SABA SOFTWARE INC
Form 10-Q
January 16, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X] **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended November 30, 2000

[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ____________ to ______________

0-19395
(Commission File number)

SABA SOFTWARE, INC.

(Exact Name of Company as Specified in Its Charter)

Delaware (State or other jurisdiction of incorporation or organization)	**94-3267638** (I.R.S. Employer Identification No.)
2400 Bridge Parkway, Redwood Shores, CA (Address of principal executive offices)	**94065-1166** (Zip Code)

(650) 696-3840
(Company s telephone number, including area code)

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

On December 31, 2000, 44,329,980 shares of Saba s Common Stock, $.001 par value, were outstanding.

SABA SOFTWARE, INC.
FORM 10-Q

QUARTER ENDED NOVEMBER 30, 2000
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PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

SABA SOFTWARE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	November 30, 2000	May 31, 2000

ASSETS		
Current assets:		
Cash and cash equivalents	$ 26,637	$ 74,033
Short-term investments	21,342	4,893
Accounts receivable, net	26,460	9,876
Prepaid expenses and other current assets	1,891	1,078
Total current assets	76,330	89,880
Property and equipment, net	8,016	6,860
Other assets	1,006	965
Total assets	$ 85,352	$ 97,705
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,674	$ 4,906
Accrued expenses	15,068	8,061
Deferred revenue	19,972	10,973
Current portion of capital lease obligations	1,329	850
Total current liabilities	40,043	24,790
Deferred revenue	843	1,125
Notes payable and other long-term liabilities	1,544	1,036
Capital lease obligations, less current portion	2,018	2,050
Total liabilities	44,448	29,001
Stockholders equity:		
Preferred stock		
Common stock	45	44
Additional paid-in capital	161,407	161,078
Deferred stock compensation	(14,993)	(24,541)
Notes receivable from stockholders	(904)	(1,042)
Accumulated deficit	(104,130)	(66,864)
Accumulated other comprehensive income (loss)	(521)	29
Total stockholders equity	40,904	68,704
Total liabilities and stockholders equity	$ 85,352	$ 97,705

See accompanying notes.

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SABA SOFTWARE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)
(Unaudited)

	Three Months Ended November 30,		Six Months Ended November 30,	
	2000	**1999**	**2000**	**1999**
Revenues:				
License	$ 5,708	$ 1,252	$ 10,128	$ 1,920
Services	7,315	2,245	12,943	3,284
Total revenues	13,023	3,497	23,071	5,204
Cost of revenues:				
Cost of license	5		8	
Cost of services	5,553	1,772	10,476	2,728
Total cost of revenues	5,558	1,772	10,484	2,728
Gross profit	7,465	1,725	12,587	2,476
Operating expenses:				
Research and development	5,445	2,724	11,008	6,246
Sales and marketing	13,848	5,133	26,077	8,560
General and administrative	2,556	1,091	5,088	1,992
Amortization of deferred stock compensation and other stock charges	4,547	2,126	9,548	3,511
Total operating costs and expenses	26,396	11,074	51,721	20,309
Loss from operations	(18,931)	(9,349)	(39,134)	(17,833)
Interest income and other, net	764	108	1,868	156
Net loss	$ (18,167)	$ (9,241)	$ (37,266)	$ (17,677)
Basic and diluted net loss per share	$ (0.43)	$ (0.63)	$ (0.89)	$ (1.26)
Shares used in computing basic and diluted net loss per share	42,119	14,564	41,915	13,996

See accompanying notes.

SABA SOFTWARE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

Six Months Ended
November 30,

	2000	1999
Operating activities:		
Net loss	$ (37,266)	$ (17,677)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,255	494
Amortization of deferred stock compensation	9,548	3,511
Changes in operating assets and liabilities		
Accounts receivable	(17,173)	(4,942)
Prepaid expenses and other current assets	(813)	(38)
Accounts payable	(1,232)	1,321
Accrued expenses	7,007	1,555
Deferred revenue	8,717	5,675
Other liabilities	508	
Net cash used in operating activities	(29,449)	(10,101)
Investing activities:		
Purchases of investments	(16,410)	
Purchases of property and equipment	(1,317)	(1,379)
Increase in other assets	(59)	
Net cash used in investing activities	(17,786)	(1,379)
Financing activities:		
Proceeds from issuance of preferred stock		30,081
Proceeds from issuance of common stock	330	457
Collections on notes receivable from stockholders	138	
Principal payments under capital lease obligations	(629)	(52)
Net cash (used in) provided by financing activities	(161)	30,486
(Decrease) increase in cash and cash equivalents	(47,396)	19,006
Cash and cash equivalents, beginning of period	74,033	10,384
Cash and cash equivalents, end of period	$ 26,637	$ 29,390
Supplemental disclosures of non-cash transactions:		
Equipment purchased under capital lease obligations	$ 1,076	$ 1,014
Common stock issued for notes receivable from stockholders	$	$ 493
Warrant issued for purchase of preferred stock for financing	$	$ 160

See accompanying notes.

SABA SOFTWARE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Saba Software, Inc. and its subsidiaries (Saba, us or we), and, in the opinion of management, reflect all adjustments (consisting only of normal recurring adjustments) necessary to fairly state Saba s consolidated financial position, results of operations, and cash flows as of and for the dates and periods presented. The condensed consolidated balance sheet as of May 31, 2000 has been prepared from Saba s audited consolidated financial statements.

These unaudited condensed consolidated financial statements should be read in conjunction with Saba s audited consolidated financial statements included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on August 29, 2000 and our unaudited condensed consolidated financial statements included in our Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on October 16, 2000. The results of operations for the three and six months ended November 30, 2000 are not necessarily indicative of results for the entire fiscal year ending May 31, 2001 or for any future period.

2. Basic and Diluted Net Loss Per Share

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

Pro forma net loss per share has been computed as described above and also gives effect, under Securities and Exchange Commission guidance, to the conversion of preferred shares not included above that automatically converted to common shares immediately prior to the closing of our initial public offering in April 2000, using the if-converted method.

The calculations of historical and pro forma basic and diluted net loss per share are as follows (in thousands, except per share amounts):

	Three Months Ended November 30,		Six Months Ended November 30,	
	2000	**1999**	**2000**	**1999**
Historical				
Net loss	$ (18,167)	$ (9,241)	$ (37,266)	$ (17,677)
Weighted-average shares of common stock outstanding	44,020	16,045	43,896	14,802
Weighted-average shares of common stock subject to repurchase	(1,901)	(1,481)	(1,981)	(806)
Weighted-average shares of common stock used in computing basic and diluted net loss per share	42,119	14,564	41,915	13,996
Basic and diluted net loss per share	$ (0.43)	$ (0.63)	$ (0.89)	$ (1.26)
Pro forma				
Net loss		$ (9,241)		$ (17,677)

Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share (from above)	14,564	13,996
Adjustment to reflect the effect of the conversion of preferred stock from the date of issuance	15,181	14,562
Weighted-average shares of common stock used in computing pro forma basic and diluted net loss per share	29,745	28,558
	$ (0.31)	$ (0.62)

3. Other Comprehensive Loss

Saba reports comprehensive loss in accordance with SFAS No. 130, Reporting Comprehensive Income. In fiscal 2000 and for the three months ended August 31, 2000, Saba s components of comprehensive loss consist of net loss and foreign currency translation adjustments. For the three months ended November 30, 2000, Saba s components of comprehensive loss consist of net loss, foreign currency translation adjustments and unrealized gain on available-for-sale securities. Prior to fiscal 2000, Saba had no material components of other comprehensive loss and, accordingly, net loss was equal to comprehensive loss in all periods.

The following table sets forth the calculation of comprehensive loss for all periods presented (in thousands):

	Three Months Ended November 30,		Six Months Ended November 30,	
	2000	1999	2000	1999
Net loss	$ (18,167)	$ (9,241)	$ (37,266)	$ (17,677)
Unrealized gain on investments	39		39	
Foreign currency translation losses	(355)		(589)	
Comprehensive loss	$ (18,483)	$ (9,241)	$ (37,816)	$ (17,677)

4. Segment Information

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

Geographic Information

Saba operates in North America, Europe and Asia-Pacific. Approximately 17% and 15% of revenues were derived from outside North America in the three and six months ended November 30, 2000, respectively. In fiscal 2000, approximately 10% of revenues were derived outside North America. At November 30, 2000 and 1999, less than 10% of Saba s assets were located outside North America.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The statements contained in this Report on Form 10-Q that are not purely historical in nature are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, hopes, intentions, beliefs and strategies regarding the future. Such forward-looking statements include, but are not limited to, statements regarding revenues from Saba Learning Exchange; expected operating expenses, non-cash expenses and losses; the expansion of our business, operations and personnel; the non-sustainability of prior growth rates; research and development, sales and marketing, and general and administrative expenses; the length of our sales cycles; the sufficiency of our cash resources and credit facilities and our ability to raise additional funds; the lack of a material impact of SFAS No. 133 on us; our ability to hedge exposure to foreign currency risk;

the concentration of our revenues from Saba Learning Enterprise; our release of enhanced and improved versions of our products and services; the use of our cash resources and credit facilities; and our intent to pursue acquisitions. These forward-looking statements involve risks and uncertainties including, but not limited to, the commercial viability of Saba Learning Exchange; our limited operating history; changes in our sales cycle; demand and pricing of our products and services; the effectiveness of and our ability to execute our business strategy; customer retention; personnel recruitment and retention; our ability to manage growth; competitive products and services; the complexities of conducting business globally; the acceptance, use and improvement of the Internet; Internet security; government regulation; technological change; our ability to release enhanced versions of our products; product defects; infringement of third party rights; ability to enforce proprietary rights; natural or technical disasters; our dependence on third parties; access to capital; acquisition challenges; and year 2000 problems. Actual results could differ materially from those projected in any forward-looking statements as a result of these risks and uncertainties, or for the reasons detailed below under the caption Factors That May Affect Future Operating Results, in other sections of this Report on Form 10-Q, and in our reports on Forms 10-Q, 8-K and 10-K as filed with the Securities and Exchange Commission from time to time. All forward-looking statements included in this Report on Form 10-Q are based on information available to us on the date of this Report on Form 10-Q, and we assume no obligation to

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update the forward-looking statements, or to update the reasons why actual results could differ from those projected in the forward-looking statements.

The following discussion should be read in conjunction with our audited consolidated financial statements and the notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on August 29, 2000 and our unaudited condensed consolidated financial statements included in our Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on October 16, 2000.

Overview

General

We are a provider of software and services that enable businesses and governments to create and deploy global networks over the Internet that increase human and business performance through human capital development and management. We provide an Internet-based software platform and related services that enable organizations to procure and deliver learning and systematically close knowledge and competency gaps across their extended enterprises. At the same time, we offer learning providers a global marketing and distribution channel.

We commenced operations in April 1997 and, through March 1998, focused substantially all of our efforts on research activities, developing our products and building our business infrastructure. We shipped our first Saba Learning Enterprise software application and began to generate revenues from software license fees, implementation and consulting services fees and support fees in April 1998. We began to operate Saba Learning Exchange in December 1999. To date, we have not generated significant revenues from the Saba Learning Exchange.

Sources of Revenues and Revenue Recognition

To date, we have generated revenues primarily from licensing Saba Learning Enterprise and providing related services, including implementation, consulting, support and education. In the future, in addition to such license and services revenues, we intend to pursue transaction-based and other forms of revenues from Saba Learning Exchange.

Our license agreements generally provide that customers pay a license fee based on a specified number of learners and the type of software modules licensed. Customers can subsequently pay additional license fees to allow additional learners to use previously licensed modules or to license additional modules. Customers that license Saba Learning Enterprise generally enter into one year support agreements pursuant to which they are entitled to receive software upgrades, error corrections and telephone and web-based assistance, usually for a fixed fee.

Although we primarily provide implementation and consulting services on a time and materials basis, a significant portion of these services have been provided on a fixed fee basis. For fixed-price contracts involving significant professional services, revenues are recognized using the percentage of completion method using the ratio of labor hours incurred to total expected labor hours as the measure of progress towards completion. We also provide professional services on a time and materials basis. We recognize revenues on time and materials contracts as the services are provided.

We recognize license revenues in accordance with the provisions of American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, Software Revenue Recognition as amended by SOP 98-4, Deferral of the Effective Date of Certain Provisions of SOP 97-2 and SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. Prior to November 30, 1999, we had not established vendor specific objective evidence for support and therefore, recognized revenues from license agreements ratably over the contract period if there was persuasive evidence of an arrangement, the software was delivered, collection was probable, and the fee was fixed or determinable. Subsequent to November 30, 1999, we generally provide for additional software platforms during the initial term of our contracts and therefore, recognize revenue ratably over the initial term, generally twelve months, beginning upon contract signing. We invoice customers for license and support fees in accordance with individual contract terms. Payment terms generally require payment of the license fees and first year support fees from the customer 30 days from the effective date of the contract. For contracts that provide for additional rights beyond the initial delivery date, revenue is recognized ratably over that period.

If an agreement includes both license and service elements, the license fee is recognized beginning on delivery of the software, provided the payment terms for licenses are not subject to additional acceptance criteria. In cases where license fee payments are contingent on the acceptance of services, recognition of revenues is deferred for both the license and the service elements until the acceptance criteria are met. Support revenues are recognized ratably over the term of the support contract, typically one year.

Cost of Revenues

Our cost of revenues include cost of our license revenues and cost of our services revenues. Our cost of license revenues include the cost of software manuals and documentation, production media and shipping costs. Our cost of services revenues include salaries and related expenses for our professional services organization. Because our cost of services revenues is greater than cost of license revenues, cost of revenues as a percentage of total revenues may fluctuate based on the mix of software and services sold.

Operating Expenses

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

We classify all charges to the research and development, sales and marketing and general and administrative expense categories based on the nature of the expenses. Each of these three categories include commonly recurring expenses such as salaries, employee benefits, travel and entertainment costs, and allocated communication, rent and depreciation costs. We allocate these expenses to each of the functional areas that derive a benefit from such expenses based upon their respective headcount. The research and development category of operating expense also includes purchased technology. The sales and marketing category of operating expenses also includes sales commissions and expenses related to public relations and advertising, trade shows and marketing collateral materials. The general and administrative category of operating expenses also includes administrative and professional services fees.

In connection with the granting of stock options to, and restricted stock purchases by, our employees, we recorded deferred stock compensation totaling approximately $38.4 million as of November 30, 2000. This amount represents the difference between the exercise or purchase price, as applicable, and the deemed fair value of our common stock for financial accounting purposes on the date these stock options were granted or purchase agreements for restricted stock were signed. This amount is included as a component of stockholders equity and is being amortized by charges to operations over the vesting period of the options or restricted stock. During the three and six months ended November 30, 2000, we amortized $4.5 million and $9.5 million, respectively, of deferred stock compensation and we had cumulatively amortized $23.4 million of the $38.4 million recorded. The amortization of the remaining deferred stock compensation will result in additional charges to operations through fiscal 2004.

History of Losses

We have incurred significant losses and negative cash flows from operations since our inception. As of November 30, 2000, we had an accumulated deficit of $104.1 million. Although our revenues have increased on a quarterly basis since May 31, 1998, we have not achieved profitability and cannot be certain that we will be able to sustain these growth rates or realize sufficient revenues to achieve profitability. We expect to continue to incur significantly greater operating expenses. We also expect to incur substantial non-cash expenses relating to stock based compensation. As a result, we expect to incur significant losses for the foreseeable future and will need to generate significantly higher revenues in order to achieve profitability. If we achieve profitability, we may not be able to sustain it.

We had 531 full-time employees at November 30, 2000. We intend to hire a significant number of employees in the future. This expansion places significant demands on our management and operational resources. To manage this rapid growth, we must invest in scalable operational systems, procedures and controls. We must also be able to recruit qualified candidates to manage our expanding operations. We expect future expansion to continue to challenge our ability to hire, train, manage and retain our employees. Additional personnel will increase our operating expenses in the foreseeable future.

Limited Operating History

We have a limited operating history that makes it difficult to forecast our future operating results. We believe that period-to-period comparisons of our operating results should not be relied upon as predictive of future performance. Our prospects must be considered in light of the risks, expenses and difficulties encountered by companies at an early state of development, particularly companies in new and rapidly evolving markets, such as human capital development and management, electronic commerce and Internet software. We may not be successful in addressing these risks and difficulties. Although we have experienced significant growth in revenues in recent periods, we do not believe that prior growth rates are sustainable or indicative of our future operating results.

Results Of Operations
Three And Six Months Ended November 30, 2000 And 1999

Revenues

Total revenues increased to $13.0 million for the three months ended November 30, 2000 from $3.5 million for the three months ended November 30, 1999. For the six months ended November 30, 2000, revenues increased to $23.1 million from $5.2 million for the six months ended November 30, 1999. The growth in revenues year-over-year reflects our relatively early stage of development and is primarily attributable to our expanding sales force. We do not expect revenues to increase at the same rate in the future. During the three and six months ended November 30, 2000 and 1999, no customer represented more than 10% of our revenues.

License revenues increased to $5.7 million, or 44% of total revenues, for the three months ended November 30, 2000, from $1.3 million, or 36% of total revenues, for the three months ended November 30, 1999. For the six months ended November 30, 2000, license revenues increased to $10.1 million from $1.9 million for the six months ended November 30, 1999. The increases in the dollar amounts of license revenues in both the three- and six-month periods are primarily attributable to increases in sales of licenses to new customers resulting from increased headcount in our sales force.

Services revenues increased to $7.3 million, or 56% of total revenues, for the three months ended November 30, 2000, from $2.2 million or 64% of total revenues, for the three months ended November 30, 1999. For the six months ended November 30, 2000, services revenues increased to $12.9 million from $3.3 million for the six months ended November 30, 1999. The increases in the dollar amounts of services revenues are primarily attributable to increased implementation and billable consulting headcount providing services in connection with increased license sales and to support services sold to our new customers.

Deferred license and services revenues reflected on our consolidated balance sheet were $20.8 million at November 30, 2000 as compared to $12.1 million at May 31, 2000.

The mix of license and services revenues as a percentage of total revenues has varied significantly due to our relatively early stage of development.

Cost of Revenues

Total cost of revenues increased to $5.6 million for the three months ended November 30, 2000, from $1.8 million for the three months ended November 30, 1999. For the six months ended November 30, 2000, total cost of revenues increased to $10.5 million from $2.7 million for the six months ended November 30, 1999. To date, our cost of software license revenues has been insignificant. The increases in the amounts of cost of revenues are primarily attributable to the hiring of additional employees to support increased customer demand for our implementation, consulting and support services. Cost of services revenues represented 76% of services revenues for the three months ended November 30, 2000 and 79% of services revenues for the three months ended November 30, 1999. For the six months ended November 30, 2000, cost of services revenues represented 81% of services revenues and 83% of services revenues for the six months ended November 30, 1999. The decreases in the cost of services as a percentage of services revenues is primarily attributable to improved utilization rates of new employees as they complete required training on Saba products and implementation methodologies and an increased blended rate per hour on sales of services to our customers.

Operating Expenses

Research and development. Research and development expenses increased to $5.4 million for the three months ended November 30, 2000, from $2.7 million for the three months ended November 30, 1999. For the six months ended November 30, 2000, research and development expenses increased to $11.0 million from $6.2 million for the six months ended November 30, 1999. The increases are primarily attributable to increases in the number of employees engaged in research and development. To date, all software development costs have been expensed in the period incurred. We believe that continued investment in research and development is critical to attaining our strategic objectives, and we anticipate that research and development expenses will continue to increase in absolute dollars as a result of our internal product development efforts.

Sales and marketing. Sales and marketing expenses increased to $13.8 million for the three months ended November 30, 2000 from $5.1 million for the three months ended November 30, 1999. For the six months ended November 30, 2000, sales and marketing expenses increased to $26.1 million from $8.6 million for the six months ended November 30, 1999. These increases are primarily attributable to our Saba marketing brand launch and campaign and increases in the number of employees in our sales and marketing organizations and related costs, such as increased sales commissions and costs associated with the establishment of sales offices in additional domestic and international locations. We anticipate that the amount of sales and marketing expenses will continue to increase in absolute dollars due to the planned growth of our sales force and to expected additional increases in advertising and marketing programs and other promotional and branding activities.

General and administrative. General and administrative expenses increased to $2.6 million for the three months ended November 30, 2000 from $1.1 million for the three months ended November 30, 1999. For the six months ended November 30, 2000, general and administrative expenses increased to $5.1 million from $2.0 million for the six months ended November 30, 1999. The increases are primarily attributable to increases in the number of executive, finance and administrative employees, as well as increases in allowances for doubtful accounts and the amount of administrative and professional services fees, including temporary staffing, legal and accounting fees. We expect that the absolute dollar amount of general and administrative expenses will continue to increase in future periods as we add personnel to support the expansion of our operations and incur additional expenses related to the anticipated growth of our business, both domestically and internationally.

Amortization of deferred stock compensation. During the three and six months ended November 30, 2000, we recorded deferred stock amortization of $4.5 million and $9.5 million, respectively. During the three and six months ended November 30, 1999, we recorded deferred stock amortization of $2.1 million and $3.5 million, respectively.

Interest income and other, net. Interest income and other, net consists of interest income, interest expense and other non-operating expenses. Interest income and other, net increased to $764,000 for the three months ended November 30, 2000, from $108,000 for the three months ended November 30, 1999. For the six months ended November 30, 2000, interest income and other, net increased to $1.9 million from $156,000 for the six months ended November 30, 1999. These increases are attributable primarily to interest income from average invested cash balances, partially offset by interest expense related to equipment loans, the proceeds of which were used to purchase computer equipment, leasehold improvements, software and office furniture and equipment.

Our results of operations could vary significantly from quarter to quarter. We expect to incur significant sales and marketing expenses to promote our software products and services. Therefore, our quarterly operating results are likely to be particularly affected by the number of customers licensing our software products during any quarter as well as sales and marketing, research and development and other expenses for a particular period. If revenues fall below our expectations, we will not be able to reduce our spending rapidly in response to the shortfall. We anticipate that our sales will continue to have long sales cycles. Therefore, the timing of future customer contracts could be difficult to predict, making it very difficult to predict revenues between quarters, and our operating results may vary significantly.

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

- dependence of our revenues on a small number of large orders;
- our ability to attract new customers;

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

• our ability to license additional products to current customers;

• the announcement or introduction of new products or services by us or our competitors; or changes in the pricing of our products and services or those of our competitors;

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

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

• the amount and timing of operating costs and capital expenses relating to expansion of our business.

Liquidity and Capital Resources

Since inception, we have funded our operations primarily through the sale of equity securities, through which we have raised net proceeds of $120.3 million through November 30, 2000, equipment leases and other debt. As of November 30, 2000, we had outstanding equipment leases of $3.3 million and $48.0 million of cash, cash equivalents and investments.

Cash used in operating activities was $29.4 million during the six months ended November 30, 2000 and $10.1 million during the six months ended November 30, 1999. The cash used during these periods was primarily attributable to net losses of $37.3 million and $17.7 million offset by $9.5 million and $3.5 million of amortization of deferred stock compensation during the six months ended November 30, 2000 and 1999, respectively. Also contributing to the use of cash in operations were increases in accounts receivable of $17.2 million and $4.9 million offset by increases in deferred revenue of $8.7 million and $5.7 million during the six months ended November 30, 2000 and 1999, respectively.

Cash used in investing activities during the six months ended November 30, 2000 and 1999 were comprised primarily of investments in property and equipment and for the six months ended November 30, 2000, included $16.4 million in net purchases of investments. Investments in property and equipment, excluding equipment acquired under capital leases, were $1.3 million during the six months ended November 30, 2000 and $1.4 million during the six months ended November 30, 1999.

Cash used in financing activities was $161,000 during the six months ended November 30, 2000 resulting primarily from payments on capital lease obligations, offset by proceeds from issuances of common stock and collections on notes receivable from stockholders. Cash provided by financing activities was $30.5 million during the six months ended November 30, 1999, resulting primarily from net proceeds from the sale of preferred stock.

At November 30, 2000, we did not have any material commitments for capital expenses. Our principal commitments consisted of obligations under capital and operating leases.

We currently anticipate that our available cash resources and credit facilities will be sufficient to meet our presently anticipated working capital, capital expense and business expansion requirements for at least the next 12 months. However, we may choose to raise additional funds within the next 12 months to support expansion, develop new or enhanced applications and services, respond to competitive pressures, acquire complementary businesses or technologies or take advantage of unanticipated opportunities. Our future liquidity and capital requirements will depend on numerous factors, including the success of our existing and new product and service offerings and competing technological and market developments. We may be required to raise additional funds through public or private financing, strategic relationships or other arrangements. There can be no assurance that additional funding, if needed, will be available on terms acceptable to us, if at all.

Market and Currency Risk

We provide our services to customers primarily in the United States and, to a lesser extent, in Europe and elsewhere throughout the world. As a result, our financial results could be affected by risks typical of an international business. Such factors include, but are not limited to, changes in foreign currency exchange rates, local regulations and restrictions and political climates, weak economic conditions in foreign markets, differing tax structures and foreign currency rate volatility. Sales are primarily made in U.S. Dollars; however, as we continue to expand our operations, more of our contracts may be denominated in Australian Dollars, British Pounds, Canadian

Dollars, Euros, French Francs and German Marks. A strengthening of the U.S. Dollar could make our products less competitive in foreign markets.

Our exposure to foreign exchange rate fluctuations also arises in part from the translation of the financial results of foreign subsidiaries into U.S. dollars in consolidation. As exchange rates vary, these results, when translated, may vary from expectations and adversely impact overall expected profitability.

Our investments are made in accordance with an investment policy approved by our Board of Directors. At November 30, 2000, the average maturity of our investment securities was approximately three months. All investment securities had maturities of less than two years. Our interest income is sensitive to changes in the general level of U.S. interest rates. Due to the nature of our cash equivalents and investments, which are primarily money market funds and commercial paper, we believe that there is no material market risk exposure.

All investments in the table below are carried at market value, which approximates cost. The table below represents principal (or notional) amounts and related weighted-average interest rates by year of maturity of our investment portfolio as of November 20, 2000. (in thousands, except percentages)

	Stated Maturity	
	One Year Or Less	**More Than One Year**
Available-for-sale securities	$ 46,260	$ 999
Weighted average interest rate	6.72%	6.64%

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities . We are required to adopt SFAS No. 133, as amended, for the fiscal year ending May 31, 2002. SFAS No. 133 establishes methods of accounting for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. Because we currently hold no derivative financial instruments and do not currently engage in hedging activities, adoption of SFAS No. 133 is expected to have no material impact on our financial condition or results of operations. We may, however, as our foreign operations increase, hedge our exposure to foreign currency risk in the future.

In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) 101 regarding recognition, presentation and disclosure of revenues. In March 2000, the SEC issued SAB 101A Amendment: Revenue Recognition in Financial Statements, which delays implementation of SAB 101 until our second quarter of fiscal 2001. In June 2000, the SEC issued SAB 101B Second Amendment: Revenue Recognition in Financial Statements, which delays the implementation of SAB 101 until our fourth quarter of fiscal 2001. We adopted SAB 101 in the first quarter of fiscal 2001 and it did not have any material effect on our accounting practices or financial results.

In March 2000, the FASB s Emerging Issues Task Force (EITF) reached a consensus on EITF 00-2, Accounting for Web Site Development Costs . EITF 00-2 discusses how an entity should account for costs incurred to develop a web site. We adopted EITF 00-2 and it has not had any material effect on our accounting practices or financial results.

In March 2000, the EITF reached a consensus on EITF 00-3, Application of AICPA Statement of Position (SOP) 97-2 to Arrangements that Include the Right to Use Software on Another Entity s Hardware . EITF 00-3 discusses whether SOP 97-2 applies to arrangements that require the vendor to host the software and whether SOP 97-2 applies to arrangements in which the customer has an option to take delivery of the software and, if so, when delivery of the software occurs and how the vendor s hosting obligation impacts revenue recognition. We adopted this EITF and it has not had a material impact on our results of operations.

In March 2000, the FASB issued Interpretation No. 44 (FIN 44), Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25 . FIN 44 clarifies the application of APB 25 for certain issues, including the definition of an employee, the treatment of the acceleration of stock options and the accounting treatment for options assumed in business combinations. FIN 44 became effective on July 1, 2000, but is applicable for certain transactions dating back to December 1998. The adoption of FIN 44 had no impact on our financial condition or results of operations.

Factors that May Affect Future Operating Results

This quarterly report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking statements as a result of certain factors including those set forth below.

We Have a Limited Operating History and Are Subject to the Risks Encountered by Early-Stage Companies

We were founded in April 1997, shipped our first products in April 1998 and began to operate Saba Learning Exchange in December 1999. Because we have a limited operating history, you should consider and evaluate our operating prospects in light of the risks and uncertainties frequently encountered by early-stage companies in rapidly evolving markets. For us, these risks include:

- risks that our revenue forecasts may be incorrect because of our limited sales to date and our long sales cycle;
- risks associated with our dependence on Saba Learning Enterprise and related services for substantially all of our revenues for the foreseeable future;
- risks that our strategy of establishing Saba Learning Exchange may not be successful; and
- risks that fluctuations in our quarterly operating results will be significant relative to our revenues.

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

We Have a History of Losses, Expect Future Losses and Cannot Assure You that We Will Achieve Profitability

We have incurred significant losses and negative cash flows from operations sin