

SABA SOFTWARE INC
Form 10-Q
April 07, 2011
[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 February 28, 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)

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

94-3267638
(I.R.S. Employer
Identification No.)

2400 Bridge Parkway
Redwood Shores, California
(Address of principal executive offices)

94065-1166
(Zip Code)

(650) 581-2500

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☐ Accelerated filer ☒

Non-Accelerated filer ☐ (do not check if a smaller reporting company) Smaller reporting company ☐

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

On March 31, 2011, 28,298,637 shares of the registrant's Common Stock, \$0.001 par value, were outstanding.

Table of Contents

SABA SOFTWARE, INC.

FORM 10-Q

QUARTER ENDED FEBRUARY 28, 2011

INDEX

Part I.	<u>FINANCIAL INFORMATION</u>	Page
		3
Item 1.	<u>Financial Statements (Unaudited)</u>	3
	<u>Condensed Consolidated Balance Sheets as of February 28, 2011 and May 31, 2010</u>	3
	<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended February 28, 2011 and 2010</u>	4
	<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended February 28, 2011 and 2010</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>	25
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	42
Item 4.	<u>Controls and Procedures</u>	43
Part II.	<u>OTHER INFORMATION</u>	45
Item 1.	<u>Legal Proceedings</u>	45
Item 1A.	<u>Risk Factors</u>	45
Item 2.	<u>Unregistered Sales of Equity Securities and Use Of Proceeds</u>	58
Item 3.	<u>Defaults Upon Senior Securities</u>	58
Item 4.	<u>(Removed and Reserved)</u>	59
Item 5.	<u>Other Information</u>	59
Item 6.	<u>Exhibits</u>	59
	<u>Signatures</u>	60

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)**

	February 28, 2011	May 31, 2010 (As Adjusted)*
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 32,049	\$ 32,002
Restricted cash	11	20
Accounts receivable, net of allowances for doubtful accounts of \$150 as of February 28, 2011 and May 31, 2010	27,922	23,352
Prepaid expenses and other current assets	3,305	2,113
Total current assets	63,287	57,487
Property and equipment, net	2,658	3,178
Goodwill	36,095	36,095
Purchased intangible assets, net	2,353	5,027
Restricted cash	421	260
Other assets	2,285	1,921
Total assets	\$ 107,099	\$ 103,968
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 3,776	\$ 3,218
Accrued compensation and related expenses	7,067	8,069
Accrued expenses	2,821	2,746
Deferred revenue	39,247	34,435
Current portion of lease obligations	1,219	450
Total current liabilities	54,130	48,918
Deferred revenue, less current portion	3,165	2,559
Other long-term liabilities	1,202	1,156
Accrued rent	350	1,785
Total Liabilities	58,847	54,418
Stockholders' equity:		
Preferred stock, issuable in series \$0.001 par value, 5,000,000 authorized shares at February 28, 2011 and May 31, 2010; none issued or outstanding		
Common stock, \$0.001 par value, 50,000,000 authorized; 28,899,494 shares issued at February 28, 2011 and 28,252,131 shares issued at May 31, 2010	29	29

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Additional paid-in capital	259,766	255,938
Treasury stock: 636,640 shares at February 28, 2011 and 121,997 shares at May 31, 2010	(3,361)	(328)
Accumulated deficit	(208,315)	(205,812)
Accumulated other comprehensive income (loss)	133	(277)
Total stockholders' equity	48,252	49,550
 Total liabilities and stockholders' equity	 \$ 107,099	 \$ 103,968

* Certain amounts have been adjusted for the retrospective change in accounting principle for sales commission (See Note 2).
See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three months ended February 28,		Nine months ended February 28,	
	2011	2010	2011	2010
		(As Adjusted)*		(As Adjusted)*
Revenues:				
Subscription	\$ 16,739	\$ 14,333	\$ 47,237	\$ 42,445
License	4,994	5,515	14,258	17,579
Professional services	8,612	6,812	25,235	19,929
Total revenues	30,345	26,660	86,730	79,953
Cost of revenues:				
Cost of subscription	4,074	4,103	11,885	12,266
Cost of license	292	163	725	597
Cost of professional services	6,427	5,070	18,115	14,420
Amortization of acquired developed technology	196	295	785	884
Total cost of revenues	10,989	9,631	31,510	28,167
Gross profit	19,356	17,029	55,220	51,786
Operating expenses:				
Research and development	4,530	4,609	13,388	13,555
Sales and marketing	10,033	7,734	30,932	23,172
General and administrative	3,862	3,530	10,693	10,985
Restructuring				(38)
Amortization of purchased intangible assets	621	634	1,891	1,903
Total operating expenses	19,046	16,507	56,904	49,577
Income (loss) from operations	310	522	(1,684)	2,209
Interest and other income (expense), net	(196)	(48)	(256)	(15)
Interest expense	3	(1)		(6)
Income (loss) before provision for income taxes	117	473	(1,940)	2,188
Provision for income taxes	(126)	(44)	(563)	(197)
Net (loss) income	\$ (9)	\$ 429	\$ (2,503)	\$ 1,991
Basic net income (loss) per share	\$	\$ 0.02	\$ (0.09)	\$ 0.07
Diluted net income (loss) per share	\$	\$ 0.01	\$ (0.09)	\$ 0.07
Shares used in computing basic net income (loss) per share	28,260	27,922	28,202	28,336

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Shares used in computing diluted net income (loss) per share	28,260	29,043	28,202	29,308
--	--------	--------	--------	--------

* Certain amounts have been adjusted for the retrospective change in accounting principle for sales commission (See Note 2).
See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Nine months ended February 28,	
	2011	2010 (As Adjusted)*
Operating activities:		
Net (loss) income	\$ (2,503)	\$ 1,991
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	1,663	1,821
Amortization of purchased intangible assets	2,674	2,787
Share-based compensation	2,211	1,267
Changes in operating assets and liabilities:		
Accounts receivable	(4,028)	(5,058)
Prepaid expenses and other current assets (Note 2)	(1,119)	73
Other assets (Note 2)	(318)	62
Accounts payable	504	409
Accrued compensation and related expenses	(1,317)	613
Accrued expenses	168	(4)
Deferred revenue (Note 2)	4,637	1,031
Restricted cash	(144)	(20)
Accrued rent	(855)	(437)
Net cash provided by operating activities	1,573	4,535
Investing activities:		
Purchases of property and equipment	(1,087)	(653)
Net cash used in investing activities	(1,087)	(653)
Financing activities:		
Proceeds from issuance of common stock under stock plans	1,934	248
Repurchase of common stock	(3,034)	(4,847)
Repurchase of stock to satisfy employee tax withholding obligations	(316)	(140)
Repayments of borrowings under credit facility		(232)
Repayments of note payable		(22)
Net cash used in financing activities	(1,416)	(4,993)
Effect of exchange rate changes on cash and cash equivalents	977	(70)
Increase (decrease) in cash and equivalents	47	(1,181)
Cash and cash equivalents, beginning of period	32,002	25,978
Cash and cash equivalents, end of period	\$ 32,049	\$ 24,797
Supplemental disclosure of other cash flow information:		
Cash paid for income taxes, net of refunds	\$ 971	\$ 317

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Cash paid for interest	\$	\$	3
------------------------	----	----	---

* Certain amounts have been adjusted for the retrospective change in accounting principle for sales commission (See Note 2).
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 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 February 28, 2011, the condensed consolidated statements of operations for the three and nine months ended February 28, 2011 and 2010 and the condensed consolidated statements of cash flows for the nine months ended February 28, 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 February 28, 2011, and the Company s results of operations for the three and nine months ended February 28, 2011 and 2010 and cash flows for the nine months ended February 28, 2011 and 2010.

These unaudited condensed consolidated financial statements should be read in conjunction with Saba s audited consolidated financial statements included in Saba s Annual Report on Form 10-K for the fiscal year ended May 31, 2010 filed with the Securities and Exchange Commission (the SEC) on August 12, 2010. The results of operations for the three and nine months ended February 28, 2011, are not necessarily indicative of results for the entire fiscal year ending May 31, 2011 or for any future period.

The condensed consolidated balance sheet at May 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by US GAAP for complete financial statements, except for the Company s voluntary change for sales commissions as described in Note 2.

Certain prior year balances have been reclassified to conform to the current year s presentation. Such reclassifications did not affect total revenues, operating income (loss) or net income (loss). The Company combined License Updates and Product Support, and OnDemand revenues as one line item in the condensed consolidated statements of operations from prior quarters, to conform to the current period presentation.

2. Summary of Significant Accounting Policies

Revenue Recognition

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13 Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (A Consensus of the FASB Emerging Issues Task Force) (ASU 2009-13) which amends the revenue recognition for certain multiple element revenue arrangements excluding license arrangements to:

provide updated guidance on whether multiple elements exist, how the elements in an arrangement should be separated, and how the arrangement consideration should be allocated to the separate elements;

require an entity to allocate arrangement consideration to each element based on a selling price hierarchy, where the selling price for an element is based on vendor-specific objective evidence (VSOE), if

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

available; third-party evidence (TPE), if available and if VSOE is not available; or the best estimate of selling price (BESP), if neither VSOE nor TPE is available; and

eliminate the use of the residual method and require an entity to allocate arrangement consideration using the selling price hierarchy. Although the amended standards were not required to be adopted by Saba until June 1, 2011 (the beginning of the Company's fiscal year 2012), Saba elected to early adopt this accounting guidance retrospectively to the beginning of its first quarter of fiscal 2011 for transactions entered into or materially modified after May 31, 2010. Saba generates revenues from the sale of software licenses, subscription services and professional services 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.

Software License Arrangements

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

Saba recognizes revenue earned on perpetual software license arrangements in accordance with FASB's Accounting Standards Codification (ASC) 985-605, *Software-Revenue Recognition*. When software arrangements involve multiple elements, the Company recognizes license revenue, using the residual method, in accordance with ASC 985-605. 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. Saba 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, Saba 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. 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 ASC 985-605 are satisfied.

Subscription Services Arrangements

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Subscription services arrangements generally include a combination of Saba products delivered as software as a service (SaaS) in an internet-based cloud architecture, product updates and support related to licenses and professional services.

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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 ASC 985-605 are satisfied.

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) VSOE if available; (ii) TPE if VSOE is not available; and (iii) BEBP if neither VSOE nor TPE is available.

VSOE. 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. Saba 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.

TPE. 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.

BESP. When it is unable to establish a selling price using VSOE or TPE, the Company uses BEBP in its allocation of arrangement consideration. The objective of BEBP 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 BEBP 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 BEBP 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, Saba recognizes revenue in accordance with ASC 985-605.

Professional Services

Professional services revenues are generally recognized as the services are performed. Although Saba 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 ASC 985-605 and relevant guidance of ASC 605-35 *Construction-Type and Certain*

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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 ASC 985-605 are not met when Saba bills a customer or a customer pays Saba, the billed or paid amount is recorded as deferred revenue, which is a liability account. As the revenue recognition criteria of ASC 985-605 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 in prior to adoption of 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.

Impact of Adoption

Prior to adoption of ASU 2009-13, the Company's professional services, when sold with cloud based offerings, did not qualify as separate units of accounting and were recognized as revenue ratably over the longest subscription period. Under subscription accounting, the Company also deferred the associated professional services costs and recognized them on a straight-line basis over the same subscription period. This resulted in the deferral of professional services revenue and professional services cost of revenue.

With the adoption of ASU 2009-13, arrangement consideration is allocated using the relative selling price method and recognized as individual deliverables in accordance with the guidance described above. Additionally, the Company expenses the direct costs related to the professional services as incurred.

Revenue for the three and nine months ended February 28, 2011 was \$30.3 million and \$86.7 million, respectively, with the adoption of ASU 2009-13. This compares with revenue of \$29.2 million and \$84.6 million for the three and nine months ended February 28, 2011, respectively, had the Company not early adopted ASU 2009-13. The primary driver of the impact was increases of \$1.1 million and \$2.0 million in professional services revenue that the Company recognized for the three and nine months ended February 28, 2011, respectively. The increase in professional services revenue primarily resulted from recognizing the professional services over a shorter period than the subscription contract term.

Cost of revenues for the three and nine months ended February 28, 2011 was \$11.0 million and \$31.5 million, respectively, with the adoption of ASU 2009-13. This compares with cost of revenues of \$10.6 million and \$30.4 million for the three and nine months ended February 28, 2011, respectively, had the Company not adopted ASU 2009-13. The increase in cost of revenues was the result of expensing direct costs related to the professional services as incurred.

As of February 28, 2011, the Company's deferred revenue was \$42.4 million, as compared to \$44.0 million had the Company not adopted ASU 2009-13.

The adoption of ASU 2009-13 resulted in an increase in total revenue for the three and nine months ended February 28, 2011. The Company is not able to reasonably estimate the amount of the changes in revenue in future periods, as the impact will vary based on the nature and volume of new or materially modified arrangements in any given future period.

Changes in Accounting Principle

In the third quarter of fiscal 2011, Saba voluntarily changed its accounting policy for sales commissions related to non-cancellable annual or multi-year SaaS contracts, from recording an expense when incurred, to deferral and amortization of the sales commission in proportion to the

revenue recognized over the non-cancellable term of the

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

contract. The Company believes this method is preferable because the commission charges are so closely related to the revenue from the non-cancelable contracts that they should be deferred and charged to expense over the same period that the related revenue is recognized. Furthermore, the adoption of this accounting policy enhances the comparability of the Company's consolidated financial statements by changing to the predominant method utilized in the Company's industry. Deferred commission amounts are recoverable through the future revenue streams under the non-cancellable arrangements. Short-term deferred commissions are included in prepaid expenses and other current assets, while long-term deferred commissions are included in other assets in the accompanying consolidated balance sheets. The amortization of deferred commissions is included in sales and marketing expense in the accompanying condensed consolidated statements of operations.

The accompanying unaudited condensed consolidated financial statements and related notes have been adjusted to reflect the impact of this change retrospectively to all prior periods.

As previously discussed in this note, the Company also adopted the new accounting standards for multiple-element revenue arrangements during fiscal 2011.

The following tables present the effects of (i) the retrospective application of the voluntary change in accounting principle for sales commissions related to non-cancellable annual or multi-year SaaS contracts for all periods presented and (ii) the adoption of the new accounting standard for multiple-element revenue arrangements, effective as of June 1, 2010 (in thousands):

Consolidated Income Statements (in thousands, except share and per share data)	2011 Three Months Ended August 31, 2010			
	As Previously Reported	Impact of Commission Adjustments	Impact of Revenue Adjustments	As Adjusted
Revenues from subscription	\$ 14,895	\$	\$ (1)	\$ 14,894
Revenues from license	\$ 4,450	\$	\$	\$ 4,450
Revenues from professional services	\$ 7,469	\$	\$ 380	\$ 7,849
Cost of professional services	\$ 5,426	\$	\$ 295	\$ 5,721
Sales and marketing	\$ 9,869	\$ (23)	\$	\$ 9,846
Income (loss) from operations	\$ (1,412)	\$ 23	\$ 84	\$ (1,305)
Net income (loss)	\$ (1,804)	\$ 23	\$ 84	\$ (1,697)
Basic net income (loss) per share	\$ (0.06)	\$	\$	\$ (0.06)
Diluted net income (loss) per share	\$ (0.06)	\$	\$	\$ (0.06)
Shares used in computing basic net income (loss) per share	28,151	28,151	28,151	28,151
Shares used in computing diluted net income (loss) per share	28,151	28,151	28,151	28,151

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

Consolidated Income Statements (in thousands, except share and per share data)	2011							
	Three Months Ended November 30, 2010				Six Months Ended November 30, 2010			
	As	Impact	Impact	As	As	Impact	Impact	As
	Previously Reported	of Commission Adjustments	of Revenue Adjustments		Previously Reported	of Commission Adjustments	of Revenue Adjustments	
Revenues from subscription	\$ 15,565	\$	\$ 39	\$ 15,604	\$ 30,460	\$	\$ 38	\$ 30,498
Revenues from license	\$ 4,732	\$	\$ 82	\$ 4,814	\$ 9,182	\$	\$ 82	\$ 9,264
Revenues from professional services	\$ 8,265	\$	\$ 509	\$ 8,774	\$ 15,734	\$	\$ 889	\$ 16,623
Cost of professional services	\$ 5,532	\$	\$ 435	\$ 5,967	\$ 10,958	\$	\$ 730	\$ 11,688
Sales and marketing	\$ 11,200	\$ (148)	\$	\$ 11,052	\$ 21,070	\$ (171)	\$	\$ 20,899
Income (loss) from operations	\$ (1,031)	\$ 148	\$ 195	\$ (688)	\$ (2,444)	\$ 171	\$ 279	\$ (1,995)
Net income (loss)	\$ (1,139)	\$ 148	\$ 195	\$ (796)	\$ (2,944)	\$ 171	\$ 279	\$ (2,495)
Basic net income (loss) per share	\$ (0.04)	\$ 0.01	\$ 0.01	\$ (0.03)	\$ (0.10)	\$ 0.01	\$ 0.01	\$ (0.09)
Diluted net income (loss) per share	\$ (0.04)	\$ 0.01	\$ 0.01	\$ (0.03)	\$ (0.10)	\$ 0.01	\$ 0.01	\$ (0.09)
Shares used in computing basic net income (loss) per share	28,197	28,197	28,197	28,197	28,197	28,197	28,197	28,197
Shares used in computing diluted net income (loss) per share	28,197	28,197	28,197	28,197	28,197	28,197	28,197	28,197

Consolidated Income Statements (in thousands, except share and per share data)	2011							
	Three Months Ended February 28, 2011				Nine Months Ended February 28, 2011			
	Computed under Prior Method	Impact of Commission Adjustments	Impact of Revenue Adjustments	As Reported	Computed under Prior Method	Impact of Commission Adjustments	Impact of Revenue Adjustments	As Reported
Revenues from subscription	\$ 16,712	\$	\$ 27	\$ 16,739	\$ 47,173	\$	\$ 64	\$ 47,237
Revenues from license	\$ 4,991	\$	\$ 3	\$ 4,994	\$ 14,173	\$	\$ 85	\$ 14,258
Revenues from professional services	\$ 7,539	\$	\$ 1,073	\$ 8,612	\$ 23,273	\$	\$ 1,962	\$ 25,235
Cost of professional services	\$ 6,007	\$	\$ 420	\$ 6,427	\$ 16,965	\$	\$ 1,150	\$ 18,115
Sales and marketing	\$ 10,351	\$ (318)	\$	\$ 10,033	\$ 31,421	\$ (489)	\$	\$ 30,932
Income (loss) from operations	\$ (691)	\$ 318	\$ 683	\$ 310	\$ (3,134)	\$ 489	\$ 961	\$ (1,684)
Net income (loss)	\$ (1,010)	\$ 318	\$ 683	\$ (9)	\$ (3,953)	\$ 489	\$ 961	\$ (2,503)
Basic net income (loss) per share	\$ (0.04)	\$ 0.01	\$ 0.03	\$ (0.00)	\$ (0.14)	\$ 0.02	\$ 0.03	\$ (0.09)
Diluted net income (loss) per share	\$ (0.04)	\$ 0.01	\$ 0.03	\$ (0.00)	\$ (0.14)	\$ 0.02	\$ 0.03	\$ (0.09)
Shares used in computing basic net income (loss) per share	28,260	28,260	28,260	28,260	28,202	28,202	28,202	28,202
	28,260	28,260	28,260	28,260	28,202	28,202	28,202	28,202

Shares used in computing diluted net income
(loss) per share

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

Consolidated Income Statements (in thousands, except share and per share data)	Three Months Ended August 31, 2009			Three Months Ended November 30, 2009			Six Months Ended November 30, 2009		
	Impact of			Impact of			Impact of		
	As	Commission	As	As	Commission	As	As	Commission	As
	Previously Reported	Adjustments	Adjusted	Previously Reported	Adjustments	Adjusted	Previously Reported	Adjustments	Adjusted
Sales and marketing	\$ 6,788	\$ 78	\$ 6,866	\$ 8,526	\$ 46	\$ 8,572	\$ 15,314	\$ 124	\$ 15,438
Income (loss) from operations	\$ 1,259	\$ (78)	\$ 1,181	\$ 552	\$ (46)	\$ 506	\$ 1,811	\$ (124)	\$ 1,687
Net income (loss)	\$ 1,020	\$ (78)	\$ 942	\$ 666	\$ (46)	\$ 620	\$ 1,686	\$ (124)	\$ 1,562
Basic net income (loss) per share	\$ 0.03		\$ 0.03	\$ 0.02		\$ 0.02	\$ 0.06		\$ 0.06
Diluted net income (loss) per share	\$ 0.03		\$ 0.03	\$ 0.02		\$ 0.02	\$ 0.06	\$ (0.01)	\$ 0.05
Shares used in computing basic net income (loss) per share	29,220	29,220	29,220	27,851	27,851	27,851	27,851	27,851	27,851
Shares used in computing diluted net income (loss) per share	29,833	29,833	29,833	28,855	28,855	28,855	28,855	28,855	28,855

Consolidated Income Statements (in thousands, except share and per share data)	Three Months Ended February 28, 2010			Nine Months Ended February 28, 2010		
	Impact of			Impact of		
	As	Commission	As	As	Commission	As
	Previously Reported	Adjustments	Adjusted	Previously Reported	Adjustments	Adjusted
Sales and marketing	\$ 7,733	\$ 1	\$ 7,734	\$ 23,047	\$ 125	\$ 23,172
Income (loss) from operations	\$ 523	\$ (1)	\$ 522	\$ 2,334	\$ (125)	\$ 2,209
Net income (loss)	\$ 430	\$ (1)	\$ 429	\$ 2,116	\$ (125)	\$ 1,991
Basic net income (loss) per share	\$ 0.02		\$ 0.02	\$ 0.07		\$ 0.07
Diluted net income (loss) per share	\$ 0.01		\$ 0.01	\$ 0.07		\$ 0.07
Shares used in computing basic net income (loss) per share	27,922	27,922	27,922	28,336	28,336	28,336
Shares used in computing diluted net income (loss) per share	29,043	29,043	29,043	29,308	29,308	29,308

Consolidated Balance Sheets**(in thousands)**

Computed under Prior Method	February 28, 2011		As Reported	As Previously Reported	May 31, 2010	
	Impact of Commission Adjustments	Impact of Revenue Adjustments			Impact of Commission Adjustments	As Adjusted

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Prepaid expenses and other current assets	\$ 2,827	\$ 455	\$ 23	\$ 3,305	\$ 1,788	\$ 325	\$ 2,113
Other assets	\$ 2,368	\$ 558	\$ (641)	\$ 2,285	\$ 1,722	\$ 199	\$ 1,921
Total assets	\$ 106,704	\$ 1,013	\$ (618)	\$ 107,099	\$ 103,444	\$ 524	\$ 103,968
Deferred revenue, current portion	\$ 40,307	\$	\$ (1,060)	\$ 39,247	\$ 34,435	\$	\$ 34,435
Deferred revenue, less current portion	\$ 3,684	\$	\$ (519)	\$ 3,165	\$ 2,559	\$	\$ 2,559
Accumulated deficit	\$ (210,290)	\$ 1,013	\$ 962	\$ (208,315)	\$ (206,336)	\$ 524	\$ (205,812)

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

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

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.

Liabilities Measured at Fair Value on a Recurring Basis

The liabilities measured at fair value on a recurring basis, excluding accrued interest components, consisted of the following types of instruments (Level 2 inputs are defined above):

	Fair Value Measurements Using Input Types Level 2 (in thousands)
Liabilities:	
Derivative financial instruments	\$ 39
Accrued Expenses	\$ 39

As discussed in note 9, *Derivative Financial Instruments*, to the condensed consolidated financial statements, the Company uses foreign currency contracts to offset its exposure to risks related to business transacted in Indian rupee. The fair value of these derivative instruments are based on pricing models using current market rates. The significant inputs to estimate the fair value include the forward and spot prices for Indian rupee. As a result, the Company classifies its derivative instruments as Level 2 of the fair value hierarchy.

3. Share-Based Compensation

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

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

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

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.

The following assumptions have been used to value the options and awards granted during the three and nine months ended February 28, 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 February 28,		Nine months ended February 28,	
	2011	2010	2011	2010
Stock Options:				
Expected volatility	55%	58%	56%	59%
Risk-free interest rates	1.98%	1.91%	1.90%	1.97%
Expected term (years)	4.84	4.7	5.41	4.3
Expected dividend yield	0%	0%	0%	0%
Employee Stock Purchase Plan:				
Expected volatility	36%	70%	43%	74%
Risk-free interest rates	0.35%	0.34%	0.38%	0.43%
Expected term (years)	0.5	2.0	0.5	2.0
Expected dividend yield	0%	0%	0%	0%

The following table summarizes the stock-based compensation expense for stock options, restricted stock units and the Company's employee stock purchase plan shares that was recorded in the Company's condensed consolidated statements of operations for the three and nine months ended February 28, 2011 and 2010, respectively:

	Three months ended February 28,		Nine months ended February 28,	
	2011	2010	2011	2010
(in thousands)				
Cost of revenues:				
Cost of subscription	\$ 62	\$ 51	\$ 154	\$ 117
Cost of professional services	63	47	163	97
Research and development	138	121	342	274
Sales and marketing	227	98	673	308
General and administrative	328	214	879	471
Share-based compensation expense included in net income (loss)				
	\$ 818	\$ 531	\$ 2,211	\$ 1,267

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

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

	Three months ended February 28,		Nine months ended February 28,	
	2011	2010	2011	2010
(in thousands)				
Stock options	\$ 521	\$ 423	\$ 1,643	\$ 1,057
Restricted stock units	253	87	508	159
Employee stock purchase plan	44	21	60	51
 Total share-based compensation	 \$ 818	 \$ 531	 \$ 2,211	 \$ 1,267

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 February 28, 2011, 97,344 shares of the RSUs vested. In order to satisfy minimum tax withholding obligations that arose on the vesting of restricted stock units, 36,626 shares of common stock pursuant to our restricted stock units were repurchased for an aggregate price of approximately \$243,000.

The weighted average estimated fair value of options granted was \$2.94 and \$2.09 per share for the three months ended February 28, 2011 and 2010, respectively. The weighted average estimated fair value of options granted was \$2.76 and \$1.97 per share for the nine months ended February 28, 2011 and 2010, respectively. The weighted average estimated fair value of RSUs granted was \$5.29 and \$4.22 per share for the three months ended February 28, 2011 and 2010, respectively. The weighted average estimated fair value of RSUs granted was \$6.11 and \$4.08 per share for the nine months ended February 28, 2011 and 2010, respectively.

4. Basic and Diluted Net Income (Loss) Per Share

Basic and diluted net income (loss) per share information for all periods is presented under the requirements of ASC 260-10 *Earnings per Share*. Basic earnings per share have been computed using the weighted-average number of shares of common stock outstanding during the period. Basic earnings 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 income (loss) per share are as follows:

	Three months ended February 28,		Nine months ended February 28,	
	2011	2010	2011	2010
		(As Adjusted)*		(As Adjusted)*
(in thousands, except per share data)				
Net (loss) income	\$ (9)	\$ 429	\$ (2,503)	\$ 1,991
 Weighted-average shares of common stock used in computing basic net income (loss) per share	 28,260	 27,922	 28,202	 28,336
Effect of dilutive employee stock plans		1,121		972
 Weighted-average shares of common stock used in computing diluted net income (loss) per share	 28,260	 29,043	 28,202	 29,308
 Basic net income (loss) per share	 \$ (0.00)	 \$ 0.02	 \$ (0.09)	 \$ 0.07

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

Diluted net income (loss) per share	\$	(0.00)	\$	0.01	\$	(0.09)	\$	0.07
-------------------------------------	----	--------	----	------	----	--------	----	------

Shares subject to anti-dilutive stock options and restricted stock-based awards excluded from calculation ⁽¹⁾	3,039	3,321	3,823	3,470
--	-------	-------	-------	-------

(1) These weighted shares relate to anti-dilutive stock options and restricted stock-based awards as calculated using the treasury stock method (described above) and could be dilutive in the future.

* Certain amounts have been adjusted in prior periods for the retrospective change in accounting principle for sales commission (See Note 2).

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

If Saba had generated net income for the three and nine months ended February 28, 2011, 1.8 million and 1.4 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. For the three and nine months ended February 28, 2010, 1.1 million common equivalent shares and 1.0 million common equivalent shares, respectively, related to employee stock plans were added to the basic weighted-average shares outstanding for purposes of calculating the diluted weighted-average shares outstanding.

Shares used in diluted net income per common share calculations exclude anti-dilutive common equivalent shares, consisting of all stock options and restricted stock units, if they have exercise prices that are higher than the average market price of the Company's common stock during the respective periods, under the treasury method. These anti-dilutive common equivalent shares totaled 3.0 million and 3.3 million shares for the three months ended February 28, 2011 and 2010, respectively. These anti-dilutive common equivalent shares totaled 3.8 million and 3.4 million shares for the nine months ended February 28, 2011 and 2010, respectively. While these common equivalent shares are currently anti-dilutive, they could be dilutive in the future.

5. Comprehensive Income (Loss)

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

	Three months ended February 28,		Nine months ended February 28,	
	2011	2010	2011	2010
		(As		(As
(in thousands)		Adjusted)*		Adjusted)*
Net income (loss)	\$ (9)	\$ 429	\$ (2,503)	\$ 1,991
Foreign currency translation gain (loss)	166	(54)	410	128
Comprehensive income (loss)	\$ 157	\$ 375	\$ (2,093)	\$ 2,119

* Certain amounts have been adjusted for the retrospective change in accounting principle for sales commission (See Note 2).

6. Goodwill and Purchased Intangible Assets

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 five to seven years.

There were no additions to intangible assets during the nine months ended February 28, 2011. The following tables provide a summary of the carrying amounts of purchased intangible assets that continue to be amortized:

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

	February 28, 2011			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
(in thousands)				
Customer relationships	\$ 14,920	\$ (12,567)	\$ 2,353	6.3 Years
Tradenames	820	(820)		5.0 Years
Acquired developed technology	5,890	(5,890)		5.0 Years
 Total	 \$ 21,630	 \$ (19,277)	 \$ 2,353	

	May 31, 2010			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
(in thousands)				
Customer relationships	\$ 14,920	\$ (10,787)	\$ 4,133	6.3 Years
Tradenames	820	(710)	110	5.0 Years
Acquired developed technology	5,890	(5,105)	785	5.0 Years
 Total	 \$ 21,630	 \$ (16,602)	 \$ 5,028	

The total expected future amortization related to acquired intangible assets as of February 28, 2011 is approximately \$0.6 million and \$1.8 million in fiscal years 2011 through 2012, respectively. All intangible assets as of February 28, 2011 are expected to be fully amortized by May 31, 2012.

Goodwill is reviewed annually for impairment (or more frequently if indicators of impairment arise or circumstances otherwise dictate). The Company completed its annual impairment assessment in fiscal 2011 and concluded that goodwill was not impaired. For the nine months ended February 28, 2011, there were no indicators of impairment of goodwill. Intangible assets are reviewed for impairment whenever events indicate that their carrying amount may not be recoverable. For the nine months ended February 28, 2011, there were no indicators of impairment of intangible assets.

7. Lease Obligations

On September 7, 2010, the Company entered into a Third Amendment to Lease with Westport Office Park, LLC (the "Landlord"), which amended the Lease Agreement dated as of March 16, 1999, as amended, between the Company and the Landlord relating to the lease of the office space comprising the Company's 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 Third Amendment to Lease also amended the Lease Agreement so that the base monthly rent payable from June 1, 2013 through May 31, 2014 under the Lease Agreement will be \$162,086 and the monthly rent payable from June 1, 2014 through May 31, 2019 under the Lease Agreement will begin at \$96,768 on June 1, 2014 and thereafter increase annually by approximately \$3,000. The amended lease modification resulted in a reduction of straight-line rent expense, beginning in the second quarter of fiscal 2011, which is reflected on the Company's condensed consolidated statement of operations.

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

8. Debt and Other Obligations

Credit Facility

On November 22, 2010, the Company entered into a credit agreement with Wells Fargo Bank, National Association. The agreement provides for a one year \$10 million line of credit. The agreement also includes a sublimit of up to \$4.0 million for letters of credit.

The agreement includes certain covenants with which the Company must comply during the term of the agreement, including that the Company's minimum cash and cash equivalents balance shall be at all times equal to not less than \$15 million (including that minimum U.S. cash and cash equivalents balance shall be not less than \$10 million), and that at the end of each fiscal quarter net losses after taxes during the four consecutive fiscal quarter period then ended shall be equal to not more than \$4 million. The Company was in compliance with the covenants as of February 28, 2011.

The line of credit is secured by all of the Company's personal property other than its intellectual property. The agreement includes certain negative covenants restricting or limiting the ability of the Company and its subsidiaries to, among other things, incur additional indebtedness, make investments and acquisitions, merge or consolidate with any other entity, and convey, sell, lease, transfer or otherwise dispose of assets. Such restrictions and limitations are subject to usual and customary exceptions contained in credit agreements of this nature.

The agreement also 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 continue to borrow under the credit 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 credit agreement as of February 28, 2011.

9. Derivative Financial Instruments

Foreign Currency Forward Contracts Not Designated as Hedges

Saba transacts business in various foreign currencies and is subject to risks associated with certain foreign currency exposures. In fiscal 2011, Saba started a program that utilizes foreign currency forward contracts to offset these risks so that increases or decreases in foreign currency exposures are offset by gains or losses on the foreign currency forward contracts in order to mitigate the risks and volatility associated with our foreign currency transactions, specifically with the Indian rupee. Saba's currency exposures typically arise from intercompany loans and other intercompany transactions that are expected to be cash-settled in the near term. Saba's ultimate realized gain or loss with respect to 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 Saba has entered into foreign currency forward contracts to offset these exposures and other factors.

Saba neither uses foreign currency forward contracts for trading purposes nor designates these forward contracts as hedging instruments pursuant to ASC 815. Accordingly, the fair values of these contracts are recorded as of the end of the reporting period on the Company's condensed consolidated balance sheet with changes in fair values recorded in the Company's condensed consolidated statement of operations. The balance sheet classification for the fair values of these forward contracts is in accrued expenses for unrealized losses. The statement of operations classification for the fair values of these forward contracts is interest and other expense, net, for both realized and unrealized gains and losses. In the tables below, Saba provides information related to its foreign currency forward contracts where all of the contracts are not designated as hedges.

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

The effects of derivative instruments on the Company's condensed consolidated financial statements are as follows as of and for each of the respective periods presented below (amounts presented exclude any income tax effects):

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Fair Value of Derivative Instruments in Condensed Consolidated Financial Statements**

	February 28, 2011	Fair Value	May 31, 2010	Fair Value
	Balance Sheet Location	(in thousands)	Balance Sheet Location	(in thousands)
Derivatives not designated as hedges:	Accrued expenses	\$ 39	Accrued expenses	

	Location and Amount of Gain (Loss) Recognized in Income on Derivative	
	Three months ended February 28, 2011	Nine months ended February 28, 2011
	(in thousands)	
Derivatives not designated as hedges:		
Foreign currency forward contracts	Interest and other income (expense), net	\$ 59

	Location and Amount of Gain (Loss) Recognized in Income on Derivative	
	Three months ended February 28, 2010	Nine months ended February 28, 2010
	(in thousands)	
Derivatives not designated as hedges:		
Foreign currency forward contracts	Interest and other income (expense), net	\$

10. Guarantees

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

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

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.

11. Income Taxes

Income tax provision for the three months ended February 28, 2011 and 2010 was \$0.1 million and \$44,000, respectively. Income tax provision for the nine months ended February 28, 2011 and 2010 was \$0.6 million and \$0.2 million, respectively. Income tax provision for the three and nine months ended February 28, 2011 consisted primarily of state taxes as well as foreign tax expense incurred as a result of local country profits. Income tax provision for the three and nine months ended February 28, 2010 consisted primarily of U.S. federal minimum

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

tax, state taxes as well as foreign tax expense incurred as a result of local country profits. The increase in provision expense for the three and nine months ended February 28, 2011 compared to the three and nine months ended February 28, 2010 was primarily related to the release of certain tax reserves during the three and nine months ended February 28, 2010.

As of February 28, 2011 and May 31, 2010, 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.

12. Litigation

Litigation Relating to Initial Public Offering of Saba

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York (the District Court) against the Company, certain of its officers and directors, and certain underwriters of the Company's initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased the Company's common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by the Company and its officers and directors of Section 11 of the Securities Act of 1933, as amended (the Securities Act), Section 10(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and other related provisions in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the initial public offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints allege that the prospectus and the registration statement for the initial public offering failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some investors in the initial public offering agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of the Company's stock. The complaints were later consolidated into a single action. The complaint seeks unspecified damages, attorney and expert fees, and other unspecified litigation costs.

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

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

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling,

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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 have been filed.

The Company intends to dispute these claims and defend the lawsuit vigorously. However, due to the inherent uncertainties of litigation and because the settlement 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 re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, is purportedly brought on behalf of the class of persons who purchased Centra's common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act and Sections 10(b) and 20(a) of the Exchange Act. The complaint alleges that, in connection with Centra's initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the aftermarket at pre-determined prices. The complaint asserts that Centra's registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92.

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

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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 have been filed.

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 settlement 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, 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

Table of Contents

SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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. The Company believes that it is free from liability for actions prior to April 28, 2009, as the Company believes 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, plaintiff filed a motion to lift the stay on the court proceedings. 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.

Litigation Relating to Claim of Patent Infringement by Saba

On November 19, 2007, a complaint was filed against the Company and ten other defendants by Gemini IP, LLC ("Gemini"), in the United States District Court for the Eastern District of Texas (No. 07-CV-521) (the "Texas District Court"). The complaint alleges infringement of a patent directed to a method for processing client help requests using a computer network and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. The Company filed an answer to the complaint denying all of the allegations. At the Company's request, the Patent Office instituted reexamination proceedings against the asserted patent and the Texas District Court stayed the action pending the outcome of those proceedings. On September 14, 2010, the Patent Office issued a Reexamination Certificate cancelling all of the patent's original claims that were asserted against the Company in the litigation. The Reexamination Certificate also includes several new claims that were added during the reexamination proceeding. On November 3, 2010, Gemini filed an amended complaint asserting the Company has infringed the patent, as amended by the Reexamination Certificate, and also adding a number of additional defendants to the suit. The Company believes that it has meritorious defenses with respect to the asserted patent 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.

13. 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 2012 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.

As previously discussed in note 2 to the condensed consolidated financial statements, the Company adopted ASU 2009-13, which amends the revenue recognition for certain multiple element revenue arrangements.

In October 2009, the FASB issued Accounting Standards Update 2009-14, *Revenue Recognition (Topic 605) Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements* (ASU

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

2009-14). ASU 2009-14 excludes tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of ASC 985-605, *Software-Revenue Recognition*. Although ASU 2009-14 is not required to be adopted by the Company until June 1, 2011 (the beginning of the Company's fiscal year 2012), the Company elected to early adopt this accounting guidance retrospectively to the beginning of its first quarter of fiscal 2011 for transactions entered into or materially modified after May 31, 2010. The adoption of ASU 2009-14 did not have an impact on the Company's condensed consolidated financial statements.

14. Related Party Transactions

During the three and nine months ended February 28, 2011 and 2010, Saba licensed software and sold related support and services to Varian Medical Systems, Inc. An Executive Vice President of Varian serves as director on Saba's Board of Directors.

During the three and nine months ended February 28, 2011 and 2010, the components of the related party transaction were as follows:

(in thousands)	Sales to Related Party Three months ended February 28,		Sales to Related Party Nine months ended February 28,	
	2011	2010	2011	2010
Varian Medical Systems, Inc.	\$ 59	\$ 56	\$ 171	\$ 112
Total	\$ 59	\$ 56	\$ 171	\$ 112

(in thousands)	Accounts Receivable February 28, May 31,	
	2011	2010
Varian Medical Systems, Inc.	\$ 51	\$ 52
Total	\$ 51	\$ 52

Table of Contents

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 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,

expected future amortization related to intangible assets, and

our ultimate realized gain or loss with respect to currency fluctuations.

(ii) in Part I, Item 2,

our belief that subscription revenue will grow in future periods,

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

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,

our plan to expand our sales coverage and marketing support, and

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 Suite, as well as related services will constitute substantially all of our revenue for the foreseeable future,

Table of Contents

our belief that the shift of customer preferences from software licenses to subscription services, including software as a service (SaaS) transactions, will continue in future periods,

the likelihood significant fluctuations in our operating results,

our plan to expand sales coverage and marketing support,

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

our intention to continue to expand our international presence,

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

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

periodically acquiring complementary businesses or technologies, and

regularly releasing new products and new versions of existing products.

These forward-looking statements involve known and unknown risks and uncertainties. Our actual results may differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are among others:

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

incorrect estimates or assumptions,

unanticipated adverse results for pending litigation,

contraction of the economy and world markets,

lack of demand for information technologies from our customers,

unanticipated need for capital for operations,

lack of demand for our products,

inability to introduce new products,

unanticipated difficulties relating to our products,

unanticipated decrease in demand for our products and services,

unanticipated changes in domestic and foreign tax regulations,

unanticipated adverse changes in the international markets,

requirements for increased spending in research and development,

lack of demand for our products,

negative effects of foreign exchange rates,

inability to accurately predict the impact of new accounting pronouncements,

unanticipated difficulties integrating and developing products acquired through acquisitions, and

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

OVERVIEW

General

We are the premier provider of a new class of people systems that combine people learning, people performance and people collaboration solutions. Our people systems enable organizations 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. Our solutions are delivered both on-premise and as SaaS in an internet-based cloud architecture, and are underpinned by global services capabilities encompassing strategic consulting, comprehensive implementation and education services and worldwide support.

The Saba People System is transformative in nature, catalyzing dramatic change in how work gets done while fostering a people-driven culture. The Saba People System enables organizations to realize unique benefits, including the following:

MOBILIZE quickly identify and communicate new strategies or challenges and engage the right people to address them:

Rapidly form and re-form teams

Identify and build expertise and new processes

Table of Contents

Continuously develop and re-skill people

Motivate and engage people by keeping them constantly connected and aware of new initiatives

ACCELERATE align and connect people to accelerate the flow of business:

Incent and reward people and teams around the right goals, ensuring that everyone is always aligned

Speed the flow of information to any person, anytime, anyplace, via multiple devices

Collect and disseminate continuous, real-time people feedback from across the organization

CULTIVATE ignite, cultivate and capture the collective people knowhow:

Enable individuals and teams to create, track, distribute, consume, and rate knowhow

Harness ideas and expertise from the extended value chain

Institutionalize organizational wisdom and make it discoverable by anyone, anytime, anywhere on multiple devices

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 People Learning products and began to generate revenues from software license fees, implementation and consulting services fees and support fees in April 1998.

Our corporate headquarters are located in Redwood Shores, California. We have an international presence in Australia, Canada, France, Germany, India, Japan 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, software licenses and professional services.

Subscription Services

Subscription revenue includes revenue from our products delivered as SaaS in internet-based cloud architecture 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 cloud-based offerings also include arrangements with customers that have separately licensed and taken possession of our software. Our subscription revenue depends upon both incremental sales of subscription services to both new and existing customers and renewals of existing agreements.

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

We believe that subscription revenue will grow in future periods as we anticipate that a substantial majority of our customers will renew their subscription agreements and we will continue to add new subscription customers. In addition, we expect the trend of customers moving toward purchasing software as service subscription offerings and away from purchasing software licenses to continue in future periods.

The trend toward increased customer adoption of SaaS transactions from license of our software solutions will have an impact on our revenues and results of operation. We recognize revenue 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, provided all other revenue

Table of Contents

recognition criteria are met for both types of arrangements. Over the longer term, assuming this trend continues, we expect that the increased adoption of SaaS 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 the results of operations of the Company.

Software Licenses

We license our software solutions in multiple-element arrangements that include 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 long, typically six to twelve months. The timing of a few large software license transactions can substantially affect our quarterly license revenue.

Professional Services

We offer comprehensive services to assist our clients in the successful implementation of our solutions and to optimize our clients' use of our solutions. Consisting primarily of consulting and education services, these offerings 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 license revenue and subscription services revenue generated from our direct sales organization in the preceding three to nine month period. In addition, our consulting and education services revenue varies following our commercial release of significant software updates as our license customers may engage our services to assist with the implementation of their software update. We provide consulting services on a time-and-materials basis and on a fixed-fee basis.

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 third party hosting service 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 comprised of the ratable amortization of technological assets acquired in an acquisition in 2006, is also included in the cost of revenue. Many factors affect our cost of revenue, including changes in the mix of products and services, pricing trends and changes in the amount of reimbursed expenses. Because cost as a percentage of revenues is higher for services than for software licenses, an increase in services, including subscription services, as a percentage of our total revenue would reduce gross profit as a percentage of total revenue.

We classify deferred revenue and deferred costs on our condensed consolidated balance sheet as current if we expect to recognize such revenue or cost within the following twelve months. As of February 28, 2011, the deferred balance of the professional services revenue related to such subscription offerings and the related deferred costs was \$1.7 million and \$0.9 million, respectively, related to contracts that were entered into prior to adoption of ASU 2009-13 and 2009-14. Deferred revenue and deferred costs related to contracts that were entered into prior to June 1, 2010 continue to be recognized and amortized ratably over the subscription period provided that such contracts were not subsequently 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

Table of Contents

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.

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 assumptions 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 allowance for doubtful accounts, the assessment of recoverability of goodwill and purchased intangible assets and share-based compensation. We have reviewed the critical accounting policies described in the following paragraphs with the Audit Committee of our Board of Directors.

Revenue recognition. In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13, Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (A Consensus of the FASB Emerging Issues Task Force) (ASU 2009-13) which amends the revenue recognition for certain multiple element revenue arrangements to:

provide updated guidance on whether multiple elements exist, how the elements in an arrangement should be separated, and how the arrangement consideration should be allocated to the separate elements;

require an entity to allocate arrangement consideration to each element based on a selling price hierarchy, where the selling price for an element is based on vendor-specific objective evidence (VSOE), if available; third-party evidence (TPE), if available and VSOE is not available; or the best estimate of selling price (BESP), if neither VSOE nor TPE is available; and

eliminate the use of the residual method and require an entity to allocate arrangement consideration using the selling price hierarchy. Although the amended standards were not required to be adopted by Saba until June 1, 2011 (the beginning of our fiscal year 2012), the Company elected to early adopt this accounting guidance retrospectively to the beginning of its first quarter of fiscal 2011 for transactions entered into or materially modified after May 31, 2010.

We generate revenues from the sale of software licenses, subscription services and professional services and recognize revenues when all of the following conditions are met:

persuasive evidence of an arrangement exists;

delivery has occurred;

the fee is fixed or determinable; and

collection is probable.

Software License Arrangements

Table of Contents

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

We recognize revenue earned on perpetual software license arrangements in accordance with ASC 985-605. When software arrangements involve multiple elements we recognize license revenue using the residual method in accordance with ASC 985-605. Under the residual method, revenue is allocated to undelivered elements based on VSOE of fair value of such undelivered elements and the residual amounts of revenue are allocated to delivered elements. We have analyzed each element in our multiple element arrangements and determined that we have sufficient vendor VSOE to allocate revenues to certain subscription offerings and professional services that are sold together with its software arrangements. Accordingly, assuming all other revenue recognition criteria are met, revenues from perpetual licenses are recognized upon delivery using the residual method. We limit our assessment of VSOE for each element to 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 revenue from licenses with a term of three years or more is generally recognized on delivery if the other conditions of ASC 985-605 are satisfied. License revenue from licenses with a term of less than three years is 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, we allocate 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 license of similar products. We do not grant our resellers the right of return and we do not recognize revenue from resellers until an end-user has been identified and the other conditions of ASC 985-605 are satisfied.

Subscription Services Arrangements

Subscription services arrangements generally include a combination of our products delivered as SaaS in an internet-based cloud architecture, product updates and support related to licenses and professional services.

Revenue from cloud-based offerings that are integrated offerings pursuant to which the customers' ability to access the our software is not separable from the services necessary to operate the software and customers are not allowed to take possession of our software are recognized ratably over the term of the arrangement as delivered or on an as-used basis if defined in the contract. We do not grant our resellers the right of return and do not recognize revenue from resellers until an end-user has been identified and the other conditions of ASC 985-605 are satisfied.

When subscription services arrangements involve multiple elements that qualify as separate units of accounting, we allocate 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) VSOE if available; (ii) TPE if VSOE is not available; and (iii) BESP if neither VSOE nor TPE is available.

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

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

Table of Contents

BESP. When it is unable to establish a selling price using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the service were sold on a stand-alone basis. We determine 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.

We have not historically priced our 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, we use BESP in order to allocate the selling price to cloud-based deliverables. In general, we use 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 our software. When these offerings are part of a multiple element arrangement involving licenses, we recognize revenue in accordance with ASC 985-605.

Professional Services

Professional service revenue is generally recognized as the services are performed. Although, we generally provide professional services on a time-and-materials basis, a portion of these services is provided on a fixed-fee basis. For services performed on a fixed-fee basis, revenue is 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 over the service delivery period using the percentage-of-completion method or, if we are unable to reliably estimate the costs to complete the services, we use the completed contract method of accounting in accordance with ASC 985-605 and relevant guidance of ASC 605-35 *Construction-Type and Certain Production Type Contracts*. A contract is considered complete when all significant costs have been incurred and the item has been accepted by the customer.

If the requirements of ASC 985-605 are not met when we bill a customer or a customer pays us, the billed or paid amount is recorded as deferred revenue, a liability account. As the revenue recognition criteria of ASC 985-605 are satisfied, the requisite amounts are recognized as revenue.

We classify deferred revenue and deferred costs on our condensed consolidated balance sheet as current if we expect 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 in prior to adoptions of ASU 2009-13, we allocate 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. Our judgment as to whether the professional services qualify as a separate unit of accounting may materially affect the timing of our revenue recognition and our results of operations.

Changes in Accounting Principle

In the third quarter of fiscal 2011, we voluntarily changed our accounting policy for sales commissions related to non-cancellable annual or multi-year SaaS contracts from recording an expense when incurred, to deferral and amortization of the sales commissions in proportion to the revenue recognized over the non-cancellable term of the contract. We believe this method is preferable because the commission charges are so closely related to the revenue from the non-cancelable contracts that they should be deferred and charged to expense over the same period that the related revenue is recognized. Furthermore, the adoption of this accounting policy enhances the comparability of our consolidated financial statements by changing to the predominant method utilized in our industry. Deferred commission amounts are recoverable through the future revenue streams under the non-cancellable arrangements. Short-term deferred commissions are included in prepaid expenses and other current assets, while long-term deferred commissions are included in other assets in the accompanying consolidated balance sheets. The amortization of deferred commissions is included in sales and marketing expense in the accompanying consolidated statements of operations.

Table of Contents

Allowance for doubtful accounts. Accounts receivable are recorded net of allowance for doubtful accounts and totaled \$27.9 million as of February 28, 2011. The allowance for doubtful accounts, which totaled \$0.2 million as of February 28, 2011, is based on our assessment of the amount of probable credit losses in the existing accounts receivable. We determine the allowance based on the aging of the accounts receivable, the financial condition of our customers and their payment history, our historical write-off experience and other assumptions. Past due balances based on order terms and other specific accounts as necessary are reviewed monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than our historical experience, we may be required to increase the allowance for doubtful accounts.

Recoverability of goodwill and purchased intangible assets. We account for goodwill under ASC 350-20 *Goodwill*. Our goodwill balance at February 28, 2011 was \$36.1 million. We account for purchased intangible assets under ASC 350-30, *Intangibles - Goodwill and Other*. Our purchased intangible assets balance at February 28, 2011 was \$2.4 million, net of accumulated amortization. The total expected future amortization related to purchased intangible assets will be approximately \$0.6 million and \$1.8 million in fiscal years 2011 and 2012, respectively.

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.

In accordance with ASC 350-30 and ASC 360-10 *Property, Plant and Equipment*, we review our long-lived asset groups, including property and equipment and other intangibles, for impairment whenever events indicate that their carrying amount may not be recoverable.

Share-based compensation. Under ASC 718-10, *Compensation - Stock Compensation*, we are required to estimate the awards that we ultimately expect to vest and to 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, actual forfeitures in the future may differ from estimates. Under ASC 718-10, the forfeiture rate must be revised if actual forfeitures differ from our original estimates. We recognize share-based compensation expense for awards granted after our adoption date 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 option 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. For restricted stock units, stock compensation is calculated based on the fair market value of the stock on the award date.

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

Table of Contents

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. We will adopt ASU 2010-28 in fiscal 2012 and any impairment to be recorded upon adoption will be recognized as an adjustment to our beginning retained earnings. We are currently evaluating the impact of the pending adoption of ASU 2010-28 on our condensed consolidated financial statements.

As previously discussed, we adopted ASU 2009-13, which amends the revenue recognition for certain multiple element revenue arrangements. In a subsequent filing with the SEC, we expect to restate and adjust our prior financial statements as presented in our Annual Report on Form 10-K for the fiscal year ended May 31, 2010 filed with the Securities and Exchange Commission August 12, 2010 in order to conform to the basis of presentation for this year after giving effect to the retrospective application of the voluntary change in accounting principle for sales commissions related to non-cancellable annual or multi-year SaaS contracts for all periods presented.

In October 2009, the FASB issued Accounting Standards Update 2009-14, *Revenue Recognition (Topic 605) Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements* (ASU 2009-14). ASU 2009-14 excludes tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of ASC 985-605, *Software-Revenue Recognition*. Although ASU 2009-14 is not required to be adopted by Saba until June 1, 2011 (the beginning of our fiscal year 2012), we elected to early adopt this accounting guidance retrospectively to the beginning of its first quarter of fiscal 2011 for transactions entered into or materially modified after May 31, 2010. The adoption of ASU 2009-14 did not have an impact on our condensed consolidated financial statements.

Table of Contents**RESULTS OF OPERATIONS****THREE AND NINE MONTHS ENDED FEBRUARY 28, 2011 AND 2010****Revenues**

(dollars in thousands)	2011	Three months ended February 28, Percent of Total Revenues	2010	Percent of Total Revenues
Revenues:				
Subscription	\$ 16,739	55%	\$ 14,333	54%
License	4,994	17%	5,515	20%
Professional services	8,612	28%	6,812	26%
Total revenues	\$ 30,345	100%	\$ 26,660	100%

(dollars in thousands)	2011	Nine month ended February 28, Percent of Total Revenues	2010	Percent of Total Revenues
Revenues:				
Subscription	\$ 47,237	55%	\$ 42,445	53%
License	14,258	16%	17,579	22%
Professional services	25,235	29%	19,929	25%
Total revenues	\$ 86,730	100%	\$ 79,953	100%

Total Revenues. Total revenues increased by \$3.7 million, or 14%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. Total revenues increased by \$6.8 million, or 8%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. As a percentage of total revenues, revenues from customers outside the United States represented 38% and 35% for the three months ended February 28, 2011 and 2010, respectively. As a percentage of total revenues, revenues from customers outside the United States represented 35% and 31% for the nine months ended February 28, 2011 and 2010, respectively. The only foreign country in which revenues represented more than 10% of total revenues was the United Kingdom, which represented 15% for the three and nine months ended February 28, 2011 and 2010.

Subscription Revenue. Subscription revenue increased by \$2.4 million, or 17%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. Subscription revenue increased by \$4.8 million, or 11%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The increases reflect an increase of subscription revenue from new customers as well as an increase in subscription revenue associated with subscription renewals.

License Revenue. License revenue decreased by \$0.5 million, or 9%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. License revenue decreased by \$3.3 million, or 19%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The decreases in license revenue reflect our customers' growing preference to use our cloud-based subscription services rather than to purchase perpetual licenses.

Professional Services Revenue. Professional services revenue increased by \$1.8 million, or 26%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. Professional services revenue increased by \$5.3 million, or 27%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The increases were primarily due to an increased demand for our professional

Table of Contents

services from our expanded customer base. In addition, for the three and nine months ended February 28, 2011, \$1.1 million and \$2.0 million of the revenue increase, respectively, are due to the impact of adopting the new accounting standard for multiple-element revenue arrangements.

Cost of Revenues

(dollars in thousands)	Three months ended February 28,			
	2011	Percent of Total Revenues	2010	Percent of Total Revenues
Cost of revenues				
Cost of subscription	\$4,074	13%	\$4,103	16%
Cost of license	292	1%	163	1%
Cost of professional services	6,427	21%	5,070	19%
Amortization of acquired developed technology	196	1%	295	1%
Total cost of revenues	\$10,989	36%	\$9,631	37%

(dollars in thousands)	Nine month ended February 28,			
	2011	Percent of Total Revenues	2010	Percent of Total Revenues
Cost of revenues				
Cost of subscription	\$11,885	14%	\$12,266	15%
Cost of license	725	1%	597	1%
Cost of professional services	18,115	21%	14,420	18%
Amortization of acquired developed technology	785	1%	884	1%
Total cost of revenues	\$31,510	37%	\$28,167	35%

Table of Contents

The following table is a summary of gross margin:

(dollars in thousands)	Three months ended February 28,	
	2011	2010
Gross margin:		
Subscription	\$ 12,665	\$ 10,230
<i>Percentage of subscription revenue</i>	<i>76%</i>	<i>71%</i>
License (including amortization of acquired developed technology)	4,506	5,057
<i>Percentage of license revenue</i>	<i>90%</i>	<i>92%</i>
Professional services	2,185	1,742
<i>Percentage of professional services revenue</i>	<i>25%</i>	<i>26%</i>
<i>Total</i>	<i>\$ 19,356</i>	<i>\$ 17,029</i>
<i>Percentage of total revenues</i>	<i>64%</i>	<i>64%</i>

(dollars in thousands)	Nine month ended February 28,	
	2011	2010
Gross margin:		
Subscription	\$ 35,352	\$ 30,179
<i>Percentage of subscription revenue</i>	<i>75%</i>	<i>71%</i>
License (including amortization of acquired developed technology)	12,748	16,098
<i>Percentage of license revenue</i>	<i>89%</i>	<i>92%</i>
Professional services	7,120	5,509
<i>Percentage of professional services revenue</i>	<i>28%</i>	<i>28%</i>
<i>Total</i>	<i>\$ 55,220</i>	<i>\$ 51,786</i>
<i>Percentage of total revenues</i>	<i>64%</i>	<i>65%</i>

Cost of Subscription Revenue. Cost of subscription revenue decreased slightly, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. The subscription gross margin increased to 76% for the three months ended February 28, 2011 from 71% for the three months ended February 28, 2010. The increase in subscription gross margin is the result of higher revenue. Cost of subscription revenue decreased by \$0.4 million, or 3%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The decrease was primarily the result of a decrease in third party hosting service fees and license product costs. The subscription gross margin increased to 75% for the nine months ended February 28, 2011 from 71% for the nine months ended February 28, 2010. The increase in subscription gross margin is primarily the result of higher revenue and the decrease in the cost of subscription revenue.

Cost of License Revenue. Cost of license revenue increased \$0.1 million or 79%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010, due to an increase in royalty expense. Gross margin on license revenue decreased to 90% for the three months ended February 28, 2011 from 92% for the three months ended February 28, 2010. The decrease in gross margin is primarily the result of a decrease in license revenue and an increase in royalty expense. Cost of license revenue increased \$0.1 million, or 21% for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010 due to an increase in royalty expense. Gross margin on license revenue decreased to 89% for the nine months ended February 28, 2011 from 92% for the nine months ended February 28, 2010. The decrease in gross margin is primarily the result of a decrease in license revenue and an increase in royalty expense.

Cost of Professional Services Revenue. For the three months ended February 28, 2011, cost of professional services revenue increased \$1.4 million, or 27%, compared to the three months ended February 28, 2010. The increase in cost of professional services revenue was primarily the result of an increase in compensation costs,

Table of Contents

(including \$0.4 million related to the adoption of ASU 2009-13, the new accounting standard for multiple-element revenue arrangements), third party billable labor and employee travel related expenses. The professional services gross margin decreased slightly to 25% for the three months ended February 28, 2011, from 26% for the three months ended February 28, 2010. For the nine months ended February 28, 2011, cost of professional services revenue increased \$3.7 million, or 26%, compared to the nine months ended February 28, 2010. The increase in cost of professional services revenue was primarily the result of an increase in compensation costs (including \$1.2 million related to the adoption of ASU 2009-13, the new accounting standard for multiple-element revenue arrangements), third party billable labor and billable travel related expenses. The professional services gross margin remained flat at 28% for the nine months ended February 28, 2011, and 2010.

Operating Expenses

	Three months ended February 28,		Percent	
	Percent		of	
	Total		Total	
	Revenue		Revenue	
	2011		2010	
(dollars in thousands)	(Adjusted)*		(Adjusted)*	
Operating expenses:				
Research and development	\$4,530	15%	\$4,609	17%
Sales and marketing	10,033	33%	7,734	29%
General and administrative	3,862	13%	3,530	13%
Restructuring		0%		0%
Amortization of purchased intangible assets	621	2%	634	2%
Total operating expenses	\$19,046	63%	\$16,507	61%

	Nine months ended February 28,		Percent	
	Percent		of	
	Total		Total	
	Revenue		Revenue	
	2011		2010	
(dollars in thousands)	(Adjusted)*		(Adjusted)*	
Operating expenses:				
Research and development	\$13,388	15%	\$13,555	17%
Sales and marketing	30,932	37%	23,172	29%
General and administrative	10,693	12%	10,985	14%
Restructuring		0%	(38)	0%
Amortization of purchased intangible assets	1,891	2%	1,903	2%
Total operating expenses	\$56,904	66%	\$49,577	62%

* Certain amounts have been adjusted for the retrospective change in accounting principle for sales commission (See Note 2). *Research and development.* Research and development expenses decreased by \$0.1 million, or 2%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. The decrease was primarily attributable to decreases in outside third party consulting of \$0.1 million. Research and development expenses decreased by \$0.2 million, or 1%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The decrease was primarily attributable to a decrease in outside third party consulting fees of \$0.4 million, partially offset by increases in professional service charges of \$0.2 million.

Table of Contents

Sales and marketing. Sales and marketing expenses increased by \$2.3 million, or 30%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. The increase was primarily attributable to increases in compensation costs primarily related to increased headcount of \$1.8 million which was reduced by \$0.3 million related to the new accounting policy for sales commissions on SaaS transactions. The \$1.8 million increase was related primarily to increased headcount, marketing related expenses of \$0.4 million and employee travel related expenses of \$0.2 million. Sales and marketing expenses increased by \$7.8 million, or 34%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The increase was primarily attributable to increases in compensation costs primarily related to increased headcount of \$5.2 million (which was reduced \$0.5 million due to the new accounting policy for sales commissions on SaaS transactions), marketing related expenses of \$1.6 million, employee travel related expenses of \$0.8 million and recruiting expenses of \$0.3 million. These increases are in line with our plan to expand our sales coverage and marketing support to align with key growth initiatives.

General and administrative. General and administrative expenses increased by \$0.3 million, or 9%, for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. The increase was primarily due to accounting and tax fees of \$0.3 million related to the changes in the accounting policy for sales commissions and the early adoption of FASB ASU 2009-13 for multiple-element revenue arrangements. General and administrative expenses decreased by \$0.3 million, or 3%, for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The decrease was primarily due to decreases in legal fees of \$0.3 million.

Amortization of purchased intangible assets. Amortization of purchased intangible assets decreased slightly due to certain components that were fully amortized for the three and nine months ended February 28, 2011, compared to the three and nine months ended February 28, 2010.

Restructuring. We did not incur restructuring expenses for the three and nine months of fiscal year ended February 28, 2011. For the three and nine months ended February 28, 2010, we adjusted prior period charges for a workforce reduction, consisting of severance and fringe benefits. The restructuring charges are classified as restructuring in our condensed consolidated statement of operations and totaled a reduction of approximately \$38,000 for the nine months ended February 28, 2010.

Other Income and Expenses, Net

Interest income and other, net. Interest income and other, net consists of interest income and other non-operating expenses. Interest income and other, net increased by \$0.1 million for the three months ended February 28, 2011 compared to the three months ended February 28, 2010. The increase was attributable to a \$0.1 million net increase in foreign currency unrealized gains related to currency fluctuations in both the euro and British pound. Interest income and other, net increased by \$0.3 million for the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. The increase was attributable to a \$0.3 million net increase in foreign currency unrealized losses related primarily to currency fluctuation in both euro and British pounds.

Provision for income taxes Income tax provision for the three months ended February 28, 2011 and 2010 was \$0.1 million and \$44,000, respectively. Income tax provision for the nine months ended February 28, 2011 and 2010 was \$0.6 million and \$0.2 million, respectively. Income tax provision for the three and nine months ended February 28, 2011 consisted primarily of state taxes as well as foreign tax expense incurred as a result of local country profits. Income tax provision for the three and nine months ended February 28, 2010 consisted primarily of U.S. federal minimum tax, state taxes as well as foreign tax expense incurred as a result of local country profits. The increase in provision expense for the three and nine months ended February 28, 2011 compared to the three and nine months ended February 28, 2010 was primarily related to the release of certain tax reserves during the three and nine months ended February 28, 2010.

As of February 28, 2011 and May 31, 2010, 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.

Table of Contents**DEFERRED REVENUES**

Deferred revenues consisted of the following:

(in thousands)	February 28, 2011	May 31, 2010	February 28, 2010
Subscription	\$ 38,486	\$ 32,985	\$ 31,497
Professional services	3,575	3,610	3,867
Software licenses	351	399	608
Total deferred revenues	\$ 42,412	\$ 36,994	\$ 35,972
Deferred revenues, current	\$ 39,247	\$ 34,435	\$ 33,234
Deferred revenues, non-current	3,165	2,559	2,738
Total deferred revenues	\$ 42,412	\$ 36,994	\$ 35,972

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. We have disproportionately lower levels of subscription renewal billings in such quarters.

COMMISSIONS

In the third quarter of fiscal 2011, we voluntarily changed our accounting policy for sales commissions related to non-cancellable annual or multi-year SaaS contracts from expensing sales commissions as incurred to capitalizing sales commissions associated with deferred revenue and amortizing commissions over the term of the related non-cancellable annual or multi-year arrangements. We believe this method is preferable because the commission charges are so closely related to the revenue from the non-cancelable contracts that they should be deferred and charged to expense over the same period that the related revenue is recognized. Further, the adoption of this accounting policy enhances the comparability of our consolidated financial statements by changing to the predominant method utilized in our industry. Deferred commission amounts are recoverable through the future revenue streams under the non-cancellable arrangements. Short-term deferred commissions are included in prepaid expenses and other current assets, while long-term deferred commissions are included in other assets in the accompanying consolidated balance sheets. The amortization of deferred commissions is included in sales and marketing expense in the accompanying consolidated statements of operations.

Table of Contents**KEY OPERATING METRICS*****Bookings***

With the increasing adoption of our SaaS offerings, we believe that bookings, which are total revenues plus the change in deferred revenue, are a key operating metric. The prevailing trend among SaaS companies is to provide bookings information. For the quarter ended February 28, 2011, bookings were \$35.8 million, or an increase of 13% compared to \$31.8 million for the quarter ended February 28, 2010. We also track our renewal rate on subscription services on a dollar basis, which for the three months ended February 28, 2011 was 86% compared to 92% for the three months ended February 28, 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, if a customer elects to purchase subscription services rather than a software license, that transaction can lead to lower revenue recognition in the quarter in which the transaction occurs. We have recently seen a shift in customer preferences toward subscription services rather than software licenses, due to increased adoption of SaaS. This trend towards increased customer adoption of the SaaS transaction 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 SaaS transactions 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 SaaS 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 the results of operation of the Company.

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)	Nine month ended February 28,	
	2011	2010
Net cash provided by operating activities	\$ 1,573	\$ 4,535
Net cash used in investing activities	\$ (1,087)	\$ (653)
Net cash used in financing activities	\$ (1,416)	\$ (4,993)

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. Our primary uses of cash from operating activities are for personnel and facilities related expenditures. As of February

Table of Contents

28, 2011, we had \$32.0 million in available cash and cash equivalents.

Net Cash Provided By Operating Activities

Net cash provided by operating activities for the nine months ended February 28, 2011 decreased by \$3.0 million to \$1.5 million from \$4.5 million for the nine months ended February 28, 2010. The \$3.0 million decrease was primarily attributable to decreased cash flow due to reduction of compensation and other accruals of \$2.0 million due to the timing of year-end bonus payments. In addition, the reduction in cash flow is due to a \$4.5 million increase in net loss for the nine months ended February 28, 2011, a reduction in prepaids of \$1.2 million, in other assets of \$0.4 million, in accounts payable of \$0.1 million, accrued rent of \$0.4 million and restricted cash of \$0.1 million offset by an increase of \$3.6 million in deferred revenue and in accounts receivable of \$1.0 million.

Total accounts receivable billing days outstanding (BDO) was 69 days at February 28, 2011 and 68 days at May 31, 2010. The increase in BDO is due to lower collections in the nine months ended February 28, 2011 compared to the nine months ended February 28, 2010. 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 76 days at February 28, 2011 and 75 days at May 31, 2010. 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 \$1.1 million for the nine months ended February 28, 2011 compared to net cash used in investing activities of \$0.7 million for the nine months ended February 28, 2010. The net cash used in investing activities was wholly attributable to the purchases of property and equipment, primarily to enhance our infrastructure necessary to deliver our cloud-based offerings.

Net Cash Used In Financing Activities

Net cash used in financing activities of \$1.4 million for the nine months ended February 28, 2011 was primarily attributable to \$3.0 million in repurchase of common stock and \$0.3 million in repurchase of stock to satisfy employee tax withholding obligations, partially offset by an increase of proceeds from issuance of common stock of \$1.9 million. Net cash used in financing activities of \$5.0 million during the nine months ended February 28, 2010 was primarily attributable to a stock buyback of \$4.8 million associated with the repurchase of 1,384,920 shares of the Company's common stock, a payment of employee withholding tax in lieu of issuing common stock upon vesting of restricted stock units of \$0.1 million and notes payable of \$0.3 million, partially offset by an increase of proceeds from issuance of common stock of \$0.2 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, 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

Table of Contents

could dilute our current stockholders' ownership interests.

During the quarter ended August 31, 2010, we entered into a non-cancelable three year contract for software services of which \$1.5 million remained outstanding as of February 28, 2011.

On September 7, 2010, we entered into a Third Amendment to Lease with Westport Office Park, LLC (the "Landlord"), which amended 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 Third Amendment to Lease also amended the Lease Agreement so that the base monthly rent payable from June 1, 2013 through May 31, 2014 under the Lease Agreement will be \$162,086, and the base monthly rent payable from June 1, 2014 through May 31, 2019 under the Lease Agreement will begin at \$96,768 on June 1, 2014 and thereafter increase annually by approximately \$3,000. The amended lease modification resulted in a reduction of straight-line rent expense beginning in the second quarter of fiscal 2011, which is reflected on our condensed consolidated statement of operations.

On November 22, 2010, we entered into a credit agreement with Wells Fargo Bank, National Association and our wholly-owned subsidiary, Saba Software International, Inc. The agreement provides for a one year \$10 million line of credit. The agreement also includes a sublimit of up to \$4.0 million for letters of credit.

The agreement includes certain covenants with which we must comply during the term of the agreement, including that our minimum cash and cash equivalents balance shall be at all times equal to not less than \$15 million (including that minimum U.S. cash and cash equivalents balance shall be not less than \$10 million), and that at the end of each fiscal quarter net losses after taxes during the four consecutive fiscal quarter period then ended shall be equal to not more than \$4 million.

The line of credit is secured by all of our personal property other than its intellectual property. The agreement includes certain negative covenants restricting or limiting our ability and our subsidiaries to, among other things, incur additional indebtedness, make investments and acquisitions, merge or consolidate with any other entity, and convey, sell, lease, transfer or otherwise dispose of assets. Such restrictions and limitations are subject to usual and customary exceptions contained in credit agreements of this nature. Due to the various restrictive covenants in the credit agreement, we may not be able to access the line of credit in the event we undertake actions that are otherwise restricted by terms of the credit agreement (absent a modification or waiver by the bank of such restrictive covenants).

The agreement also 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 credit 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 credit agreement as of February 28, 2011.

As of February 28, 2011, other than the renewal of the non-cancelable three year contract for software services and the new amended lease, 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, 2010.

Off-Balance Sheet Arrangements

As of February 28, 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

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

Table of Contents

We do not believe that we currently have any material exposure to interest rate risk resulting from our investments. At February 28, 2011, we had available cash and cash equivalents totaling \$32.0 million. Of this amount, approximately \$13.8 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.

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 inter-company accounts with our foreign subsidiaries. These inter-company 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 and nine months ended February 28, 2011, our total change of realized and unrealized losses compared to the prior year, due to movements in foreign currencies, primarily British pound, Japanese yen, Indian rupee and Australian dollar, were \$.01 million and \$0.3 million, respectively. 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 financial statements.

Starting in the first quarter of fiscal 2011, we started a program that primarily utilizes foreign currency forward contracts, specifically in Indian rupee, to offset these risks so that increases or decreases in our foreign currency exposures are offset by gains or losses on the foreign currency forward contracts in order to mitigate the risks and volatility associated with our foreign currency transactions. Our ultimate realized gain or loss with respect to 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 and other factors.

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.

Table of Contents

(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.

Table of Contents

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, 2010, except for changes to the risk factors entitled "While we achieved profitability during fiscal year 2010, we may incur future losses and cannot assure you that we will sustain profitability on a consistent basis"; "Fluctuations in our quarterly results could cause our stock price to experience significant fluctuations or declines"; "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"; "Future acquisitions and growth initiatives may be difficult to integrate, disrupt our business, dilute stockholder value or divert management's attention"; and "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".

While we achieved profitability during fiscal year 2010, we may incur future losses and cannot assure you that we will sustain profitability on a consistent basis.

We incurred losses during the first second and third quarter of fiscal 2011 and we cannot be certain that we will realize sufficient revenues to regain profitability on a quarterly or annual basis, especially if we continue to experience a shift in 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, which will impact our operating results. Also, any impairment of our goodwill would result in additional non-cash charges that would further impact our operating results. As of February 28, 2011, we had \$2.4 million of purchased intangible assets to be amortized as a result of our January 2006 acquisition of Centra Software, Inc. ("Centra") and May 2005 acquisition of THINQ Learning Solutions, Inc. ("THINQ") and our goodwill balance was \$36.1 million. Further, starting with the first quarter of fiscal 2007, we were required to record as an expense charges related to all current outstanding and future grants of stock options in our reported results from operations in accordance with ASC 718-10 *Compensation - Stock Compensation*, which was issued by the FASB in December 2004. These non-cash expenses have made it and will continue to make it significantly more difficult for us to continue to achieve profitability. We may not be able to sustain profitability on a consistent basis, 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.

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 could continued or further weakness in the global economy could in the future 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

Table of Contents

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.

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;

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.

Due to these and other factors, we believe 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. 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.

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, delivering Saba's people suites on certain web services, was recently introduced and could encounter unexpected problems. These problems could be attributable to our products, third party software, telecommunications failures, security breaches, or the

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

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

Table of Contents

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 orders or data, would adversely affect our adoption and renewal rates for the Saba People Cloud and adversely impact our ability to achieve our business plan and forecasted financial results.

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 in recent quarters where we have experienced a shift of some customer transactions away from software licenses to software, as a software 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 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 learning management, performance management, talent management, compensation and recruiting, including SumTotal and Success Factors;

Companies that offer collaboration solutions, such as Microsoft, Adobe 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;

Potential customers' internal development efforts; and

Companies that operate Internet-based marketplaces for the sale of on-line learning.

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

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

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.

Table of Contents

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.

Failure to adequately expand and ramp our direct sales force will impede our growth.

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.

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 our third fiscal quarter of 2011, 14% of our subscription services on a total annual contract dollar basis were not 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.

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.

In addition, we have recently seen a shift in customer preferences toward subscription services rather than software licenses, and this trend may have an impact on our revenues and results of operation. In particular, we generally recognize revenue for subscription service, including SaaS, over the life of the subscription agreement. As a result, if a customer elects to purchase subscription services rather than a software license, that transaction can lead to lower revenue recognition in the quarter in which the transaction occurs. This trend towards increased customer adoption of the SaaS transaction may have an adverse impact on our revenues and results of operation in a particular quarter.

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

Table of Contents

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 Suite 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 Suite 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 nine 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 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 factor 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.

Table of Contents

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.

The loss of our senior executives and key personnel would likely cause our business to suffer.

Our ability to implement a successful long-term strategy, strengthen our competitive position, expand our customer base, and develop and support our products depends to a significant degree on the performance of the senior management team and other key employees. The loss of any of these individuals could harm our business. Our success will depend in part on our ability to attract and retain additional personnel with the highly specialized expertise necessary to generate revenue and to engineer, design and support our products and services. Like other technology companies, we face intense competition for qualified personnel. We may not be able to attract or retain such personnel.

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

Table of Contents

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 35% and 31% of our revenues for the first nine months of our fiscal 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 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;

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, Australia and Japan, or have exposures in inter-company 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 require contract terms that differ from our standard arrangements. In addition, government

Table of Contents

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.

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.

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 nine months of fiscal year 2011, we recognized approximately 35% percent 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 Australian dollars, Canadian dollars, Japanese yen and other 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. 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. Since the beginning of fiscal 2011, we started a program that primarily utilized foreign currency forward contracts to offset some of these risks so that increases or decreases in our foreign currency exposures were offset by gains or losses on the foreign currency forward contracts in order to mitigate the risks and volatility associated with our foreign currency transactions. 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 currency fluctuations will generally depend on the size and type of cross-currency

Table of Contents

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 expect to continue periodically to acquire complementary businesses or technologies and 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 and successfully complete 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 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 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. In addition, the Sarbanes-Oxley Act, and rules subsequently implemented by the SEC and The NASDAQ Stock Market, have imposed a variety of requirements and restrictions on public companies,

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

including requiring changes in corporate governance practices. In addition, the SEC and the U.S. Congress are proposing additional significant corporate governance-

Table of Contents

related rules. Our management and other personnel will need to devote a substantial amount of time to these new compliance initiatives. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly.

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 too 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. 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

Table of Contents

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.

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 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.

Table of Contents

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 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.

Our disaster recovery plan does not include redundant systems, and a disaster could severely damage our operations.

Our disaster recovery plan does not include fully redundant systems for our services at an alternate site. A disaster could severely harm our business because our services could be interrupted for an indeterminate length of time. Our operations depend upon our ability to maintain and protect the computer systems needed for the day-to-day operation of the subscription business. A number of these computer systems are located on or near known earthquake fault zones. Although these systems are designed to be fault-tolerant, the systems are vulnerable to damage from fire, floods, earthquakes, power loss, telecommunications failures and other events. Additionally, we do not carry sufficient business insurance to compensate us for all potential losses that could occur.

We outsource the management and maintenance of a portion of our subscription business to third parties and will depend upon them to provide adequate management and maintenance services.

We rely on third parties to provide key components of our networks and systems. For instance, we rely on third-party Internet service providers to host our products for our subscription customers. We also rely on third-party communications service providers for the high-speed connections that link our networks and our Internet service providers' Web servers and office systems to the Internet. Our reliance on third party providers limits our ability to control critical customer service functions and communications systems. Any Internet or communications systems failure or interruption could result in disruption of our service or loss or compromise of customer orders and data. These failures, especially if they are prolonged or repeated, would make our services less attractive to customers and tarnish our reputation.

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. Although we have never sustained such a breach, if our security measures were ever breached as a result of third party action,

Table of Contents

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.

For example, from the beginning of fiscal 2010 through February 28, 2011, the market price for our common stock has fluctuated between \$7.43 per share and \$3.05 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.

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

Edgar Filing: SABA SOFTWARE INC - Form 10-Q

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. The purchase price, the

Table of Contents

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.

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 February 28, 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
December 1 31, 2010		\$		\$ 3,191
Additional shares authorized				8,191
January 1 31, 2011	213,994 ⁽¹⁾	6.60	1,180	7,011
February 1 28, 2011	24,049	6.58	159	6,852
Total	238,043		\$ 1,339	\$ 6,852

(1) Includes 37,000 shares of common stock pursuant to our restricted stock units program for an aggregate price of approximately \$243,000 to satisfy tax withholding obligations that arose on the vesting of restricted stock units.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Table of Contents

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.

Table of Contents

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: April 7, 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)

Table of Contents

EXHIBIT INDEX

Exhibit

Number	Document
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.
18.1	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 April 7, 2011.
31.2	Certification of William Slater, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated April 7, 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 April 7, 2011.
32.2	Certification of William Slater, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated April 7, 2011.

- (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 28, 2010.