*, using the modified prospective transition method resulted in the recognition of stock-based compensation expense for the three and six months ended November 30, 2006 which included: (a) compensation expense for all stock-based instruments granted prior to, but not yet vested as of June 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all stock-based instruments granted on or after June 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Because the Company elected to use the modified prospective transition method, results for prior periods have not been restated.

The Company currently uses the Black-Scholes-Merton option pricing model to determine the fair value of stock options and employee stock purchase plan (ESPP) shares. The determination of the fair value of stock-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, risk-free interest rate and expected dividends. The Company estimates the expected term of stock-based awards granted by applying the simplified method in accordance with SAB 107. The Company estimates the volatility of its common stock based upon 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 stock-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.

Adoption of SFAS 123R

The following table summarizes the stock-based compensation expense for stock options and ESPP shares that was recorded in the Company's results of operations in accordance with SFAS 123R for the three and six months ended November 30, 2006.

	Three Months Ended November 30, 2006	Six Months Ended November 30, 2006
(in thousands, except per share data)		
Cost of revenues	\$ 54	\$ 114
Research and development	92	171
Sales and marketing	195	418
General and administrative	157	304
Stock-based compensation expense included in net loss	\$ 498	\$ 1,007

Effect of stock-based compensation on net loss per share:

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Basic and diluted	\$	0.02	\$	0.04
-------------------	----	------	----	------

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

The Company used the following assumptions to estimate the fair value of options granted for the three and six months ended November 30, 2006 and 2005:

	Three Months Ended		Six Months Ended	
	November 30, 2006	November 30, 2005	November 30, 2006	November 30, 2005
Stock Options:				
Expected volatility	62.70%	48.96%	65.03%	48.96%
Risk-free interest rates	4.49%	3.93%	4.66%	3.93%
Expected term (years)	4.1	2.5	4.1	2.5
Expected dividend yield	0.00%	0.00%	0.00%	0.00%
Forfeiture rate	25.00%	37.67%	25.00%	37.67%

Price data and activity for the Company's equity compensation plans during the six months ended November 30, 2006, are summarized as follows:

	Outstanding Options	Weighted Average Exercise Price
	(Number of Shares)	Per Share
Balance at May 31, 2006	3,932,104	\$ 5.28
Granted	1,241,650	\$ 6.04
Exercised	(110,145)	\$ 4.08
Forfeited or expired	(786,474)	\$ 7.93
Balance at November 30, 2006	4,277,135	\$ 5.05

The weighted average fair value of options granted during the six months ended November 30, 2006 was \$2.40 per share.

Stock options issued under equity compensation plans outstanding and exercisable at November 30, 2006 were as follows:

Ranges of Exercisable Prices	Shares	Options Outstanding			Options Exercisable		
		Weighted-Average Remaining Contractual Life (Yrs)	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value
\$ 0.02 - \$ 2.52	276,902	2.14	\$ 2.19	\$ 888,936	257,286	\$ 2.17	\$ 832,247
\$ 2.53 - \$ 3.62	66,112	3.52	\$ 3.53	123,629	39,634	\$ 3.53	74,116
\$ 3.63 - \$ 3.63	302,265	2.90	\$ 3.63	535,009	225,149	\$ 3.63	398,514
\$ 3.78 - \$ 3.78	388,437	3.26	\$ 3.78	629,268	244,887	\$ 3.78	396,717

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

\$ 3.80 - \$ 4.50	1,007,542	3.94	\$ 4.07	1,345,015	391,426	\$ 4.09	513,543
\$ 4.51 - \$ 6.00	1,212,471	5.38	\$ 5.20	326,749	93,041	\$ 4.95	41,671
\$ 6.01 - \$ 7.00	819,325	5.58	\$ 6.40		375	\$ 6.60	
\$ 7.01 - \$ 9.00	148,228	1.22	\$ 8.09		148,228	\$ 8.09	
\$ 9.01 - \$ 11.00	14,775	1.59	\$ 10.66		14,775	\$ 10.66	
\$ 11.01 - \$ 117.50	41,078	0.55	\$ 28.77		41,078	\$ 28.77	
\$ 0.02 - \$ 117.50	4,277,135	4.27	\$ 5.05	\$ 3,848,606	1,455,879	\$ 4.84	\$ 2,256,808

The Company defines in-the-money options at November 30, 2006 as options that had exercise prices that were lower than the \$5.40 market price of its common stock at that date. The aggregate intrinsic value of options outstanding at November 30, 2006 is calculated as the difference between the exercise price of the underlying options and the market price of its common stock for the 3.0 million shares that were in-the-money at that date. There were 1.3 million in-the-money options exercisable at November 30, 2006. The total intrinsic value of options exercised during the three and six months ended November 30, 2006 was \$89,000 and \$166,000, respectively, determined as of the date of exercise.

The Company recorded \$498,000 and \$1,007,000 in stock-based compensation expense before income tax

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

benefit for stock options and shares granted under its ESPP in its results of operations for the three and six months ended November 30, 2006, respectively.