

STELLENT INC
Form 10-Q
November 09, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004.

OR

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

COMMISSION FILE NUMBER 0-19817.

STELLENT, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

MINNESOTA

41-1652566

(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

(I.R.S. EMPLOYER
IDENTIFICATION NO.)

7777 GOLDEN TRIANGLE DRIVE, EDEN
PRAIRIE, MINNESOTA

55344-3736

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(ZIP CODE)

(952) 903-2000

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR,
IF CHANGED SINCE LAST REPORT)

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

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934) Yes [X] No []

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common Stock, \$.01 par value - 26,902,638 shares as of November 5, 2004.

STELLENT, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STELLENT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)
(UNAUDITED)

	September 30, 2004	March 31, 2004
	<hr/>	<hr/>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 37,130	\$ 44,165
Short-term marketable securities	21,563	22,366
Accounts receivable, net	27,223	19,165
Prepaid royalties	1,086	1,851
Prepaid expenses and notes	5,566	4,905
	<hr/>	<hr/>
Total current assets	92,568	92,452
Long-term marketable securities	5,390	6,981
Property and equipment, net	5,361	4,471
Prepaid royalties, net of current	1,340	1,482
Goodwill	67,180	14,780
Other intangible assets, net	7,040	2,230
Investments and notes in other companies	1,136	1,136
Other	1,065	1,156
	<hr/>	<hr/>
Total assets	\$181,080	\$124,688
	<hr/>	<hr/>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,044	\$ 2,748
Deferred revenue	17,153	10,097
Commissions payable	1,919	1,301
Accrued expenses and other	7,780	5,786
Current installments of obligations under capital lease	578	
	<hr/>	<hr/>
Total current liabilities	29,474	19,932
Deferred revenue, net of current portion		51
	<hr/>	<hr/>

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Total liabilities	29,474	19,983
Shareholders' equity		
Common stock	269	223
Additional paid-in capital	239,937	189,221
Unearned compensation	(751)	
Accumulated deficit	(88,496)	(85,415)
Accumulated other comprehensive income	647	676
	<u> </u>	<u> </u>
Total shareholders' equity	151,606	104,705
	<u> </u>	<u> </u>
Total liabilities and shareholders' equity	\$181,080	\$124,688
	<u> </u>	<u> </u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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STELLENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Revenues:				
Product licenses	\$14,775	\$10,215	\$26,454	\$20,060
Services	13,181	8,306	24,162	15,848
Total revenues	<u>27,956</u>	<u>18,521</u>	<u>50,616</u>	<u>35,908</u>
Cost of revenues:				
Product licenses	1,068	1,116	2,360	2,216
Amortization of capitalized software from acquisitions	643	315	1,106	836
Services	6,610	4,183	11,907	7,981
Total cost of revenues	<u>8,321</u>	<u>5,614</u>	<u>15,373</u>	<u>11,033</u>
Gross profit	<u>19,635</u>	<u>12,907</u>	<u>35,243</u>	<u>24,875</u>
Operating expenses:				
Sales and marketing	10,931	9,560	20,720	19,522
General and administrative	3,057	2,617	5,581	4,941
Research and development	4,867	3,348	8,665	6,523
Acquisition-related sales, marketing and other costs			886	
Amortization of acquired intangible assets and unearned compensation	175	118	354	1,770
Restructuring charges			2,461	812
Total operating expenses	<u>19,030</u>	<u>15,643</u>	<u>38,667</u>	<u>33,568</u>
Income (loss) from operations	605	(2,736)	(3,424)	(8,693)
Other:				
Interest income, net	149	249	343	541

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	_____	_____	_____	_____
Net income (loss)	\$ 754	\$ (2,487)	\$ (3,081)	\$ (8,152)
	_____	_____	_____	_____
Net Income (loss) per common share				
Basic	\$ 0.03	\$ (0.11)	\$ (0.12)	\$ (0.37)
Diluted	\$ 0.03	\$ (0.11)	\$ (0.12)	\$ (0.37)
Weighted average common shares outstanding				
Basic	26,720	21,916	25,300	21,873
Diluted	27,776	21,916	25,300	21,873

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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STELLENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	SIX MONTHS ENDED SEPTEMBER 30,	
	2004	2003
	<hr/>	<hr/>
OPERATING ACTIVITIES		
Net loss	\$ (3,081)	\$ (8,152)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	1,719	1,728
Amortization of intangible assets, acquisition expense and unearned compensation	1,459	2,606
Changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable	(5,262)	(2,369)
Prepaid expenses and other current assets	750	(235)
Accounts payable and other liabilities	(1,067)	288
Accrued liabilities	(48)	1,358
Deferred revenue	811	(765)
Accrued commissions	618	52
	<hr/>	<hr/>
Net cash flows used in operating activities	(4,101)	(5,489)
	<hr/>	<hr/>
INVESTING ACTIVITIES:		
Maturities of marketable securities, net	7,541	4,933
Purchases of property and equipment	(930)	(1,017)
Business acquisition costs, net of cash acquired	(10,657)	(2,047)
	<hr/>	<hr/>
Net cash flows provided by (used in) investing activities	(4,046)	1,869
	<hr/>	<hr/>
FINANCING ACTIVITIES:		
Repurchase of common stock		(308)
Proceeds from exercise of stock options and warrants	950	372
Proceeds from issuance of stock under Employee Stock Purchase Plan and other	432	375
Payments under capital leases	(241)	
	<hr/>	<hr/>
Net cash flows provided by financing activities	1,141	439
	<hr/>	<hr/>

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Cumulative effect of foreign currency translation adjustment	(29)	168
	<u> </u>	<u> </u>
Net decrease in cash	(7,035)	(3,013)
Cash and equivalents, beginning of period	44,165	37,439
	<u> </u>	<u> </u>
Cash and equivalents, end of period	\$ 37,130	\$34,426
	<u> </u>	<u> </u>
Supplemental disclose of non-cash investing and financing activities:		
Non-cash financing activity - issuance of common stock for business combination	\$ 41,416	\$ 754
	<u> </u>	<u> </u>
Non-cash financing activity - assumption of stock option plan related to business combination	\$ 7,964	\$
	<u> </u>	<u> </u>
Non-cash investing and financing activity purchase of equipment through capital leases	\$ 819	\$
	<u> </u>	<u> </u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

NOTE 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions for Quarterly Reports on Form 10-Q and instructions for Article 10 of Regulation S-X. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, have been recorded as necessary to present fairly Stellent, Inc.'s (Stellent or the Company) consolidated financial position, results of operations and cash flow for the periods presented. These financial statements should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Fiscal Year 2004 Annual Report on Form 10-K. The consolidated results of operations for the three and six month periods ended September 30, 2004 and 2003 are not necessarily indicative of the results that may be expected for any future period. References to fiscal years 2005 and 2004, represent the twelve months ended March 31, 2005 and 2004, respectively.

The condensed consolidated balance sheet at March 31, 2004 has been derived from 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 of America for complete financial statements. Such disclosure are contained in the Company's Annual Report on Form 10-K.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Revenue Recognition

Revenue consists principally of software license, support, consulting and training fees. The Company recognizes revenue in accordance with 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, and Securities and Exchange Commission Staff Accounting Bulletin 101, Revenue Recognition in Financial Statements.

Product license revenue is recognized under SOP 97-2 when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable and supported and the arrangement does not require services that are essential to the functionality of the software.

Persuasive Evidence of an Arrangement Exists The Company determines that persuasive evidence of an arrangement exists with respect to a customer under, i) a signature license agreement, which is signed by both the customer and the Company or, ii) a purchase order, quote or binding letter-of-intent received from and signed by the customer, in which case the customer has either previously executed a signature license agreement with us or will receive a shrink-wrap license agreement with the software. The Company does not offer product return rights to end users or resellers.

Delivery has Occurred The Company's software may be either physically or electronically delivered to the customer. The Company determines that delivery has occurred upon shipment of the software pursuant to the billing terms of the arrangement or when the software is made available to the customer through electronic delivery. Customer acceptance

generally occurs at delivery.

The Fee is Fixed or Determinable If at the outset of the customer arrangement, the Company determines that the arrangement fee is not fixed or determinable, revenue is typically recognized when the arrangement fee becomes due and payable. Fees due under an arrangement are generally deemed fixed and determinable if they are payable within twelve months.

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

Collectibility is Probable and Supported The Company determines whether collectibility is probable and supported on a case-by-case basis. The Company may generate a high percentage of our license revenue from our current customer base, for whom there is a history of successful collection. The Company assesses the probability of collection from new customers based upon the number of years the customer has been in business and a credit review process, which evaluates the customer's financial position and ultimately their ability to pay. If the Company is unable to determine from the outset of an arrangement that collectibility is probable based upon the Company's review process, revenue is recognized as payments are received.

With regard to software arrangements involving multiple elements, the Company allocates revenue to each element based on the relative fair value of each element. The Company's determination of fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence (VSOE). The Company limits its assessment of VSOE for each element to the price charged when the same element is sold separately. The Company has analyzed all of the elements included in its multiple-element arrangements and have determined that it has sufficient VSOE to allocate revenue to consulting services and post-contract customer support (PCS) components of its license arrangements. Generally, the Company sells its consulting services separately, and has established VSOE on this basis. VSOE for PCS is determined based upon the customer's annual renewal rates for these elements. Accordingly, assuming all other revenue recognition criteria are met, revenue from perpetual licenses is recognized upon delivery using the residual method in accordance with SOP 98-9, and revenue from PCS is recognized ratably over their respective terms, typically one year.

The Company's direct customers typically enter into perpetual license arrangements. The Company's Content Components Division (CCD) generally enters into term-based license arrangements with its customers, the term of which generally exceeds one year in length. The Company recognizes revenue from time-based licenses at the time the license arrangement is signed, assuming all other revenue recognition criteria are met, if the term of the time-based license arrangement is greater than twelve months. If the term of the time-based license arrangement is twelve months or less, the Company recognizes revenue ratably over the term of the license arrangement.

Services revenue consists of fees from consulting services and PCS. Consulting services include needs assessment, software integration, security analysis, application development and training. The Company bills consulting services fees either on a time and materials basis or on a fixed-price schedule. In general, our consulting services are not essential to the functionality of the software. The Company's software products are fully functional upon delivery and implementation and generally do not require any significant modification or alteration for customer use. Customers purchase the Company's consulting services to facilitate the adoption of its technology and may dedicate personnel to participate in the services being performed, but they may also decide to use their own resources or appoint other professional service organizations to provide these services. Software products are billed separately from professional services. The Company recognizes revenue from consulting services as services are performed. The Company's customers typically purchase PCS annually, and the Company prices PCS based on either a percentage of the product license fee or product list price, as applicable. Customers purchasing PCS receive product upgrades, Web-based technical support and telephone hot-line support.

Customer advances and billed amounts due from customers in excess of revenue recognized are recorded as deferred revenue.

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

Cash, Cash Equivalents, Marketable Securities and Investments in Other Companies

Cash and Cash Equivalents: The Company considers all short-term, highly liquid investments that are readily convertible into known amounts of cash and have original maturities of three months or less to be cash equivalents.

Marketable Securities: Investments in debt securities with a remaining maturity of one year or less at the date of purchase are classified as short-term marketable securities. Investments are held in debt securities of the United States government and with corporations that have the highest possible credit rating. Investments in debt securities with a remaining maturity of greater than one year are classified as long-term marketable securities. These investments are classified as held to maturity and recorded at amortized cost as the Company has the ability and positive intent to hold to maturity.

Investments in Other Companies: Investments in other companies includes investments in non-public, start-up technology companies for which the Company uses the cost method of accounting. Investments are classified as long-term as the Company anticipates holding them for more than one year. The Company holds less than 20% interest in, and does not directly or indirectly exert significant influence over any of the respective investees.

Warranties

The Company generally warrants its software products for a period of 30 to 90 days from the date of delivery and estimates probable product warranty costs at the time revenue is recognized. The Company exercises judgment in determining its accrued warranty liability. Factors that may affect the warranty liability include historical and anticipated rates of warranty claims, material usage, and service delivery costs. Warranty costs incurred have not been material.

Indemnification Obligations

The Company generally undertakes intellectual property indemnification obligations in its software products or services agreements with customers. Typically, these obligations provide that the Company will indemnify, defend and hold the customers harmless against claims by third parties that its software products or services infringe upon the copyrights, trademarks, patents or trade secret rights of such third parties. No such claim has been made by any third party with regard to the Company's software products or services.

Comprehensive Income (Loss)

Comprehensive income (loss) includes foreign currency translation adjustments and unrealized gains or losses on the Company's available for sale securities. Total comprehensive loss was \$3,110 and \$7,984, respectively, for the six months ended September 30, 2004 and 2003.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets

and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 (IN THOUSANDS, EXCEPT PER SHARE DATA)
 (UNAUDITED)

New Accounting Pronouncements

In November 2002, the FASB reached a consensus on EITF Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. This EITF sets out criteria for whether revenue can be recognized separately from other deliverables in a multiple deliverable arrangement. The criteria considers whether the delivered item has stand-alone value to the customer, whether the fair value of the delivered item can be reliably determined and the rights of return for the delivered item. This EITF was required to be adopted by the Company beginning April 1, 2004. The adoption of this EITF did not have a material effect on the Company's consolidated financial statements.

In June 2004, the FASB's Emerging Issues Task Force (EITF) issued EITF 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF 03-1 provides further guidance on the meaning of other-than-temporary impairment and its application to debt and equity securities. A majority of EITF 03-1 was effective for all reporting periods beginning after June 15, 2004. In September of 2004, the FASB issued FSP EITF Issue 03-1-1, which delayed the effective date for the measurement and recognition guidance included in the EITF related to debt securities. The adoption of this EITF did not and is not anticipated to have a material effect on how the company analyzes and records other than temporary impairments on its investments in other companies.

Stock-based Compensation

The Company has stock option plans for employees and a separate stock option plan for directors. The intrinsic value method is used to value the stock options issued to employees and directors, and the Company accounts for those plans under the recognition and measurement principles of Financial Accounting Standards Board (FASB) APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. In the periods presented, no stock-based employee compensation cost is reflected in net income (loss), as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Had the fair value method been applied, the compensation expense would have been different. The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had applied the fair value method for the following periods:

Supplemental information:

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
Net income (loss) as reported	\$ 754	\$ (2,487)	\$ (3,081)	\$ (8,152)
Less: Total stock based employee compensation expense determined under fair value based method for all awards	(3,338)	(2,433)	(6,360)	(4,271)

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Net loss pro forma	\$ (2,584)	\$ (4,920)	\$ (9,441)	\$ (12,423)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Weighted average shares outstanding				
Basic	26,720	21,916	25,300	21,873
Diluted	27,776	21,916	25,300	21,873
Net income (loss) per share as reported				
Basic and diluted	\$ 0.03	\$ (0.11)	\$ (0.12)	\$ (0.37)
Net loss per share pro forma				
Basic and diluted	\$ (0.10)	\$ (0.22)	\$ (0.37)	\$ (0.57)

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 (IN THOUSANDS, EXCEPT PER SHARE DATA)
 (UNAUDITED)

Note 2. Basic and Diluted Net Income (Loss) Per Common Share

Basic net income (loss) per share is computed using the weighted average number of shares outstanding of common stock. Diluted net income (loss) per share is computed using the weighted average number of shares of common stock and common equivalent shares outstanding during the period. Common equivalent shares consist of stock options and warrants (using the treasury stock method) of 1,056 and 1,121 shares for the three months ended September 30, 2004 and 2003, respectively, and 1,106 and 692 shares for the six months ended September 30, 2004 and 2003, respectively. Common equivalent shares are excluded from the computation if their effect is anti-dilutive.

Note 3. Mergers and Acquisitions

On May 13, 2004, the Company acquired the outstanding shares of Stellent, S.A. De C.V. for approximately \$750, creating a business presence in Mexico. The Company is required to make contingent consideration payments (earn out) for two years from the date of acquisition. Earn out amounts cannot exceed \$300 in the first year and \$450 in the second year after the acquisition which will be recorded as goodwill. No contingent consideration accruals or payments were required through September 30, 2004.

On May 28, 2004, the Company acquired all outstanding shares of Optika Inc. for \$10,000 in cash, approximately 4,200 shares of the Company's common stock valued at \$41,416, the assumption of Optika's outstanding common stock options, and direct acquisition costs of approximately \$1,839. The Company acquired Optika in order to add to, or strengthen and expand, its Universal Content Management software in the areas of document imaging, business process management and compliance capabilities. The valuation of the Company's stock was set at an average price at the time the merger agreement was signed, which was January 11, 2004. The fair value of Optika's option plan of \$7,964 was estimated as of January 11, 2004 using the Black-Scholes option-pricing model with the following assumptions: no estimated dividends, expected volatility of 95%, risk free interest rate of 2.5% and expected option terms of 3 years for all options.

The total estimated purchase price is allocated to Optika's net tangible and identifiable intangible assets based upon their estimated fair values as of the date of completion of the acquisition. The excess of the purchase price over the net tangible and identifiable intangible assets has been recorded as goodwill. A restructuring plan was adopted as a result of the acquisition. The acquisition restructuring charge relates to severance costs for terminated employees of \$596 and facility closing costs of \$263 primarily related to lease obligations. During the three months ended September 30, 2004, the Company paid out \$336 and \$147 in severance and facility costs, respectively. At September 30, 2004, the remaining amount to be paid related to severance and facilities were \$260 and \$116, respectively. Based upon the purchase price and valuation, the following represents the allocation of the aggregate purchase price to the acquired net assets of Optika:

Net tangible assets	\$ 3,840
Acquisition restructuring charge	(859)
Goodwill	51,243
Identifiable intangible assets	6,100
Unearned compensation	895

Total estimated purchase price	\$61,219

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 (IN THOUSANDS, EXCEPT PER SHARE DATA)
 (UNAUDITED)

The estimate of unearned compensation was based on the fair market value of the unvested options as of May 28, 2004. Compensation expense will be recognized over the remaining vesting period of the options, which ranges from one month to 48 months, as each option grant vests.

Stellent's management valued the identifiable intangible assets acquired using an appraisal. Identifiable intangible assets consist of:

	Fair Value	Estimated Useful Life	Estimated Annual Amortization
Developed software	\$3,400	3 years	\$1,133
Contractual customer relationships	2,700	10 years	270
	<u>\$6,100</u>		<u>\$1,403</u>

As part of the acquisition of Optika the Company also acquired net deferred tax assets of approximately \$13,390. These deferred tax assets relate to net operating loss (NOL) carryforwards and the tax effects of temporary differences primarily related to deferred revenue, depreciation and amortization and other accrued expenses.

The Company has recorded a full valuation allowance against the net deferred tax assets due to the uncertainty of future taxable income, which is necessary to realize the benefits of the deferred tax assets. NOL carryforwards were approximately \$34,803. These NOLs begin to expire in 2009 and are subject to annual utilization limits due to prior ownership changes.

Realization of the NOL carryforwards and the deferred tax temporary differences, which were acquired, are contingent on future taxable earnings. The deferred tax assets were reviewed for expected utilization using a more likely than not approach by assessing the available positive and negative evidence surrounding their recoverability. Accordingly, a full valuation allowance has been recorded against the Company's deferred tax asset.

The Company will continue to assess and evaluate strategies that will enable the deferred tax asset, or portion thereof, to be utilized, and will reduce the valuation allowance appropriately at such time when it is determined that the more likely than not criteria is satisfied. Reversal of the valuation allowance will be applied first to reduce to zero any goodwill related to the acquisition, then to reduce to zero other noncurrent intangible assets related to the acquisition, and then to reduce income tax expense.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisition of Optika had occurred as of April 1, 2003:

	Three months ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Net revenues	\$27,956	\$23,872	\$53,166	\$50,258
Net income (loss)	\$ 754	\$ (2,759)	\$ (6,644)	\$ (9,726)
Net income (loss) per share				
Basic	\$.03	\$ (0.10)	\$ (.26)	\$ (0.38)
Diluted	\$.03	\$ (0.10)	\$ (.26)	\$ (0.38)
Weighted average shares outstanding				
Basic	26,720	26,688	25,300	25,657
Diluted	27,776	26,688	25,300	25,657

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisition occurred as of April 1, 2003, nor are they necessarily indicative of the results that may occur in the future.

During the second quarter of fiscal year 2005 the Company acquired a Korean entity for approximately \$200. This amount was recorded as goodwill and other intangible assets.

Note 4. Contingencies

The Company is a defendant, along with certain current and former officers and directors of the Company, in a putative class action lawsuit entitled *In re Stellent Securities Litigation*. The lawsuit is a consolidation of several related lawsuits (the first of which was commenced on July 31, 2003) and is pending before the United States District Court for the District of Minnesota. The plaintiff alleges that the defendants made false and misleading statements relating to the Company and its future financial prospects in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The plaintiff seeks monetary damages against the defendants in unspecified amounts. Management believes the lawsuit is without merit and will vigorously defend the lawsuit.

Additionally, the Company is subject to various claims and litigation in the ordinary course of its business, including employment matters and intellectual property claims. Management does not believe the outcome of any current legal matters will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Note 5. Restructuring Charges

In the quarter ended September 30, 2002, in connection with management's plan to reduce costs and improve operating efficiencies, the Company recorded a restructuring charge of approximately \$800. The restructuring charge was comprised primarily of severance pay and benefits related to the involuntary termination of 27 employees of approximately \$400 with the remaining \$400 related to the closing of facilities and other exit costs. At September 30, 2004, \$383 remained to be paid in connection with these charges.

In the quarter ended December 31, 2002, in connection with management's plan to reduce costs and improve operating efficiencies, the Company recorded an additional restructuring charge of approximately \$700. This restructuring charge was comprised primarily of severance pay and benefits related to the involuntary termination of 28 employees of approximately \$400 with the remaining \$300 related to the closing of facilities and other exit costs. At September 30, 2004, no amounts remained to be paid in connection with these charges.

In the quarter ended June 30, 2003, in connection with management's plan to reduce costs and improve operating efficiencies, the Company recorded a restructuring charge of approximately \$800. This restructuring charge was comprised primarily of \$400 in severance pay and benefits related to the involuntary termination of employees, with the remaining \$400 related to the closing of facilities and other exit costs. This plan included the closing of an office facility as part of its acquisition of certain assets of Active IQ in March 2003. The facility was closed during the quarter ended June 30, 2003 and approximately \$50 was recorded to facility closing costs and future lease payments. The remaining \$350 of facility closing costs related to a change in the estimated costs of closing a research and development facility in Massachusetts, which was closed in the quarter ended September 30, 2002. At September 30,

2004, approximately \$6 remained to be paid in connection with these charges.

In the quarter ended June 30, 2004, with the integration of Optika and in connection with management's plans to reduce costs and improve operating efficiencies, the Company approved a restructuring plan in June 2004. The restructuring plan includes the termination of approximately 30 employees of Stellent, Inc. and the shutdown of the Company's New York facility. Restructuring charges during the first quarter of fiscal year 2005 related to this plan were approximately \$1,900 for employee termination benefits and approximately \$600 for excess facilities. At September 30, 2004, approximately \$1,280 remained to be paid in connection with these charges.

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 (IN THOUSANDS, EXCEPT PER SHARE DATA)
 (UNAUDITED)

The table below summarizes the Company's restructuring plans:

Restructuring Plans

	Second Quarter		Third Quarter		Fourth Quarter		First Quarter		First Quarter		Total
	Fiscal 03		Fiscal 03		Fiscal 03		Fiscal 04		Fiscal 05		
	Employee termin. benefit	Other exit costs	Employee termin. benefits	Other exit costs	Employee termination benefits	Other exit costs	Employee termin. benefits	Other exit costs	Employee termin. benefits	Other exit costs	
Balance at April 1, 2003	\$ 54	\$304	\$ 33	\$	\$240	\$ 43	\$	\$	\$	\$	\$ 674
Expense Payments	(36)	(65)	(33)		(60)	(11)	396	56	(245)		452
Change in estimate Payments		360									(450)
	—	—	—	—	—	—	—	—	—	—	360
Balance at June 30, 2003	18	599			180	32	151	56			1,036
Expense Payments	(18)	(43)			(60)		(38)	(56)			(215)
Balance at September 30, 2003		556			120	32	113				821
Expense Payments		(43)			(60)		(38)				(141)
Balance at December 31,		513			60	32	75				680

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2003	—	—	—	—	—	—	—	—	—	—
Expense Payments		(49)		(60)	(32)					(141)
Change in estimate						(69)				(69)
Balance at March 31, 2004		464				6				470
Expense Payments		(48)						1,866	595	2,461
								(306)		(354)
Balance at June 30, 2004		416				6		1,560	595	2,577
Expense Payments		(33)						(794)	(81)	(908)
Balance at September 30, 2004	\$	\$383	\$	\$	\$	\$ 6	\$	\$ 766	\$514	\$1,669

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

FORWARD-LOOKING STATEMENTS

This Form 10-Q for the period ended September 30, 2004 contains certain forward-looking statements within the meaning of the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Such forward-looking statements are based on the beliefs of our management as well as on assumptions made by, and information currently available to, us at the time such statements were made. When used in this Form 10-Q, the words anticipate, believe, estimate, expect, intend and similar expressions, as they relate us, are intended to identify such forward-looking statements. Although we believe these statements are reasonable, readers of this Form 10-Q should be aware that actual results could differ materially from those projected by such forward-looking statements as a result of the risk factors listed below. Readers of this Form 10-Q should consider carefully the factors listed below, as well as the other information and data contained in this Form 10-Q. We caution the reader, however, that such list of may not be exhaustive and that those or other factors, many of which are outside of our control, could have a material adverse effect on us and our results of operations. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth hereunder. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

OVERVIEW

In 1997, we launched one of the first software product suites on the market specifically developed and created for managing business documents using the Web. From the beginning, we focused on developing software that could be quickly implemented, easily used and easily scaled from line-of-business to enterprise-wide applications. This focus remains true today. While early on we developed document management and Web content management applications, in recent years we also expanded our product set to address market needs for: (a) Web-based management of digital assets, which are digital materials such as photos and graphics, and business records; (b) imaging; (c) business process management; and (d) records management.

The business information we manage for our customers is in an electronic form and is generally considered unstructured data, or data that is not easily managed by relational databases. In fact, the vast majority of information in any business is considered to be unstructured information, and typically resides in areas such as personal computers, conventional file servers and paper documents.

Our Universal Content Management software addresses primarily four areas of the enterprise content management market, Web content management, document management, digital asset management and imaging, which are supported by collaboration, records management and business process management services. Currently, customers use our Universal Content Management software to organize and maintain the electronic business information created by internal and external sources using a broad range of common software applications, such as Microsoft Office, AutoDesk AutoCAD and Sun StarOffice. This electronic business information includes items such as Web pages, digital assets, scanned images, Microsoft Office documents, scanned invoices, spreadsheets, email and forms. Our software also assists in the conversion of paper documents to electronic format. Using our technology, customers can then publish that information to public Web sites and/or secure Web sites available only to select audiences. Common applications powered by our technology include corporate intranets, accounts payable/receivable processes, claims processing, public Web sites, call centers/self-help Web sites, compliance processes and dealer extranets as well as enterprise-wide content management initiatives.

Additionally, software vendors and manufacturers of electronic devices, such as cell phones and PDAs, embed our Content Component software within their own technology to enable users to access and view electronic information from those applications or devices. We market our products primarily to customers in the financial services, healthcare (including insurance), government, and manufacturing industries located in the United States, Canada, Europe, Latin America and Asia.

On May 28, 2004, we acquired all outstanding shares of Optika Inc. for \$10 million in cash, approximately 4.2 million shares of Stellent common stock and the assumption by Stellent of Optika's outstanding common stock options. We acquired Optika in order to add to or strengthen and expand our Universal Content Management software in the areas of document imaging, business process management, ERP implementations and compliance capabilities. Accordingly, the results of Optika are incorporated in our consolidated financials since the acquisition date of May 28, 2004. We approved a restructuring plan in June 2004, which included the termination of approximately 30 employees and a related restructuring charge of approximately \$1.9 million and the shutdown of our New York sales facility and a related restructuring charge of approximately \$0.6 million. We anticipate the effects of this restructuring will result in a decrease in combined expenses of approximately \$3.5 million in fiscal year 2005, which includes personnel-related cost savings of approximately \$2.8 million and facility and other duplicate administrative cost savings of approximately \$0.7 million. We have realized some of these cost synergy savings during the second quarter ended September 30, 2004.

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RESULTS OF OPERATIONS

THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2004 AND 2003

REVENUES

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Product licenses	\$14,775	\$10,215	45%	\$26,454	\$20,060	32%
Services	13,181	8,306	59%	24,162	15,848	52%
Total	\$27,956	\$18,521	51%	\$50,616	\$35,908	41%

As a percentage of total revenue:

Product licenses	53%	55%	52%	56%
Services	47%	45%	48%	44%

Revenues totaled \$28.0 million and \$50.6 million for the second quarter and first half of fiscal year 2005, respectively, compared to \$18.5 million and \$35.9 million for the second quarter and first half of fiscal year 2004. Total revenues for the second quarter and first half of fiscal year 2005 were up \$9.4 million and \$14.7 million, or 51% and 41%, respectively, from the second quarter and first half of fiscal year 2004. The increases in revenue were due to our acquisition of Optika on May 28, 2004 and two seven-figure license transactions in the second quarter of fiscal year 2005 related to Content Component Software. Additionally, we had an increase in revenues for services due to a larger base of installed products and increased use by our customers of our Consulting Services personnel to implement our software. As we license our products, whether on a perpetual basis for our Universal Content Management software or on a term basis for our Content Components software, our installed base of products increases. Since the rate of annual renewals of post contract customer support services on our Universal Content Management and Content Component software has remained high, our post contract customer support revenues have grown as our installed base of products has grown. Also, Universal Content Management revenues related to consulting services work can increase as a result of a larger installed base of products. We expect our installed base of products to continue to increase and our services revenue to grow.

Product Licenses

Revenues generated from product licenses totaled \$14.8 million and \$26.5 million for the second quarter and first half of fiscal year 2005, respectively, increases of \$4.6 million and \$6.4 million, or 45% and 32%, respectively, from \$10.2 million and \$20.1 million in the second quarter and first half of fiscal year 2004. The increases in revenues were attributable to two seven-figure license transactions in the second quarter of fiscal year 2005 related to our Content Component software, revenues from our Optika acquisition, an increase in Universal Content Management software revenues in Asia Pacific, with these increases being partially offset by decreased sales of Universal Content Management software in Europe. The market for our products at any particular time is highly dependent on

information technology spending and we cannot be certain whether, and if so, when, spending on information technology will fluctuate. We anticipate that the percentage of license revenue to total revenue will remain between 52% and 54% in fiscal year 2005, but that license revenue in absolute dollars will increase.

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Services

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Consulting services and training	\$ 5,042	\$3,545	42%	\$ 9,400	\$ 6,582	43%
Post contract support	8,139	4,761	71%	14,762	9,266	59%
Total	\$13,181	\$8,306	59%	24,162	15,848	52%

As a percentage of total revenue:

Services and training	18%	19%	19%	18%
Post contract support	29%	26%	29%	26%

Revenues for services, consisting of consulting services, training and post-contract customer support, totaled \$13.2 million and \$24.2 million for the second quarter and first half of fiscal year 2005, respectively, increases of \$4.9 million and \$8.3 million or 59% and 52%, respectively, from \$8.3 million and \$15.8 million in second quarter and first half of fiscal year 2004. The increase in revenues for services was due to the Optika acquisition, an increase in consulting services revenue as our customers software implementations have become larger and more numerous and an increase in post-contract customer support due to the acquisition of Optika and a larger installed base of Universal Content Management and Content Component products. We anticipate that the percentage of service revenue to total revenue will remain between 45 percent and 48 percent in fiscal year 2005, but that service revenue in absolute dollars will increase.

Generally, customers prefer to have us perform consulting services rather than using their internal information technology staff, a trend we believe will continue. Our consulting service revenue relates almost exclusively to our Universal Content Management software as our Content Components software is embedded in another companies software and that company would typically perform the consulting services. As we license our products, whether on a perpetual basis for our Universal Content Management software or on a term basis for our Content Components software, our installed base of products increases. Since the rate of annual renewals of post-contract customer support services on our Universal Content Management and Content Component software has remained high, our post contract customer support revenues grow because we have a larger installed base of products. Also, Universal Content Management revenues related to consulting services work can increase as a result of a larger installed base of products. Because we expect the trend toward companies increasingly using the Web for communicating and publishing business information and the trend toward electronic devices being used increasingly to view electronic information to continue, we expect our installed base of products to continue to grow and our services revenues attributable to post-contract customer support to continue to increase.

If our license revenues decline in the future, our support and services revenues may also decline. Specifically, a decline in license revenues may result in fewer consulting services engagements. Additionally, since post-contract

customer support contracts are generally sold with each license transaction, a decline in license revenues may also result in a decline in customer support revenues. However, since post-contract customer support revenues are recognized over the duration of the support contract, the impact would lag behind a decline in license revenues.

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Cost of Revenues General

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Cost of product licenses	\$ 1,068	\$ 1,116	(4)%	\$ 2,360	\$ 2,216	7%
Cost of amortization of capitalized software from acquisitions	643	315	104%	1,106	836	32%
Cost of services	6,610	4,183	58%	11,907	7,981	49%
Total cost of revenues	\$ 8,321	\$ 5,614	48%	\$15,373	\$11,033	39%
Gross profit	\$19,635	\$12,907	52%	\$35,243	\$24,875	42%
As a percentage of total revenue						
Cost of product licenses	4%	6%		5%	6%	
Cost of amortization of capitalized software from acquisitions	2%	2%		2%	2%	
Cost of services	24%	23%		24%	22%	
Total cost of revenues	30%	30%		30%	31%	
Gross margin	70%	70%		70%	69%	

Total cost of revenues increased by \$2.7 million and \$4.3 million, or 48% and 39%, respectively, to \$8.3 million and \$15.4 million for the second quarter and first half of fiscal year 2005 from \$5.6 million and \$11.0 million, respectively, in the second quarter and first half of fiscal year 2004. Total cost of revenues as a percentage of total revenues were 30% for the second quarter and first half of fiscal year 2005, compared to 30% and 31% in the second quarter and first half of fiscal year 2004, respectively. Overall Gross profit increased by \$6.7 million and \$10.4 million, or 52% and 42%, respectively, to \$19.6 million and \$35.2 million in the second and first half of fiscal year 2005 from \$12.9 million and \$24.9 million, respectively, in the second quarter and first half of fiscal year 2004. Total gross profit as a percentage of total revenues were 70% for the second quarter and first half of fiscal year 2005 compared to 70% and 69% in the second quarter and first half of fiscal year 2004, respectively. The increase in gross profit dollars was attributable to the increase in product license revenues and services described above.

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Cost of Revenues Product Licenses

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Cost of product licenses	\$ 1,068	\$ 1,116	(4)%	\$ 2,360	\$ 2,216	7%
Cost of amortization of capitalized software from acquisitions	643	315	104%	1,106	836	32%
Total cost of product licenses	\$ 1,711	\$ 1,431	20%	\$ 3,466	\$ 3,052	14%
Gross profit - product licenses	\$ 13,064	\$ 8,784	49%	\$ 22,988	\$ 17,008	35%
As a percentage of product license revenue:						
Cost of product licenses	7%	11%		9%	11%	
Cost of amortization of capitalized software from acquisitions	4%	3%		4%	4%	
Total cost of product license revenues	12%	14%		13%	15%	
Product license gross margin	88%	86%		87%	85%	

Cost of product licenses includes costs of licensing third-party software embedded in or sold in conjunction with our software products as well as expenses incurred to manufacture, package and distribute our software products and related documentation.

Cost of revenues for product licenses. Cost of revenues for product licenses totaled \$1.7 million and \$3.5 million for the second quarter and first half of fiscal year 2005, respectively, increases of \$0.3 million and \$0.4 million, or 20% and 14%, respectively, from \$1.4 million and \$3.1 million in the second quarter and first half of fiscal year 2004. Gross profit as a percentage of revenues for product licenses were 88% and 87% for the second quarter and first half of fiscal year 2005 up from 86% and 85% in the second quarter and first half of fiscal year 2004. The overall gross margin percentage increase in product licenses can be attributed to higher levels of our Content Component software revenue in the second quarter of fiscal year 2005, which carry a lower cost of revenue than our Universal Content Management software revenue. During the second quarter of fiscal year 2005, we recorded two seven-figure license transactions related to our Content Component software, both coming from current customers. The overall increase in cost of revenues dollars for product licenses was attributable to the acquisition of Optika on May 28, 2004, changes in product mix, a reduction in certain costs related to royalties for third-party technology incorporated into our products, which became fully amortized in the previous fiscal year, and was partially offset by amortization of capitalized software from acquisitions discussed below. As new versions of our Universal Content Management software

continue to be released, we may elect to license or purchase more third party software to be included in our Universal Content Management products in order for us to provide certain functionality that we believe is necessary to be competitive.

Amortization of Capitalized Software from Acquisitions. Cost of product license revenues related to amortization of capitalized software from acquisitions for the second quarter and first half of fiscal year 2005 were \$0.6 million and \$1.1 million, respectively, compared to \$0.3 million and \$0.8 million in the second quarter and first half of fiscal year 2004, respectively. The cost of revenues for amortization of capitalized software from acquisitions was attributable to the amortization of capitalized software obtained in the acquisition of certain assets of RESoft, Kinecta, Active IQ Ancept and Optika, in July 2001, April 2002, March 2003, August 2003 and May 2004, respectively. The increase in cost of revenues related to amortization of capitalized software from acquisitions was attributable to the acquisition of Optika on May 28, 2004, which was partially offset by the completion of amortization of capitalized software related to our acquisition of Content Components Division (CCD) in June of 2003 and RESoft in June of 2004. We acquired technology from the companies listed above to incorporate the technology into our Universal Content Management products in order to maintain competitive functionality. We expect to continue to evaluate selective potential acquisitions. To the extent we consummate additional acquisitions, and depending on the structure of such acquisitions, the assets acquired and the consideration paid, our costs of revenues related to amortization of capitalized software from acquisitions may increase.

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Cost of Revenues Services

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Consulting services and training	\$5,431	\$3,242	68%	\$ 9,610	\$6,096	58%
Post contract support	1,179	941	25%	2,297	1,885	22%
Total	\$6,610	\$4,183	58%	\$11,907	\$7,981	49%
Gross profit - services	\$6,571	\$4,123	59%	\$12,255	\$7,867	56%
As a percentage of respective revenue:						
Consulting services and training cost of revenue	108%	91%		102%	93%	
Post contract support cost of revenues	14%	20%		16%	20%	
Total cost of service revenues	50%	50%		49%	50%	
Services gross margin	50%	50%		51%	50%	

Cost of services revenues, consisting of personnel and unbilled travel expenses for consulting services, training and post-contract customer support, totaled \$6.6 million and \$11.9 million for the second quarter and first half of fiscal year 2005, which represents increases of \$2.4 million and \$3.9 million, or 58% and 49%, respectively, from \$4.2 million and \$8.0 million in the second quarter and first half of fiscal year 2004. Gross profit as a percentage of revenues for services were 50% and 51%, respectively, for the second quarter and first half of fiscal year 2005, compared to 50% in the second quarter and first half of fiscal year 2004. The increase in the gross profit in dollars and as a percentage of services revenues was due to the revenue generated from the acquisition of Optika's install base since May 28, 2004, the increase in revenues from post-contract customer support from a larger installed base of Universal Content Management products, with little additional support staff needed, and a higher installed base of Content Component software, which requires very little support staff needed as support is generally provided by the company that embeds our software. In general, we have had a fairly consistent rate of annual post-contract support renewals in both our Universal Content Management and Content Component software partially offset by lower utilization of consulting services personnel related to our Universal Content Management software. Our consulting services and training costs as a percentage of revenue were up during the second quarter and first half of fiscal 2005 when compared to the same periods in the prior year as a result of using a higher level of outside consultants for professional services revenue generated from the Optika acquisition. However, we anticipate that our cost of consulting and training services as a percentage of total consulting and training revenue will decrease during the remainder of fiscal year 2005 as we believe that we can optimize the combined departments and increase the services utilization. During the recent economic slowdown, we saw less competition for skilled software post-contract customer support personnel than we experienced during stronger economic periods. If economic conditions improve, competition for skilled software post-contract customer support personnel may increase and our services costs of

revenues may increase and may offset certain of the anticipated cost savings related to the Optika acquisition.

Since our support and service revenues have lower gross margins than our license revenues, our overall gross margins will typically decline if our support and service revenues increase as a percent of total revenues. Our cost of support and service revenues as a percentage of support and service revenues may vary from period to period, depending in part on whether the services are performed by our in-house staff, subcontractors or third-party system integrators. If our customers perform more services activities in-house or increase the use of third-party systems integrators, our support and service revenues and cost of support and service revenues realized on a per-customer basis may decline.

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OPERATING EXPENSES

Sales and Marketing

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Sales and marketing	\$10,931	\$9,560	14%	\$20,720	\$19,522	6%
Percentage of total revenues	39%	52%		41%	54%	

Sales and marketing expenses consist of salaries, commissions, benefits and related costs for sales and marketing personnel, travel and marketing programs, including customer conferences, promotional materials, trade shows and advertising. Sales and marketing expenses were \$10.9 million and \$20.7 million for the second quarter and first half of fiscal year 2005, respectively, increases of \$1.4 million and \$1.2 million, or 14% and 6%, respectively, from \$9.6 million and \$19.5 million in the second quarter and first half of fiscal year 2004, respectively. As a percentage of total revenues, sales and marketing expenses were 39% and 41% for the second quarter and first half of fiscal year 2005, compared to 52% and 54% in the second quarter and first half of fiscal year 2004. The increase in dollars is a direct result of the Optika acquisition on May 28, 2004. The overall decrease in sales and marketing as a percentage of revenue is primarily due to achieving cost synergies from this acquisition and also attributable to the restructurings undertaken by us at the end of the first quarter in fiscal year 2005. We believe that our sales and marketing expenses as a percentage of total revenue will continue to decrease slightly during fiscal year 2005 as we continue to optimize the integration of the Optika sales and marketing departments and increase the productivity of our sales personnel. During fiscal year 2004, we saw less competition for general software sales and marketing personnel than we experienced during stronger economic periods. However, competition has intensified for sales personnel who have been successful in the current market conditions. If economic conditions improve, competition for general software sales and marketing personnel may increase and our sales and marketing expenses may increase and may offset anticipated cost savings related to the Optika acquisition.

General and Administrative

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
General and administrative	\$3,057	\$2,617	17%	\$5,581	\$4,941	13%
Percentage of total revenues	11%	14%		11%	14%	

General and administrative expenses consist of salaries and related costs for general corporate functions, including finance, accounting, human resources, legal and information technology, as well as insurance, professional fees, facilities costs and bad debt expense. General and administrative expenses totaled \$3.1 million and \$5.6 million during the second quarter and first half of fiscal year 2005, respectively, increases of \$0.4 million and \$0.6 million, or 17% and 13%, respectively, from \$2.6 million and \$4.9 million in the second quarter and first half of fiscal year 2004. The increase in general and administrative expenses was due to increased legal, accounting and other professional fees associated with additional regulations enacted by the Federal government and defense of a class action lawsuit. We believe most cost savings associated with consolidating the accounting, finance and human resource departments of Optika with our corporate headquarters, along with eliminating duplicate expenses such as certain insurance expenses and professional service expense associated with the Optika acquisition will be offset by higher levels of professional fees and consulting costs to comply with regulations that Congress, the Securities and Exchange Commission and the national stock exchanges have enacted or have proposed to enact for publicly traded companies and ongoing defense of a class action lawsuit for the remainder of fiscal year 2005.

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Research and Development

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Research and development	\$4,867	\$3,348	45%	\$8,665	\$6,523	33%
Percentage of total revenues	17%	18%		17%	18%	

Research and development expenses consist of salaries and benefits, third-party contractors, facilities and related overhead costs associated with our product development and quality assurance activities. Research and development costs totaled \$4.9 million and \$8.7 million for the second quarter and first half of fiscal year 2005, respectively, increases of \$1.5 million and \$2.1 million, or 45% and 33%, respectively, from \$3.3 million and \$6.5 million in the second quarter and first half of fiscal year 2004. The increase in research and development expense was due to our acquisition of Optika on May 28, 2004. We believe that our fiscal year 2005 research and development expenses will remain consistent as a percentage of total revenue as compared to the quarter ended September 30, 2004 as no significant changes are anticipated with respect to headcount or currently scheduled programs.

Acquisition-Related Sales, Marketing and Other Costs

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Acquisition - related sales, marketing and other costs	\$	\$	%	\$ 886	\$	100%
Percentage of total revenues	%	%		2%	%	

During the first quarter of fiscal year 2005 we recognized acquisition-related sales, marketing and other costs totaling \$0.9 million related to the Optika acquisition. Approximately \$0.6 million of these costs related to advertising done in various periodicals announcing the completion of the Optika acquisition. We have generally not done this type of advertising in the past. From time to time we may seek to acquire businesses, products or technologies that are complementary to our business. Depending on the size, nature and structure of any future business acquisitions, our acquisition-related sales and marketing and other costs may increase substantially.

Amortization of Acquired Intangible Assets and Unearned Compensation

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Amortization of acquired intangible assets and other	\$ 175	\$ 118	48%	\$ 354	\$ 1,770	(80)%
Percentage of total revenues	1%	1%		1%	5%	

Amortization of intangible assets acquired related to our acquisitions of CCD in July 2000, RESoft in July 2001, Kinecta in April 2002 and Optika on May 28, 2004. A portion of the purchase price of certain assets of CCD was allocated to core technology, customer base, software, trademarks and other intangibles, and was being amortized over the assets estimated useful lives of three to four years. A portion of the purchase price of certain assets of each of RESoft and Kinecta was allocated to certain intangible assets, such as customer base and trademarks, and is also being amortized over their useful lives of three years. A portion of the purchase price of certain assets of Optika was allocated to contractual customer relationships and is being amortized over 10 years. Amortization of acquired intangible assets and unearned compensation totaled \$0.2 million and \$0.4 million during the second quarter and first half of fiscal year 2005, respectively, compared to \$0.1 million and \$1.8 million in the second quarter and first half of fiscal year 2004. The decrease when comparing the first half of fiscal year 2005 to the same period fiscal year 2004 is attributable to the completion in June 2003 of amortization of substantially all of the intangibles related to our acquisition of CCD.

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Restructuring Charges

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Restructuring charges	\$	\$	%	\$2,461	\$812	203%
Percentage of total revenues				5%	2%	

We assessed many factors in determining whether and when to restructure our operations, with significant consideration being the performance of the economy and the information technology markets in the United States and in Europe. During the first quarter of fiscal year 2005, in connection with the Optika acquisition and management's plan to reduce costs and improve operating efficiencies, we recorded a restructuring charge of approximately \$2.5 million. The restructuring charge was comprised of severance pay and benefits related to the involuntary termination of employees of approximately \$1.9 million with the remaining \$0.6 million related to the closing of excess facilities and other exit costs. These cost reduction measures were taken to take advantage of the cost synergies from the Optika acquisition. However, we may be required to re-invest in certain areas to expand our customer base, grow our revenues and invest in product development, which may eliminate or exceed these cost savings.

Other Income (Expense)

(in thousands, except for percentages)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2004	2003	Change	2004	2003	Change
Interest income	\$ 149	\$ 249	(40)%	\$ 343	\$ 541	37%
As % of Total Revenue:						
Interest income	1%	1%		1%	2%	

Interest income was related to short-term investments purchased with the proceeds of our public stock offerings completed in June 1999 and March 2000 and the short-term investments received in the Optika acquisition.

The decreases in net interest income for the second quarter and first half of fiscal year 2005 when compared to the same periods of fiscal year 2004 were due to reduced amounts of invested funds and decreases in the market interest rates earned by invested funds which have declined over the prior year.

Net Operating Loss Carryforwards

As of March 31, 2004, we had net operating loss carryforwards of approximately \$96.9 million. The net operating loss carryforwards will expire at various dates beginning in 2011, if not utilized. The Tax Reform Act of 1986 imposes substantial restrictions on the utilization of net operating losses and tax credits in the event of an ownership change of a corporation. Our ability to utilize net operating loss carryforwards on an annual basis will be limited as a result of ownership changes in connection with the sale of equity securities. We have provided a valuation allowance against the entire amount of the deferred tax asset as of March 31, 2004 because of uncertainty regarding its full realization. Our accounting for deferred taxes involves the evaluation of a number of factors concerning the realizability of our deferred tax assets. In concluding that a valuation allowance was required, management considered such factors as our history of operating losses, potential future losses and the nature of our deferred tax assets.

Liquidity and Capital Resources

We have funded our operations and satisfied our capital expenditure requirements primarily through public offerings of securities.

To date, we have invested our capital expenditures in property and equipment, consisting largely of computer hardware and software. Capital expenditures for the first half of fiscal year 2005 totaled \$0.9 million. We have also entered into capital and operating leases for facilities and equipment. We expect that our capital expenditures will increase as our employee base grows.

As of September 30, 2004, we had \$64.1 million in cash and marketable securities and \$63.1 million in working capital. We currently believe that our cash and cash equivalents on hand will be sufficient to meet our working capital requirements for the foreseeable future, particularly through March 31, 2005. On a longer term basis, we may require additional funds to support our working capital requirements or for other purposes and may seek to raise such additional funds through public or private equity financings or from other sources. We cannot be certain that additional financing will be available on terms favorable to us, or on any terms, or that any additional financing will not be dilutive.

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We continue to evaluate potential strategic acquisitions that could utilize equity and/or cash resources. Such opportunities could develop quickly due to market and competitive factors.

Cash, cash equivalents and marketable securities decreased \$9.4 million, or 13%, to \$64.1 million as of September 30, 2004 from \$73.5 million at March 31, 2004. The decrease was primarily due to the cash used in the acquisition of Optika.

Cash provided by (used in) was as follows (in thousands):

	Six Months Ended September 30,	
	2004	2003
Cash used in operating activities	\$(4,101)	\$(5,489)
Cash provided by (used in) investing activities	\$(4,046)	\$ 1,869
Cash provided by financing activities	\$ 1,141	\$ 439

Operating Activities. Net cash used in operating activities of \$4.1 million in the first half of fiscal year 2005 resulted from a loss from operations of \$3.1 million. After excluding the effects of non-cash expenses including depreciation and amortization of \$1.7 million and amortization of intangible assets of \$1.5 million, our net cash position increased \$0.1 million before the changes in working capital components. Additional cash usage was the result of an increase of \$5.3 million in accounts receivable and a \$0.5 million decrease in accounts payable and all other accrued liabilities, offset by a \$0.8 million decrease in prepaid expenses and a \$0.8 million increase in deferred revenues.

A number of non-cash items were charged to expense and increased our net loss in the first half of fiscal year 2005 and 2004. These items include depreciation and amortization of property and equipment and intangible assets. The extent to which these non-cash items increase or decrease in amount and increase or decrease our future operating results will have no corresponding impact on our operating cash flows.

Our primary source of operating cash flow is the collection of accounts receivable from our customers offset by payments to our employees, vendors and service providers. We measure the effectiveness of our collection efforts by an analysis of average accounts receivable days outstanding (days outstanding). Days outstanding were 97 days and 90 days in the first half of fiscal years 2005 and 2004, respectively. Collections of accounts receivable and related days outstanding will fluctuate in future periods due to the timing and amount of our future revenues, payment terms on customer contracts and the effectiveness of our collection efforts.

Our operating cash flows will also be impacted in the future based on the timing of payments to our vendors. We endeavor to pay our vendors and service providers in accordance with invoice terms and conditions. The timing of cash payments in future periods will be impacted by the nature of vendor arrangements and management's assessment of our cash inflows.

Investing Activities. Net cash used in investing activities was \$4.0 million in the first half of fiscal year 2005. This resulted from net maturities of marketable securities of \$7.5 million, offset by approximately \$10.7 million used in acquiring Optika and other entities, and approximately \$0.9 million to purchase property and equipment.

Generally, our investment portfolio is classified as held to maturity. Our investments objectives are to preserve principal and provide liquidity while at the same time maximizing yields without significantly increasing risk. We generally hold investments in commercial paper, corporate bonds and United States government agency securities to maturity.

We anticipate that we will continue to purchase property and equipment necessary in the normal course of our business. The amount and timing of these purchases and the related cash outflows in future periods is difficult to predict and is dependent on a number of factors including the hiring of employees, the rate of change of computer hardware and software used in our business and our business outlook.

Financing Activities. Net cash provided by financing activities of \$1.1 million in first half of fiscal year 2005 included approximately \$1.4 million from the net proceeds from the issuance of common stock, offset by \$0.2 million for payments related to capital lease obligations.

Our cash flows from financing activities are the result of cash receipts from the issuance of common stock and our repurchases of common stock. We receive cash from the exercise of common stock options and the sale of common stock under our Employee Stock Purchase Plan. While we expect to continue to receive these proceeds in future periods, the timing and amount of such proceeds is difficult to predict and is contingent on a number of factors including the price of our common stock, the number of employees participating in our stock option plans and our Employee Stock Purchase Plan and general market conditions. From time to time, our Board of Directors has approved common stock repurchase programs allowing management to repurchase shares of our common stock in the open market.

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Financial Risk Management

As a global concern, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our consolidated financial results. Our primary exposures relate to non-United States dollar-denominated revenues and operating expenses in Europe, Asia Pacific, Australia and Canada. At the present time, the exposure is not significant. We do not anticipate significant currency gains or losses in the near term.

Recent Accounting Pronouncements

In November 2002, the FASB reached a consensus on EITF Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. This EITF sets out criteria for whether revenue can be recognized separately from other deliverables in a multiple deliverable arrangement. The criteria considers whether the delivered item has stand-alone value to the customer, whether the fair value of the delivered item can be reliably determined and the rights of return for the delivered item. This EITF was required to be adopted by the Company beginning April 1, 2004. The adoption of this EITF did not have a material effect on the Company's consolidated financial statements.

In June 2004, the FASB's Emerging Issues Task Force (EITF) issued EITF 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF 03-1 provides further guidance on the meaning of other-than-temporary impairment and its application to debt and equity securities. A majority of EITF 03-1 was effective for all reporting periods beginning after June 15, 2004. In September of 2004, the FASB issued FSP EITF Issue 03-1-1, which delayed the effective date for the measurement and recognition guidance included in the EITF related to debt securities. The adoption of this EITF did not and is not anticipated to have a material effect on how the company analyzes and records other than temporary impairments on its investments in other companies.

Critical Accounting Policies and Estimates

In preparing our condensed consolidated financial statements, we make estimates, assumptions and judgments that can have a significant impact on our revenues, loss from operations and net loss, as well as on the value of certain assets and liabilities on our consolidated balance sheet. We believe that there are several accounting policies that are critical to an understanding of our historical and future performance, as these policies affect the reported amounts of revenues, expenses and significant estimates and judgments applied by management. While there are a number of accounting policies, methods and estimates affecting our consolidated financial statements, areas that are particularly significant include:

revenue recognition;

estimating the allowance for doubtful accounts;

estimating the accrual for restructuring and excess facilities costs;

Accounting for income taxes; and

valuation and evaluating impairment of long-lived assets, intangible assets and goodwill.

Revenue Recognition

We currently derive all of our revenues from licenses of software products and related services. We recognize revenue in accordance with 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, and Securities and Exchange Commission Staff Accounting Bulletin 101, Revenue Recognition in Financial Statements.

Product license revenue is recognized under SOP 97-2 when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable and supported and the arrangement does not require services that are essential to the functionality of the software.

Persuasive Evidence of an Arrangement Exists We determine that persuasive evidence of an arrangement exists with respect to a customer under, i) a signature license agreement, which is signed by both the customer and us, or, ii) a purchase order, quote or binding letter-of-intent received from and signed by the customer, in which case the customer has either previously executed a signature license agreement with us or will receive a shrink-wrap license agreement with the software. We do not offer product return rights to end users or resellers.

Delivery has Occurred Our software may be either physically or electronically delivered to the customer. We determine that delivery has occurred upon shipment of the software pursuant to the billing terms of the arrangement or when the software is made available to the customer through electronic delivery. Customer acceptance generally occurs at delivery.

The Fee is Fixed or Determinable If at the outset of the customer arrangement, we determine that the arrangement fee is not fixed or determinable, revenue is typically recognized when the arrangement fee becomes due and payable. Fees due under an arrangement are generally deemed fixed and determinable if they are payable within twelve months.

Collectibility is Probable and Supported We determine whether collectibility is probable and supported on a case-by-case basis. We may generate a high percentage of our license revenue from our current customer base, for whom there is a history of successful collection. We assess the probability of collection from new customers based upon the number of years the customer has been in business and a credit review process, which evaluates the customer's financial position and ultimately their ability to pay. If we are unable to determine from the outset of an arrangement that collectibility is probable based upon our review process, revenue is recognized as payments are received.

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With regard to software arrangements involving multiple elements, we allocate revenue to each element based on the relative fair value of each element. Our determination of fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence (VSOE). We limit our assessment of VSOE for each element to the price charged when the same element is sold separately. We have analyzed all of the elements included in our multiple-element arrangements and have determined that we have sufficient VSOE to allocate revenue to consulting services and post-contract customer support (PCS) components of our license arrangements. Generally, we sell our consulting services separately, and have established VSOE on this basis. VSOE for PCS is determined based upon the customer's annual renewal rates for these elements. Accordingly, assuming all other revenue recognition criteria are met, revenue from perpetual licenses is recognized upon delivery using the residual method in accordance with SOP 98-9, and revenue from PCS is recognized ratably over their respective terms, typically one year.

Our direct customers typically enter into perpetual license arrangements. Our Content Components Division generally enters into term-based license arrangements with its customers, the term of which generally exceeds one year in length. We recognize revenue from time-based licenses at the time the license arrangement is signed, assuming all other revenue recognition criteria are met, if the term of the time-based license arrangement is greater than twelve months. If the term of the time-based license arrangement is twelve months or less, we recognize revenue ratably over the term of the license arrangement.

Services revenue consists of fees from consulting services and PCS. Consulting services include needs assessment, software integration, security analysis, application development and training. We bill consulting services fees either on a time and materials basis or on a fixed-price schedule. In general, our consulting services are not essential to the functionality of the software. Our software products are fully functional upon delivery and implementation and generally do not require any significant modification or alteration for customer use. Customers purchase our consulting services to facilitate the adoption of our technology and may dedicate personnel to participate in the services being performed, but they may also decide to use their own resources or appoint other professional service organizations to provide these services. Software products are billed separately from professional services. We recognize revenue from consulting services as services are performed. Our customers typically purchase PCS annually, and we price PCS based on a percentage of the product license fee. Customers purchasing PCS receive product upgrades, Web-based technical support and telephone hot-line support.

Customer advances and billed amounts due from customers in excess of revenue recognized are recorded as deferred revenue.

We follow very specific and detailed guidelines, discussed above, in determining revenues; however, certain judgments and estimates are made and used to determine revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue recognized for any period if different conditions were to prevail. For example, in determining whether collection is probable, we assess our customers ability and intent to pay. Our actual experience with respect to collections could differ from our initial assessment if, for instance, unforeseen declines in the overall economy occur and negatively impact our customers financial condition.

Accounts Receivable and Allowance for Doubtful Accounts

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of assets and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Specifically, we make estimates as to the overall collectibility of accounts receivable and provide an allowance for amounts deemed to be uncollectible. Management specifically analyzes its accounts receivable and historical bad debt experience, customer concentrations, customer credit-worthiness, current economic trends and changes in its customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

Restructuring and Excess Facilities Accrual

Due to the recent economic slowdown and associated reduction in information technology spending, we implemented a series of restructuring and facility consolidation plans to improve our operating performance. Restructuring and facilities consolidation costs consist of expenses associated with workforce reductions and consolidation of excess facilities.

Workforce Reductions. In connection with our restructuring plans, we accrue for severance payments and other related termination benefits provided to employees in connection with involuntary staff reductions. We accrue for these benefits in the period when benefits are communicated to the terminated employees. Typically, terminated employees are not required to provide continued service to receive termination benefits. If continued service is required, then the severance liability is accrued over the required service period. In general, we use a formula based on a combination of the number of years of service and the employee's position within our company to calculate the termination benefits to be provided to affected employees. At September 30, 2004, approximately \$0.8 million was accrued for future severance and termination benefits payments.

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Excess Facilities. In connection with our restructuring and facility consolidation plans, we perform evaluations of our then-current facilities requirements and identify facilities that are in excess of our current and estimated future needs. When a facility is identified as excess and we have ceased use of the facility, we accrue the fair value of the lease obligations. In determining fair value, we consider expected sublease income over the remainder of the lease term and related exit costs if any. To determine the estimated sublease income, we receive appraisals from real estate brokers to aid in our estimate. In addition, during our evaluation of our facilities requirements, we also identify operating equipment and leasehold improvements that may have suffered a reduction in their economic useful lives. Most of our excess facilities are being marketed for sublease and are currently unoccupied. Accordingly, our estimate of excess facilities could differ from actual results and such differences could result in additional charges that could materially affect our consolidated financial position and results of operations. At September 30, 2004, we had approximately \$0.9 million accrued for excess facilities. We reassess our excess facilities liability each period based on current real estate market conditions.

Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax liability in each of the jurisdictions in which we do business. This process involves estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We must then assess the likelihood that these deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not more likely than not or unknown, we must establish a valuation allowance.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. At March 31, 2004, we have recorded a full valuation allowance of \$56.1 million against our deferred tax assets, due to uncertainties related to our ability to utilize our deferred tax assets, consisting principally of certain net operating losses carried forward. The valuation allowance is based on our estimates of taxable income by jurisdiction and the period over which our deferred tax assets will be recoverable. The Company had U.S. net operating loss (NOL) carryforwards of approximately \$81.1 million and foreign net operating losses of approximately \$15.8 million at March 31, 2004, which begin to expire in 2011. These NOLs are subject to annual utilization limitations due to prior ownership changes.

Realization of the NOL carryforwards and other deferred tax temporary differences are contingent on future taxable earnings. The deferred tax asset was reviewed for expected utilization using a more likely than not approach as required by SFAS No. 109, Accounting for Income Taxes, by assessing the available positive and negative evidence surrounding its recoverability.

We will continue to assess and evaluate strategies that will enable the deferred tax asset, or portion thereof, to be utilized, and will reduce the valuation allowance appropriately at such time when it is determined that the more likely than not approach is satisfied.

Valuation and Evaluation of Impairment of Long-lived Assets, Goodwill and Other Acquired Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets acquired. We have elected to complete the annual impairment test of goodwill on January 1 of each year. We engaged an independent outside professional services firm to assist us in our impairment testing of goodwill as of January 1, 2003. Based on this assistance, we completed our annual goodwill impairment test on January 1, 2003 and reviewed this valuation and our financial position as of January 1, 2004 and determined that there was no impairment of goodwill at those times. Additionally, no circumstances occurred during the first half of fiscal year 2005 which would have created an

impairment loss at September 30, 2004.

We evaluate the recoverability of our long-lived assets in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS 144 requires recognition of impairment of long-lived assets in the event that events or circumstances indicate that an impairment may have occurred and when the net book value of such assets exceeds the future undiscounted cash flows attributed to such assets. We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. No impairment of long-lived assets has occurred through September 30, 2004.

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RISK FACTORS

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

The risks and uncertainties described below are not the only risks we face. These risks include those that we consider to be significant to your decision whether to invest in our common stock at this time. There may be risks that you, in particular, view differently than we do, and there are other risks and uncertainties that we do not presently know of or that we currently deem immaterial, but that may, in fact, harm our business in the future. If any of these events occur, our business, results of operations and financial condition could be seriously harmed, the trading price of our common stock could decline and you may lose part or all of your investment.

You should consider carefully the following factors, in addition to other information in this Quarterly Report on Form 10-Q, in evaluating our company and business.

BECAUSE OUR INFRASTRUCTURE COSTS ARE GENERALLY FIXED AND THE TIMING OF OUR REVENUES FROM QUARTER TO QUARTER IS HIGHLY VARIABLE, OUR FUTURE PERFORMANCE IS DIFFICULT TO PREDICT, MAKING AN INVESTMENT IN OUR COMMON STOCK SUBJECT TO HIGH VOLATILITY.

While our products and services are not seasonal, our revenues and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. If our quarterly revenues or operating results fall below the expectations of investors or securities analysts, the price of our common stock could fall substantially. A large part of our sales typically occurs in the last month of a quarter, frequently in the last week or even the last days of the quarter. If these sales were delayed from one quarter to the next for any reason, our operating results could fluctuate dramatically. In addition, our sales cycles may vary, making the timing of sales difficult to predict. Furthermore, our infrastructure costs are generally fixed. As a result, modest fluctuations in revenues between quarters may cause large fluctuations in operating results. These factors all tend to make the timing of revenues unpredictable and may lead to high period-to-period fluctuations in operating results.

Our quarterly revenues and operating results may fluctuate for several additional reasons, many of which are outside of our control, including the following:

- demand for our products and services;
- the timing of new product introductions and sales of our products and services;
- unexpected delays in introducing new products and services;
- increased expenses, whether related to sales and marketing, research and development or administration;
- changes in the rapidly evolving market for Web content management solutions;
- the mix of revenues from product licenses and services, as well as the mix of products licensed;
- the mix of services provided and whether services are provided by our staff or third-party contractors;
- the mix of domestic and international sales;
- costs related to possible acquisitions of technology or businesses;

general economic conditions; and

public announcements by our competitors.

WE HAVE A HISTORY OF MAKING ACQUISITIONS, INCLUDING LARGE STRATEGIC ACQUISITIONS, AND FUTURE POTENTIAL ACQUISITIONS MAY BE DIFFICULT TO COMPLETE OR TO INTEGRATE AND MAY DIVERT MANAGEMENT'S ATTENTION AND CAUSE OUR OPERATING RESULTS TO SUFFER.

We may seek to acquire or invest in businesses, products or technologies that are complementary to our business. If we identify an appropriate acquisition opportunity, we may be unable to negotiate favorable terms for that acquisition, successfully finance the acquisition or integrate the new business or products into our existing business and operations. In addition, the negotiation of potential acquisitions and the integration of acquired businesses or products may divert management time and resources from our existing business and operations. To finance acquisitions, we may use a substantial portion of our available cash or we may issue additional securities, which would cause dilution to our shareholders.

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WE MAY NOT BE PROFITABLE IN THE FUTURE, WHICH WOULD CAUSE OUR FINANCIAL POSITION TO SUFFER AND MAY CAUSE THE MARKET PRICE OF OUR STOCK TO FALL.

Our revenues may not grow in future periods and we may not sustain profitability. If we do not sustain profitability, our financial position will suffer and the market price of our stock may fall. Our ability to sustain profitable operations depends upon many factors beyond our direct control. These factors include, but are not limited to:

the demand for our products;

our ability to quickly introduce new products;

the level of product and price competition;

our ability to control costs; and

general economic conditions.

THE INTENSE COMPETITION IN OUR INDUSTRY FROM RECENT AND EXPECTED INDUSTRY CONSOLIDATION MAY REDUCE OUR FUTURE SALES AND PROFITS.

The market for our products is highly competitive and is likely to become more competitive from recent and expected industry consolidation. We may not be able to compete successfully in our chosen marketplace, which may have a material adverse effect on our business, operating results and financial condition. Additional competition may cause pricing pressure, reduced sales and margins, or prevent our products from gaining and sustaining market acceptance. Many of our current and potential competitors have greater name recognition, access to larger customer bases, and substantially more resources than we have. Competitors with greater resources than ours may be able to respond more quickly than we can to new opportunities, changing technology, product standards or customer requirements.

WE DEPEND ON THE CONTINUED SERVICE OF OUR KEY PERSONNEL; IF WE LOSE THE SERVICES OF OUR KEY PERSONNEL OUR ABILITY TO EXECUTE OUR OPERATING PLAN, AND OUR OPERATING RESULTS, MAY SUFFER.

We are a small company and depend greatly on the knowledge and experience of our senior management team and other key personnel. If we lose any of these key personnel, our business, operating results and financial condition could be materially adversely affected. Our success will depend in part on our ability to attract and retain additional personnel with the highly specialized expertise necessary to generate revenue and to engineer, design and support our products and services. Like other software companies, we face intense competition for qualified personnel. We may not be able to attract or retain such personnel.

WE HAVE RELIED AND EXPECT TO CONTINUE TO RELY ON SALES OF OUR UNIVERSAL CONTENT MANAGEMENT SOFTWARE, WHICH INCLUDES OUR IMAGING AND BUSINESS PROCESS MANAGEMENT SOFTWARE, AND CONTENT COMPONENT SOFTWARE PRODUCTS FOR OUR REVENUES; IF OUR UNIVERSAL CONTENT MANAGEMENT SOFTWARE AND IMAGING AND BUSINESS PROCESS MANAGEMENT SOFTWARE DOES NOT GAIN AND MAINTAIN CUSTOMER ACCEPTANCE, OUR REVENUES AND OPERATING RESULTS MAY SUFFER.

We currently derive all of our revenues from product licenses and services associated with our system of content management, business process management and viewing software products. The market for content management and viewing software products is new and rapidly evolving. We cannot be certain that a viable market for our products will continue or that it will be sustainable. If we do not increase employee productivity and revenues related to our

existing products or generate revenues from new products and services, our business, operating results and financial condition may be materially adversely affected. We will continue to depend on revenues related to new and enhanced versions of our software products for the foreseeable future. Our success will largely depend on our ability to increase sales from existing products and generate sales from product enhancements and new products. We cannot be certain that we will be successful in upgrading and marketing our existing products or that we will be successful in developing and marketing new products and services. The market for our products is highly competitive and is subject to rapid technological change. Technological advances could make our products less attractive to customers and adversely affect our business. In addition, complex software product development involves certain inherent risks, including risks that errors may be found in a product enhancement or new product after its release, even after extensive testing, and the risk that discovered errors may not be corrected in a timely manner.

IF WE CANNOT PROTECT OUR INTELLECTUAL PROPERTY, WHICH CONSISTS PRIMARILY OF OUR PROPRIETARY SOFTWARE PRODUCTS, AND DO SO COST-EFFECTIVELY, OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION MAY SUFFER.

If we are unable to protect our intellectual property, or incur significant expense in doing so, our business, operating results and financial condition may be materially adversely affected. Any steps we take to protect our intellectual property may be inadequate, time consuming and expensive. We currently have one pending patent application; but, no patent has yet been issued. Without significant patent or copyright protection, we may be vulnerable to competitors who develop functionally equivalent products. We may also be subject to claims that our current products infringe on the intellectual property rights of others. Any such claim may have a material adverse effect on our business, operating results and financial condition.

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We anticipate that software product developers will be increasingly subject to infringement claims due to growth in the number of products and competitors in our industry, and the overlap in functionality of products in different industries. Any infringement claim, regardless of its merit, could be time-consuming, expensive to defend, or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements may not be available on commercially favorable terms, or at all.

We rely on trade secret protection, confidentiality procedures and contractual provisions to protect our proprietary information. Despite our attempts to protect our confidential and proprietary information, others may gain access to this information. Alternatively, other companies may independently develop substantially equivalent information.

OUR PRODUCTS MAY NOT BE COMPATIBLE WITH COMMERCIAL WEB BROWSERS AND OPERATING SYSTEMS, WHICH MAY LIMIT OUR ABILITY TO GENERATE REVENUES FROM OUR PRODUCTS.

Our products utilize interfaces that are compatible with commercial Web browsers. In addition, our Stellent Content Management System is a server-based system written in Java that functions in both Windows NT and UNIX environments. We must continually modify our products to conform to commercial Web browsers and operating systems. If our products were to become incompatible with commercial Web browsers and operating systems, our business would be harmed. In addition, uncertainty related to the timing and nature of product introductions or modifications by vendors of Web browsers and operating systems may have a material adverse effect on our business, operating results and financial condition.

WE COULD BE SUBJECT TO PRODUCT LIABILITY CLAIMS IF OUR SOFTWARE PRODUCTS DAMAGE CUSTOMERS DATA, FAIL TO MAINTAIN ACCESS SECURITY OR OTHERWISE FAIL TO PERFORM TO SPECIFICATIONS, WHICH COULD HARM OUR OPERATING RESULTS AND FINANCIAL POSITION AND REDUCE THE VALUE OF AN INVESTMENT IN OUR COMMON STOCK.

If software errors or design defects in our products cause damage to customers data and our agreements do not protect us from related product liability claims, our business, operating results and financial condition may be materially adversely affected. In addition, we could be subject to product liability claims if our security features fail to prevent unauthorized third parties from entering our customers intranet, extranet or Internet Websites. Our software products are complex and sophisticated and may contain design defects or software errors that are difficult to detect and correct. Errors, bugs or viruses spread by third parties may result in the loss of market acceptance or the loss of customer data. Our agreements with customers that attempt to limit our exposure to product liability claims may not be enforceable in certain jurisdictions where we operate.

FUTURE REGULATION OF THE INTERNET OR AFFECTING WEB-BASED COMMUNICATIONS COULD BE ADOPTED THAT RESTRICT OUR BUSINESS, WHICH MAY LIMIT OUR ABILITY TO GENERATE REVENUES FROM OUR PRODUCTS.

Federal, state or foreign agencies may adopt new legislation or regulations governing the use and quality of Web content. We cannot predict if or how any future laws or regulations would impact our business and operations. Even though these laws and regulations may not apply to our business directly, they could indirectly harm us to the extent that they impact our customers and potential customers.

WE HAVE BEEN NAMED A DEFENDANT IN SECURITIES CLASS-ACTION LAWSUITS AND WE MAY IN THE FUTURE BE NAMED IN ADDITIONAL LITIGATION, WHICH MAY RESULT IN SUBSTANTIAL COSTS AND DIVERT MANAGEMENT S ATTENTION AND RESOURCES.

Shareholder class-action suits have been filed naming Stellent and certain of our current and former officers and directors as co-defendants. We intend to vigorously defend ourselves against the suits. However, because litigation by its nature is uncertain and the lawsuit is still in its early stages, the likelihood of a favorable outcome cannot be predicted at this time. If the plaintiff prevailed in the lawsuit and the damages awarded against us significantly exceeded the limits of our insurance policies, this outcome could have a material adverse impact on our Company's financial condition and results of operations.

More generally, securities class-action litigation has often been brought against companies following periods of volatility in the price of their securities. This risk is greater for technology companies, which have experienced greater-than-average stock price volatility in recent years and, as a result, have been subject to, on average, a greater number of securities class-action claims than companies in other industries. We may in the future be the target of this kind of litigation, and such litigation could also result in substantial costs and divert management's attention and resources.

THE MARKET PRICE OF OUR COMMON STOCK COULD FLUCTUATE SIGNIFICANTLY DUE TO VARIATIONS IN OUR OPERATING RESULTS, CHANGES IN THE SOFTWARE INDUSTRY AND OTHER FACTORS, RESULTING IN SUDDEN CHANGES IN THE MARKET VALUE OF AN INVESTMENT IN OUR COMMON STOCK.

The market price of our common stock has fluctuated significantly in the past and may do so in the future. The market price of our common stock may be affected by each of the following factors, many of which are outside of our control:

- variations in quarterly operating results;
- changes in estimates by securities analysts;
- changes in market valuations of companies in our industry;
- announcements of significant events, such as major sales;
- acquisitions of businesses or losses of major customers;
- sales of our equity securities.

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IF THE WEB DOES NOT CONTINUE TO GROW AND GAIN ACCEPTANCE, THE SIZE OF THE POTENTIAL MARKET FOR OUR PRODUCTS WILL BE LIMITED AND OUR REVENUES AND OPERATING RESULTS COULD SUFFER.

Our products are designed to be used with intranets, extranets and the Internet. If the use of these methods of electronic communication does not grow, our business, operating results and financial condition may be materially adversely affected. Continued growth in the use of the Web will require ongoing and widespread interest in its capabilities for communication and commerce. Its growth will also require maintenance and expansion of the infrastructure supporting its use and the development of performance improvements, such as high speed modems. The Web infrastructure may not be able to support the demands placed on it by continued growth. The ongoing development of corporate intranets depends on continuation of the trend toward network-based computing and on the willingness of businesses to reengineer the processes used to create, store, manage and distribute their data. All of these factors are outside of our control.

WE CAN ISSUE SHARES OF PREFERRED STOCK WITHOUT SHAREHOLDER APPROVAL, WHICH COULD ADVERSELY AFFECT THE RIGHTS OF COMMON SHAREHOLDERS.

Our articles of incorporation permit us to establish the rights, privileges, preferences and restrictions, including voting rights, of unissued shares of our capital stock and to issue such shares without approval from our shareholders. The rights of holders of our common stock may suffer as a result of the rights granted to holders of preferred stock that may be issued in the future. In addition, we could issue preferred stock to prevent a change in control of our company, depriving shareholders of an opportunity to sell their stock at a price in excess of the prevailing market price.

OUR SHAREHOLDER RIGHTS PLAN AND CERTAIN PROVISIONS OF MINNESOTA LAW MAY MAKE A TAKEOVER OF STELLENT DIFFICULT, DEPRIVING SHAREHOLDERS OF OPPORTUNITIES TO SELL SHARES AT ABOVE-MARKET PRICES.

Our shareholder rights plan and certain provisions of Minnesota law may have the effect of discouraging attempts to acquire Stellent without the approval of our board of directors. Consequently, our shareholders may lose opportunities to sell their stock for a price in excess of the prevailing market price.

NEW LEGISLATION AND POTENTIAL NEW ACCOUNTING PRONOUNCEMENTS ARE LIKELY TO IMPACT OUR FUTURE CONSOLIDATED FINANCIAL POSITION AND RESULTS OF OPERATIONS.

Recently, there have been significant regulatory changes, including the Sarbanes-Oxley Act of 2002, and there may be new accounting pronouncements or regulatory rulings that will have an impact on our future consolidated financial position and results of operations. The Sarbanes-Oxley Act of 2002 and other rule changes and proposed legislative initiatives following several highly publicized corporate accounting and corporate governance failures are likely to increase general and administrative costs. Further, proposed initiatives may result in changes in accounting rules, including legislative and other proposals to account for employee stock options as an expense. These and other potential changes could materially increase the expenses we report under accounting principles generally accepted in the United States of America and adversely affect our consolidated operating results. Additionally, the impact of these changes may increase costs incurred by our customer and prospects which could result in delays or cancellations in spending on enterprise content management software and services like we provide. Such delays and cancellations could have a material adverse impact on our consolidated statement of operations and financial condition.

RISKS RELATED TO OUR ACQUISITION OF OPTIKA

REALIZING THE BENEFITS FROM OUR ACQUISITION OF OPTIKA REQUIRES US TO OVERCOME INTEGRATION AND OTHER CHALLENGES WHICH MAY BE DIFFICULT BECAUSE OPTIKA IS ACCUSTOMED TO OPERATING AS AN AUTONOMOUS BUSINESS.

Any failure to meet the challenges involved in successfully integrating our preexisting operations with those of Optika or to realize any of the anticipated benefits or synergies of the acquisition could seriously harm our operating results. Realizing the benefits of the acquisition will depend in part on our ability to overcome significant challenges, including:

combining Optika's Colorado-based operations with our Minnesota headquartered preexisting operations;

integrating and managing the combined company with a small management team;

retaining and assimilating the key personnel of Optika accustomed to working without the oversight of a parent company;

integrating the sales organization of Optika, which relies extensively on indirect sales channels and generates a high proportion of maintenance and other revenues, with our preexisting sales organization, which relies extensively on direct sales and generates a high proportion of product license revenues;

retaining preexisting customers of each company in light of changes that may occur as a result of the acquisition and attracting new customers while overcoming integration challenges;

retaining strategic partners in light of changes that may occur in each company's operations as a result of the acquisition and attracting new strategic partners while overcoming integration challenges; and

creating and maintaining uniform standards, controls, procedures, policies and information for two companies accustomed to operating under autonomous management.

The risks of failure to overcome these integration challenges include:

the potential disruption of our on-going business and distraction of our management;

lost sales or decreased revenues as a result of difficulties inherent in combining product offerings, coordinating sales and marketing efforts to communicate effectively our capabilities;

the potential need to demonstrate to customers that the acquisition will not result in adverse changes in customer service standards or business; and

impairment of relationships with employees, suppliers and customers as a result of any integration of new management personnel.

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CHARGES TO EARNINGS RESULTING FROM THE APPLICATION OF THE PURCHASE METHOD OF ACCOUNTING MAY ADVERSELY AFFECT OUR MARKET VALUE.

In accordance with accounting principles generally accepted in the United States of America, we accounted for the acquisition using the purchase method of accounting, which will result in charges to earnings that could have a material adverse effect on the market value of our common stock. Under the purchase method of accounting, we allocated the total purchase price in the acquisition to Optika's net tangible assets, amortizable intangible assets and intangible assets with indefinite lives based on their fair values as of the date of the closing of the acquisition, and recorded the excess of the purchase price over those fair values as goodwill. We will incur additional depreciation and amortization expense over the useful lives of certain of the net tangible and intangible assets acquired in connection with the acquisition. In addition, to the extent the value of goodwill or intangible assets with indefinite lives becomes impaired, we may be required to incur material charges relating to the impairment of those assets. These depreciation, amortization and potential impairment charges could have a material impact on our results of operations.

IN ORDER TO BE SUCCESSFUL, WE MUST RETAIN AND MOTIVATE KEY EMPLOYEES, WHICH MAY BE DIFFICULT IN LIGHT OF THE GEOGRAPHIC SEPARATION OF OUR HEADQUARTERS AND OPTIKA'S OPERATIONS, OPTIKA'S HISTORY OF OPERATING AS AN INDEPENDENT BUSINESS AND UNCERTAINTY REGARDING OPERATIONAL ROLES FOLLOWING THE ACQUISITION; AND FAILURE TO DO SO COULD SERIOUSLY HARM OUR ABILITY TO EXECUTE OUR OPERATING STRATEGY.

In order to be successful, we must retain and motivate executives and other key employees, including those in managerial, sales and technical positions. Failure to do so could leave us without the management capacity to execute our operating strategy, which could adversely affect our operating results. Retaining and motivating Optika employees may be difficult if we cannot overcome the geographic separation of Optika's Colorado operations and our Minnesota headquarters to make employees feel like they are a part of a cohesive business operation. We may experience difficulty retaining and motivating Optika employees if those employees feel as though they had greater operating freedom when Optika was an independent business. Our employees may experience uncertainty about their future role with us until or after our strategies are announced or executed. These circumstances may adversely affect our ability to attract and retain key management, sales and technical personnel. We also must continue to motivate employees and keep them focused on our strategies and goals, which may be particularly difficult due to the potential distractions of the acquisition.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our interest income on cash, cash equivalents and marketable securities is affected by changes in interest rates in the United States. The Company believes that there may be future exposure to interest rate market risk.

Our investments are held primarily in commercial paper which is affected by equity price market risk and other factors. The Company does not anticipate that exposure to these risks will have a material impact on us, due to the nature of our investments.

The Company has no history of, and does not anticipate in the future, investing in derivative financial instruments. Many transactions with international customers are entered into in U.S. dollars, precluding the need for foreign currency hedges. Any transactions that are currently entered into in foreign currency are not deemed material to the financial statements. Thus, the exposure to market risk is not material.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on this evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There was no change in our internal control over financial reporting during our most recently completed fiscal quarter 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 the normal course of business, we are subject to various claims and litigation, including employment matters and intellectual property claims. Management does not believe the outcome of any current legal matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

The Company is a defendant, along with certain current and former officers and directors of the Company, in a putative class action lawsuit entitled *In re Stellent Securities Litigation*. The lawsuit is a consolidation of several related lawsuits (the first of which was commenced on July 31, 2003) and is pending before the United States District Court for the District of Minnesota. The plaintiff alleges that the defendants made false and misleading statements relating to the Company and its future financial prospects in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The plaintiff seeks monetary damages against the defendants in unspecified amounts. We believe the lawsuit is without merit and will vigorously defend the lawsuit.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

On August 11, 2004 the Company held its Annual Meeting of the Shareholders to consider a vote upon the following proposals. The tabulation of the votes, in favor, against, and abstaining with regard to the proposals is set forth below.

PROPOSAL	AFFIRMATIVE VOTES	NEGATIVE VOTES	ABSTAIN VOTES	BROKER NON-VOTES
1. Election of Directors:				
Robert F. Olson	22,747,083	2,664,013		
Philip E. Soran	23,488,349	1,922,747		
Kenneth H. Holec	23,477,157	1,933,939		
Raymond A. Tucker	23,407,248	2,003,848		
Steven C. Waldron	23,418,851	1,992,245		
Alan B. Menkes	23,495,049	1,916,047		
2. To approve the amendment and restatement of the Stellent, Inc. 1997 Director Stock Option Plan to increase the aggregate number of shares of common stock authorized for issuance under such plan by 200,000 shares.	12,121,735	4,539,044	137,113	8,613,204
3. Ratification of the appointment of Grant Thornton LLP as independent auditors for the Company for fiscal year March 31, 2005.	24,131,777	1,264,428	14,891	

ITEM 5. OTHER INFORMATION

Not applicable.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits filed with this report.

FILE	DESCRIPTION	REFERENCE
3.1	Amended and Restated Articles of Incorporation	Incorporated by reference to Exhibit 3.1 of the Registrants Form 8-K dated August 29, 2001
3.2	Bylaws	Incorporated by reference to Exhibit 4.2 of the Registrants Registration Statement on Form S-8, File No. 333-75828
31.1	Certification by Robert F. Olson, Chairman of the Board, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Electronic Transmission
31.2	Certification by Gregg A. Waldon, Executive Vice President, Chief Financial Officer, Secretary and Treasurer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Electronic Transmission
32.1	Certification by Robert F. Olson, Chairman of the Board, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Electronic Transmission
32.2	Certification by Gregg A. Waldon, Executive Vice President, Chief Financial Officer, Secretary and Treasurer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Electronic Transmission

(b) Reports on Form 8-K.

On July 22, 2004, the Company filed an Amendment No. 1 to the Current Report on Form 8-K to provide financial statements of Optika required by Item 7(a) of Form 8-K and the pro forma financial information required by Item 7(b) of Form 8-K.

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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.

Stellent, Inc.
(Registrant)

Date: November 9, 2004

By: /s/ Robert F. Olson

Robert F. Olson,
Chairman of the Board, President and
Chief Executive Officer
(Principal Executive Officer)

Date: November 9, 2004

By: /s/ Gregg A. Waldon

Gregg A. Waldon
Executive Vice President, Chief
Financial Officer,
Secretary and Treasurer
(Principal Financial and Accounting Officer)

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