

SABA SOFTWARE INC
Form 10-Q
January 14, 2004
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 30, 2003

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

For the transition period from _____ to _____

000-30221

(Commission File number)

SABA SOFTWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of

94-3267638
(I.R.S. Employer

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incorporation or organization)

Identification No.)

2400 Bridge Parkway,

Redwood Shores, CA
(Address of principal executive offices)

94065-1166
(Zip Code)

(650) 696-3840

(Registrant's telephone number, including area code)

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

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

On December 31, 2003, 13,494,177 shares of the registrant's Common Stock, \$.001 par value, were outstanding.

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SABA SOFTWARE, INC.

FORM 10-Q

QUARTER ENDED NOVEMBER 30, 2003

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Table of Contents**PART 1: FINANCIAL INFORMATION****Item 1. Financial Statements****SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

(unaudited)

	NOVEMBER 30, 2003	MAY 31, 2003
	<u> </u>	<u> </u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 17,127	\$ 17,566
Short-term investments	1,307	3,631
Accounts receivable, net	7,761	9,315
Prepaid expenses and other current assets	1,123	1,218
	<u> </u>	<u> </u>
Total current assets	27,318	31,730
Property and equipment, net	1,563	2,385
Goodwill, net	5,288	5,288
Purchased intangible assets, net	265	542
Other assets	951	891
	<u> </u>	<u> </u>
Total assets	\$ 35,385	\$ 40,836
	<u> </u>	<u> </u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,428	\$ 1,713
Accrued expenses	6,590	6,527
Deferred revenue	7,585	9,497
Current portion of debt and lease obligations	5,209	675
	<u> </u>	<u> </u>
Total current liabilities	20,812	18,412
Deferred revenue	14	31
Accrued rent	2,647	2,691
Debt and lease obligations, less current portion	953	1,242
	<u> </u>	<u> </u>
Total liabilities	24,426	22,376
Stockholders' equity:		
Preferred stock, issuable in series: \$0.001 par value; 1,250,000 authorized shares at November 30, 2003; none issued or outstanding		
	54	53

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Common stock: \$0.001 par value; 50,000,000 authorized shares at November 30, 2003;
13,483,215 shares issued at November 30, 2003 and 13,328,680 shares issued at May 31, 2003

Additional paid-in capital	191,875	191,241
Deferred stock compensation	(4)	(45)
Treasury stock: 102,578 shares held at November 30, 2003 and at May 31, 2003, at cost	(232)	(232)
Accumulated deficit	(180,529)	(172,329)
Accumulated other comprehensive loss	(205)	(228)
	<hr/>	<hr/>
Total stockholders' equity	10,959	18,460
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 35,385	\$ 40,836
	<hr/>	<hr/>

See Accompanying Notes to Condensed Consolidated Financial Statements.

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SABA SOFTWARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

(unaudited)

	THREE MONTHS		SIX MONTHS	
	ENDED		ENDED	
	NOVEMBER 30,		NOVEMBER 30,	
	2003	2002	2003	2002
Revenues:				
License	\$ 2,444	\$ 2,439	\$ 3,996	\$ 9,889
Services	5,764	7,028	12,425	14,274
Total revenues	8,208	9,467	16,421	24,163
Cost of revenues:				
Cost of license	66	26	151	76
Cost of services	2,945	3,493	6,343	6,786
Amortization of acquired developed technology	97	388	194	776
Total cost of revenues	3,108	3,907	6,688	7,638
Gross profit	5,100	5,560	9,733	16,525
Operating expenses:				
Research and development	2,555	2,998	5,206	6,025
Sales and marketing	3,771	7,750	8,472	14,690
General and administrative	1,043	1,769	2,315	3,122
Amortization of deferred stock compensation and other stock charges	12	613	42	1,964
Amortization of purchased intangible assets	42	259	84	517
Settlement of litigation			1,701	
Total operating expenses	7,423	13,389	17,820	26,318
Loss from operations	(2,323)	(7,829)	(8,087)	(9,793)
Interest income (expense) and other, net	48	26	(31)	122
Loss before provision for income taxes	(2,275)	(7,803)	(8,118)	(9,671)
Provision for income taxes	(37)	(88)	(82)	(153)
Net loss	\$ (2,312)	\$ (7,891)	\$ (8,200)	\$ (9,824)
Basic and diluted net loss per share	\$ (0.17)	\$ (0.62)	\$ (0.61)	\$ (0.80)
Shares used in computing basic and diluted net loss per share	13,382	12,719	13,361	12,330



See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six months ended November 30,	
	2003	2002
Operating activities:		
Net loss	\$ (8,200)	\$ (9,824)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	943	1,534
Amortization of purchased intangible assets	84	517
Amortization of acquired developed technology	193	776
Amortization of deferred stock compensation	42	1,071
Issuance of common stock to third parties		82
Compensation expense resulting from acceleration of vesting of common stock		640
Acceleration of deferred stock compensation for options cancelled in the option exchange program		171
Changes in operating assets and liabilities:		
Accounts receivable	1,581	3,397
Prepaid expenses and other current assets	95	(181)
Other assets	(9)	(48)
Accounts payable	(285)	(155)
Accrued expenses	683	(626)
Accrued rent	(44)	(22)
Deferred revenue	(1,929)	(789)
Other liabilities	(61)	(26)
Net cash used in operating activities	(6,907)	(3,483)
Investing activities:		
Purchases of short-term investments		(9,749)
Proceeds from redemptions and maturities of short-term investments	2,320	14,024
Purchases of property and equipment	(121)	(262)
Net cash provided by investing activities	2,199	4,013
Financing activities:		
Proceeds from issuance of common stock under stock plans	59	246
Proceeds from issuance of common stock in private placement, net of issuance costs		9,195
Repurchase of common stock		(2)
Borrowings under credit facility, net of issuance costs	6,783	1,351
Repayments on borrowings under the credit facility	(2,521)	(1,021)
Repayments on note payable	(36)	(34)
Principal payments under capital lease obligations	(16)	(754)
Collections on notes receivable from stockholders		123
Net cash provided by financing activities	4,269	9,104
Increase (decrease) in cash and cash equivalents	(439)	9,634
Cash and cash equivalents, beginning of period	17,566	9,523

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Cash and cash equivalents, end of period	17,127	19,157
Short-term investments, end of period	1,307	8,334
	<hr/>	<hr/>
Total cash, cash equivalents and short-term investments, end of period	\$ 18,434	\$ 27,491
	<hr/>	<hr/>
Supplemental disclosure of non-cash transactions:		
Equipment purchased under capital lease obligations	\$	\$ 103
	<hr/>	<hr/>
Common stock issued for settlement of litigation	\$ 576	\$
	<hr/>	<hr/>

See Accompanying Notes to Condensed Consolidated Financial Statements.

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SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

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

These unaudited condensed consolidated financial statements should be read in conjunction with Saba's audited consolidated financial statements included in Saba's Annual Report on Form 10-K filed with the Securities and Exchange Commission on August 29, 2003. The results of operations for the three and six months ended November 30, 2003 are not necessarily indicative of results for the entire fiscal year ending May 31, 2004 or for any future period.

The condensed consolidated balance sheet at May 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

All share and per share data included in the unaudited condensed consolidated financial statements and the notes thereto has been retroactively adjusted to reflect a one-for-four reverse split approved by Saba's stockholders in May 2003.

2. Basic and Diluted Net Loss Per Share

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

Three months ended		Six months ended	
November 30,		November 30,	
<hr/>		<hr/>	
2003	2002	2003	2002

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Net loss	\$ (2,312)	\$ (7,891)	\$ (8,200)	\$ (9,824)
Weighted-average shares of common stock outstanding	13,409	12,845	13,375	12,477
Weighted-average shares of common stock subject to repurchase	(27)	(126)	(14)	(147)
Weighted-average shares of common stock used in computing basic and diluted net loss per share	13,382	12,719	13,361	12,330
Basic and diluted net loss per share	\$ (0.17)	\$ (0.62)	\$ (0.61)	\$ (0.80)

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

	Three months ended November 30,		Six months ended November 30,	
	2003	2002	2003	2002
Net loss	\$ (2,312)	\$ (7,891)	\$ (8,200)	\$ (9,824)
Foreign currency translation (loss) gain	17	(4)	28	(54)
Unrealized (loss) gain on investments	(2)	(5)	(5)	(9)
Comprehensive loss	\$ (2,297)	\$ (7,900)	\$ (8,177)	\$ (9,887)

4. Segment Information

Saba operates in a single operating segment, providing software and services that increase business performance through human capital development and management.

Geographic Information

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

	Total Revenue		Total Revenue	
	Three months ended November 30,		Six months ended November 30,	
	2003	2002	2003	2002
United States	\$ 4,925	\$ 7,098	\$ 10,244	\$ 19,224
International	3,283	2,369	6,177	4,939
Total	\$ 8,208	\$ 9,467	\$ 16,421	\$ 24,163

	Long-Lived Assets	
	As of November 30, 2003	As of May 31, 2003
United States	\$ 6,910	\$ 7,970
International	206	245
Total	\$ 7,116	\$ 8,215

Major Customers

For the three and six months ended November 30, 2003, no customer accounted for greater than 10% of revenues. For the three and six months ended November 30, 2002, one customer accounted for greater than 10% of revenues.

5. Credit Facility

In October 2003, Saba amended certain terms of its existing credit facility. In November 2003, Saba borrowed \$4.5 million against the line of credit, which was repaid in December 2003. Saba also borrowed \$39,000 in the form of an equipment term loan at an interest rate of 6.09%, which must be repaid in 36 monthly installments of principal plus interest. Borrowings under the credit facility are secured by substantially all of Saba's tangible assets.

The credit facility requires Saba to satisfy certain covenants including a financial covenant related to unrestricted cash and cash equivalents. As of November 30, 2003, Saba was in compliance with all such covenants.

6. Restructuring

During the three months ended November 30, 2003, Saba recorded a net restructuring charge of \$39,000. The charge was comprised of \$80,000 for an excess facility that arose after default by a subtenant, which was partially offset by a \$41,000 decrease to a workforce reduction charge accrual made in a prior period that resulted from severance payments that were less than previous estimates. The facilities charge was recorded under SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, and was classified in the statement of operations as

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research and development. The charge was recorded based on the present value of the sum of non-cancelable lease costs, less estimates for future sublease income, which will be paid over the estimated vacancy period through fiscal 2005. While the facilities charge does not result in cash savings, operating expenses will be reduced by \$30,000 for the remainder of fiscal 2004 and \$45,000 thereafter.

During the six months ended November 30, 2003, Saba consolidated an additional excess facility resulting in a restructuring charge of \$393,000. The restructuring charge was recorded under SFAS No. 146 and was classified in the statement of operations as follows: cost of revenues - \$154,000, research and development - \$127,000, sales and marketing - \$73,000 and general and administrative - \$39,000. The excess facilities charge was recorded based on the present value of the sum of non-cancelable lease costs, less estimates for future sublease income, which will be paid over the estimated vacancy period through fiscal 2006. While the facilities charge does not result in cash savings, operating expenses will be reduced by \$104,000 for the remainder of fiscal 2004 and \$240,000 thereafter. During the three months ended November 30, 2003, Saba recognized an accretion expense of \$4,000 due to the passage of time in accordance with SFAS No. 146.

Saba's estimated costs to exit excess facilities are based on available commercial rates. The actual loss incurred in exiting these facilities could be different from Saba's estimates. A summary of the restructuring charges and related accruals are outlined as follows:

	Workforce Reduction Charges	Facilities Related Charges	Total
	<u> </u>	<u> </u>	<u> </u>
	(in thousands)		
Accrual as of May 31, 2003	\$ 129	\$ 880	\$ 1,009
Charges		393	393
Deductions - cash payments	(5)	(183)	(188)
	<u> </u>	<u> </u>	<u> </u>
Accrual as of August 31, 2003	\$ 124	\$ 1,090	\$ 1,214
Charges		80	80
Accretion		4	4
Reduction of accrual	(41)		(41)
Deductions - cash payments	(4)	(240)	(244)
	<u> </u>	<u> </u>	<u> </u>
Accrual as of November 30, 2003	\$ 79	\$ 934	\$ 1,013
	<u> </u>	<u> </u>	<u> </u>
Estimated remaining cash expenditures	\$ 79	\$ 934	\$ 1,013
	<u> </u>	<u> </u>	<u> </u>

7. Stock Options and Equity Instruments Exchanged for Services

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

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	Three months ended November 30,		Six months ended November 30,	
	2003	2002	2003	2002
	(in thousands, except per share amounts)			
Net loss as reported	\$ (2,312)	\$ (7,891)	\$ (8,200)	\$ (9,824)
Add: Total stock-based employee compensation expense included in net loss	12	613	42	1,881
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(3,117)	(3,102)	(6,479)	(6,514)
Adjusted net loss	\$ (5,417)	\$ (10,380)	\$ (14,637)	\$ (14,457)
Net loss per share as reported	\$ (0.17)	\$ (0.62)	\$ (0.61)	\$ (0.80)
Adjusted net loss per share	\$ (0.40)	\$ (0.82)	\$ (1.10)	\$ (1.17)

8. Recent Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires businesses to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Saba's adoption of SFAS No. 143 for its fiscal year beginning June 1, 2003 did not have a material effect on Saba's financial position or results of operations.

In February 2003, the FASB issued EITF No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF No. 00-21 requires revenue arrangements with multiple deliverables to be divided into separate units of accounting. If the deliverables in the arrangement meet certain criteria, arrangement consideration should be allocated among the separate units based on their relative fair values. Applicable revenue recognition criteria should be considered separately for each unit. The guidance in EITF No. 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Saba does not expect the adoption of EITF No. 00-21 to have a material effect on its financial position or results of operations.

9. Legal Matters

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York against Saba, certain of its officers and directors, and certain underwriters of Saba's initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased Saba common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by Saba and its officers and directors of the Securities Act of 1933 in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints were later consolidated into a single action. On July 16, 2003, a committee of Saba's board of directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of Saba and of the individual defendants for the conduct alleged in the action to be wrongful in the amended complaint. Saba would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims Saba may have against its underwriters. Any direct financial impact of the proposed settlement is expected to be borne by Saba's insurers. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other issuer defendants in the proposed settlement, the consent of Saba's insurers to the

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settlement, and the completion of acceptable final settlement documentation. Furthermore, the settlement is subject to a hearing on fairness and approval by the court overseeing the initial public offering litigation. If the settlement is not finalized, Saba believes that the claim asserted by these lawsuits are without merit, and intends to defend these actions vigorously. However, due to the inherent uncertainties of litigation, Saba cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect Saba's business, financial condition and results of operations.

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On May 31, 2002, IP Learn, LLC (IP Learn) filed a complaint against Saba in the United States District Court for the Northern District of California. The complaint alleged that Saba infringed four U.S. patents assigned to IP Learn and asks the court for a preliminary and permanent injunction, as well as unspecified damages. IP Learn later amended the complaint to add a fifth patent to the suit. Substantially similar complaints have been filed against at least four other companies in Saba's industry. In September 2003, Saba reached an agreement with IP Learn regarding the settlement of the pending litigation. Under the terms of the settlement agreement, Saba is required to pay \$1.1 million over nine months. As of November 30, 2003, \$875,000 was remaining on the cash obligation. In addition, Saba issued approximately 134,000 shares of its common stock valued as of the settlement date at \$576,000.

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

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

The following discussion of financial condition and results of operations should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended May 31, 2003. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the Securities Act) and Section 21E of the Securities and Exchange Act of 1934 (the Exchange Act). All statements in this Quarterly Report on Form 10-Q other than statements of historical fact are forward-looking statements for purposes of these provisions, including any statements of the plans and objectives for future operations and any statement of assumptions underlying any of the foregoing. Statements that include the use of terminology such as may, will, expects, believes, plans, estimates, potential, or contingent negative thereof or other comparable terminology are forward-looking statements. Forward-looking statements include, in Item 2, statements regarding an increase in operating expenses, including sales and marketing, research and development, and general and administrative, incurrence of non-cash expenses relating to stock compensation, amortization of purchased intangible assets and any potential goodwill impairment, estimated excess facilities charges, growth of our operations and personnel, fluctuations in operating results from quarter to quarter, long sales cycles, possible acquisitions and strategic ventures, expansion of our sales and marketing organization, sufficiency of cash resources, credit facilities and cash flows to meet working capital, capital expense and business expansion requirements, development of new or enhanced applications and services, market risk exposure, impact of EITF No. 00-21, and the significance of Saba Enterprise Learning and related services, as well as other products, for our revenues. These forward-looking statements involve risks and uncertainties, and it is important to note that our actual results could 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 the heading Management's Discussion and Analysis of Financial Condition and Results of Operations Factors That May Impact Future Operating Results. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement or risk factor.

OVERVIEW

We are a leading provider of human capital development and management solutions, which are designed to increase organizational performance through the implementation of a management system for aligning, developing and managing people. Our solutions can help large enterprises to efficiently manage regulatory

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compliance, increase sales and channel readiness, accelerate time-to-competency of people across the extended enterprise, increase speed of customer acquisition, shorten time-to-market of new products and increase visibility into organizational performance.

General

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 Learning products and began to generate revenues from software license fees, implementation and consulting services fees and support fees in April 1998. We began to operate Saba Exchange in December 1999 and our application service provider (ASP) edition of Saba Learning in September 2000, and shipped our generally available version of Saba Performance in August 2003. To date, we have not generated significant revenues from Saba Exchange, Saba Learning ASP Edition or Saba Performance.

Sources of Revenues and Revenue Recognition

To date, we have generated revenues primarily from licensing Saba Enterprise Learning, and providing related services, including implementation, consulting, support, hosting and education.

We recognize revenues in accordance with the provisions of American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. Under SOP 97-2, as amended, we recognize revenues when all of the following conditions are met:

persuasive evidence of an agreement exists;

delivery of the product has occurred;

the fee is fixed or determinable; and

collection of these fees is probable.

SOP 97-2, as amended, requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. We have analyzed each element in our multiple-element arrangements and determined that we have sufficient vendor-specific objective evidence (VSOE) to allocate revenues to support, consulting and education services and an additional language version of our product. Accordingly, assuming all other revenue recognition criteria are met, revenues from perpetual licenses are recognized upon delivery using the residual method in accordance with SOP 98-9. 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 management, having the relevant authority to do so, for an element not yet sold separately.

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License revenues are generally recognized on delivery if the other conditions of SOP 97-2 are satisfied, including sales to domestic and international distributors or value-added resellers (collectively, resellers). We do not grant our resellers the right of return and we do not recognize revenue from resellers until the end-user has been identified. Revenues from our application service provider offering and from our hosting services are generally recognized ratably over the term of the arrangement. Support revenue is recognized ratably over the support term, typically 12 months, and revenue related to implementation, consulting, education and other services is generally recognized as the services are performed. Although we primarily provide implementation and consulting services on a time and materials basis, a significant portion of these services is provided on a fixed-fee basis. 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. We use labor hours incurred as a percentage of total expected hours as the measure of progress towards completion.

Cost of Revenues

Our cost of revenues includes cost of our license revenues and cost of our services revenues. Our cost of license revenues includes the cost of manuals and product documentation, production media, shipping costs and royalties to third parties. Our cost of services revenues includes salaries and related expenses for our

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professional services organization, as well as third-party hosting costs and billed expenses. Because our cost of services revenues is greater than cost of license revenues, cost of total revenues as a percentage of total revenues will fluctuate based on the mix of licenses and services sold.

Operating Expenses

Our operating expenses are classified into three general operational categories: research and development, sales and marketing, and general and administrative. In addition, our operating expenses include amortization of deferred stock compensation and other stock charges, and amortization of purchased intangible assets.

We classify all operating expenses, except stock compensation, other stock charges and amortization of purchased intangible assets, 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, employee benefits, travel and entertainment costs, and allocated communication, rent and depreciation costs. We allocate these expenses to each of the functional areas that derive a benefit from such expenses based upon their respective headcounts. The sales and marketing category of operating expenses also includes sales commissions and expenses related to public relations and advertising, trade shows and marketing collateral materials. The general and administrative category of operating expenses also includes allowances for doubtful accounts and administrative and professional services fees.

In connection with the granting of stock options to, and restricted stock purchases by, our employees, prior to our initial public offering, we recorded deferred stock compensation totaling approximately \$38.4 million. This amount represents the difference between the exercise or purchase price, as applicable, and the deemed fair value of our common stock for financial accounting purposes on the date these stock options were granted or purchase agreements for restricted stock were signed. As of November 30, 2003, the remaining deferred stock compensation related to our initial public offering amounted to \$4,000 and will result in additional charges to operations through the third quarter of fiscal 2004.

Our March 2001 acquisition of Human Performance Technologies, Inc. resulted in purchased intangible assets of \$4.6 million, and our June 2001 acquisition of Ultris Inc. resulted in goodwill of \$7.8 million and purchased intangible assets of \$1.3 million. Purchased intangible assets consist of intellectual property, customer base and noncompetition agreements. The intangible assets are stated at cost less accumulated amortization and are being amortized on a straight-line basis over their estimated useful lives of six months to three years. As of November 30, 2003, purchased intangible assets amounted to \$265,000 and will result in additional charges to operations through the first quarter of fiscal 2005. Effective June 1, 2002, we adopted SFAS No. 142, Goodwill and Other Intangible Assets. As required by SFAS No. 142, we no longer amortize goodwill, but review it annually (or more frequently if impairment indicators arise) for impairment. Prior to June 1, 2002, goodwill was being amortized on a straight-line basis over its estimated useful life of three years.

History of Losses

We have incurred significant losses and negative cash flows from operations since our inception. As of November 30, 2003, we had an accumulated deficit of \$180.5 million. We have not achieved profitability and cannot be certain that we will be able to realize sufficient revenues to achieve or, if achieved, sustain profitability. We also expect to incur non-cash expenses relating to stock compensation, amortization of purchased intangible assets and any potential goodwill impairment. We need to generate higher revenues in order to achieve profitability. If we achieve profitability, we may not be able to sustain it.

Limited Operating History

We have a limited operating history that makes it difficult to forecast our future operating results. We believe that period-to-period comparisons of our operating results should not be relied upon as predictive of future performance. Our prospects must be considered in light of the risks, expenses and difficulties

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encountered by companies at a relatively early stage of development, particularly companies in new and rapidly evolving markets, such as human capital development and management. We may not be successful in addressing these risks and difficulties.

RESULTS OF OPERATIONS

THREE AND SIX MONTHS ENDED NOVEMBER 30, 2003 AND 2002

Revenues

Total revenues decreased to \$8.2 million for the three months ended November 30, 2003 from \$9.5 million for the three months ended November 30, 2002. The decrease was primarily attributable to decreased services revenues. For the six months ended November 30, 2003, revenues decreased to \$16.4 million from \$24.2 million for the six months ended November 30, 2002. The decrease was primarily attributable to decreased license revenues in the United States. As a percentage of total revenues, revenues from customers outside the United States represented approximately 40% for the three months ended November 30, 2003 and 25% for the three months ended November 30, 2002. As a percentage of total revenues, revenues from customers outside the United States represented approximately 38% for the six months ended November 30, 2003 and 20% for the six months ended November 30, 2002. During the three and six months ended November 30, 2003, no customer represented more than 10% of our revenues. During the three and six months ended November 30, 2002, one customer represented more than 10% of our revenues.

License revenues were \$2.4 million during the three months ended November 30, 2003 and 2002, representing 30% of total revenues for the three months ended November 30, 2003 and 26% of total revenues for the three months ended November 30, 2002. For the six months ended November 30, 2003, license revenues decreased to \$4.0 million, or 24% of total revenues, from \$9.9 million, or 41% of total revenues, for the six months ended November 30, 2002. The decrease in the dollar amount of license revenues was primarily attributable to a decrease in new license sales. Also contributing to the decrease was a large license sale in the prior year that represented more than 10% of our total revenues in the three and six month periods.

Services revenues decreased to \$5.8 million, or 70% of total revenues, for the three months ended November 30, 2003, from \$7.0 million, or 74% of total revenues, for the three months ended November 30, 2002. For the six months ended November 30, 2003, services revenues were \$12.4 million, or 76% of total revenues, and \$14.3 million, or 59% of total revenues, for the six months ended November 30, 2002. The decreases in dollar amount of services revenues were primarily attributable to decreased consulting revenues, which were partially offset by an increase in support revenues. The decline in consulting revenues was due to a decrease in new license implementations and an increase in the number of implementations performed by third-party systems integrators. The increase in the use of third-party systems integrators was partially due to an increase in the mix of international customers where third-party systems integrators are more frequently utilized.

The mix of license and services revenues as a percentage of total revenues has varied significantly primarily due to variability in new license sales.

Cost of Revenues

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Total cost of revenues decreased to \$3.1 million for the three months ended November 30, 2003 from \$3.9 million for the three months ended November 30, 2002. The decrease was primarily attributable to a decrease in services personnel. For the six months ended November 30, 2003, total cost of revenues decreased to \$6.7 million from \$7.6 million for the six months ended November 30, 2002. The decrease was primarily attributable to a decrease in services personnel partially offset by an increase in allocated facilities expenses, which related to excess facilities charges incurred during the six months ended November 30, 2003. Cost of services revenues represented 51% of services revenues for the three months ended November 30, 2003 and 50% of services revenues for the three months ended November 30, 2002. The slight increase in the cost of services as a percentage of services revenues was primarily attributable to a lower consultant utilization rate, which was partially offset by an increased percentage of higher margin support revenues as a percentage of total services revenues. For the six months ended November 30, 2003, cost of services revenues represented 51% of services revenues and 48% of services revenues for the six months ended

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November 30, 2002. The increase in the cost of services as a percentage of services revenues was primarily attributable to an increase in allocated facilities expenses, as well as a lower consultant utilization rate. This increase was partially offset by an increased percentage of higher margin support revenues as a percentage of total services revenues.

The cost of revenues includes amortization of acquired developed technology of \$97,000 for the three months ended November 30, 2003 and \$388,000 for the three months ended November 30, 2002. Cost of revenues includes amortization of acquired developed technology of \$194,000 for the six months ended November 30, 2003 and \$776,000 for the six months ended November 30, 2002. This amortization resulted from our March 2001 acquisition of Human Performance Technologies, Inc. and June 2001 acquisition of Ultris Inc.

Operating Expenses

Research and development. Research and development expenses decreased to \$2.6 million for the three months ended November 30, 2003 from \$3.0 million for the three months ended November 30, 2002. For the six months ended November 30, 2003, research and development expenses decreased to \$5.2 million from \$6.0 million for the six months ended November 30, 2002. The decreases were primarily attributable to a decrease in research and development personnel in the U.S., offset by increased staffing in our lower-cost development center in India.

Sales and marketing. Sales and marketing expenses decreased to \$3.8 million for the three months ended November 30, 2003 from \$7.8 million for the three months ended November 30, 2002. For the six months ended November 30, 2003, sales and marketing expenses decreased to \$8.5 million from \$14.7 million for the six months ended November 30, 2002. The decreases were primarily attributable to reduced sales and marketing personnel, lower commission expense due to a decline in revenues and lower expenditures for marketing programs.

General and administrative. General and administrative expenses decreased to \$1.0 million for the three months ended November 30, 2003 from \$1.8 million for the three months ended November 30, 2002. The decrease was primarily attributable to a decrease in general and administrative personnel. For the six months ended November 30, 2003, general and administrative expenses decreased to \$2.3 million from \$3.1 million for the six months ended November 30, 2002. The decrease was primarily attributable to a decrease in general and administrative personnel, which was partially offset by an increase in legal expenses.

Amortization of deferred stock compensation and other stock charges. Amortization of deferred stock compensation and other stock charges decreased to \$12,000 for the three months ended November 30, 2003 from \$613,000 for the three months ended November 30, 2002. For the six months ended November 30, 2003, amortization of deferred stock compensation and other stock charges decreased to \$42,000 from \$2.0 million for the six months ended November 30, 2002. Included in the six months ended November 30, 2002 was \$750,000 for compensation expense resulting from the acceleration of vesting of common stock for certain terminated employees. This charge was partially offset by a reduction in amortization of deferred stock compensation of \$261,000 that resulted from the cancellation of unvested stock options as a result of employee attrition and reductions in workforce. Also included in the six months ended November 30, 2002 was \$171,000 related to the acceleration of amortization of deferred stock compensation for options that were cancelled in accordance with our voluntary stock option exchange program.

Amortization of purchased intangible assets. Amortization of purchased intangible assets decreased to \$42,000 for the three months ended November 30, 2003 from \$259,000 for the three months ended November 30, 2002. For the six months ended November 30, 2003, amortization of purchased intangible assets decreased to \$84,000 from \$517,000 for the six months ended November 30, 2002. This amortization resulted from our March 2001 acquisition of Human Performance Technologies, Inc. and June 2001 acquisition of Ultris Inc.

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Settlement of litigation. In September 2003, we reached an agreement regarding the settlement of pending patent litigation and recorded a charge of \$1.7 million. Under the terms of the settlement agreement,

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we are required to pay \$1.1 million over nine months. As of November 30, 2003, \$875,000 was remaining on the cash obligation. In addition, we issued approximately 134,000 shares of our common stock valued as of the settlement date at \$576,000.

Restructuring charges

During the three months ended November 30, 2003, we recorded a net restructuring charge of \$39,000. The charge was comprised of \$80,000 for an excess facility that arose after default by a subtenant, which was partially offset by a \$41,000 decrease to a workforce reduction charge accrual made in a prior period that resulted from severance payments that were less than previous estimates. The facilities charge was classified in the statement of operations as research and development. The charge relates to non-cancelable lease costs, less estimates for sublease income, which will be paid over the estimated vacancy period through fiscal 2005. While the facilities charge does not result in cash savings, operating expenses will be reduced by \$30,000 for the remainder of fiscal 2004 and \$45,000 thereafter. Our estimated costs to exit this facility are based on available commercial rates. The actual loss incurred could be different from our estimates.

During the three months ended August 31, 2003, we consolidated an excess facility resulting in a restructuring charge of \$393,000, which was classified in the statement of operations as follows: cost of revenues - \$154,000, research and development - \$127,000, sales and marketing - \$73,000 and general and administrative - \$39,000. The excess facilities charge relates to non-cancelable lease costs, less estimates for sublease income, which will be paid over the estimated vacancy period through fiscal 2006. While the facilities charge does not result in cash savings, operating expenses will be reduced by \$104,000 for the remainder of fiscal 2004 and \$240,000 thereafter. Our estimated costs to exit this facility are based on available commercial rates. The actual loss incurred could be different from our estimates.

Interest income (expense) and other, net

Interest income (expense) and other, net consists of interest income, interest expense and other non-operating expenses. Interest income (expense) and other, was income of \$48,000 for the three months ended November 30, 2003, and income of \$26,000 for the three months ended November 30, 2002. The increase was primarily attributable to foreign exchange gains resulting from favorable fluctuations in foreign currency denominated receivables. Interest income (expense) and other, was expense of \$31,000 for the six months ended November 30, 2003 and income of \$122,000 for the six months ended November 30, 2002. The decrease was primarily attributable to foreign exchange losses resulting from unfavorable fluctuations in foreign currency denominated receivables and a decrease in interest income due to a decline in our short-term investment balance.

Provision for income taxes

From inception through November 30, 2003, we incurred net losses for federal and state tax purposes. Income tax expense was \$37,000 during the three months ended November 30, 2003 and \$88,000 during the three months ended November 30, 2002. Income tax expense was \$82,000 for the six months ended November 30, 2003 and \$153,000 during the six months ended November 30, 2002. The income tax expense consists entirely of foreign tax expense incurred as a result of local country profits.

FLUCTUATIONS OF QUARTERLY RESULTS

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Our results of operations could vary significantly from quarter to quarter. If revenues fall below our expectations, we will not be able to reduce our spending rapidly in response to the shortfall and operating losses will increase. 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 revenues between quarters.

We are subject to employer payroll taxes, both domestic and foreign, on employee exercises of non-qualified stock options. These taxes are recorded as a charge to operations in the period such options are exercised based on actual gains realized by employees, measured by the difference between the price of our common stock on the date of exercise and the exercise price. We receive domestic tax deductions for gains realized by domestic employees on the exercise of non-qualified stock options for which the benefit is recorded as additional paid-in capital when realized. Our taxes and cash flows could vary significantly from quarter to quarter depending on the number of non-qualified stock options exercised by employees in any quarter and, consequently, our results of operations.

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Other factors that could affect our quarterly operating results include those described below and under the caption Factors That May Affect Future Operating Results:

dependence of our revenues on a small number of large orders and the average order value;

our ability to attract new customers;

any changes in revenue recognition policies and provisions and interpretations of these provisions;

our ability to license additional products to current customers;

the announcement or introduction of new products or services by us or our competitors;

changes in the pricing of our products and services or those of our competitors;

variability in the mix of our products and services revenues in any quarter;

technical difficulties or service interruptions of our computer network systems or the Internet generally;

the amount and timing of operating costs and capital expenditures relating to expansion or contraction of our business; and

foreign currency fluctuations.

LIQUIDITY AND CAPITAL RESOURCES

Since inception, we have funded our operations primarily through the sale of equity securities, through which we have raised net proceeds of \$135.8 million through November 30, 2003, equipment leases and other debt. As of November 30, 2003, we had outstanding equipment lease obligations of \$61,000, debt of \$6.1 million and \$18.4 million of cash, cash equivalents and short-term investments.

Cash used in operating activities was \$6.9 million during the six months ended November 30, 2003 and \$3.5 million during the six months ended November 30, 2002. Cash used in operating activities during the six months ended November 30, 2003 was primarily attributable to a net loss of \$8.2 million, which was partially offset by a decrease in accounts receivable of \$1.6 million. Cash used in operating activities during the six months ended November 30, 2002 was primarily attributable to a net loss of \$9.8 million, which was partially offset by a decrease in accounts receivable of \$3.4 million, depreciation and amortization of \$1.5 million and amortization of deferred stock compensation of \$1.1 million.

Cash provided by investing activities during the six months ended November 30, 2003 was primarily attributable to redemptions and maturities of short-term investments of \$2.3 million. Cash provided by investing activities during the six months ended November 30, 2002 was primarily

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attributable to net redemptions and maturities of short-term investments of \$4.3 million.

Cash provided by financing activities during the six months ended November 30, 2003 was primarily attributable to \$6.9 million from the borrowings under our credit facility, which was partially offset by repayments of \$2.5 million. Cash provided by financing activities during the six months ended November 30, 2002 was primarily attributable to \$9.2 million from the proceeds of the issuance of common stock in a private placement.

At November 30, 2003, we did not have any material commitments for capital expenses. Our principal commitments consisted of obligations under capital and operating leases, a note payable, our credit facility and the settlement of pending patent litigation entered into in September 2003. In October 2003, we amended certain terms related to our existing credit facility. In November 2003, we borrowed \$4.5 million against the line of credit, which was repaid in December 2003. We also borrowed \$39,000 in the form of an equipment term loan at an interest rate of 6.09%, which must be repaid in 36 monthly installments of principal plus interest.

The following table summarizes our contractual obligations at November 30, 2003 and the effect these obligations are expected to have on our liquidity and cash flows in future periods, excluding the \$4.5 million

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repayment of the line of credit that occurred in December 2003. Of the \$28.3 million in operating leases, net of sublease income, \$1.1 million has been included in accrued restructuring charges as of November 30, 2003. Sublease income included in the table below amounted to \$151,000 for fiscal 2004, \$290,000 for fiscal 2005, \$239,000 for fiscal 2006 and \$30,000 for fiscal 2007.

	<u>Total</u>	<u>Operating Leases</u>	<u>Capital Leases</u>	<u>Debt Obligations</u>
	(in thousands)			
Fiscal Year Ending May 31,				
2004	\$ 1,841	\$ 1,489	\$ 17	\$ 335
2005	3,445	2,729	37	679
2006	3,230	2,699	7	524
2007	2,383	2,321		62
2008	2,351	2,351		
Thereafter	15,939	15,939		
	<u>\$ 29,189</u>	<u>\$ 27,528</u>	<u>\$ 61</u>	<u>\$ 1,600</u>

We currently anticipate that our available cash resources and credit facilities, 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 could choose, to raise additional funds at any time. 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 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.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in conformity with generally accepted accounting principles 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 there are a number of accounting policies, methods and estimates affecting 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 restructuring costs. Our critical accounting policies are described in the following paragraphs.

Revenue recognition. Our revenue recognition policies are described at the beginning of Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

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Allowance for doubtful accounts. Accounts receivable are recorded net of allowance for doubtful accounts and totaled \$7.8 million as of November 30, 2003. The allowance for doubtful accounts, which totaled \$295,000 as of November 30, 2003, is based on our assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. 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. Effective June 1, 2002, we adopted SFAS No. 142. As such, we ceased amortization of goodwill as of May 31, 2002. In addition, we evaluated our purchased intangible assets and determined that all such assets have determinable lives. Total amortization of goodwill prior to June 1, 2002 was \$2.5 million and our remaining goodwill balance at November 30, 2003 was \$5.3 million. Amortization of purchased intangible assets, including acquired developed technology, was \$84,000 for the six months ended November 30, 2003 and \$517,000 for the six months ended November 30, 2002. Our remaining purchased intangible asset balance was \$265,000 as of November 30, 2003.

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SFAS No. 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment; while the second phase, if necessary, measures 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 an interim basis if circumstances dictate. Any reduction of enterprise fair value below the amount of stockholders' equity could require us to write down the value of goodwill to its fair value and record an expense for the impairment loss.

Restructuring costs. During the three months ended November 30, 2003, we consolidated an excess facility resulting in a restructuring charge of \$80,000. The restructuring charge, which was recorded under SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, included non-cancelable lease costs, less estimates for future sublease income. The total accrued restructuring balance as of November 30, 2003 was \$1.0 million, which was comprised of \$934,000 for facilities related charges and \$79,000 for workforce reduction charges. The assumptions we have made are based on the current market conditions in the various areas where we have vacant space and necessarily entail a high level of management judgment. These market conditions can fluctuate greatly due to such factors as changes in property occupancy rates and the rental prices charged for comparable properties. These changes could materially affect our accrual. If, in future periods, it is determined that we have over accrued for restructuring charges for the consolidation of facilities, the reversal of such over accrual would have a favorable impact on our results of operations in the period this was determined and would be recorded as a credit to restructuring costs. Conversely, if it is determined that our accrual is insufficient, an additional charge would have an unfavorable impact on our results of operations in the period this was determined.

RECENT ACCOUNTING PRONOUNCEMENTS

In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires businesses to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Our adoption of SFAS No. 143 for our fiscal year beginning June 1, 2003 did not have a material effect on our financial position or results of operations.

In February 2003, the FASB issued EITF No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF No. 00-21 requires revenue arrangements with multiple deliverables to be divided into separate units of accounting. If the deliverables in the arrangement meet certain criteria, arrangement consideration should be allocated among the separate units based on their relative fair values. Applicable revenue recognition criteria should be considered separately for each unit. The guidance in EITF No. 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. We do not expect the adoption of EITF No. 00-21 to have a material effect on our financial position or results of operations.

FACTORS THAT MAY IMPACT FUTURE OPERATING RESULTS

We have a limited operating history and are subject to the risks encountered by early-stage companies

We were founded in April 1997 and shipped our first products in April 1998. Because we have a limited operating history, you should consider and evaluate our operating prospects in light of the risks and uncertainties frequently encountered by early-stage companies in rapidly evolving markets. For us, these risks include:

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risks that our revenue forecasts may be incorrect because of our limited sales to date and our long sales process;

risks associated with our dependence on Saba Learning, and related services, for substantially all of our revenues for the foreseeable future;

risks that our new products, such as Saba Performance and Saba Content, will fail to achieve market acceptance;

risks that our strategy of establishing Saba Exchange may not be successful;

risks that fluctuations in our quarterly operating results will be significant relative to our revenues; and

risks that the current economic downturn will continue to negatively impact the demand for our products and services.

These risks and other risks are described in more detail below. Our future growth will depend substantially on our ability to address these and the other risks described in this section. If we do not successfully address these risks, our business would be significantly harmed.

We have a history of losses, expect future losses and cannot assure you that we will achieve profitability

We have incurred significant losses and negative cash flows from operations since our inception. We have not achieved profitability and cannot be certain that we will realize sufficient revenues to achieve or sustain profitability. We expect to derive substantially all of our revenues for the foreseeable future from the licensing of Saba Learning and providing related services. Over the longer term, we expect to derive revenues from Saba Exchange, which is based on an evolving and unproven business model, and new products such as Saba Performance and services related to these offerings. In the future, we expect to continue to incur substantial non-cash expenses relating to the amortization of deferred compensation and purchased intangible assets that will contribute to our net losses. As of November 30, 2003, we had \$265,000 of purchased intangible assets to be amortized. As a result of all of the foregoing, we expect to incur losses for the foreseeable future and will need to generate significantly higher revenues in order to achieve profitability. If we achieve profitability, we may not be able to sustain it.

Fluctuations of our 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. We believe that quarter-to-quarter comparisons of our revenues and operating results are not necessarily meaningful and should not be relied on as indicators of future performance. Our operating expenses are based on our expectations of future revenues and are relatively fixed in the short-term. During fiscal 2004 and fiscal 2003 we took actions to reduce our operating expenses and, while we may from time to time reduce operating expenses in response to variability in our revenues, including variabilities caused by downturns in the United States and/or international economies, over the long term we generally expect to increase our operating expenses to expand our sales and marketing operations, fund greater levels of research and development, develop new alliances, increase our services and support capabilities and improve our operational and financial systems. If our revenues do not increase along with these expenses, our business would be seriously harmed and net losses in a given quarter would be even larger than expected. 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.

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Our quarterly revenues are especially subject to fluctuations because they depend on the sale of a small number of relatively large orders, principally orders for Saba Learning and related services. As a result, our quarterly operating results may fluctuate if we are unable to complete a sufficient number of large orders in any particular quarter. We have not fully developed our business model for Saba Exchange, including the structure and amount of the fees we intend to charge. As this business model evolves, the potential for fluctuations in our quarterly results could increase. Furthermore, our quarterly revenues may be affected significantly by changes in revenue recognition policies and procedures based on changes to, or new, applicable accounting standards and how these standards are interpreted.

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Our lengthy sales cycle could cause delays in revenue growth

The period between our initial contact with a potential customer and the purchase of our products and services is often long. A customer's decision to purchase our products and services requires the commitment to increase performance through human capital development and management, involves a significant allocation of resources, and is influenced by a customer's budgetary cycles. To successfully sell our products and services, we generally must educate our potential customers regarding the use and benefits of our products and services, which can require significant time and resources. Many of our potential customers are large enterprises that generally take longer to make significant business decisions. Our typical sales cycle has been approximately 6 to 12 months. The delay or failure to complete sales in a particular quarter could reduce our revenues in that quarter. If our sales cycle unexpectedly lengthens 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 order, it could harm our ability to meet our forecasts for a given quarter.

A decline in the price of, or demand for, our main product, Saba Learning or our related services offerings would seriously harm our revenues and operating margins

To date, Saba Learning and related services have accounted for a substantial majority of our revenues. We anticipate that revenues from Saba Learning and related services will continue to constitute a substantial majority of our revenues for the foreseeable future. Consequently, a decline in the price of, or demand for, Saba Learning or failure to achieve broad market acceptance would seriously harm our business.

We are exposed to recent unfavorable economic conditions

We have seen a rapid and increasingly severe downturn in the United States economy since the first quarter of fiscal 2001 (ended August 31, 2000), which has been further stalled by terrorist attacks in September 2001 and the war in Iraq in early 2003. There can be no certainty as to the severity or duration of this downturn. Although we cannot predict the extent and timing, if any, of the impact of economic downturns in the United States on economies in other countries or geographic regions, we are seeing an economic slowdown in certain international markets in which we conduct business. If the economic conditions in the United States continue or worsen or if a global economic slowdown intensifies, the demand for our products and services may be reduced. Not only may these economic slowdowns reduce our customers' and prospects' budgets for our products and services, but also they may adversely affect our customers' ability to pay for our products and services. Accordingly, these economic slowdowns may have a material adverse impact on our business, operating results and financial condition.

Our performance depends on a new market: human capital development and management

The market for software solutions that automate human capital development and management is relatively new and rapidly evolving. Substantially all of our revenues are attributable to the suite of products and services in this market. If this market fails to develop or develops more slowly than we expect, or if we fail to identify the challenges and risks in this new market or successfully address these risks, our business would be harmed.

Our strategy of establishing Saba Exchange is unproven and may not be successful

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We must more fully establish and enhance Saba Exchange, where organizations and learning providers can transact business and collaborate. Our success depends on a significant number of organizations implementing Saba Learning and conducting business with learning providers over the Internet through Saba Exchange. If this business strategy is flawed, or if we are unable to execute it effectively, our revenues may be seriously harmed. We began operating Saba Exchange in December 1999. Accordingly, we have limited experience developing and operating Saba Exchange. To date, only a limited number of learning providers and organizations are connected to Saba Exchange. It is possible that we, together with the organizations and learning providers who comprise this exchange, will not be able to effectively operate this exchange, both in terms of technical performance as well as commercial viability. It is possible that an insufficient number of

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organizations and/or learning providers will join and remain in Saba Exchange, and that we will be unable to generate significant revenues from Saba Exchange. Unless a critical mass of organizations and learning providers join Saba Exchange, our solutions may not achieve widespread market acceptance and our business would be seriously harmed. To date, we have not generated significant revenues from Saba Exchange.

If we lose key personnel or are unable to attract and retain additional qualified personnel, we may not be able to successfully manage our business and achieve our objectives

We believe our future success will depend upon our ability to retain our key management personnel. These employees are not subject to employment contracts. We may not be successful in attracting, assimilating and retaining our key employees in the future. Our future success and our ability to expand our operations will also depend in large part on our ability to attract and retain additional qualified technical, sales and marketing personnel. Competition for these types of employees is intense due to the limited number of qualified professionals and the high demand for them, particularly in the San Francisco Bay Area, where our headquarters is located. We have in the past experienced difficulty in recruiting qualified personnel. Failure to attract, assimilate and retain personnel, particularly technical, sales and marketing personnel, would have a material adverse effect on our business and potential growth. Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees, all of whom have been granted stock options or been sold restricted stock.

Difficulties we may encounter managing our growth could adversely affect our results of operations

We intend to grow our business significantly. To support our growth plans, we may need to expand our existing management, operational, financial and human resources, customer service and management information systems and controls. We may be unable to expand these systems and to manage our planned growth successfully, and this inability would adversely affect our business.

Intense competition in our target market could impair our ability to grow and to achieve profitability

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 market and license training, learning, performance, content, resource, talent and staffing management systems;

enterprise software vendors that offer human resources information systems and employee relationship management systems with training and performance modules;

potential customers' internal development efforts;

companies that operate Internet-based marketplaces for the sale of on-line learning;

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companies that operate Internet-based marketplaces for the sale of goods and services and could potentially decide to evolve their marketplaces to include content offerings; and

Internet portals that offer learning content, performance support tools or recruiting services.

Because there are relatively low barriers to entry in the electronic commerce market, which comprises a portion of our business model, we expect competition from a variety of established and emerging companies

Many of our competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Competition could seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products and services obsolete, unmarketable or less competitive. Our current and potential

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competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other learning solution providers, 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.

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

International revenues accounted for 40% of our revenues for the three months ended November 30, 2003 and 25% for the three months ended November 30, 2002. International revenues accounted for 38% of our revenues for the six months ended November 30, 2003 and 20% of our revenues for the six months ended November 30, 2002. We intend to expand our international presence in the future. Conducting business outside of the United States is subject to certain risks, including:

changes in regulatory requirements and tariffs;

language barriers;

difficulties in staffing and managing foreign operations;

longer payment cycles and greater difficulty in collecting accounts receivable;

reduced protection of intellectual property rights;

potentially harmful tax consequences;

fluctuating exchange rates;

price controls and other restrictions on foreign currency;

difficulties in obtaining import and export licenses;

political and social unrest or disturbances;

the burden of complying with a variety of foreign laws; and

political or economic constraints on international trade.

We might not successfully market, sell or distribute our products and services in foreign markets, and we cannot be certain that one or more of the factors indicated above will not materially adversely affect our future international operations, and consequently, our business and future growth.

We may become subject to government regulation and legal uncertainties that could reduce demand for our products and services or increase the cost of doing business, thereby adversely affecting our financial results

We are not currently subject to direct regulation by any domestic or foreign governmental agency, other than regulations applicable to businesses generally, export control laws and laws or regulations directly applicable to Internet commerce. However, due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may become applicable to us or may be adopted in the future with respect to the Internet covering issues such as:

user privacy;

taxation;

content;

right to access personal data;

copyrights;

distribution; and

characteristics and quality of services.

The applicability of existing laws governing issues such as property ownership, copyrights, and other intellectual property issues, encryption, taxation, libel, export or import matters and personal privacy to the Internet is uncertain. The vast majority of these laws were adopted prior to the broad commercial use of the Internet and related technologies. As a result, they do not contemplate or address the unique issues of the Internet and related technologies. Changes to these laws, including some recently proposed changes, could create uncertainty in the Internet marketplace. Such uncertainty could reduce demand for our services or increase the cost of doing business due to increased costs of litigation or increased service delivery costs.

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In addition, we could be liable for the misuse of personal information. The Federal Trade Commission, the European Union and certain state and local authorities have been investigating some Internet companies regarding their use of personal information. We could incur additional expenses if new regulations regarding the use of personal information are introduced or if these authorities choose to investigate our privacy practices.

Our market is subject to rapid technological change and, to compete, we must continually enhance our products and services

We must continue to enhance and improve the performance, functionality and reliability of our products and services. The software and electronic commerce industries are characterized by rapid technological change, changes in user requirements and preferences, frequent new product and services introductions embodying new technologies and the emergence of new industry standards and practices that could render our products and services obsolete. In the past, we have discovered that some of our customers desire additional performance and functionality not currently offered by our products. Our success will depend, in part, on our ability to both internally develop and license leading technologies to enhance our existing products and services, develop new products and services that address the increasingly sophisticated and varied needs of our customers, and respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis. In addition, the development of our technology and other proprietary technology involves significant technical and business risks. We may fail to use new technologies effectively or to adapt our proprietary technology and systems to customer requirements or emerging industry standards. If we are unable to adapt to changing market conditions, customer requirements or emerging industry standards, we may not be able to increase our revenues and expand our business.

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. Any delay in releasing future products or enhancements of our products could cause our stock price to decline.

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

Products as complex as ours often contain unknown and undetected errors or performance problems. Many serious defects are frequently found during the period immediately following introduction and initial shipment of new products or enhancements to existing products. 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 or delays in customer acceptance 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 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 a decrease in our revenues.

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Claims by third parties that we infringe their intellectual property rights may result in costly 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 could become subject to 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 noninfringing technology, obtain a license or cease selling the products that contain the infringing intellectual property. We may be unable to develop noninfringing technology or obtain a license on commercially reasonable terms, if at all.

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, or develop similar technology independently. In addition, we have two patents issued in the United States and six 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 patent, 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.

We do not have a comprehensive disaster recovery plan or back-up system, and a disaster could severely damage our operations

We currently do not have a comprehensive disaster recovery plan in effect and do not have 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 Saba Exchange and Saba Learning ASP Edition. A number of these computer systems are located on or near known earthquake fault zones. Although these systems are designed to be fault tolerant, they 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 our hosted and ASP solutions 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 Saba Exchange and Saba Enterprise Learning Suite for customers who desire to have these solutions hosted. We also rely on third-party communications service providers for the high-speed connections that link our and our Internet service providers' Web servers and office systems to the Internet. 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.

We depend upon continuing our relationship with third-party integrators who support our solutions

Our success depends upon the acceptance and successful integration by customers of our products. We often rely on third-party systems integrators to assist with implementation of our products. We will need to continue to rely on these systems integrators even as we increase the size of our professional services group.

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If large systems integrators fail to continue to support our solution or commit resources to us, if any of our customers are not able to successfully integrate our solution or if we are unable to adequately train our existing systems integration partners, our business, operating results and financial condition could suffer. In addition, we have only limited control over the level and quality of service provided by our current and future third-party integrators.

We may not be able to secure necessary funding in the future; additional funding may result in dilution to our stockholders

We require substantial working capital to fund our business. We have had significant operating losses and negative cash flow from operations since inception and expect this to continue for the foreseeable future. We expect to use our available cash resources and credit facilities primarily to fund sales and marketing activities, research and development, and continued operations, and possibly make future acquisitions. We believe that our existing capital resources will be sufficient to meet our capital requirements for the next twelve months. However, if our capital requirements increase materially from those currently planned or if revenues fail to materialize, we may require additional financing sooner than anticipated. If additional funds are raised through the issuance of equity securities, the percentage ownership of our stockholders will be reduced, stockholders may experience dilution, or such equity securities may have rights, preferences or privileges senior to those of the holders of our common stock. Additional financing may not be available when needed on terms favorable to us or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to develop or enhance our products and services, take advantage of future opportunities or respond to competitive pressures.

Our past and future acquisitions may result in disruptions to our business if we fail to adequately integrate acquired businesses

In March 2001, we acquired Human Performance Technologies, Inc. and, in June 2001, we acquired Ultris Inc. As part of our overall business strategy, we expect to continue to acquire complementary businesses or technologies that will provide additional products or services offerings, additional industry expertise or an expanded geographic presence. These acquisitions could result in the use of significant amounts of cash, potentially dilutive issuances of equity securities, or the incurrence of debt. In addition, any acquisition may increase the risk of future write-offs for acquired in-process research and development, write-offs for the impairment of goodwill or long-lived assets, or amortization of expenses related to intangible assets, any of which could materially adversely affect our business and our operating results. For example, as of November 30, 2003, we had an aggregate of \$265,000 of purchased intangible assets to be amortized as a result of the acquisition of Human Performance Technologies, Inc. and Ultris Inc. Although these two acquisitions are fully integrated, future acquisitions involve 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; and

the potential loss of key employees of the acquired company.

Our stock price may fluctuate substantially

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;

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; and

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

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In addition, the stock market in general, and the Nasdaq National Market and 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. 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.

Sales of shares eligible for future sale could cause our stock price to decline

If our stockholders sell substantial amounts of our common stock (including shares issued upon the exercise of outstanding options and warrants) in the public market, the market price of our common stock could fall. Such sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

The anti-takeover provisions in our charter documents could adversely affect the rights of the holders of our common stock

Our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws contain provisions that could make it harder for a third-party to acquire us without the consent of our board of directors. For example, if a potential acquiror were to make a hostile bid for us, the acquiror 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 acquiror would also be required to provide advance notice of its proposal to remove directors at an annual meeting. The acquiror will not be able to cumulate votes at a meeting, which will require the acquiror 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 acquiror. 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.

Our board of directors could choose not to negotiate with an acquiror that it did not feel was in our strategic interests. If the acquiror was discouraged from offering to acquire us or prevented from successfully completing a hostile acquisition by our anti-takeover measures, you could lose the opportunity to sell your shares at a favorable price.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our investments are made in accordance with an investment policy approved by our Board of Directors. All investments are carried at market value, which approximates cost. At November 30, 2003, all of our investments were considered available-for-sale securities and the average

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maturity of our investment securities was approximately two months. The weighted average interest rate of our portfolio was approximately 1.0% at November 30, 2003. Due to the nature of our cash equivalents and short-term investments, which are primarily money market funds, commercial paper, and U.S. government agency bonds, we believe that there is no material market risk exposure.

The revolving line of credit portion of our credit facility allows us to make draws at a variable interest rate of the bank's Prime Rate plus between 1% and 2%. In November 2003, we borrowed \$4.5 million against the line of credit, which was repaid in December 2003. Therefore, only future borrowings would be affected by changes in the market interest rates.

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The equipment term loan portion of our credit facility allows us to make draws at either a variable interest rate equal to the greater of the 5.5% or the bank's Prime Rate plus 1.5% or a fixed interest rate equal to the 36-month U.S. Treasury note plus 3.7%. As of November 30, 2003, we had outstanding equipment term loans of \$440,000 that carry fixed interest rates ranging from 4.9% to 6.90%. Therefore, only future borrowings on the equipment term loan portion of our credit facility would be affected by changes in market interest rates.

As of November 30, 2003, we also had an outstanding term loan of \$933,000 that carried a variable interest rate based on the bank's Prime Rate plus 1.25%. If the bank's Prime Rate were to change by 10% from its level at November 30, 2003, the impact would not be material to our financial position or results of operations.

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. As we continue to expand our operations, more of our contracts may be denominated in Australian Dollars, Canadian Dollars and Japanese Yen. 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 the translation of the financial results of foreign subsidiaries into U.S. dollars in consolidation. As exchange rates vary, these results, when translated, may vary from expectations and adversely impact overall expected profitability.

ITEM 4. CONTROLS AND PROCEDURES

As of November 30, 2003, our management evaluated, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in this report. There has been no change in our internal control over financial reporting that occurred during the fiscal quarter ended November 30, 2003 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York against us, certain of our officers and directors, and certain underwriters of our initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased our common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by us and our officers and directors of the Securities Act of 1933 in connection with certain alleged compensation arrangements entered into by the underwriters in

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connection with the offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints were later consolidated into a single action. On July 16, 2003, a committee of our board of directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of us and of the individual defendants for the conduct alleged in the action to be wrongful in the amended complaint. We would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or

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release certain potential claims we may have against our underwriters. Any direct financial impact of the proposed settlement is expected to be borne by our insurers. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other issuer defendants in the proposed settlement, the consent of our insurers to the settlement, and the completion of acceptable final settlement documentation. Furthermore, the settlement is subject to a hearing on fairness and approval by the court overseeing the initial public offering litigation. If the settlement is not finalized, we believe that the claim asserted by these lawsuits are without merit, and intend to defend these actions vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect our business, financial condition and results of operations.

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

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

In September 2003, we issued 134,055 shares of our common stock in connection with the settlement of patent litigation. These shares were issued in accordance with the exemption set forth in Section 4(2) of the Securities and Exchange Act of 1933, as amended. These sales were made without general solicitation or advertising.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Saba held its Annual Meeting of Stockholders on November 6, 2003. Of the 13,271,408 shares outstanding as of the record date, 11,027,907 shares were present or represented by proxy at the meeting. At this meeting the following actions were voted upon:

- (1) Election of Director. To elect two Class III Directors to serve until the 2006 annual meeting of stockholders or until their respective successors have been elected or appointed. The results of the vote on this action were as follows:

	<u>For</u>	<u>Against</u>	<u>Abstain</u>	<u>Non-Vote</u>
Douglas C. Allred	10,921,833	0	106,074	0
Michael J. Moritz	10,012,283	0	1,015,624	0

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- (2) Ratification of the Appointment of Independent Auditors. To ratify the appointment by the board of directors of Ernst & Young LLP as our independent auditors for the fiscal year ending May 31, 2004. The results of the vote on this action were as follows:

For	Against	Abstain	Non-Vote
10,859,140	163,319	5,448	0

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- a. Exhibits

See Exhibit Index following the signature page.

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b. Reports on Form 8-K.

On September 22, 2003, we filed a current report on Form 8-K in order to furnish our earnings press release for our preliminary financial results for the first fiscal quarter ended August 31, 2003 and a press release announcing the appointment of Bobby Yazdani as Chairman of the Board and Chief Executive Officer.

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SIGNATURES

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

Dated: January 14, 2004

SABA SOFTWARE, INC.

By: /s/ Bobby Yazdani

*Chief Executive Officer and
Chairman of the Board
(Principal Executive Officer)*

By: /s/ Ronald W. Kisling

*Chief Financial Officer (Principal
Financial and Accounting Officer)*

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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⁾	Amended and Restated Bylaws of the Company effective as of September 18, 2003.
3.3	Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Company effective as of May 12, 2003.
4.1	Reference is made to Exhibits 3.1 and 3.2.
10.14	Amended and Restated Loan and Security Agreement dated October 31, 2003 between Silicon Valley Bank and the Company.
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.
31.2	Certification of Ronald W. Kisling, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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.
32.2	Certification of Ronald W. Kisling, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
(1)	Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (Registration No. 333-95761) previously filed with the SEC.
(2)	Incorporated by reference to the Company's quarterly report on Form 10-Q for the period ended August 31, 2003, previously filed with the SEC.