CHORDIANT SOFTWARE INC
Form 10-K
February 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

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

For the fiscal year ended September 30, 2006

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: 000-29357

CHORDIANT SOFTWARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	**93-1051328**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer identification No.)**

20400 Stevens Creek Blvd., Suite 400
Cupertino, California 95014
(Address of principal executive offices, including zip code)

(408) 517-6100
(Registrant’s telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock $.001 Par Value per Share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 **x** No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Transition Report on Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of March 31, 2006, the last business day of the registrant's most recently completed second fiscal quarter: $252,691,824.

As of January 31, 2007, there were 79,842,253 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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EXPLANATORY NOTE

Restatements of Consolidated Financial Statements

Restatement relating to stock-based compensation

In this Form 10-K, Chordiant Software, Inc. ("Chordiant", "the Company" or "we") is restating its consolidated balance sheet as of September 30, 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for each of the fiscal periods ended September 30, 2005 and September 30, 2004, and each of the quarters in fiscal year 2005 and the first two quarters in fiscal year 2006. We are also restating the pro forma disclosures for stock-based compensation expense required under Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation," (SFAS 123) included in Note 13 to our Consolidated Financial Statements. This Form 10-K also reflects the restatement of Selected Consolidated Financial Data for the fiscal year ended September 30, 2005, the nine month period ended September 30, 2004, and the fiscal years ended December 31, 2003 and December 31, 2002 in Item 6 of this Form 10-K.

Previously filed annual reports on Form 10-K and quarterly reports on Form 10-Q affected by the restatements have not been amended and should not be relied on.

Our decision to restate our consolidated financial statements was based on facts obtained by management and the results of an independent review into our stock option accounting that was conducted by the Audit Committee of the Board of Directors.

In July 2006, the Company's Board of Directors initiated a review of the Company's historical stock option grant practices and appointed the Audit Committee to oversee the investigation. The Audit Committee's review focused on processes used to establish the option exercise prices and to obtain required approvals of stock option grants and the related measurement dates used for financial reporting purposes. The Audit Committee and its legal advisors reviewed the Company's historical stock option grants and related accounting including an assessment and review of the Company's accounting policies, internal records, supporting documentation and email communications, as well as interviews with current and former employees and current and former members of the Company's executive management and Board of Directors.

The Audit Committee determined that, pursuant to the requirements of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25), the correct measurement dates for a number of stock option grants made by Chordiant during the period 2000 to 2006 ("Review Period") differ from the measurement dates previously used to account for such option grants. The Audit Committee identified errors related to the determination of the measurement dates for grants of options where the price of the Company's stock on the selected grant date was lower than the price on the actual grant date which would permit recipients to exercise these options at a lower exercise price. Under these circumstances, the Company should have recorded deferred stock compensation expense, which subsequently should have been amortized as stock compensation expense over the vesting period of the stock options.

On November 26, 2006, the Board of Directors, upon the recommendation of the Audit Committee and management, after considering the quantitative and qualitative analysis prepared by management relating to these errors, concluded that the Company should restate certain of its historical financial statements. To correct the accounting errors, our Annual Report on Form 10-K for the year ended September 30, 2006 and our Quarterly Report on Form 10-Q for the three months ended June 30, 2006, includes restated consolidated and condensed consolidated financial statements and selected consolidated financial data for the years ended December 31, 2002 and 2003, the nine-month period ended September 30, 2004, the fiscal year ended September 30, 2005, and the quarters ended December 31, 2005 and

March 31, 2006.

The Company also recorded adjustments related to payroll withholding tax for certain options formerly classified as incentive stock option (ISO) grants under Internal Revenue Service regulations. These options were determined to have been granted with an exercise price below the fair market value of our stock on the actual grant date and therefore do not qualify for ISO treatment. The disqualification of ISO classification and the resulting conversion to non-qualified status results in additional payroll withholding tax obligations on the exercise of these options.

There was no income tax benefit associated with the increase to the stock-based compensation expense as the Company has had a full valuation allowance for the deferred tax assets for the periods being restated.

To the extent stock options have been exercised, the Company has pursued and continues to pursue the recovery of the price difference between the original and revised measurement dates from certain former officers.

The Company is recording approximately $8.3 million of additional pre-tax, non-cash stock-based compensation expense and associated withholding taxes for the fiscal periods 2000 through 2006. The impact of recognizing stock-based compensation expense and associated withholding taxes resulting from the investigation of past stock option grants is as follows (dollars in thousands):

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Fiscal Period		Additional Compensation Expense
2000	$	474
2001		2,082
2002		2,715
2003		1,529
Adjustment to accumulated deficit as of December 31, 2003		6,800
2004		928
2005		325
2006 and thereafter		208
Total	$	8,261

For more information regarding the investigation and findings relating to stock option practices and the restatement, please refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Restatement of Consolidated Financial Statements," and Note 3 - "Restatement of Previously Issued Consolidated Financial Statements" in Item 8. For more information regarding the investigation and findings relating to stock option practices and the restatement and our remedial measures, see Item 9A, "Controls and Procedures."

Previously Disclosed Restatement of Financial Statements Reported in our 2005 Form 10-K

In the course of preparing the 2005 financial results for the year ended September 30, 2005, the Company and its independent registered public accounting firm, BDO Seidman, LLP, identified certain errors in the Company's 2005 interim financial statements for the quarters ended December 31, 2004, March 31, 2005, and June 30, 2005. On December 6, 2005, management concluded that the Company should restate the Company's interim financial statements for the quarters ended December 31, 2004, March 31, 2005, and June 30, 2005 due to such errors. On December 6, 2005, senior management of the Company met with the Audit Committee of the Board of Directors of the Company to discuss management's conclusion. The Audit Committee concurred with management's conclusion. These errors are more fully described in Note 19 to the Consolidated Financial Statements contained in the Annual Report on Form 10-K filed with the SEC on December 9, 2005.

Previously Disclosed Change in Year End and Prior Restatement of Financial Statements Reported in our 2004 Form 10-K

On December 29, 2004, the Board of Directors of Chordiant approved a change in Chordiant's fiscal year end from December 31st to September 30th. In the course of preparing the 2004 financial results for the new fiscal year ended September 30, 2004, the Company identified certain errors relating to expense and revenue timing, the valuation of a guarantee, prepaid account balances, estimates used to compute stock offering costs, warrant valuations and stock based compensation in the interim financial statements for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004. Due to the aggregate number of errors identified in the previously issued interim financial statements and the relative percentages represented by those errors in the quarters, management concluded that the interim financial statements for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004 should be restated. The Audit Committee of the Board of Directors concurred with management's conclusion. As a result, Chordiant filed a Transition Report on Form 10-K/T for the transition period from January 1, 2004 to September 30, 2004 to reflect the change in fiscal year and the related restatement for the quarters ended March 31, 2004, June 30,

2004 and September 30, 2004.

All financial information contained in this fiscal 2006 Annual Report on Form 10-K gives effect to these prior restatements.

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CHORDIANT SOFTWARE, INC.

ANNUAL REPORT ON FORM 10-K

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PART I

FORWARD-LOOKING INFORMATION

Except for the historical information contained herein, this Annual Report contains certain information that is forward-looking in nature. This information is based on our current expectations, assumptions, estimates and projections about our business and our industry, and involves known and unknown risks, uncertainties and other factors that may cause our or our industry's results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied in, or contemplated by the forward-looking statements. Words such as "believe," "anticipate," "expect," "intend," "plan," "will," "may," "should," "estimate," "predict," "guidance," "potential," "continue" or the negative of such terms or other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors more fully described under the caption "Risk Factors" and those discussed elsewhere in this document. These and many other factors could affect the future financial and operating results of Chordiant. Chordiant undertakes no obligation to update any forward-looking statement to reflect events after the date of this report.

ITEM 1. BUSINESS

Overview

Chordiant is an enterprise software company that delivers products that improve the customer front-office processes for the global banking, insurance, and telecommunications markets. Chordiant provides companies in these markets with innovative solutions that help them more effectively manage their customer interactions.

In the market we offer an enterprise system that utilizes predictive decisioning, analytical modeling, and strategy formulation in real-time for decision management and execution at the point of sale. This capability enables organizations to improve the accuracy of marketing offers for retention, up-selling, cross selling, and modeling risk scenarios such as customer churn and likelihood of default on payments.

We believe our solutions add business value and return-on-investment for our customers by reducing operational costs, and increasing employee productivity. These improvements are realized by automating key business processes and supporting organizational decision-making associated with the servicing, selling, marketing and fulfillment of customer requests across the enterprise. We offer solutions to our clients that include software applications, business processes, tools and services that will integrate their customer information and corporate systems to produce a real-time view of customers across multiple business channels. Our solutions offer businesses additional flexibility to create and set their policies and processes to control the quality of servicing, fulfillment and marketing to their customers.

On December 21, 2004, we acquired KiQ Limited, a privately held United Kingdom software company ("KiQ"), for an aggregate purchase price of approximately $20 million, which was comprised of $9.7 million in cash, $9.4 million in our common stock and approximately $0.9 million in associated transaction costs. Through this transaction, we acquired a decision management system that advances the state of analytics by exploiting the power of predictive data mining, analytical modeling, and strategy formulation into real-time decision management and execution. Products and patent-pending technology acquired by us in this transaction enable organizations to significantly increase the accuracy of marketing offers for retention, up-selling, cross selling, and to model risk scenarios such as customer churn and likelihood to default on payments. With the addition of KiQ's products and patent-pending technology we

are able to deliver a range of applications for real-time recommendation, retention, risk management and recruitment.

As a result of the transaction, Chordiant added new customers primarily in financial services and telecommunications industries. A total of 20 KiQ employees, including two founders and 15 engineering and technical staff, joined us as employees in December 2004.

Product Solutions

Our products are designed for global enterprises seeking to optimize their customer experiences through effective decision analysis, marketing, selling and servicing efforts. We have designed our products to integrate customer information from different data sources and systems of record, automate business processes based on a customer's specific profile and requests, and provide uniform service and information to customers across multiple communication channels. Our products are designed to enable companies to deliver appropriate recommendations (also known as "next best action"), services, offers and information to a targeted customer at the time of customer need while complying with relevant business policy and industry regulatory requirements.

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Our solutions are designed to address the enterprise requirements of global consumer companies serving millions of customers across multiple business channels integrating multiple lines of business. The solution suite is typically licensed as an integrated set of software products that include one or more vertical market applications running on top of a common layer of foundation technology and supporting tools. Chordiant's software is based on open systems software standards that are widely adopted by our industry and capable of deployment throughout an enterprise's information technology infrastructure. Chordiant software is built to be highly scalable and adaptable to a customer's specific business requirements or technology infrastructure.

Products and Solutions

Our solutions are designed to address a variety of business needs within our three target vertical markets of banking, insurance, and telecommunications:

· **Call Center and Customer Service Desktop (Call Center Advisor - Browser Edition)**: This product is a web browser-based guided desktop for the effective management of customer contacts, service requests, and customer case history in the call center channel. The desktop is integrated with leading computer telephony integration products, working with our own queue based work management to deliver 'universal queues' to the enterprise. This product is used by customer services professionals across all our target markets. It is designed to meet the high volume transaction and business processes common in enterprise contact centers. The desktop also acts as a delivery channel for our decision management and marketing products together with the other business applications that Chordiant sells.

· **Marketing Director**: We provide applications for driving unified, personalized marketing campaigns and response management across multiple media types and multiple channels including email, web, phone, and mobile messaging (MMS/SMS). These products are used by marketing professionals across all our target markets to segment and target prospects and customers and deliver to them effective marketing campaigns. The Marketing Director suite of products integrates with our Decision Management products to provide an integrated campaign management system.

· **Recommendation Advisor**: An application which provides flexible lead collection and routing in a common guided selling desktop, integrated with marketing campaigns and product fulfillment. Predictive and adaptive analytics guide staff toward best offers and "next best action" in the context of inbound or outbound customer interactions. This product is used by sales and service professionals across our target markets to manage leads and deliver highly effective sales messages.

· **Credit Card Disputes, Charge-backs and Fraud**: These modular applications are designed to automate and optimize customer and mid-office functions associated with credit card dispute handling and fraud investigation and recovery. The products use Chordiant technology to implement the dispute and chargeback regulatory requirements of credit card associations to assist organizations in managing their compliance of these complex regulations. This application is used by customer service professionals in the credit card segment of banking to drive more cost effective, compliant handling of disputes and fraud cases.

· **Teller**: A guided desktop product and supporting financial transaction components for retail bank tellers/cashiers or other cash-based desktop applications. This product is used in the banking and lending sectors by customer-facing staff in bank branches or stores to effectively process cash and related financial transactions on behalf of the customer. The solution utilizes the Chordiant Enterprise Platform (described below) in providing company-wide case management, customer history, and work management between front office and back office operations.

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Wholesale Lending Point of Sale (POS): A product which offers loan quoting and origination for indirect lending channels. This product is used in the lending and banking sectors by third party and captive brokers to effectively sell, process, and fulfill various lending products. It utilizes the Chordiant Enterprise Platform to provide the necessary scale, and it is designed to integrate with existing banking systems.

· **Lending**: Products which provide a common process-driven lending infrastructure and services across an organization to increase efficiency of loan originations, quoting, account opening and loan risk assessment and management such as required by Basel II. Our lending products are used in banking and lending by a variety of users and desktop applications.

· **Insurance**: Products which provide a common process-driven insurance infrastructure and services across an organization to increase efficiency of case management, claims processing, quoting, and risk management. Our insurance products are used in the insurance sector by a variety of users and desktop applications.

· **Collections**: This product is currently in development. This product is designed to deliver automation and operational efficiency to debt recovery and collections professionals. The first generally available release, consisting of core collections functions, is expected in the third fiscal quarter of 2007. The product is designed to make extensive use of the Chordiant decision management technology to deliver real time decisioning.

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Technology

Chordiant applications share a common technology platform and set of development and configuration tools. Chordiant technology is built to scale to tens of thousands of users and integrate seamlessly into our customer's IT infrastructure. Chordiant technology is generally built based on standards as defined in Java 2 Enterprise Edition (J2EE). Chordiant technology works alongside third party J2EE Application Servers, such as those from International Business Machines Corporation (IBM) and BEA Systems Inc.

Chordiant technology is based on a service oriented architecture (SOA). This architecture provides a framework for large or growing businesses to provide multi-channel interaction and process orchestration across multiple lines of business. The framework (also known as Chordiant Enterprise Platform) provides a pre-integrated environment that supports the business applications required by these large scale organizations. With predictive decisioning built-in, organizations can utilize Chordiant technology to obtain customer behavioral insight and use this to drive the most appropriate business processes, guiding staff through the best tasks to increase responsiveness, reduce errors, shorten cycle times, and present the most relevant offers to customers in each interaction.

· **Enterprise Platform: Foundation Server, Café, and Tools Platform**: Consisting of a family of services with enterprise-wide process orchestration and case management at its core, the Chordiant Enterprise Platform product family provides a common, highly scalable base platform for all Chordiant solutions. The product family incorporates industry standards such as J2EE, model driven development, AJAX high performance thin client desktops, Java Server Faces (JSF), and enterprise open source technologies including Hibernate, and Apache Trinidad. The products are supported by process development and administration tools that use the Eclipse integrated development environment.

The Enterprise Platform incorporates module 'servers' to deliver additional functionality as needed including business rules, decision management, telephony integration, connectivity to systems of record and interaction channel management. These allow organizations to implement only those functions that are required for their particular business requirement without interfering with future project requirements.

· **Decisioning**: Consisting of flexible services and tools for adaptive decisioning, predictive decisioning, and rules, our Decisioning product family allows organizations to effectively drive application behavior based on industry or organizational models and logic. This capability allows business users advanced control over business priorities, and enables the business to refine offer and service management in real-time. Decision management is a suite of products and comprises:

• Chordiant Data Preparation Director—Chordiant Data Preparation Director allows non-IT users to combine, manipulate and aggregate customer data using an easy to use visual interface.

• Chordiant Predictive Analytics Director—Chordiant Predictive Analytics Director provides marketing professionals functionality which enables in-depth analysis of significant amounts of customer information using data-mining and predictive analytical capabilities.

• Chordiant Strategy Director—Chordiant Strategy Director allows users to design customer interaction strategies and marketing offers based on decisions and rules that reflect customer behavior, preferences, legislation, corporate policies and desired business outcomes. The resulting decision logic is executed in our campaign management solution for outbound communication or executed in real-time in multiple channels of communication.

• Chordiant Decision Monitor—Chordiant Decision Monitor provides management with insight into business results, measures data analysis effectiveness, and allows an organization to learn from current and future data models. It is a

software module in which decisions are automatically logged and stored in a monitoring database together with the relevant data as well as subsequent customer information and behavior. This module can be integrated and analyzed by third party business intelligence tools.

• Chordiant Deployment Manager—Chordiant Deployment Manager provides the administrative function to prepare available data in the operational environment and implement the decision logic into production campaigns, business processes and applications.

• Chordiant Real-Time Decisioning Services—Chordiant Real-Time Decisioning Server generates a decisioning service that can be hosted in industry-standard application servers.

• Chordiant Database Decisioning Services—The Chordiant Database Decisioning Server provides an application for datamining, analysis, and modeling to create the optimal decision logic and the appropriate decisions outcomes.

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Chordiant Mesh Collaboration

Announced in fiscal year 2006, Chordiant Mesh is a collaborative development network where customers, partners, and Chordiant staff can work together on solutions to respond to customer initiatives. Chordiant Mesh is a development infrastructure layer that allows the organizations to collaborate on a wide variety of solutions, components, and tools. By applying principles from open source projects to a member-driven high-end ecosystem, Chordiant Mesh facilitates far greater collaboration, agility, speed to market, transparency, and quality than customers are accustomed to receiving from high-end enterprise software providers.

Key benefits of Chordiant Mesh are:

- A fabric for the maintenance of infrastructure level code and reduction of customization and cost of ownership.
- A set of tools and methodologies for building applications collaboratively with Chordiant and its partners.
- Enables and enhances the IT systems "grid" to better support high value SOA – based applications;
- Enhancement of the ability of IT departments to provide support, control and flexibility.
- By leveraging open-source development models, Chordiant can take code revisions submitted by community members – customers, partners and Chordiant itself – and allow these to be incorporated into its products when appropriate.

The collaborative development approach enables Chordiant to be in closer collaboration with its enterprise customers.

Strategic Direction

The Company is focused on solving problems for our global accounts through helping them improve the quality of the customer experience they deliver in the banking, insurance, and telecommunications industries. Chordiant anticipates that it will increasingly deliver business-focused applications based on an open and adaptable core information technology ("IT") infrastructure that provides high levels of business agility and fast return on investment for enterprises by allowing rapid changes to their IT systems. Within the markets above, Chordiant will continue to develop domain-level solutions for these markets, focusing on the most mission-critical business processes facing our customers.

Customers

We target global brand leaders in our core markets. Our customers include: ING, Canada, Inc., HSBC Technology and Services (USA), Inc., Capital One Services, Inc., O2 (UK) Limited, Time Warner Cable, Inc., Covad Communication Company, 21st Century Insurance, T-Mobile, Lloyds TSB Bank plc, Bank of Ireland Group, The Royal Bank of Scotland plc, Metropolitan Life Insurance Company, Signal Iduna, Deutsche Bank AG, Canadian Tire Financial Services, Canadian Imperial Bank of Commerce, Halifax plc, British Telecommunications plc, Connecticut General Life Insurance Company, Citibank Credit Services Inc. (USA), and Sky Subscribers Services Limited. As we deploy new applications, we anticipate that a certain percentage of these and new customers will adopt these new applications and expand their investment in Chordiant products. For the year ended September 30, 2006, Citicorp Credit Services Inc. (USA) accounted for 12% of our total revenues.

Technology

Chordiant's solutions and core technology are implemented using industry standard software that includes J2EE, XML, and Web Services. This industry standard set of development specifications leverages the strengths of the Java programming language to enable software applications that are easier to develop, configure and integrate with legacy and third-party information technology systems.

Chordiant’s architecture leverages J2EE and Web Services extensively to provide a services oriented architecture for use by Chordiant applications and other systems. The business services and related business components use a data persistence foundation with built-in support for Oracle and DB2 databases as well as IBM WebSphere MQ messaging. Generally, our software is easily integrated with other data sources, including those built on the Java Connector Architecture (JCA).

Chordiant’s web browser technology delivers consistent self-service and agent-driven customer interaction processes using a rich web-based application platform that provides desktop interface behavior in a browser-based technology with high performance, low maintenance costs, and flexibility to meet the differing demands of a diverse user population.

Certain of our products use technology modules from third-party technology providers including IBM, BEA Systems, Sun Microsystems, Ingenieria de Software Bancario, S.L. (ISBAN) and certain other non-public entities. Our enterprise platform solutions support industry standard J2EE application servers including IBM WebSphere and BEA WebLogic. Our server software runs on UNIX server platforms from Sun Microsystems, IBM and Linux.

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Sales and Marketing

We license our solutions and sell services primarily through a direct sales organization that is complemented by selling and support efforts through business alliance partners such as IBM, Tata Consulting, and Accenture, systems integrators and technology vendors. Our market focus is the business-to-consumer segment of the economy with a targeted effort on leading consumer focused industries and companies using multiple channels as the means of conducting business and serving customers.

The sales process generally ranges from six to twenty four months depending on the level of knowledge that prospective customers need about the use and benefits of our solutions and the involvement of systems integrators. During the sales process, we typically approach the senior management teams of the business and information technology departments of a prospective customer's organization. We utilize sales teams consisting of sales and technical professionals who work with our systems integration partners to create company specific proposals, presentations and proof of concept demonstrations that address the needs of the business and its technology requirements.

Our corporate offices are located in Cupertino, California, and we maintain an applications development center in Bedford, New Hampshire. In Europe, we have offices in the greater metropolitan areas of London, Madrid, Amsterdam, Frankfurt, and Munich. We have sales and support personnel in various additional locations in North America and Europe.

Our Services

We offer a comprehensive set of customer services including professional consulting services and product support and training services. We believe that providing high quality customer service is critical to achieving rapid product implementation and customer success.

Professional Services

We provide implementation consulting and customer support services to licensed customers through our worldwide professional services organization. Our professional services consulting teams often assist customers and systems integrator partners in the design and implementation of our software solutions.

Our professional services organization deploys consultants as part of the project team alongside systems integration partners and members of the customer's internal team to provide subject matter expertise, technical knowledge, business engineering, project guidance and quality assessments during the entire solution lifecycle. In the design stage, we provide a variety of professional services that help determine a customer's business processes and the technical requirements of the solutions implementation. In the implementation stage, we use a delivery methodology to assist customers and integration partners in planning and managing the implementation. Typically, systems integrators, supported by our consultants, provide overall program management and coordinate the implementation of our products with a customer's existing communications, applications, databases and transaction systems. In the final phases of an implementation, the systems integrators provide deployment services to enable a customer's internal team to implement the system, train internal users and provide first-level end-user support.

Although our primary strategy is to leverage our strategic systems integration partners for implementations, our internal professional services organization is often integral in implementing our enterprise platform software solutions for our customers. We believe that our consulting services enhance the use and administration of our software solutions, facilitate the implementation of our solutions and result in sharing best business practices with client and systems integrator project teams. In addition to implementing our software, our professional services organization

works closely with our internal research and development organization to enhance existing software solutions.

In addition to our internal professional services organization, in calendar 2006, we renewed for one year our agreement with Ness Technologies Inc., Ness Global Services, Inc. and Ness Technologies India, Ltd. (collectively, "Ness"), that we originally entered into in 2003. Ness provides our customers with technical product support, a sustaining engineering function, product testing services, and product development services through their global technical resources and operations center in Bangalore, India. Ness is an independent contracting company with global technical resources. The agreement with Ness may be extended for additional one year terms at our discretion. Our agreement with Ness enables them, at our direction, to attract, train, assimilate and retain sufficient highly qualified personnel to perform technical support and certain sustaining engineering functions.

Educational Services

We provide educational services to train and enable our systems integrators and customers to use our products and technologies. We offer a comprehensive series of training modules to provide the knowledge and skills to successfully deploy, use and maintain our products. These training courses focus on the technical aspects of our products as well as business issues and processes. Training courses can be provided on-site for a custom session for a fee and through classroom and lab instruction. In addition, we provide certification programs for our partners and customers.

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Customer Support

We provide our customers with unspecified support and maintenance services including telephone support, web-based support and updates to our products and documentation. We believe that providing a high level of technical support is critical to customer satisfaction. We also offer training programs to our customers and other companies with which we have relationships to accelerate the implementation and adoption of our solutions by the users within a company. Fees for our training services are typically charged separately from our software license, maintenance and consulting fees.

Our customers have a choice of support and maintenance options depending on the level of service desired. Our technical support services are available to clients by telephone, over the web, by e-mail and on-site. Additionally, we provide unspecified product enhancement releases to all customers as part of our support and maintenance contracts. We use a customer service automation system to track each customer inquiry until it is resolved. We also make use of our website and a secured customer forum to provide product information and technical support information worldwide 24 hours a day, seven days a week.

Strategic Partnerships

Establishing partnerships and alliances with third parties that provide additional services and resources for implementing our solutions to enhance our sales and service organizations' productivity is an important element of our strategy. These relationships and alliances fall into the following categories:

Consulting and System Integration Relationships. To enhance the productivity of our sales and service organizations, we have established relationships with systems integrators, complementary technology providers and alternative service providers. We have established relationships and trained professionals at a number of systems integrators including: Accenture, IBM Global Services, Ness Technologies, Tata Consultancy Services and Business Services, and InfoGain. We plan to expand these relationships to increase our capacity to license and implement our products. We believe that expanding our relationships with systems integrators and independent consulting firms will enable us to gain a greater share of our target markets.

Technology Partnerships. We make extensive use of industry platforms and embrace a number of core technologies in our solution offerings. We have formed partnerships with vendors of software and hardware technology platforms. We currently maintain technology relationships with vendors such as Avaya/Lucent, Alcatel/Genesys, BEA Systems, Cisco Systems, IBM, Oracle, ISBAN and Sun Microsystems. Many of these companies voluntarily provide us with early releases of new technology platforms, education related to those platforms and limited access to their technical resources to facilitate adoption of their technology.

Product Development

We have made substantial investments in research and development through internal development, acquisitions and technology licensing. Our product development efforts are focused on extending our enterprise software solutions, application components, industry specific processes and business process functionality, and continued integration of industry-specific transaction systems and services. Our product development organization is responsible for new software products, product architecture, core technologies, product testing, quality assurance and enabling the compatibility of our products with third-party hardware and software platforms.

Our product development resources are organized into a number of development teams including:

- Foundational Server, Tools, Mesh, Fulfillment, and Release Management;

- Decision Management Products;
- Card and Banking Applications;
- Collections Applications;
- Marketing Applications;
- Product Design, Architecture, and Documentation; and
- Product Test and Quality.

Our product development teams have experience in enterprise and distributed computing, J2EE and object oriented development, data management, process and workflow engineering, transaction system interfaces, Internet and Web-Services technologies. Our research and development expenditures were $25.9 million and $20.3 million for the years ended September 30, 2006 and September 30, 2005, respectively.

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Competition

The market for our products is competitive, rapidly evolving, and can be affected by new product introductions and other market activities of industry participants. The competitive landscape is quickly evolving to address the need for enterprise-wide integration of IT assets and the convergence of customer interaction applications, back-office systems and business processes. The most significant competition we face is from customers' internal development efforts, custom system integration, as well as other software providers that offer integration and development platforms.

Internal Development

Many of our customers and potential customers have in the past attempted to develop customer service, call center, customer relationship management and new front-office systems in-house or with the help of systems integrators. Internal information technology departments have staffed projects to build their own systems utilizing a variety of tools. In some cases, such internal development projects have been successful in satisfying the needs of an organization. The cost of internal development and total cost-of-ownership has risen to become a primary concern of the business and management. We expect that internal development will continue to be a significant source of competition.

Custom System Integration Projects

Another source of competition results from systems integrators engaged to build a custom development application. The introduction of a systems integrator typically increases the likelihood of success for the customer. The competitive factors in this area require that we demonstrate to the customer the cost savings and advantages of configurable, upgradeable and commercially supported software products developed by a dedicated professional software organization.

We frequently rely on system consulting and systems integration firms for implementation and other global services, as well as recommendations of our products during the evaluation stage of the purchase process. Many of these third parties have similar and often more established relationships with our competitors. We cannot assure that these third parties, many of whom have significantly greater resources than us, will not market software products in competition with us.

Application Software Competitors

As discussed, our primary competition is from internal development at our customers and potential customers. However, other competitors include providers of traditional, first-generation customer relationship management, enterprise resources planning, call center, marketing automation software and sales force automation software. These vendors include, among others, companies such as: Oracle Software, Pegasystems, Inc., Unica, SSA Global Technologies, Fidelity Systems, S1 Corporation, and Amdocs.

Some of these companies have longer operating histories, greater financial, marketing and other resources, greater name recognition in other markets and a larger base of customers than we do. In addition, some companies have well-established relationships with our current and potential customers. As a result, these competitors may be able to devote greater resources to the development, promotion and sale of their products than we can.

We believe that we compete favorably in the industries we serve based on the following competitive advantages: process-driven solutions for servicing and selling; real-time and transactional processes; real-time decision management and vertical processes implemented in a multi-channel architecture. The technology advantages include: Chordiant architecture providing an open services oriented architecture providing for integration with multiple legacy

systems, third-party applications and communication channels and advanced browser based application environment for high volume call center, mid-office and branch operations.

There is no one competitor, nor are there a small number of competitors that are dominant in our market. There are many factors that may increase competition in the enterprise customer relationship management market, including (i) entry of new competitors, (ii) mergers and alliances among existing competitors, (iii) consolidation in the software industry and (iv) technological changes or changes in the use of the Internet. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which could materially and adversely affect our business, operating results and financial condition. Recent continuing consolidation in the software industry during 2006 may indicate that we will face new competitors in the future. Within the year Oracle completed an acquisition of i-flex Solutions Ltd., a banking software maker headquartered in Mumbai, India. In 2005 Oracle had purchased a 43% stake in the company. Also in 2006, International Business Machines (IBM) acquired Webify, a provider of middleware to companies primarily in the insurance industry. In addition, in September 2005, IBM had acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In January 2006, Oracle acquired Siebel Systems, Inc., a maker of customer relationship management software products. While we do not believe that either i-flex Solutions, DWL, or Webify have been significant competitors of Chordiant in the past, the acquisition of these companies by Oracle and IBM may indicate that we will face increased competition from significantly larger and more established entities in the future.

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We cannot assure that we will be able to compete successfully against current and future competitors or that the competitive pressure faced by us will not materially and adversely affect our business, operating results and financial condition.

Intellectual Property and Proprietary Rights

Our success is in part dependent upon our ability to develop and protect proprietary technology and intellectual proprietary rights. We rely primarily on a combination of contractual provisions, confidentiality procedures, patents pending, trade secrets, and copyright and trademark laws to protect our intellectual property and proprietary rights.

We license our products through non-exclusive license agreements that impose restrictions on customers' ability to utilize the software. In addition, we seek to avoid disclosure of our trade secrets, including requiring employees, customers and others with access to our proprietary information to execute confidentiality agreements with us and restricting access to our source code. We also seek to protect our rights in our products, documentation and other written materials under trade secret and copyright laws. Due to rapid technological change, we believe factors such as the technological and creative skills of our personnel, new product developments and enhancements to our existing products are more important than the various legal protections of our technology to establishing and maintaining a technology leadership position.

We integrate third party software into our products. Costs associated with integrated technology provided by third parties historically accounts for approximately 2% to 5% of total license revenues. The third party software may not continue to be available on commercially reasonable terms or at all. If we cannot maintain licenses to key third party software, shipments of our products could be delayed until equivalent software is developed or licensed and integrated into our products. Moreover, although we are generally indemnified against claims if technology licensed from third parties infringes the intellectual property and proprietary rights of others, this indemnification is not always available for all types of intellectual property and proprietary rights and in some cases the scope of this indemnification is limited. There can be no assurance that infringement or invalidity claims arising from the incorporation of third-party technology or claims for indemnification from our customers resulting from these claims will not be asserted or prosecuted against us. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources, in addition to potential product redevelopment costs and delays.

Despite our efforts to protect our proprietary rights, existing laws afford only limited protection. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. There can be no assurance that we will be able to protect our proprietary rights against unauthorized third party copying or use. Use by others of our proprietary rights could materially harm our business. Furthermore, policing the unauthorized use of our products is difficult and expensive litigation may be necessary in the future to enforce our intellectual property rights.

Third parties may claim, and have claimed, that we have infringed, or currently infringe, their current or future products. We expect that software developers will increasingly be subject to infringement claims as the number of products in different industry segments overlap. Any claims, with or without merit, are time-consuming, result in costly litigation, prevent product shipment, cause delays, or require us to enter into royalty or licensing agreements, any of which could harm our business. Patent litigation in particular has complex technical issues and inherent uncertainties. If an infringement claim against us was successful and we could not obtain a license on acceptable terms, license a substitute technology or redesign to avoid infringement, our business would be harmed.

The Company does not currently hold any patents but has certain patents pending.

Employees

As of September 30, 2006, we employed 325 full time employees. Of that total, 87 were primarily engaged in product development, engineering or systems engineering, 93 were engaged in sales and marketing, 83 were engaged in professional services and 62 were engaged in operational, financial and administrative functions.

None of our employees are represented by a labor union and we have never experienced a work stoppage. We believe that our relations with our employees are good. We believe our future success will depend in part on our continued ability to recruit and retain highly skilled technical, finance, management and marketing personnel.

Financial Information About Geographic Areas

For a detailed description of our sales by geographic region, we incorporate by reference the information in Note 15 to our consolidated financial statements contained in Item 8 of this Form 10-K. Although the Company's revenues are not considered seasonal, our international operations do experience a slow down in the summer months. For information relating to the risks attendant to our foreign operations, we incorporate by reference the information under the headings "—Risk Factors—If we fail to adequately address the difficulties of managing our international operations, our revenues and operating expenses will be adversely affected" and "—Risk Factors—Fluctuations in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets and could negatively affect our operating results and cash flows."

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Backlog

For a detailed discussion of backlog, we incorporate by reference the information in Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” under the heading Financial Trends, Backlog.

Available Information

We were incorporated in California in March 1991 and were reincorporated in Delaware in October 1997.

We maintain a site on the world-wide web at www.chordiant.com; however, information found on our website is not incorporated by reference into this Annual Report on Form 10-K. We make available free of charge on or through our website our filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

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ITEM 1A. RISK FACTORS

The matters relating to the Audit Committee of the Board's review of our historical stock option granting practices and the restatement of our consolidated financial statements have required us to incur substantial expenses, have resulted in litigation, and may result in additional litigation and future government enforcement actions.

On July 24, 2006, the Company announced that the Audit Committee of the Company's Board of Directors, with the assistance of independent legal counsel, was conducting a review of our stock option practices covering the time from the Company's initial public offering in 2000 through June 2006. As described in the Explanatory Note immediately preceding Part I, Item 1, and in Note 3 "Restatement of Previously Issued Consolidated Financial Statements" in Notes to Consolidated Financial Statements in the Form 10-K, the Audit Committee reached a conclusion that incorrect measurement dates were used for financial accounting purposes for stock option grants in certain prior periods. As a result, the Company has recorded additional non-cash stock-based compensation expense, and related tax effects, related to certain stock option grants, and the Company has restated certain previously filed financial statements included in the Form 10-K.

This review of our historical stock option granting practices has required us to incur substantial expenses for legal, accounting, tax and other professional services, has diverted our management's attention from our business, and could in the future adversely affect our business, financial condition, results of operations and cash flows.

Our historical stock option granting practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation and regulatory proceedings. Several derivative complaints have been filed pertaining to allegations relating to stock option grants. We cannot assure you that these or future similar complaints or any future litigation or regulatory action will result in the same conclusions reached by the Audit Committee. The conduct and resolution of these matters will be time consuming, expensive and distracting from the conduct of our business.

We contacted the SEC regarding the Audit Committee's review and, in July 2006, the SEC commenced an investigation into our historical stock option grant practices. In November 2006, a representative of the Audit Committee and its advisors met with the enforcement staff of the SEC and provided them with a report of the Audit Committee's investigation and findings. In January 2007, the enforcement staff of the SEC notified the Company that its investigation had been terminated and no enforcement action had been recommended to the Commission.

The finding of the Audit Committee's review are more fully described in Note 3 to the Consolidated Financial Statements and in Item 9A of this Annual Report on Report on Form 10-K for the year ended September 30, 2006.

We may be subject to further investigation by the SEC or litigation by private parties in connection with the restatement of our interim financial statements for the fiscal quarters ended March 31, 2004, June 30, 2004, September 30, 2004, December 31, 2004, March 31, 2005, June 30, 2005, December 31, 2005, and March 31, 2006 and the fiscal years ended 2001, 2002, 2003, 2005 and nine months ended September 30, 2004.

In March 2005, we concluded that our interim financial statements for the fiscal quarters ended March 31, June 30, and September 30, 2004 should no longer be relied upon because of various errors in such financial statements. We restated those financial statements, which were reported in our 2004 Transition Report on Form 10-K/T filed with the SEC on March 29, 2005. Additionally, in the course of preparing our 2005 financial results for the year ended September 30, 2005, the Company and its independent registered public accounting firm, BDO Seidman, LLP, identified certain errors in the Company's 2005 interim financial statements for the quarters ended December 31, 2004, March 31, 2005, and June 30, 2005 and management concluded that as a result of these errors, the Company

should restate the Company's interim financial statements for these quarters. These errors are more fully described in Note 19 to the Consolidated Financial Statements contained in our Annual Report on Form 10-K filed with the SEC on December 9, 2005. On November 26, 2006, the Board of Directors, upon the recommendation of the Audit Committee and management concluded that Chordiant would restate its historical financial statements for the years ended December 31, 2001, 2002 and 2003, the nine-month period ended September 30, 2004, the fiscal year ended September 30, 2005, and the quarters ended December 31, 2005 and March 31, 2006. These errors are more fully described in Note 3 to the Consolidated Financial Statements contained in this Annual Report.

Section 408 of the Sarbanes-Oxley Act of 2002 (SOX) requires that the SEC review a public company's filings no less frequently than once every 3 years. The SEC's staff in the Division of Corporation Finance in Washington D.C. has reviewed the Company's annual report on Form 10-K for the fiscal year ended September 30, 2005 and has commented on the annual report to which the Company has provided written responses. The SEC may begin an investigation or we may be subject to private litigation, which could require significant management and financial resources which could otherwise be devoted to the operation of our business. If we are subject to an SEC investigation or civil litigation, we could be required to pay penalties or damages or have other remedies imposed upon us. In addition, we could become the target of expensive securities litigation related to other matters in the future. Any SEC investigation or litigation could adversely affect our business, results of operations, financial position or cash flows.

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Historically, we have not been profitable and we may continue to incur losses, which may raise vendor viability concerns thereby making it more difficult to close license transactions with new and existing customers.

We incurred losses of $16.0 million and $19.9 million for the years ended September 30, 2006 and 2005, respectively. As of September 30, 2006, we had an accumulated deficit of $232.9 million. We may continue to incur losses and cannot be certain that we can generate sufficient revenues to achieve profitability. Continued losses may leave many customers reluctant to enter into new large value license transactions without some assurance that we will operate profitably. If we fail to enter into new large value license transactions due to lack of vendor profitability and or viability concerns, our revenues will decline, which could further adversely affect our operating results.

Because a small number of customers account for a substantial portion of our revenues, the loss of a significant customer could cause a substantial decline in our revenues.

We derive a significant portion of our license and service revenues from a limited number of customers. The loss of a major customer could cause a decrease in revenues and net income. For the year ended September 30, 2006, Citicorp Credit Services accounted for 12% of our total revenue. While our customer concentration has fluctuated, we expect that a limited number of customers will continue to account for a substantial portion of our revenues. As a result, if we lose a major customer, or if a contract is delayed or cancelled or we do not contract with new major customers, our revenues and net loss would be adversely affected. In addition, customers that have accounted for significant revenues in the past may not generate revenues in any future period, causing our failure to obtain new significant customers or additional orders from existing customers to materially affect our operating results.

If we fail to adequately address the difficulties of managing our international operations, our revenues and operating expenses will be adversely affected.

For the year ended September 30, 2006, international revenues were $37.5 million or approximately 38% of our total revenues. While North American revenues have increased recently as a percentage of our overall revenues, international revenues will continue to represent a significant portion of our total revenues in future periods. We have faced, and will continue to face, difficulties in managing international operations which include:

- Difficulties in hiring qualified local personnel;

- Seasonal fluctuations in customer orders;

- Longer accounts receivable collection cycles;

- Expenses associated with licensing products and servicing customers in foreign markets;

- Economic downturns and political uncertainty in international economies; and

- Expectations of European economic growth that is lower than for the US.

Any of these factors could have a significant impact on our ability to license products on a competitive and timely basis and could adversely affect our operating expenses and net income. Additionally we closed our only French office in the first fiscal quarter of 2007. The absence of a business office in France may harm our ability to attract and retain customers in that country.

Our known backlog of business may not result in revenue.

An increasingly material portion of our revenues has been derived from large orders, as major customers deployed our products. We define backlog as contractual commitments by our customers through purchase orders or contracts. Backlog is comprised of software license orders which have not been accepted by customers or have not otherwise met all of the required criteria for revenue recognition, deferred revenue from customer support contracts, and deferred consulting and education orders for services not yet completed or delivered. Backlog is not necessarily indicative of revenues to be recognized in a specified future period. There are many factors that would impact the Company's filling of backlog, such as the Company's progress in completing projects for its customers and Chordiant's customers' meeting anticipated schedules for customer-dependent deliverables. The Company provides no assurances that any portion of its backlog will be filled during any fiscal year or at all or that its backlog will be recognized as revenues in any given period. In addition, it is possible that customers from whom we expect to derive revenue from backlog will default and as a result we may not be able to recognize expected revenue from backlog.

Fluctuations in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets and could negatively affect our operating results and cash flows.

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A significant portion of our sales and operating expenses result from transactions outside of the United States, often in foreign currencies. These currencies include the United Kingdom Pound Sterling, the Euro and the Canadian Dollar. Our international sales comprised 38% of our total sales for the year ended September 30, 2006. Our international sales comprised 50% of our total sales for the year ended September 30, 2005. Our future operating results will continue to be subject to fluctuations in foreign currency rates, especially if international sales grow as a percentage of our total sales, and we may be negatively impacted by fluctuations in foreign currency rates in the future. For the year ended September 30, 2006, we had an unrealized foreign currency translation gain of approximately $1.2 million.

Geopolitical concerns could make the closing of license transactions with new and existing customers difficult.

Our revenues will decrease in fiscal year 2007 or beyond if we are unable to enter into new large-scale license transactions with new and existing customers. The current state of world affairs and geopolitical concerns have left many customers reluctant to enter into new large value license transactions without some assurance that the economy both in the customer’s home country and worldwide will have some economic and political stability. Geopolitical instability will continue to make closing large license transactions difficult. In addition, we cannot predict what effect the U.S. military presence overseas or potential or actual political or military conflict have had or are continuing to have on our existing and prospective customers’ decision-making process with respect to licensing or implementing enterprise-level products such as ours. Our ability to enter into new large license transactions also directly affects our ability to create additional consulting services and maintenance revenues, on which we also depend.

Competition in our markets is intense and could reduce our sales and prevent us from achieving profitability.

Increased competition in our markets could result in price reductions for our products and services, reduced gross margins and loss of market share, any one of which could reduce our future revenues. The market for our products is intensely competitive, evolving and subject to rapid technological change. Historically, our primary competition has been from internal development, custom systems integration projects and application software competitors. In particular, we compete with:

• *Internal information technology departments:* in-house information technology departments of potential customers have developed or may develop systems that provide some or all of the functionality of our products. We expect that internally developed application integration and process automation efforts will continue to be a significant source of competition.

• *Custom systems integration projects:* we compete with large systems integrators who may develop custom solutions for specific companies which may reduce the likelihood that they would purchase our products and services.

• *Point application vendors:* we compete with providers of stand-alone point solutions for web-based customer relationship management and traditional client/server-based, call-center service customer and sales-force automation solution providers.

In addition, recent continuing consolidation in the software industry during 2006 may indicate that we will face new competitors in the future. Within the year Oracle completed an acquisition of i-flex Solutions Ltd., a banking software maker headquartered in Mumbai, India. In 2005 Oracle had purchased a 43% stake in the company. Also in 2006, IBM acquired Webify, a provider of middleware to companies primarily in the insurance industry. In addition, in September 2005, IBM had acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In January 2006, Oracle acquired Siebel Systems, Inc., a maker of customer relationship management software products. Siebel Systems, Inc. was a competitor of ours. While we do not believe that either i-flex Solutions, DWL or Webify have been significant competitors of Chordiant in the past, the acquisition of these companies by Oracle and IBM may indicate that we will face increased competition from significantly larger

and more established entities in the future.

Many of our competitors have greater resources and broader customer relationships than we do. In addition, many of these competitors have extensive knowledge of our industry. Current and potential competitors have established, or may establish, cooperative relationships among themselves or with third parties to offer a single solution and to increase the ability of their products to address customer needs.

We may experience a shortfall in revenue, earnings, cash flow or otherwise fail to meet public market expectations, which could materially and adversely affect our business and the market price of our common stock.

Our revenues and operating results may fluctuate significantly because of a number of factors, many of which are outside of our control. Some of these factors include:

• Size and timing of individual license transactions;

- Delay or deferral of customer implementations of our products and subsequent impact on revenues;
- Lengthening of our sales cycle;
- Potential additional deterioration and changes in domestic and foreign markets and economies;
- Success in expanding our global services organization, direct sales force and indirect distribution channels;
- Timing of new product introductions and product enhancements;
- Appropriate mix of products licensed and services sold;
- Levels of international transactions;
- Activities of and acquisitions by competitors;
- Product and price competition; and
- Our ability to develop and market new products and control costs.

One or more of the foregoing factors may cause our operating expenses to be disproportionately high during any given period or may cause our revenues and operating results to fluctuate significantly. Based upon the preceding factors, we may experience a shortfall in revenues and earnings or otherwise fail to meet public market expectations, which could materially and adversely affect our business, financial condition, results of operations and the market price of our common stock.

If our stockholders approve our proposed reverse stock split, our stock price may be adversely affected.

On February 15, 2007, our stockholders will consider at a special meeting whether to approve a reverse split of our outstanding shares of common stock by a ratio of two and one-half (2.5) to 1 (the “Reverse Split”). If approved and our Board of Directors proceed to effect the Reverse Split, our stock price may decline back to pre-Reverse Stock split levels. If the Reverse Split is effected and the per share price of our common stock declines, the percentage decline as an absolute number and as a percentage of our overall market capitalization may be greater than would occur in the absence of the Reverse Split.

Our operating results and cash flows fluctuate significantly and delays in delivery or implementation of our products or changes in the payment terms with customers may cause unanticipated declines in revenues or cash flow, which could disappoint investors and result in a decline in our stock price.

Our quarterly revenues depend primarily upon product implementation by our customers. We have historically recognized a significant portion of our license and services revenue through the percentage-of-completion method, using labor hours incurred as the measure of progress towards completion of implementation of our products and we expect this practice to continue. The percentage of completion accounting method requires ongoing estimates of progress of complicated and frequently changing technology projects. Documenting the measure of progress towards completion of implementation is subject to potential errors and changes in estimates. As a result, even minor errors or minor changes in estimates may lead to significant changes in accounting results which may be revised in later quarters due to subsequent information and events. Thus, delays or changes in customer business goals or direction when implementing our software may negatively impact our quarterly revenue. Additionally, we may increasingly

enter into term, subscription or transaction based licensing transactions that would cause us to recognize license revenue for such transactions over a longer period of time than we have historically experienced for our perpetual licenses. In addition, a significant portion of new customer orders have been booked in the third month of each calendar quarter, with many of these bookings occurring in the last two weeks of the third month. We expect this trend to continue and, therefore, any failure or delay in bookings would decrease our quarterly revenue and cash flows. The terms and conditions of individual license agreements with customers vary from transaction to transaction. Historically, the Company has been able to obtain prepayments for product in some cases. Other transactions link payment to the delivery or acceptance of products. In particular, we have deferred the recognition of all revenue from the license order from Citicorp Credit Services, Inc. that we received in December of 2006 pending our completion and delivery of a collections application that was one of the required elements under that license order. We currently anticipate that we will deliver the collections application in the third fiscal quarter of 2007 but any delay in our development or delivery of that application could result in a significant delay in our ability to recognize revenue from that license and may cause an unanticipated shortfall in our revenue. If we are unable to negotiate prepayments of fees our cash flows and financial ratios with respect to accounts receivable would be negatively impacted. If our revenues, operating margins or cash flows are below the expectations of the investment community, our stock price is likely to decline.

If we fail to maintain and expand our relationships with systems integrators and other business partners, our ability to develop, market, sell, and support our products may be adversely affected.

Our development, marketing and distribution strategies rely on our ability to form and maintain long-term strategic relationships with systems integrators, in particular, our existing business alliance partners, IBM, and Accenture. These business relationships often consist of joint marketing programs, technology partnerships and resale and distribution arrangements. Although most aspects of these relationships are contractual in nature, many important aspects of these relationships depend on the continued cooperation between the parties. Divergence in strategy, change in focus, competitive product offerings or potential contract defaults may interfere with our ability to develop, market, sell, or support our products, which in turn could harm our business. If either IBM or Accenture were to terminate their agreements with us or our relationship were to deteriorate, it could have a material adverse effect on our business, financial condition and results of operations. In many cases, these parties have extensive relationships with our existing and potential customers and influence the decisions of these customers. A number of our competitors have stronger relationships with IBM and Accenture and, as a result, these systems integrators may be more likely to recommend competitors' products and services. In addition, in September 2005, IBM had acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In 2006, IBM acquired Webify, a provider of middleware to companies primarily in the insurance industry. While we do not believe that either DWL or Webify had been a direct competitor of Chordiant in the past, IBM's acquisition of DWL and Webify may indicate that IBM will become a competitor of ours in the future. While the Company currently has good relationship with IBM, this relationship and the Company's strategic relationship agreement with IBM may be harmed if the Company increasingly finds itself competing with IBM. Our relationships with systems integrators and their willingness to recommend our products to their customers could be harmed if the Company were to be subject to a take over attempt from a competitor of such systems integrators.

If systems integrators fail to properly implement our software, our business, reputation and financial results may be harmed.

We are increasingly relying on systems integrators to implement our products, and this trend may continue. As a result, we have less quality control over the implementation of our software with respect to these transactions and are more reliant on the ability of our systems integrators to correctly implement our software. If these systems integrators fail to properly implement our software, our business, reputation and financial results may be harmed.

Our primary products have a long sales and implementation cycle, which makes it difficult to predict our quarterly results and may cause our operating results to vary significantly.

The period between initial contact with a prospective customer and the implementation of our products is unpredictable and often lengthy, ranging from three to twenty-four months. Thus, revenue and cash receipts could vary significantly from quarter to quarter. Any delays in the implementation of our products could cause reductions in our revenues. The licensing of our products is often an enterprise-wide decision that generally requires us to provide a significant level of education to prospective customers about the use and benefits of our products. The implementation of our products involves significant commitment of technical and financial resources and is commonly associated with substantial implementation efforts that may be performed by us, by the customer or by third-party systems integrators. If we underestimate the resources required to meet the expectations we have set with a customer when we set prices, then we may lose money on that customer engagement. If this happens with a large customer engagement, then this could have a material adverse effect on our financial results. Customers generally consider a wide range of issues before committing to purchase our products, including product benefits, ability to operate with existing and future computer systems, vendor financial stability and longevity, ability to accommodate increased transaction volume and product reliability.

If we do not improve our internal control over financial reporting, investors could lose confidence in our financial reporting and customers may delay purchasing decisions, which would harm our business and the market price of our common stock.

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our business could be harmed. We are a complex company with complex accounting issues and thus subject to related risks of errors in financial reporting which may cause problems in corporate governance, the costs of which may outweigh the costs of the underlying errors themselves. For example, the Audit Committee of the Company's Board of Directors, with the assistance of outside legal counsel, conducted a review of our stock option practices covering the time from the Company's initial public offering in 2000 through September 2006. The Audit Committee reached a conclusion that incorrect measurement dates were used for financial accounting purposes for stock option grants in certain prior periods. As a result, the Company has recorded additional non-cash stock-based compensation expense, and related tax effects, related to stock option grants and concluded that a material weakness surrounding the control activities relating to the stock option grants existed at September 30, 2006. To correct these accounting errors, we restated the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended September 30, 2006 and our Quarterly Report on Form 10-Q for the three months ended June 30, 2006. As a result of this need to restate financial statements, management and the Audit Committee determined that material weaknesses in our internal control over financial reporting existed. These material weaknesses have contributed to increased expenses and efforts required for our financial reporting.

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If we are not successful in implementing effective internal controls over financial reporting, customers may delay purchasing decisions or we may lose customers, create investor uncertainty, face litigation and the market price of our common stock may decline. For more information, please refer to the discussion under the heading "Item 9A. Controls and Procedures" in this Annual Report on Form 10-K.

If we are not able to successfully manage our partner operations in India, our operations and financial results may be adversely affected.

In fiscal year 2003, we entered into an agreement with Ness Technologies Inc., Ness Global Services, Inc. and Ness Technologies India, Ltd. (collectively, "Ness"), an independent contracting company with global technical resources and an operations center in Bangalore, India and operations in other locations. The agreement provides for Ness, at our direction, to attract, train, assimilate and retain sufficient highly qualified personnel to perform staffing for consulting projects, technical support, product test and certain sustaining engineering functions. As of September 30, 2006, we use the services of approximately 126 consultants through Ness. In addition, as a result of the reduction in our workforce that took place in July 2005, and the reduction in our workforce that took place in October 2006, by approximately 10% in each instance, we are now more dependent on Ness. The expansion of this agreement is an important component of our strategy to address the business needs of our customers and manage our expenses. The success of this operation will depend on our ability and Ness's ability to attract, train, assimilate and retain highly qualified personnel in the required periods. A disruption of our relationship with Ness could adversely affect our operations. Failure to effectively manage the organization and operations will harm our business and financial results.

We have incurred and may continue to incur, in future periods, significant stock-based compensation charges related to certain stock options and stock awards, which may adversely affect our reported financial results.

On October 1, 2005, we adopted SFAS 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors including employee stock options, restricted stock awards and employee stock purchases related to the ESPP based on estimated fair values. For the year ended September 30, 2006, we recorded $4.7 million of compensation expense associated with these awards. Although the effect from the adoption of SFAS 123(R) is expected to continue to have a material impact on the Company's results of operations, future changes to various assumptions used to determine the fair value of awards issued, or the amount and type of equity awards granted create uncertainty as to the amount of future stock-based compensation expense.

If our products do not operate effectively in a company-wide environment, we may lose sales and suffer decreased revenues.

If existing customers have difficulty deploying our products or choose not to fully deploy our products, it could damage our reputation and reduce revenues. Our success requires that our products be highly scalable, and able to accommodate substantial increases in the number of users. Our products are expected to be deployed on a variety of computer software and hardware platforms and to be used in connection with a number of third-party software applications by personnel who may not have previously used application software systems or our products. These deployments present very significant technical challenges, which are difficult or impossible to predict. If these deployments do not succeed, we may lose future sales opportunities and suffer decreased revenues. If we underestimate the resources required to meet the expectations we have set with a customer when we set prices, then we may lose money on that customer engagement. If this happens with a large customer engagement then this could have a material adverse effect on our financial results.

Defects in our products could diminish demand for our products and result in decreased revenues, decreased market acceptance and injury to our reputation.

Errors may be found from time-to-time in our new, acquired or enhanced products. Any significant software errors in our products may result in decreased revenues, decreased sales, and injury to our reputation and/or increased warranty and repair costs. Although we conduct extensive product testing during product development, we have in the past discovered software errors in our products as well as in third-party products, and as a result have experienced delays in the shipment of our new products.

Because competition for qualified personnel is intense, we may not be able to retain or recruit personnel, which could impact the development and sales of our products.

If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or fail to reach expected levels of productivity, our ability to develop and market our products will be weakened. Our success depends largely on the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel. In particular, we have recently had significant turnover of our executives as well as in our in our sales,

marketing and finance organizations and many key positions are held by people who are new to the Company or to their roles. If these people are unable to quickly become familiar with the issues they face in their roles or are not well suited to their new roles, then this could result in the Company having problems in executing its strategy or in reporting its financial results. Because of the dependency on a small number of large deals, we are uniquely dependent upon the talents and relationships of a few executives and have no guarantee of their retention. Changes in key sales management could affect our ability to maintain existing customer relationships or to close pending transactions. We have been targeted by recruitment agencies seeking to hire our key management, finance, engineering, sales and marketing and professional services personnel. In addition, in July 2005 and again in October of 2006, we reduced the size of our workforce by approximately 10% in each instance, which may have a negative effect on our ability to attract and retain qualified personnel.

To date, our sales have been concentrated in the financial services, telecommunications and retail markets, and if we are unable to continue sales in these markets or successfully penetrate new markets, our revenues may decline.

Sales of our products and services in three large markets—financial services, telecommunications and retail markets accounted for approximately 89 % and 87 % of our total revenues for the year ended September 30, 2006 and 2005, respectively. We expect that revenues from these three markets will continue to account for a substantial portion of our total revenues for the foreseeable future. If we are unable to successfully increase penetration of our existing markets or achieve sales in additional markets, or if the overall economic climate of our target markets deteriorates, our revenues may decline.

Low gross margin in services revenues could adversely impact our overall gross margin and income.

Our services revenues have had lower gross margins than our license revenues. Service revenues comprised 58% and 62% of our total revenues for the year ended September 30, 2006 and 2005, respectively. Gross margin on service revenues was 46% and 42% for the year ended September 30, 2006 and 2005, respectively. License revenues comprised 42% and 38% of our total revenues for the years ended September 30, 2006 and 2005, respectively. Gross margins on license revenues were 96% and 97% for the years ended September 30, 2006 and 2005, respectively.

As a result, an increase in the percentage of total revenues represented by services revenues, or an unexpected decrease in license revenues, could have a detrimental impact on our overall gross margins. To increase services revenues, we would expand our services organization, successfully recruit and train a sufficient number of qualified services personnel, enter into new implementation projects and obtain renewals of current maintenance contracts by our customers. This expansion could further reduce gross margins in our services revenues.

We may not have the workforce necessary to support our platform of products if demand for our products substantially increased, and, if we need to rebuild our workforce in the future, we may not be able to recruit personnel in a timely manner, which could negatively impact the development and sales of our products.

In July 2005 and again in October of 2006, we reduced the size of our workforce by approximately 10% in each instance. In the event that demand for our products increases, we may need to rebuild our workforce or increase outsourced functions to companies based in foreign jurisdictions and we may be unable to hire, train or retain qualified personnel in a timely manner, which may weaken our ability to market our products in a timely manner, negatively impacting our operations. Our success depends largely on ensuring that we have adequate personnel to support our platform of products as well as the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel.

If we fail to introduce new versions and releases of functional and scalable products in a timely manner, customers may license competing products and our revenues may decline.

If we are unable to ship or implement enhancements to our products when planned, or fail to achieve timely market acceptance of these enhancements, we may suffer lost sales and could fail to achieve anticipated revenues. We have in the past, and expect in the future, to derive a significant portion of our total revenues from the license of our primary product suite. Our future operating results will depend on the demand for the product suite by future customers, including new and enhanced releases that are subsequently introduced. If our competitors release new products that are superior to our products in performance or price, or if we fail to enhance our products or introduce new features and functionality in a timely manner, demand for our products may decline. We have in the past experienced delays in the planned release dates of new versions of our software products and upgrades. New versions of our products may not be released on schedule or may contain defects when released.

We depend on technology licensed to us by third parties, and the loss or inability to maintain these licenses could prevent or delay sales of our products.

We license from several software providers technologies that are incorporated into our products. We anticipate that we will continue to license technology from third parties in the future. This software may not continue to be available on

commercially reasonable terms, if at all. While currently we are not materially dependent on any single third party for such licenses, the loss of the technology licenses could result in delays in the license of our products until equivalent technology is developed or identified, licensed and integrated into our products. Even if substitute technologies are available, there can be no guarantee that we will be able to license these technologies on commercially reasonable terms, if at all.

Defects in third party products associated with our products could impair our products' functionality and injure our reputation.

The effective implementation of our products depends upon the successful operation of third-party products in conjunction with our products. Any undetected defects in these third-party products could prevent the implementation or impair the functionality of our products, delay new product introductions or injure our reputation. In the past, while our business has not been materially harmed, product releases have been delayed as a result of errors in third-party software and we have incurred significant expenses fixing and investigating the cause of these errors.

Our customers and systems integration partners may have the ability to alter our source code and resulting inappropriate alterations could adversely affect the performance of our products, cause injury to our reputation and increase operating expenses.

Customers and systems integration partners may have access to the computer source code for certain elements of our products and may alter the source code. Alteration of our source code may lead to implementation, operation, technical support and upgrade problems for our customers. This could adversely affect the market acceptance of our products, and any necessary investigative work and repairs could cause us to incur significant expenses and delays in implementation.

If our products do not operate with the hardware and software platforms used by our customers, our customers may license competing products and our revenues will decline.

If our products fail to satisfy advancing technological requirements of our customers and potential customers, the market acceptance of these products could be reduced. We currently serve a customer base with a wide variety of constantly changing hardware, software applications and networking platforms. Customer acceptance of our products depends on many factors such as:

- Our ability to integrate our products with multiple platforms and existing or legacy systems; and,
- Our ability to anticipate and support new standards, especially Internet and enterprise Java standards.

Our failure to successfully integrate with future acquired or merged companies and technologies could prevent us from operating efficiently.

Our business strategy includes pursuing opportunities to grow our business, both through internal growth and through merger, acquisition and technology and other asset transactions. To implement this strategy, we may be involved in merger and acquisition activity and additional technology and asset purchase transactions. Merger and acquisition transactions are motivated by many factors, including, among others, our desire to grow our business, acquire skilled personnel, obtain new technologies and expand and enhance our product offerings. Growth through mergers and acquisitions has several identifiable risks, including difficulties associated with successfully integrating distinct businesses into new organizations, the substantial management time devoted to integrating personnel, technology and entire companies, the possibility that we might not be successful in retaining the employees, undisclosed liabilities, the failure to realize anticipated benefits (such as cost savings and synergies) and issues related to integrating acquired

technology, merged/acquired companies or content into our products (such as unanticipated expenses). Realization of any of these risks in connection with any technology transaction or asset purchase we have entered into, or may enter into, could have a material adverse effect on our business, operating results and financial condition.

If we become subject to intellectual property infringement claims, including patent infringement claims, these claims could be costly and time-consuming to defend, divert management's attention, cause product delays and have an adverse effect on our revenues and net income.

We expect that software product developers and providers of software in markets similar to our target markets will increasingly be subject to infringement claims as the number of products and competitors in our industry grows and the
functionality of products overlap. Any claims, with or without merit, could be costly and time-consuming to defend, divert our management's attention or cause product delays. If any of our products were found to infringe a third party's proprietary rights, we could be required to enter into royalty or licensing agreements to be able to sell our products. Royalty and licensing agreements, if required, may not be available on terms acceptable to us or at all.

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In particular, if we were sued for patent infringement by a patent holding company, one which has acquired large numbers of patents solely for the purpose of bringing suit against alleged infringers rather than practicing the patents, it may be costly to defend such suit. We have received a letter from one such patent holding company alleging that our products may infringe their one or more of their patents. If any of our products were found to infringe such patent, the patent holder could seek an injunction to enjoin our use of the infringing product. If we were not able to remove or replace the infringing portions of software with non-infringing software, and were no longer able to license some or all of our software products, such an injunction would have an extremely detrimental effect on our business. If we were required to settle such claim, it could be extremely costly. A patent infringement claim could have a material adverse effect on our business, operating results and financial condition.

The application of percentage of completion and completed contract accounting to our business is complex and may result in delays in the reporting of our financial results and revenue not being recognized as we expect.

Although we attempt to use standardized license agreements designed to meet current revenue recognition criteria under generally accepted accounting principles, we must often negotiate and revise terms and conditions of these standardized agreements, particularly in multi-product transactions. At the time of entering into a transaction, we assess whether any services included within the arrangement require us to perform significant implementation or customization essential to the functionality of our products. For contracts involving significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenues using the percentage-of-completion method using labor hours incurred as the measure of progress towards completion. The application of the percentage of completion method of accounting is complex and involves judgments and estimates, which may change significantly based on customer requirements. This complexity combined with changing customer requirements could result in delays in the proper determination of our percentage of completion estimates and revenue not being recognized as we expect.

We have also entered into co-development projects with our customers to jointly develop new vertical applications, often over the course of a year or longer. In such cases we may only be able to recognize revenue upon delivery of the new application. The accounting treatment for these co-development projects could result in delays in the recognition of revenue. The failure to successfully complete these projects to the satisfaction of the customer could have a material adverse effect on our business, operating results and financial condition.

Changes in our revenue recognition model could result in short term declines to revenue.

Historically, a high percentage of license revenues have been accounted for on the percentage of completion method of accounting or recognized as revenue upon the delivery of product. If we were to modify future contracts with customers, or to enter into new types of transactions accounted for on a subscription or term basis, revenues might be recognized over a longer period of time. The impact of this change would make revenue recognition more predictable over the long term, but it might also result in a short term reduction of revenue as the new transactions took effect.

We may continue to encounter unexpected delays in implementing the requirements relating to internal control over financial reporting and we expect to incur additional expenses and diversion of management’s time as a result of performing future system and process evaluation, testing and remediation required to comply with future management assessment and auditor attestation requirements.

In connection with the Company’s compliance with Section 404 under SOX for the fiscal years ended September 30, 2006 and 2005, we identified certain material weaknesses. In future periods, we will continue to document our internal controls to allow management to report on, and our independent registered public accounting firm to attest to, our internal control, over financial reporting as required by Section 404 of SOX, within the time frame required by Section 404. We may encounter unexpected delays in implementing those requirements, therefore, we cannot be

certain about the timing of the completion of our evaluation, testing and remediation actions or the impact that these activities will have on our operations. We also expect to incur additional expenses and diversion of management's time as a result of performing the system and process evaluation, testing and remediation required to comply with management's assessment and auditor attestation requirements. If we are not able to timely comply with the requirements set forth in Section 404 in future periods, we might be subject to sanctions or investigation by the regulatory authorities. Any such action could adversely affect our business or financial results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

On August 8, 2006, we received a comment letter from the staff of the Division of Corporation Finance of the SEC. Additional questions were received in comment letter dated October 27, 2006 and January 25, 2007. The comments from the staff were issued with respect to its review of our Form 10-K for the year ended September 30, 2005, our Forms 10-Q for the quarterly periods ended December 31, 2005 and March 31, 2006 and Forms 8-K filed on February 9 and May 4, 2006. The staff's letters included comments relating the application of, and disclosures relating to, the percentage of completion method of accounting; the accounting for post-contract customer support; the accounting for arrangements that include a subscription element; and the presentation of non-GAAP operating results appearing in press releases.

On August 17, 2006 and November 13, 2006, we responded to the staff's comments and included supplemental analyses and information requested by the staff. On January 27, 2007, we received a third comment letter from the Division of Corporation Finance of the SEC. In this most recent set of comments, the staff is requesting additional clarifications of our November 13, 2006 responses. As of the date of the filing of this Form 10-K, we are in the process of responding to this latest set of comments.

ITEM 2. PROPERTIES

Our headquarters are located in offices that are approximately 25,000 square feet in Cupertino, California pursuant to an office lease expiring in December 2008. We also lease office space in Mahwah New Jersey and Bedford, New Hampshire. Outside of the United States, we have offices in the greater metropolitan areas of London, Madrid, Amsterdam, Frankfurt and Munich. Subsequent to September 30, 2006, we relocated our London office, closed our French office, and believe our existing facilities meet our current needs and that we will be able to obtain additional commercial space as needed.

ITEM 3. LEGAL PROCEEDINGS

Beginning in July 2001, we and certain of our officers and directors ("Individuals") were named as defendants in a series of class action stockholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, "In re Chordiant Software, Inc. Initial Public Offering Securities Litigation, Case No. 01-CV-6222". In the amended complaint, filed in April 2002, the plaintiffs allege that we, the Individuals, and the underwriters of our initial public offering ("IPO") violated section 11 of the Securities Act of 1933 and section 10(b) of the Exchange Act of 1934 based on allegations that the our registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, our IPO underwriters. The complaint also contains claims against the Individuals for control person liability under Securities Act section 15 and Exchange Act section 20. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies ("Issuers") that conducted IPO's of their common stock in the late 1990s or in the year 2000 (collectively, the "IPO Lawsuits").

In August 2001, all of the IPO Lawsuits were consolidated for pretrial purposes before United States Judge Shira Scheindlin of the Southern District of New York. In July 2002, we joined in a global motion to dismiss the IPO Lawsuits filed by all of the Issuers (among others). In October 2002, the Court entered an order dismissing the Individuals from the IPO Cases without prejudice, pursuant to an agreement tolling the statute of limitations with respect to the Individuals. In February 2003, the court issued a decision denying the motion to dismiss the Section 11 claims against Chordiant and almost all of the other Issuers and denying the motion to dismiss the Section 10(b) claims against Chordiant and many of the Issuers.

In June 2003, Issuers and plaintiffs reached a tentative settlement agreement that would, among other things, result in the dismissal with prejudice of all claims against the Issuers and Individuals in the IPO Lawsuits, and the assignment to plaintiffs of certain potential claims that the Issuers may have against the underwriters. The tentative settlement also provides that, in the event
that plaintiffs ultimately recover less than a guaranteed sum of $1 billion from the IPO underwriters, plaintiffs would be entitled to payment by each participating Issuer’s insurer of a pro rata share of any shortfall in the plaintiffs’ guaranteed recovery. In September 2003, in connection with the possible settlement, those Individuals who had entered tolling agreements with plaintiffs (described above) agreed to extend those agreements so that they would not expire prior to any settlement being finalized. In June 2004, Chordiant and almost all of the other Issuers entered into a formal settlement agreement with the plaintiffs. On February 15, 2005, the Court issued a decision certifying a class action for settlement purposes, and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. On August 31, 2005, the Court reaffirmed class certification and preliminary approval of the modified settlement in a comprehensive Order, and directed that Notice of the settlement be published and mailed to class members beginning November 15, 2005. On February 24, 2006, the Court dismissed litigation filed against certain underwriters in connection with the claims to be assigned to the plaintiffs under the settlement. On April 24, 2006, the Court held a Final Fairness Hearing to determine whether to grant final approval of the settlement. On December 5, 2006, the Second Circuit Court of Appeals vacated the lower Court's earlier decision certifying as class actions the six IPO Lawsuits designated as "focus cases." The Court has ordered a stay of all proceedings in all of the IPO Lawsuits pending the outcome of Plaintiffs' rehearing petition to the Second Circuit. Accordingly, the Court's decision on final approval of the settlement remains pending.

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If this settlement is not finalized as proposed, then this action may divert the efforts and attention of our management and, if determined adversely to us, could have a material impact on our business, results of operations, financial condition or cash flows.

On August 1, 2006, a stockholder derivative complaint was filed in the United States District Court for the Northern District of California by Jesse Brown under the caption Brown v. Kelly, et al. Case No. C06-04671 JW (N.D. Cal.). On September 13, 2006, a second stockholder derivative complaint was filed in the United States District Court for the Northern District of California by Louis Suba under the caption Suba v. Kelly et al., Case No. C06-05603 JW (N.D. Cal.). Both complaints were brought purportedly on behalf of the Company against certain current and former officers and directors. On November 27, 2006, the court entered an order consolidating these actions and requiring the plaintiffs to file a consolidated complaint. The consolidated complaint was filed on January 11, 2007. The consolidated complaint alleges, among other things, that the named officers and directors: (a) breached their fiduciary duties as they colluded with each other to backdate stock options, (b) violated section 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder through their alleged actions, and (c) were unjustly enriched by their receipt and retention of such stock options. The Company's response to the complaint is due on February 28, 2007.

In September 2006, the Company received a letter from Acacia Technologies Group, a patent holding company, suggesting that the Company may be infringing on two patents, designated by United States Patent Numbers 5,537,590 and 5,701,400, which are held by one of their patent licensing and enforcement subsidiaries. The Company is currently reviewing the validity of these patents and whether the Company’s products may infringe upon them. The Company has not formed a view of whether the Company may have liability for infringement of these patents. Any related claims, whether or not they have merit, could be costly and time-consuming to defend, divert our management’s attention or cause product delays. If any of our products were found to infringe such patents, the patent holder could seek an injunction to enjoin our use of the infringing product. If we were required to settle such a claim, it could have a material impact on our business, results of operations, financial condition or cash flows.

We are also subject to various other claims and legal actions arising in the ordinary course of business. The ultimate disposition of these various other claims and legal actions is not expected to have a material effect on our business, financial condition, results of operations or cash flows. However, litigation is subject to inherent uncertainties.

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

On August 1, 2006, our Annual Meeting of Stockholders was held in Cupertino, California. Of the 79,616,230 shares outstanding and entitled to vote as of the record date of June 15, 2006, 70,010,495 shares were present or represented by proxy at the meeting. At the meeting, stockholders were asked to vote with respect to (i) the election of two Class III directors to hold office until the 2009 Annual Meeting of Stockholders or until such time as their respective successors are elected and qualified and the election to re-designate one Class III director to Class II to hold office for the remaining Class II term until the 2008 Annual Meeting of Stockholders and (ii) the ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm for our fiscal year ending September 30, 2006.

The following nominees were elected as class III directors, each to hold office until the 2009 Annual Meeting of Stockholders or until such time as their respective successors are elected and qualified, by the vote set forth below:

Nominee	Votes For	Withheld	Broker Non-Votes
Samual T. Spadafora (1)	66,311,843	3,698,652	0
William J. Raduchel	67,926,871	2,083,624	0

(1) On November 30, 2006 Mr. Spadafora resigned from the Board of Directors

The following nominee was re-designated from a class III director to a class II to hold office for the remaining class II term until the 2008 Annual Meeting of Stockholders or until such time as their respective successors are elected and qualified, by the vote set forth below:

Nominee	Votes For	Withheld	Broker Non-Votes
David A. Weymouth	67,833,889	2,176,606	0

In addition to the directors elected above, David R. Springett, Steven R. Springsteel, Charles E. Hoffman and Richard G. Stevens continued to serve as directors after the annual meeting.

The selection of BDO Seidman, LLP as our independent registered public accounting firm for our fiscal year ended September 30, 2006 was ratified by the vote set forth below:

Votes For	Votes Against	Abstentions	Broker Non-Votes
69,859,087	133,075	18,333	0

The Company has changed the date of the 2007 annual meeting of stockholders which was previously scheduled to be held on or about March 1, 2007. The Company expects to hold the 2007 annual meeting of stockholders on April 24, 2007.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq National Market under the symbol "CHRD." The following table shows, for the periods indicated, the high and low per share sales prices of our common stock, as reported by the NASDAQ National Market. The prices appearing in the tables below reflect over-the-counter market quotations, which reflect inter-dealer prices, without retail mark-up, markdown or commission and may not necessarily represent actual transactions.

	High		Low	
Year Ended September 30, 2006				
First Quarter (October 1 - December 31)	$	3.00	$	2.49
Second Quarter (January 1 - March 31)	$	3.53	$	2.56
Third Quarter (April 1 - June 30)	$	3.60	$	2.86
Fourth Quarter (July 1 - September 30)	$	3.20	$	2.29
Year Ended September 30, 2005				
First Quarter (October 1 - December 31)	$	3.50	$	1.78
Second Quarter (January 1 - March 31)	$	2.35	$	1.64
Third Quarter (April 1 - June 30)	$	2.16	$	1.38
Fourth Quarter (July 1 - September 30)	$	3.00	$	2.15

As of January 31, 2007, there were approximately 246 holders of record of our common stock who together held approximately 3,804,797 shares of our common stock. The remainder of our shares outstanding is held by brokers and other institutions on behalf of stockholders. We have never paid or declared any cash dividends. We currently expect to retain working capital for use in the operation and expansion of our business and therefore do not anticipate paying any cash dividends.

In response to the SEC's adoption of Rule 10b5-1 under the Securities Exchange Act of 1934, we approved amendments to our insider trading policy on July 20, 2001 to permit our directors, executive officers and certain key employees to enter into trading plans or arrangements for systematic trading in our securities. We have been advised that certain of our directors, officers and key employees have entered into trading plans for selling shares in our securities. As of September 30, 2006, the directors and executive officers who have entered into trading plans include Samuel T. Spadafora who has since retired as an executive officer and resigned as a member of the Board and James D. St. Jean. We anticipate that, as permitted by Rule 10b5-1 and our insider trading policy, some or all of our directors, executive officers and employees may establish trading plans at some date in the future.

Securities Authorized for Issuance Under Equity Compensation Plans

For information relating to securities authorized for issuance under our equity compensation plans, please refer to the information under the heading, "Employee Benefit Plans" in Item 8, Footnote 13 of this Form 10-K**.**

Recent Sales of Unregistered Securities

On August 12, 2002, we entered into an agreement with IBM to market our products and services to customers. We issued a fully vested and exercisable warrant to purchase up to 0.2 million shares of common stock. The exercise price was set at $2.25 per share. The warrant was valued at $0.1 million based on the Black-Scholes model using the following assumptions: volatility: 105%, risk-free interest rate: 3.22% and fair market value of our common stock at

the grant date: $0.84. The value of the warrant was recorded as a prepaid expense and was offset against revenue during 2003 upon the completion of an IBM revenue generating transaction. On September 20, 2006, IBM exercised the warrants in a cashless transaction resulting in 48,075 of Chordiant shares being issued to IBM.

The shares were issued under the exemption from registration under the Securities Act of 1933 (the"Act") set forth in Section 4(2) of the Act

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The consolidated balance sheet as of September 30, 2005 and the consolidated statements of operations for the fiscal year ended September 30, 2005 and the nine months ended September 30, 2004 have been restated as set forth in this 2006 Form 10-K. We derived the selected data for the nine months ended September 30, 2004 and years ended September 30, 2005 and 2006 from our audited restated consolidated financial statements and notes thereto appearing in this Form 10-K. The consolidated statements of operations data for the years ended December 31, 2002 and 2003 and the consolidated balance sheet date as of September 30, 2004, December 31, 2003 and 2002 have been restated to conform to the restated consolidated financial statements included in this Form 10-K and are presented herein on an unaudited basis. The data for the consolidated financial statements for the nine months ended September 30, 2004 and years ended December 31, 2003 and 2002 have been restated to reflect the impact of stock-based compensation adjustments described below, but such restated data have not been audited and are derived from the books and records of the Company. The diluted net loss per share computation excludes potentially dilutive shares of common stock (restricted stock, options and warrants to purchase common stock), since their effect would be anti-dilutive. See the notes to our Consolidated Financial Statements for a detailed explanation of the determination of the shares used to compute basic and diluted net loss per share. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related notes thereto included in Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below. The information presented in the following tables has been adjusted to reflect the restatement of the Company's financial results, which is more fully described in the "Explanatory Note" preceding Part 1, Item 1 and in Note 3 "Restatement of Previously Issued Consolidated Financial Statements" to our Consolidated Financial Statements in this Form 10-K.

The Company has not amended its previously-filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods affected by this restatement. The financial information that has been previously filed or otherwise reported for these periods is superseded by the information in this Annual Report on Form 10-K, and the financial statements and related financial information contained in such previously-filed reports should no longer be relied upon.

	Years Ended September 30,		Nine Months Ended September 30,	Years Ended December 31,	
	2006	2005 Restated(1)	2004 Restated(1)	2003 Restated(1)(2)	2002 Restated(1)(2)
	(amounts in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenues	$ 97,536	$ 83,725	$ 61,023	$ 68,266	$ 73,851
Net loss	(16,001)	(19,865)	(1,371)	(17,932)	(35,036)
Net loss per share—basic and diluted	$ (0.21)	$ (0.27)	$ (0.02)	$ (0.30)	$ (0.64)
Weighted average shares used in computing basic and diluted net loss per	77,682	74,449	69,761	59,353	55,055

share

	Years Ended September 30,			Years Ended December 31,	
	2006	2005	2004	2003	2002
		Restated(1)	Restated(1)	Restated(1)(2)	Restated(1)(2)
	(amounts in thousands, except per share data)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 45,278	$ 38,546	$ 55,748	$ 36,218	$ 30,731
Working capital	22,323	23,733	46,296	19,480	20,569
Total assets	111,503	107,250	115,340	83,811	90,759
Current and long term portion of capital lease obligations	95	309	508	—	—
Short-term and long-term borrowings	—	—	—	—	1,250
Short-term and long-term deferred revenue	29,505	26,197	20,581	18,396	18,594
Stockholders' equity	$ 57,225	$ 65,157	$ 75,912	$ 48,350	$ 50,811

(1) See Note 3 - "Restatement of Previously Issued Consolidated Financial Statements" to our Consolidated Financial Statements for a discussion of these adjustments

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	Years Ended September 30, 2005 (1)			Nine Months Ended September 30 2004 (1)		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
	(amounts in thousands, except per share data)					
Consolidated Statement of Operations Data:						
Revenues	$ 83,725	$ —	$ 83,725	$ 61,023	$ —	$ 61,023
Net loss	(19,540)	(325)	(19,865)	(443)	(928)	(1,371)
Net loss per share—basic and diluted	$ (0.26)	$ (0.01)	$ (0.27)	$ (0.01)	$ (0.01)	$ (0.02)
Weighted average shares used in computing basic and diluted net loss per share	74,449	—	74,449	69,761	—	69,761

	September 30,					
	2005 (1)			2004 (1)		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
	(amounts in thousands, except per share data)					
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$ 38,546	$ —	$ 38,546	$ 55,748	$ —	$ 55,748
Working capital	24,133	(400)	23,733	46,560	(264)	46,296
Total assets	107,250	—	107,250	115,340	—	115,340
Current and long term portion of capital lease obligations	309	—	309	508	—	508
Short-term and long-term borrowings	—	—	—	—	—	—
Short-term and long-term deferred revenue	26,197	—	26,197	20,581	—	20,581
Stockholders' equity	$ 65,557	$ (400)	$ 65,157	$ 76,176	$ (264)	$ 75,912

(1) See Note 3 - "Restatement of Previously Issued Consolidated Financial Statements" to our Consolidated Financial Statements for a discussion of these adjustments.

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	Years ended December 31,					
	2003 (1) (2)			2002 (1) (2)		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
	(amounts in thousands, except per share data)					
Consolidated Statement of Operations Data:						
Revenues	$ 68,266	$ —	$ 68,266	$ 73,851	$ —	$ 73,851
Net loss	(16,403)	(1,529)	(17,932)	(32,321)	(2,715)	(35,036)
Net loss per share—basic and diluted	$ (0.28)	$ (0.02)	$ (0.30)	$ (0.59)	$ (0.05)	$ (0.64)
Weighted average shares used in computing basic and diluted net loss per share	59,353	—	59,353	55,055	—	55,055

	December 31,					
	2003 (1) (2)			2002 (1) (2)		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
	(amounts in thousands, except per share data)					
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$ 36,218	$ —	$ 36,218	$ 30,731	$ —	$ 30,731
Working capital	19,576	(96)	19,480	20,569	—	20,569
Total assets	83,811	—	83,811	90,759	—	90,759
Short-term and long-term borrowings	—	—	—	1,250	—	1,250
Short-term and long-term deferred revenue	18,396	—	18,396	18,594	—	18,594
Stockholders' equity	$ 48,446	$ (96)	$ 48,350	$ 50,811	$ —	$ 50,811

(1) See Note 3 - "Restatement of Previously Issued Consolidated Financial Statements" to our Consolidated Financial Statements for a discussion of these adjustments.

(2) The unaudited consolidated statements of operations data for the fiscal years ended December 31, 2003 and 2002, and the unaudited consolidated balance sheet data as of September 30, 2004, December 31, 2003 and 2002 have been revised to reflect adjustments related to the restatement described below under "Management's Discussion and

Analysis of Financial Condition and Results of Operations - Restatement of Consolidated Financial Statements" and Note 3 of the Notes to the Consolidated Financial Statements. The cumulative after tax impact of all restatement adjustments related to years prior to 2002 totaled $2.6 million and these amounts are reflected in the restated stockholders' equity at December 31, 2001. The impact on previously reported net loss of these adjustments was a decrease of $2.1 million and $0.5 million or 4.9% and 1.3% for the fiscal years 2001 and 2000, respectively. The impact on previously reported basic and diluted loss per share of these adjustments was an increase in loss per share of ($0.04) and ($0.01) for fiscal years 2001 and 2000, respectively

No dividends have been paid or declared since our inception. Effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," and ceased amortizing goodwill balances. Effective October 1, 2005, the Company adopted SFAS No. 123R as more fully described in Note 1 to the Consolidated Financial Statements contained in this Annual Report.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Safe Harbor

The following discussion and analysis contains forward-looking statements. These statements are based on our current expectations, assumptions, estimates and projections about our business and our industry, and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's results, levels of activity, performance or achievement to be materially different from any future results, levels of activity, performance or achievements expressed or implied in or contemplated by the forward-looking statements. Words such as "believe," "anticipate," "expect," "intend," "plan," "will," "may," "should," "estimate," "predict," "guidance," "potential," "continue" or the negative of such terms or other similar expressions, identify forward-looking statements. Our actual results and the timing of events may differ significantly from those discussed in the forward-looking statements as a result of various factors, including but not limited to, those discussed in Item 1 of this Form 10-K under the caption "Risk Factors" and those discussed elsewhere in this Annual Report and in our other filings with the Securities and Exchange Commission. Chordiant undertakes no obligation to update any forward-looking statement to reflect events after the date of this report.

Restatement of Consolidated Financial Statements and Related Proceedings

The following information has been adjusted to reflect the restatement of the Company's financial results, which is more fully described in the "Explanatory Note" immediately preceding Part I, Item 1 and in Note 3, "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements of this Form 10-K. The impact of the restatements on the Company's results of operations resulted in an increase in stock-based compensation expenses and associated payroll tax expense of $2.1 million, $2.7 million, $1.5 million for the twelve months ended December 31, 2001, 2002, 2003, respectively, $0.9 million for the nine months ended September 30, 2004, $0.3 million for the twelve months ended 2005, and $0.2 million for the twelve months ended 2006.

Executive Overview

As an enterprise software vendor, we generate substantially all of our revenues from the financial services, telecommunications, and retail industries. Our customers typically fund purchases of our software and services out of their lines of business and information technology budgets. As a result, our revenues are heavily influenced by our customers' long-term business outlook and willingness to invest in new enterprise information systems and business applications.

Beginning in late calendar 2000, the financial services and telecommunications industries entered into a steep and long economic downturn, with industry sales dropping from late 2000 through the first part of 2003. Over the past several years, our customers have focused on controlling costs and reducing risk, including constraining information technology and lines of business expenditures and requiring more favorable pricing terms from their suppliers and pursuing consolidation within their own industries. As a result of this downturn, our license fee revenues declined 19% in fiscal 2003.

Beginning in the latter part of 2003, economic conditions began to show signs of improvement, which were reflected in increases in various economic indicators such as productivity, labor statistics and consumer confidence. This trend has continued through our fiscal year 2006 and appears to have had a favorable impact, specifically in information technology spending. For the year ended September 30, 2006 and 2005 and the nine months ended September 30, 2004, we were able to grow total revenues on a year over year basis.

Software Industry Consolidation and Possible Increased Competition

The software industry in general is continuing to undergo a period of consolidation, and there has been recent consolidation in sectors of the software industry in which we operate. During 2006, Oracle completed the acquisition of i-flex Solutions Ltd., a banking software maker headquartered in Mumbai, India, acquired Siebel Systems, Inc., a maker of customer relationship management software products and acquired Portal Software, a provider of billing and revenue management solutions for the communications and media industry. Also, during 2006, IBM acquired Webify, a provider of middleware to companies primarily in the insurance industry.

In September 2005, IBM acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In September 2005, SSA Global Technologies acquired Epiphany, Inc., a maker of customer relationship management software products. While we do not believe that these acquired companies are direct competitors of Chordiant, the acquisition activity of these large corporations of software providers to the industries we target may indicate that we will face increased competition from significantly larger and more established entities in the future.

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Stock-based Compensation Expense

On October 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors related to employee stock options ("employee stock purchases") based on estimated fair values. Stock-based compensation expense recognized under SFAS 123(R) for the year ended September 30, 2006 was $4.7 million which consisted of stock-based compensation expense related to employee stock options of $2.7 million and stock-based compensation expense related to restricted stock awards of $2.0 million.

Upon adoption of SFAS 123(R), we began estimating the value of employee stock options on the date of grant using the Black-Scholes model. Prior to the adoption of SFAS 123(R), the value of each employee stock option was estimated on the date of grant using the Black-Scholes model for the purpose of the pro forma financial information in accordance with SFAS 123. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. The use of a Black-Scholes model requires the use of extensive actual employee exercise behavior data and the use of a number of complex assumptions including expected volatility, risk-free interest rates, expected lives and expected dividend yields. The weighted-average estimated value of employee stock options granted during the twelve months ended September 30, 2006 was $1.99 per share using the Black-Scholes model with the following weighted-average assumptions:

	For the twelve months ended September 30,		For the nine months ended September 30,
	2006	2005	2004
Expected lives in years	3.9	2.6	2.6
Risk free interest rates	4.8%	3.3%	2.8%
Volatility	88%	98%	85%
Dividend yield	0%	0%	0%

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model with the weighted average assumptions for volatility, expected term and risk-free rate. With the adoption of SFAS 123(R) on October 1, 2005, we used the trinomial lattice valuation technique to determine the assumptions used in the Black-Scholes model. The trinomial lattice valuation technique was used to provide a better estimate of fair values and meet the fair value objectives of SFAS 123(R). The expected term of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior. The risk-free interest rate is based on the U.S. Treasury rates in effect during the corresponding period of grant. The expected volatility rate is based on the historical volatility of our stock price.

As stock-based compensation expense recognized in the consolidated statement of operations for fiscal year 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

If factors change and we employ different assumptions in the application of SFAS 123(R) in future periods, the compensation expense that we record under SFAS 123(R) may differ significantly from what we have recorded in the current period. The estimated value of a stock option is most sensitive to the volatility assumption. Based on the September 30, 2006 variables, it is estimated that a change of 10% in either the volatility, expected life or interest rate

assumption would result in a corresponding 7%, 4% or 1% change in the estimated value of the option being valued using the Black-Scholes model.

Financial Trends

Backlog. An increasingly material portion of our revenues has been derived from large orders, as major customers deployed our products. As of September 30, 2006 and 2005, we had approximately $36 million and $33 million, respectively, in backlog, which we define as contractual commitments by our customers through purchase orders or contracts. Backlog is comprised of:

• software license orders which have not been accepted by customers or have not otherwise met all of the required criteria for revenue recognition. This component includes both unbilled amounts plus billed amounts classified as deferred revenue;

• deferred revenue from customer support contracts;

• consulting service orders representing the unbilled remaining balances of consulting contracts not yet completed or delivered, plus deferred consulting revenue; and

• education orders for services not yet completed or delivered.

Backlog is not necessarily indicative of revenues to be recognized in a specified future period and except for items included in non-current deferred revenue, backlog is generally recognizable as revenue within a twelve-month period. There are many factors that would impact Chordiant's conversion of backlog as recognizable revenue, such as Chordiant's progress in completing projects for its customers, Chordiant's customers meeting anticipated schedules for customer-dependent deliverables and customers increasing the scope or duration of a contract causing license revenue to be deferred for a longer period of time.

Chordiant provides no assurances that any portion of its backlog will be recognized as revenue during any fiscal year or at all or that its backlog will be recognized as revenues in any given period. In addition, it is possible that customers from whom we expect to derive revenue from backlog will default and as a result we may not be able to recognize expected revenue from backlog.

Product Development. Chordiant has entered into several product co-development arrangements with its customers. These projects relate to software products that were in various stages of development prior to the consummation of the individual arrangements. Upon the completion of the software, the Company intends to license these products to other customers. License revenue relating to these arrangements will be deferred until the delivery of the final products, provided all other requirements of SOP 97-2 are met. Expenses associated with these co-development arrangements are expensed as incurred as they are considered to be research and development costs that do not qualify for capitalization or deferral. The accounting for these transactions differs from the percentage of completion method or completed contract method, as expenses are recognized in the period incurred and no revenue is recognized until the final product is delivered. As of September 30, 2006, license fees aggregating approximately $2.6 million associated with these arrangements had been deferred. We expect that research and development costs will increase as the volume of co-development activities increase.

Gross margins. Management focuses on license and service gross margin in evaluating our financial condition and operating performance. Gross margins on license revenues were 96%, 97%, and 94% for twelve months ended September 30, 2006, 2005, and 2004, respectively. The changes in gross margins are primarily related to the amortization expense associated with capitalized software development costs pertaining to a banking product. We expect license gross margin on current products to range from 95% to 97% in the foreseeable future. The margin will fluctuate with the mix of products sold. Historically, the enterprise solution products have higher associated third party royalty expense than the marketing solution products and decision management products. The banking product that was completed during the year ended September 30, 2005 also has higher royalties than other products.

Gross margins on service revenues were 46%, 42%, and 40% for the twelve months ended September 30, 2006, 2005, and 2004, respectively. The increase in gross margins from 2005 and 2004 is primarily due to improved service utilization rates in the U.S. In addition, margins increased as a result of the company switching to lower cost third party service providers and an increase in higher margin post-contract customer support revenues.

Service revenues. Service revenues as a percentage of total revenues were 58%, 62%, and 59% for the twelve months ended September 30, 2006, 2005, and 2004, respectively. We expect that service revenues will represent between 50% and 60% of our total revenues in the foreseeable future.

Revenues from international customers versus North America revenues. For all periods presented, revenues were principally derived from customer accounts in North America and Europe. For the twelve months ended September 30, 2006, 2005, and 2004, international revenues were $37.5 million, $42.0 million, and $45.3 million or approximately 38%, 50%, and 56% of our total revenues, respectively. We believe international revenues will continue to represent a significant portion of our total revenues in future periods. International revenues were negatively impacted for the fiscal year ended September 30, 2006, as compared to fiscal year ended September 30, 2005, as both the British Pound and the Euro decreased in average value by less than 1% and approximately 3%, respectively, as compared to the U.S. Dollar.

For the twelve months ended September 30, 2006, 2005, and 2004, North America revenues were $60.0 million, $41.7 million, and $30.2 million or approximately 62%, 50%, and 44%% of our total revenues, respectively. As the U.S. economy has strengthened, we have seen an increase in North America revenues. Large customers have become more willing to invest in new enterprise infrastructure projects. We believe North America revenues will continue to represent an increasing portion of our total revenues in the future.

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Acquisition of KiQ Limited. On December 21, 2004, we acquired KiQ Limited, a privately-held United Kingdom software company with branch offices in the Netherlands (“KiQ”), specializing in the development and sales of decision management systems. The year ended September 30, 2005 includes the revenue and expense of KiQ from the acquisition date, December 21, 2004, through the end of the fiscal year, September 20, 2005. The year ended September 30, 2006 includes the revenues and expenses of KiQ for the entire fiscal year. The acquisition resulted in an increase to our headcount of approximately 20 employees as of the acquisition date. The majority of these individuals are in the Cost of Service and Research and Development areas, accordingly personnel costs are now higher in these categories for the years ended September 30, 2005 and 2006. KiQ operations have been integrated into the financial operations and the decision management products are actively being marketed to customers across all regions.

Costs related to compliance with the Sarbanes-Oxley Act of 2002. Significant professional services are included in general and administrative costs relating with efforts to comply with the Sarbanes-Oxley Act of 2002. For the year ended September 30, 2006 and 2005, these costs were $1.8 million, and $4.5 million, respectively. We expect these costs to continue for the year ended September 30, 2007. While these costs are expected to decline as compared to the costs incurred for the year ended September 30, 2006, the level and timing of the decline is uncertain.

Costs related to stock option investigation. Significant professional services are included in general and administrative costs associated with the Company’s stock option investigation which is more fully described in the “Explanatory Note” immediately preceding Part I, Item 1 and in Note 3, “Restatement of Previously Issued Consolidated Financial Statements” in Notes to Consolidated Financial Statements of this Form 10-K. For the year ended September 30, 2006, these costs were $1.2 million. We expect these costs to continue through the first half of fiscal year 2007. In the first quarter of fiscal 2007, we incurred aggregate costs of $1.0 million.

Reduction in workforce. In October 2006, the Company initiated a restructuring plan intended to align its resources and cost structure with expected future revenues. The restructuring plan included a balancing of services resources worldwide, an elimination of duplicative functions internationally, and a shift in the U.S. field organization toward a focus on domain-based sales and pre-sales teams.

The restructuring plan included an immediate reduction in positions of slightly more than ten percent of the Company's workforce, consolidation of European facilities, and the closure of our French office. A majority of the positions eliminated were in Europe. The plan was committed to on October 24, 2006, and employees were begun to be notified on October 25, 2006.

The Company estimates that it will record pre-tax cash restructuring charges, in the first quarter of fiscal year 2007 of approximately $1.9 to $2.1 million for severance costs, between $4.0 million to $4.8 million for exiting excess facilities, and $0.1 million for other charges. The facilities are subject to operating leases expiring thru 2010. The Company anticipates that between $5.2 million to $6.2 million of the charge will result in cash expenditures of which the majority will be severance paid in cash during the first quarter of fiscal year 2007.

In July 2005, we undertook an approximate 10% reduction in our workforce. In connection with this action, we incurred a one-time cash charge of approximately $1.0 million in the fourth quarter ended September 30, 2005 for severance benefits.

Past results may not be indicative of future performance. We believe that period-to-period comparisons of our operating results should not be relied upon as indicative of future performance. Our prospects must be considered given the risks, expenses and difficulties frequently encountered by companies in early stages of development, particularly companies in new and rapidly evolving businesses. There can be no assurance we will be successful in addressing these risks and difficulties. Moreover, we may not achieve or maintain profitability in the future.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, we evaluate the estimates, including those related to our allowance for doubtful accounts, valuation of stock-based compensation, valuation of goodwill and intangible assets, valuation of deferred tax assets, restructuring costs, contingencies, vendor specific objective evidence ("VSOE") of fair value in multiple element arrangements and the estimates associated with the percentage-of-completion method of accounting for certain of our revenue contracts. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting judgments and estimates are used in the preparation of our consolidated financial statements:

• Revenue recognition, including estimating the total estimated time required to complete sales arrangements involving significant implementation or customization essential to the functionality of our products;

• Estimating valuation allowances and accrued liabilities, specifically the allowance for doubtful accounts, and assessment of the probability of the outcome of our current litigation;

• Stock-based compensation expense;

• Accounting for income taxes;

• Valuation of long-lived and intangible assets and goodwill;

• Restructuring costs; and

• Determining functional currencies for the purposes of consolidating our international operations.

Revenue recognition. We derive revenues from licenses of our software and related services, which include assistance in implementation, customization and integration, post-contract customer support, training and consulting. The amount and timing of our revenue is difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in increased operating losses. The accounting rules related to revenue recognition are complex and are affected by interpretation of the rules and an understanding of industry practices, both of which are subject to change. Consequently, the revenue recognition accounting rules require management to make significant estimates based on judgments.

Software license revenue is recognized in accordance with Statement of Position No. 97-2 “Software Revenue Recognition,” as amended by Statement of Position No. 98-9 “Software Revenue Recognition with Respect to Certain Arrangements” (collectively “SOP 97-2”).

For arrangements with multiple elements, we recognize revenue for services and post-contract customer support based upon VSOE of fair value of the respective elements. VSOE of fair value for the services element is based upon the standard hourly rates we charge for the services when such services are sold separately. The VSOE of fair value for annual post-contract customer support is generally established with the contractual future renewal rates included in the contracts when the renewal rate is substantive and consistent with the fees when support services are sold separately. When contracts contain multiple elements and VSOE of fair value exists for all undelivered elements, we account for the delivered elements, principally the license portion, based upon the “residual method” as prescribed by SOP 97-2. In multiple element transactions where VSOE is not established for an undelivered element, we recognize revenue upon the establishment of VSOE for that element or when the element is delivered.

At the time we enter into a transaction, we assess whether any services included within the arrangement require us to perform significant implementation or customization essential to the functionality of our products.

For contracts for products that do not involve significant implementation or customization essential to the product functionality, we recognize license revenues when there is persuasive evidence of an arrangement, the fee is fixed or determinable, collection of the fee is probable and delivery has occurred as prescribed by SOP No. 97-2.

For contracts that involve significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenue using either the percentage-of-completion method or the completed contract method as prescribed by Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Product-Type Contracts" ("SOP 81-1").

The percentage-of-completion method is applied when we have the ability to make reasonable dependable estimates of the total effort required for completion using labor hours incurred as the measure of progress towards completion. The progress toward completion is measured based on the "go-live" date. We define the "go-live" date as the date the essential product functionality has been delivered or the application enters into a production environment or the point at which no significant additional Chordiant supplied professional service resources are required. Estimates are subject to revisions as the contract progresses to completion. We account for the changes as changes in accounting estimates when the information becomes known. Information impacting estimates obtained after the balance sheet date but before the issuance of the financial statements is used to update the estimates. Provisions for estimated contract losses, if any, are recognized in the period in which the loss becomes

probable and can be reasonably estimated. When we sell additional licenses related to the original licensing agreement, revenue is recognized upon delivery if the project has reached the go-live date, or if the project has not reached the go-live date, revenue is recognized under the percentage-of-completion method. We classify revenues from these arrangements as license and service revenues based upon the estimated fair value of each element using the residual method.

The completed contract method is applied when we are unable to obtain reasonable dependable estimates of the total effort required for completion. Under the completed contract method, all revenue and related costs of revenue are deferred and recognized upon completion.

For product co-development arrangements relating to software products in development prior to the consummation of the individual arrangements, where the Company retains the intellectual property being developed, and intends to sell the resulting products to other customers, license revenue is deferred until the delivery of the final product, provided all other requirements of SOP 97-2 are met. Expenses associated with these co-development arrangements are accounted for under SFAS 86 and are normally expensed as incurred as they are considered to be research and development costs that do not qualify for capitalization or deferral.

Revenue from subscription or term license agreements, which include software, rights to unspecified future products and maintenance, is recognized ratably over the term of the subscription period. Revenue from subscription or term license agreements, which include software, but exclude rights to unspecified future products or maintenance, is recognized upon delivery of the software if all conditions of recognizing revenue have been met including that the related agreement is non-cancelable, non-refundable and provided on an unsupported basis.

In situations in which we are obligated to provide unspecified additional software products in the future, we recognize revenue as a subscription ratably over the term of the subscription period.

Revenues generated from fees charged to customers for providing transaction processing are recognized as revenue in the same period as the related transactions occur.

We recognize revenue for post-contract customer support ratably over the support period which ranges from one to three years.

Our training and consulting services revenues are recognized as such services are performed on an hourly or daily basis for time and material contracts. For consulting services arrangements with a fixed fee, we recognize revenue on the proportional performance method.

For all sales we use either a signed license agreement or a binding purchase order where we have a master license agreement as evidence of an arrangement. Sales through our third party systems integrators are evidenced by a master agreement governing the relationship together with binding purchase orders or order forms on a transaction-by-transaction basis. Revenues from reseller arrangements are recognized on the “sell-through” method, when the reseller reports to us the sale of our software products to end-users. Our agreements with customers and resellers do not contain product return rights.

We assess collectibility based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We generally do not request collateral from our customers. If we determine that the collection of a fee is not probable, we defer the fee and recognize revenue at the time collection becomes probable, which is generally upon the receipt of cash. If a transaction includes extended payment terms, we recognized revenue as the payments become due and payable.

Allowance for doubtful accounts. We must make estimates of the uncollectability of our accounts receivables. We specifically analyze accounts receivable and analyze historical bad debts, customer concentrations, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Generally, we require no collateral from our customers. Our gross accounts receivable balance was $19.1 million with an allowance for doubtful accounts of $0.1 million as of September 30, 2006. Our gross accounts receivable balance was $19.2 million with an allowance for doubtful accounts of $0.2 million as of September 30, 2005. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required. To date bad debts have not been material and have been within management's expectations.

Stock-based Compensation Expense. Upon adoption of SFAS 123(R) on October 1, 2005, we began estimating the value of employee stock options on the date of grant using the Black-Scholes model. Prior to the adoption of SFAS 123(R), the value of each employee stock option was estimated on the date of grant using the Black-Scholes model for the purpose of the pro forma financial disclosure in accordance with SFAS 123. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex

and subjective variables. These variables include, but are not limited to the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. The expected term of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior. The expected volatility is based on the historical volatility of our stock.

With the adoption of SFAS 123(R) on October 1, 2005, we used the trinomial lattice valuation technique to determine the assumptions used in the Black-Scholes model. The trinomial lattice valuation technique was used to provide better estimates of fair values and meet the fair value objectives of SFAS 123(R).

In connection with the Company's restatement of its consolidated financial statements, the Company has applied judgment in choosing whether to revise measurement dates for prior options grants. Information regarding the restatement, including ranges of possible additional stock-based compensation expense if other measurement dates had been selected for certain grants, is set forth in Note 3-"Restatement of Previously Issued Consolidated Financial Statements" in the Notes to Consolidated Financial Statements of this Form 10-K.

Accounting for income taxes. As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations.

We have recorded a valuation allowance equal to 100% of the deferred tax assets as of September 30, 2006, due to uncertainties related to our ability to utilize our net deferred tax assets, primarily consisting of certain net operating losses carried forward and research and development tax credits. Deferred tax assets have been fully reserved for in all periods presented.

Valuation of long-lived and intangible assets and goodwill. We assess the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Furthermore, we assess the impairment of goodwill annually. Factors we consider important which could trigger an impairment review include the following:

• Significant underperformance relative to expected historical or projected future operating results;

• Significant changes in the manner of our use of the acquired assets or the strategy for our overall business;

• Significant negative industry or economic trends;

• Significant decline in our stock price for a sustained period;

• Market capitalization declines relative to net book value; and

• A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

When one or more of the above indicators of impairment occurs we estimate the value of long-lived assets and intangible assets to determine whether there is impairment. We measure any impairment based on the projected

discounted cash flow method, which requires us to make several estimates including the estimated cash flows associated with the asset, the period over which these cash flows will be generated and a discount rate commensurate with the risk inherent in our current business model. These estimates are subjective and if we made different estimates, it could materially impact the estimated fair value of these assets and the conclusions we reached regarding an impairment. To date, we have not identified any triggering events which would require us to perform this analysis.

We are required to perform an impairment review of our goodwill balance on at least an annual basis. This impairment review involves a two-step process as follows:

Step 1—We compare the fair value of our reporting units to the carrying value, including goodwill, of each of those units. For each reporting unit where the carrying value, including goodwill, exceeds the unit's fair value, we proceed on to Step 2. If a unit's fair value exceeds the carrying value, no further work is performed and no impairment charge is necessary.

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Step 2—We perform an allocation of the fair value of the reporting unit to our identifiable tangible and non-goodwill intangible assets and liabilities. This derives an implied fair value for the reporting unit's goodwill. We then compare the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. If the carrying amount of the reporting unit's goodwill is greater than the implied fair value of its goodwill, an impairment charge would be recognized for the excess.

We determined that we have one reporting unit. We completed a goodwill impairment review for the period including September 30, 2006 and 2005 and performed Step 1 of the goodwill impairment analysis required by Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," and concluded that goodwill was not impaired as of September 30, 2006 and 2005 using the methodology described above. Accordingly, Step 2 was not performed. We will continue to test for impairment on an annual basis and on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting units below their carrying amount.

Restructuring costs. During fiscal years 2005, 2003, and the nine months ended September 30, 2004, we implemented cost-reduction plans as part of our continued effort to streamline our operations to reduce ongoing operating expenses. In October 2006, we implemented a restructuring plan intended to align our resources and cost structure. These plans resulted in restructuring charges related to, among others, the consolidation of excess facilities. These charges relate to facilities and portions of facilities we no longer utilize and either seek to terminate early or sublease. Lease termination costs and brokerage fees for the abandoned facilities were estimated for the remaining lease obligations and were offset by estimated sublease income. Estimates related to sublease costs and income are based on assumptions regarding the period required to locate and contract with suitable sub-lessees and sublease rates which can be achieved using market trend information analyses provided by a commercial real estate brokerage retained by us. Each reporting period we review these estimates and to the extent that these assumptions change due to new agreements with landlords, new subleases with tenants, or changes in the market, the ultimate restructuring expenses for these abandoned facilities could vary by material amounts.

Determining functional currencies for the purpose of consolidation. We have several foreign subsidiaries that together account for a significant portion of our revenues, expenses, assets and liabilities.

In preparing our consolidated financial statements, we are required to translate the financial statements of the foreign subsidiaries from the currency in which they keep their accounting records, generally the local currency, into United States dollars. This process results in exchange gains and losses which, under the relevant accounting guidance are either included within the statement of operations or as a separate part of our net equity under the caption "accumulated other comprehensive income (loss)." Under the relevant accounting guidance, the treatment of these translation gains or losses is dependent upon management's determination of the functional currency of each subsidiary. The functional currency is determined based on management's judgment and involves consideration of all relevant economic facts and circumstances affecting the subsidiary. Generally, the currency in which the subsidiary conducts a majority of its transactions, including billings, financing, payroll and other expenditures would be considered the functional currency but any dependency upon the parent and the nature of the subsidiary's operations must also be considered.

If any subsidiary's functional currency were deemed to be the local currency, then any gain or loss associated with the translation of that subsidiary's financial statements would be included in cumulative translation adjustments. However, if the functional currency were deemed to be the United States dollar then any gain or loss associated with the translation of these financial statements would be included within our statement of operations. If we dispose of any of our subsidiaries, any cumulative translation gains or losses would be recognized in our statement of operations. If we determine that there has been a change in the functional currency of a subsidiary to the United States dollar, any translation gains or losses arising after the date of change would be included within our statement of operations.

Based on our assessment of the factors discussed above, we consider the relevant subsidiary's local currency to be the functional currency for each of our international subsidiaries. Accordingly, foreign currency translation gains and loses are included as part of accumulated other comprehensive income within our balance sheet for all periods presented.

The magnitude of these gains or losses is dependent upon movements in the exchange rates of the foreign currencies in which we transact business against the United States dollar. These currencies include the United Kingdom Pound Sterling, the Euro and the Canadian Dollar. Any future translation gains or losses could be significantly higher than those reported in previous periods. At September 30, 2006, approximately $14.6 million of our cash and cash equivalents were held by our subsidiaries outside of the United States.

Prior to June 30, 2005, the settlement of accumulated intercompany loans and advances was not planned or anticipated. Loans and advances made subsequent to this date are anticipated as cash balances may need to be transferred between entities. Exchange gains or losses on these intercompany balances are reflected in the statement of operations.

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Recent Accounting Pronouncements

In December 2006, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) EITF 00-19-2, "Accounting for Registration Payment Arrangements." This FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, "Accounting for Contingencies." The guidance is effective for fiscal years beginning December 15, 2006. The Company has evaluated the new pronouncement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 provides guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The guidance is applicable for fiscal years ending after November 15, 2006. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, ("SFAS 157") "Fair Value Measurement." SFAS 157 defines fair value, establishes a framework for measuring fair value, and also expands disclosures about fair value measurements. The SFAS 157 is effective for periods beginning after November 15, 2007. The Company is currently evaluating the effects of implementing this new standard.

In September 2006, the FASB issued SFAS No. 158, ("SFAS 158") "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 88, 106 and 132R." SFAS 158 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's under funded status. The requirement to recognize the funded status of a defined postretirement plan and the disclosure requirements are effective for fiscal years ending after December 31, 2006. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position based on the technical merits of the position. This interpretation is effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings; accordingly, the Company expects to adopt this standard in its fiscal year commencing October 1, 2007. The Company is currently evaluating the effects of implementing this new standard.

In March 2006, the FASB Emerging Issues Task Force issued Issue 06-3 (EITF 06-3), "How Sales Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement." A tentative consensus was reached that a company should disclose its accounting policy (i.e., gross or net presentation) regarding presentation of taxes within the scope of EITF 06-3. If taxes are significant, a company should disclose the amount of such taxes for each period for which an income statement is presented. The guidance is effective for periods beginning after December 15, 2006. The Company presents sales net of sales taxes in its consolidated statement of operations and does not anticipate changing its policy as a result of EITF 06-3.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140", which is effective for fiscal years beginning after September 15, 2006. This statement was

issued to simplify the accounting for servicing rights and to reduce the volatility that results from using different measurement attributes. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140", which is effective for fiscal years beginning after September 15, 2006. The statement was issued to clarify the application of FASB Statement No. 133 to beneficial interests in securitized financial assets and to improve the consistency of accounting for similar financial instruments, regardless of the form of the instruments. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In November 2005, the FASB issued Staff Position ("FSP") FAS123(R)-3, "Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards." This FSP requires an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS No. 123(R), or the alternative transition method as described in the FSP. An entity that

adopts SFAS No. 123(R) using the modified prospective application may make a one-time election to adopt the transition method described in this FSP. An entity may take up to one year from the later of its initial adoption of SFAS No. 123(R) or the effective date of this FSP to evaluate its available transition alternatives and make its one-time election. This FSP became effective in November 2005. The Company has elected the alternative transition method as described in the FSP.

In November 2005, the FASB issued FSP FAS115-1/124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends FASB Statements No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations," and APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In June 2005, the FASB issued SFAS No. 154 ("SFAS 154"), "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements." SFAS 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. The Company does not believe adoption of SFAS 154 will have a material effect on our consolidated financial position, results of operations or cash flows.

In March 2005, the FASB issued Financial Interpretation No. 47 ("FIN 47"), "Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143." FIN 47 requires asset retirement obligations to be recorded when a legal obligation exists even though the timing and/or method of the settlement of such obligations is conditional on a future event. FIN 47 is effective for fiscal years beginning after December 15, 2005. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In December 2004, the FASB issued FSP No. FSP 109-2 ("FSP 109-2"), "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004." FSP 109-2 provides guidance under FASB Statement No. 109 ("SFAS 109"), "Accounting for Income Taxes," with respect to recording the potential impact of the repatriation provisions of the American Jobs Creation Act of 2004 (the "Jobs Act") on enterprises' income tax expense and deferred tax liability. The Jobs Act was enacted on October 22, 2004. FSP 109-2 states that an enterprise is allowed
time beyond the financial reporting period of enactment to evaluate the effect of the Jobs Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying SFAS 109. FSP 109-2 is effective for fiscal years after December 15, 2005. The Company has evaluated the impact of the repatriation provisions and has determined that it will not have a material impact on its consolidated financial statements.

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Results of Operations

On December 29, 2004, Chordiant's Board of Directors approved a change in the Company's fiscal year end from December 31 to September 30. The nine-month results reported by the Company relate to the transitional period ended September 30, 2004. The financial information for the twelve months ended September 30, 2004 is unaudited and is presented for comparative purposes.

The following table sets forth, in dollars (in thousands) and as a percentage of total revenues, consolidated statements of operations data for the periods indicated. This information, except for the year ended September 30, 2004, has been derived from the consolidated financial statements included elsewhere in this Annual Report.

	Years Ended September 30,						Nine Months Ended	
	2006		2005 (Restated) (1)		2004 (Restated) (1) (Unaudited)		September 30, 2004 (Restated) (1)	
Statements of Operations Data:								
Revenues:								
License	$ 40,514	42%	$ 31,678	38%	$32,909	41%	$23,661	39%
Service	57,022	58	52,047	62	47,714	59	37,362	61
Total revenues	97,536	100	83,725	100	80,623	100	61,023	100
Cost of revenues:								
License	1,690	2	1,079	1	1,836	2	1,262	2
Service	30,566	31	30,155	36	28,617	36	21,630	35
Amortization of intangible assets	1,211	1	1,068	2	1,838	2	1,044	2
Total cost of revenues	33,467	34	32,302	39	32,291	40	23,936	39
Gross profit	64,069	66	51,423	61	48,332	60	37,087	61
Operating expenses:								
Sales and marketing	33,616	34	29,561	36	24,395	30	17,825	29
Research and development	25,858	27	20,272	24	18,569	23	13,160	22
General and administrative	20,445	21	18,549	22	9,293	12	7,099	12
Amortization of intangible assets	—	—	117	—	222	—	126	—
Restructuring expense	—	—	1,052	1	1,200	2	172	—
Purchased in-process research and development	—	—	1,940	2	—	—	—	—
Total operating expenses	79,919	82	71,491	85	53,679	67	38,382	63
Loss from operations	(15,850)	(16)	(20,068)	(24)	(5,347)	(7)	(1,295)	(2)
Interest income, net	1,120	1	755	1	515	1	498	1
Other expense, net	(627)	—	(103)	—	9	—	(132)	—
Loss before income taxes	(15,357)	(15)	(19,416)	(23)	(4,823)	(6)	(929)	(1)
	644	1	449	1	899	1	442	1

Provision for income taxes								
Net loss	$ (16,001)	(16)%	$ (19,865)	(24)%	$ (5,722)	(7)%	$ (1,371)	(2)%

(1) - See Note 3 - "Restatement of Previously Issued Consolidated Financial Statements" to our Consolidated Financial Statements for a discussion of these adjustments.

Comparison of the Year Ended September 30, 2006 to the Year Ended September 30, 2005

Revenues

License Revenue. Total license revenue increased $8.8 million, or 28%, to $40.5 million for the year ended September 30, 2006 compared to $31.7 million for the year ended September 30, 2005. License revenues for enterprise solutions increased $5.8 million, or 23%, to $30.4 million for the year ended September 30, 2006 compared to $24.6 million for the year ended September 30, 2005. This increase was primarily due to an increase in value of the average customer transaction. License

revenues for marketing solutions increased $3.9 million, or 161%, to $6.4 million for the year ended September 30, 2006 compared to $2.5 million for the year ended September 30, 2005. License revenues for decision management solutions relate to the products acquired in the KiQ transaction. License revenues for decision manager decreased $0.8 million, or 19% to 3.8 million for the year ended September 30, 2006 compared to $4.6 million for year ended September 30, 2005.

Service Revenue. Total service revenue, which include reimbursement of out-of-pocket expenses, increased $5.0 million, or 10%, to $57.0 million for the year ended September 30, 2006 compared to $52.0 million for the year ended September 30, 2005. This increase is primarily related to a $2.3 million increase in support and maintenance revenue, a $2.1 million increase in training revenue and a $0.5 million increase in consulting revenue. Service revenue associated with enterprise solution products decreased less than $0.5 million, or 1%, to $39.9 million for the year ended September 30, 2006 compared to $40.4 million for the year ended September 30, 2005. Service revenues associated with marketing solution products increased $3.3 million, or 34%, to $13.0 million for the year ended September 30, 2006 compared to $9.7 million for the year ended September 30, 2005. Service revenues associated with decision management solution products relate to the products acquired in the KiQ transaction. Service revenues associated with decision management increased $2.2 million or 114% to $4.1 million for the year ended September 30, 2006 compared to $1.9 million for the year ended September 30, 2005.

Reimbursement of out-of-pocket expenses (which are included in total service revenues) decreased $0.2 million, or 4%, to $3.3 million for the year ended September 30, 2006 compared to $3.5 million for the year ended September 30, 2005.

Cost of revenues

License. Cost of license revenues includes third-party software royalties and amortization of capitalized software development costs. Royalty expenses can vary depending upon the mix of products sold within the period. The capitalized software development costs pertain to a banking product that was completed and available for general release in August 2005. Annual amortization expense associated with this product is $0.9 million. Amortization of these costs is expected through 2008.

Cost of license revenues increased $0.6 million, or 57%, to $1.7 million for the year ended September 30, 2006 compared to $1.1 million for the year ended September 30, 2005. This increase is primarily related to the fiscal year 2006 including a full year of amortization related to the banking product versus the prior year which included only 1.5 months of amortization. These costs resulted in license gross margins of approximately 96% and 97% for the years ended September 30, 2006 and 2005, respectively.

Service. Cost of service revenues consists primarily of personnel, third-party consulting, facility and travel costs incurred to provide consulting implementation and integration, consulting customization, training, post-contract customer support services. Cost of service revenues increased $0.4 million, or 1%, to $30.6 million for the year ended September 30, 2006 compared to $30.2 million for the year ended September 30, 2005. This increase in costs is primarily due to increases in personnel related costs of $0.7 million related to an increase in headcount, facility and information technology costs of $0.6 million, third party support and maintenance costs of $0.3 million offset by a decrease in third party consulting costs of $1.5 million. These costs resulted in service gross margins of approximately 46% and 42% for the years ended September 30, 2006 and 2005, respectively.

Amortization of intangible assets (included in cost of revenues). Amortization of intangible assets cost consists primarily of the amortization of amounts paid for developed technologies, customer lists and trade-names resulting from business acquisitions. Amortization of intangible assets was $1.2 million for the year ended September 30, 2006 compared to $1.1 million for the year ended September 30, 2005. The amortization expense in the year ended

September 30, 2006 is solely related to $6.1 million of intangible assets associated with the acquisition of KiQ in December 2004. We expect to continue to amortize these assets through December 2009.

Operating Expenses

Sales and marketing. Sales and marketing expenses is composed primarily of costs associated with selling, promoting and advertising our products, product demonstrations and customer sales calls. These costs consist primarily of employee salaries, commissions and bonuses, benefits, facilities, travel expenses and promotional and advertising expenses. Sales and marketing expenses increased $4.0 million, or 14%, to $33.6 million for the year ended September 30, 2006 compared to $29.6 million for the year ended September 30, 2005. The $4.0 million increase in these expenses was mainly attributable to an increase of $2.7 million in personnel related expenses, $1.0 million in sales events, and $0.3 million increase in legal contract and personnel costs.

Research and development. Research and development expenses is composed primarily of costs associated with the development of new products, enhancements of existing products and quality assurance activities. These costs consist primarily of employee salaries and benefits, facilities, the cost of software and development tools and equipment and consulting costs, including costs for offshore consultants. Research and development expenses increased $5.6 million, or 27%, to $25.9 million for the year ended September 30, 2006 compared to $20.3 million for the year ended September 30, 2005. This increase was driven by two large co-development projects; one in North America and one in the United Kingdom. The United Kingdom project was completed in September 2006 and the North America project is expected to be completed in the second half of 2007. This $5.6

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million increase in costs was primarily composed of $6.6 million in consulting expenses related to our outsourcing of technical support and certain sustaining engineering functions and $0.4 million in travel costs which were offset by decreases of $1.1 million in personnel costs and $0.3 million in information technology costs.

General and administrative. General and administrative expenses is composed primarily of costs associated with our executive and administrative personnel (e.g. the CEO, legal and finance personnel). These costs consist primarily of employee salaries, bonuses, stock compensation expense, benefits, facilities, consulting costs, including costs for Sarbanes-Oxley Act of 2002 (SOX) consultants and stock option investigation professional services.

General and administrative expenses increased $1.9 million, or 10%, to $20.4 million for the year ended September 30, 2006 compared to $18.5 million for the year ended September 30, 2005. The increase in costs is primarily due to increases of $3.4 million for personnel costs, $0.7 million for severance costs associated with two senior executives, offset by a reduction of $2.3 million in professional services as consultants. The increase in personnel costs and decrease in professional services was driven by the replacement of accounting consultants with permanent employees. The decrease in professional services was also due to a decrease in SOX consulting fees of $2.7 million which was offset by stock option investigation professional fees of $1.2 million during the year. We do not expect to experience the same level of decrease in SOX costs in 2007 that we did in 2006. We expect the costs associated with the stock option investigation to continue in the first half of 2007.

Amortization of intangible assets (included in operating expenses). There was no amortization of intangible assets included in operating costs for 2006. All intangible assets attributable to operating expenses were fully amortized in 2005. Amortization of intangible assets included in operating expenses was $0.1 million for the year ended September 30, 2005. These intangible assets are the result of the Prime Response acquisition in March 2001.

Purchased in-process research and development. In-process research and development expense represents acquired technology that, on the date of acquisition, had not achieved technological feasibility and did not have an alternative future use, based on the state of development. Because the product under development may not achieve commercial viability, the amount of acquired in-process research and development was immediately expensed. The nature of the efforts required to develop the purchased in-process research and development into a commercially viable product principally relate to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its designed specifications, including functions, features and technical performance requirements. There was no purchased in-process research and development expense for the year ended September 30, 2006. For the year ended September 30, 2005, we recorded an expense of $1.9 million related to acquired in-process technology attributable to the acquisition of KiQ.

Restructuring expenses. In July 2005, we announced a reduction in workforce and incurred a one-time cash charge of approximately $1.1 million in the year ended September 30, 2005. During the year ended September 30, 2004, we announced plans to reallocate staff between our North American and European operations to better support our growth in North America, and an associated restructuring expense was recorded. Please refer to Note 7 to the Consolidated Financial Statements, “Restructuring.”

Stock-based compensation (included in individual operating expense and cost of revenue categories). The following table sets forth our stock-based compensation expense in terms of absolute dollars and functional breakdown for the years ended September 30, 2006 and 2005 (in thousands):

	Years Ended September 30,	
	2006	**2005**
		(Restated) (1)
Stock-based compensation expense:		

Cost of revenues	$	248	$	690
Sales and marketing		2,327		986
Research and development		332		843
General and administrative		1,788		512
Total stock-based compensation expense	$	4,695	$	3,031

(1) - See Note 3 - “Restatement of Previously Issued Consolidated Financial Statements” to our Consolidated Financial Statements for a discussion of these adjustments.

For the year ended September 30, 2006, the aggregate stock-based compensation cost included in cost of revenues and in operating expenses was $4.7 million which is a combination of $2.7 million related to stock options and $2.0 million associated with restricted stock awards. Included in the restricted stock award compensation expense of $2.0 million is $1.2 million associated with the amortization of restricted stock awards attributable to the KiQ acquisition in December 2004. Amortization of deferred stock-based compensation attributable to the acquisition of KiQ will be expensed through June 2007.

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For the year ended September 30, 2005, the aggregate stock-based compensation cost included in cost of revenues and in operating expenses was $3.0 million which was a combination of a $0.4 million benefit related to stock options and $3.4 million expense associated with restricted stock awards. Included in the restricted stock award compensation expense of $3.4 million is $2.7 million associated with the amortization of restricted stock awards attributable to the KIQ acquisition.

Interest income, net. Interest income, net, consists primarily of interest income generated from our cash and cash equivalents, offset by interest expense incurred in connection with our capital leases and letters of credit. Interest income, net, increased to approximately $1.1 million for the year ended September 30, 2006 from $0.8 million for the year ended September 30, 2005. This increase is primarily due to improved interest rates related to interest-bearing cash and cash equivalents accounts and a higher average cash balance during 2006 versus 2005.

Other expense, net. These gains and losses are primarily associated with foreign currency transaction gains or losses and re-measurement of our short-term intercompany balances between the U.S. and our foreign denominated subsidiaries. Other expense resulted in a net loss of $0.6 million for the year ended September 30, 2006 as compared to a net loss of $0.1 million for the same period in the prior year. The change is primarily attributable to currency exchange gains and losses recognized during the years ended September 30, 2006 and 2005. These gains and losses are primarily associated with our U.S. dollar account balances held in Europe and the U.S. dollar's fluctuations in value against the Euro and U.K. Pound Sterling.

Provision for income taxes. Our provisions for income taxes were $0.6 million and $0.4 million for the years ended September 30, 2006 and 2005, respectively. The provisions were attributable to taxes on earnings from our foreign subsidiaries and certain state income taxes.

Our deferred tax assets primarily consist of net operating loss carryforwards, nondeductible allowances and research and development tax credits. We have recorded a valuation allowance for the full amount of our net deferred tax assets, as the future realization of the tax benefit is not considered by management to be more-likely-than-not.

Comparison of the Year Ended September 30, 2005 to the Year Ended September 30, 2004

Revenues

License Revenue. Total license revenue decreased $1.2 million, or 4%, to $31.7 million for the year ended September 30, 2005 compared to $32.9 million for the year ended September 30, 2004. License revenues for enterprise solutions decreased $2.2 million, or 8%, to $24.6 million for the year ended September 30, 2005 compared to $26.8 million for the year ended September 30, 2004. This decrease was primarily due to the timing of revenues recognized under the percentage-of-completion method of accounting**.** The timing and amount of revenue recognized is influenced by the progress of work performed relative to the project length of customer contracts and the dollar value of such contracts. License revenues for marketing solutions decreased $3.6 million, or 60%, to $2.5 million for the year ended September 30, 2005 compared to $6.1 million for the year ended September 30, 2004. License revenues for decision management solutions relate to the products acquired in the KiQ transaction and were $4.6 million for year ended September 30, 2005.

Service Revenue. Total service revenues, which include reimbursement of out-of-pocket expenses, increased $4.3 million, or 9%, to $52.0 million for the year ended September 30, 2005 compared to $47.7 million for the year ended September 30, 2004. Service revenues associated with enterprise solution products increased $4.0 million, or 12%, to $40.2 million for the year ended September 30, 2005 compared to $36.2 million for the year ended September 30, 2004. This increase was due to a continuation in large customer implementations as well as

maintenance, support and consulting revenues associated with license agreements entered into in current and prior periods. Service revenues associated with marketing solution products decreased $1.9 million, or 16%, to $9.7 million for the year ended September 30, 2005 compared to $11.6 million for the year ended September 30, 2004. Service revenues associated with decision management solution products relate to the products acquired in the KiQ transaction and were $1.9 million for the year ended September 30, 2005.

Reimbursement of out-of-pocket expenses (which are included in total service revenues) increased $0.6 million, or 22%, to $3.5 million for the year ended September 30, 2005 compared to $2.8 million for the year ended September 30, 2004. This increase is primarily due to the higher number of third party consultants and employees working on projects.

Cost of revenues

License. Cost of license revenues decreased $0.7 million, or 41%, to $1.1 million for the year ended September 30, 2005 compared to $1.8 million for the year ended September 30, 2004. These costs resulted in license gross margins of approximately 97% and 94% for the year ended September 30, 2005 and 2004, respectively. The license gross margin for the year ended September 30, 2005 is higher than in the recent past due to lower royalties payable associated with the mix of products sold. The number of product components subject to the payment of royalties in the past declined during the year ended September 30, 2005.

Revenues derived from the sale of KiQ products are also not subject to significant royalties.

Service. Cost of service revenues increased $1.4 million, or 5%, to $30.2 million for the year ended September 30, 2005 compared to $28.6 million for the year ended September 30, 2004. These costs resulted in service gross margins of approximately 42% and 40% for the years ended September 30, 2005 and 2004, respectively.

Amortization of intangible assets (included in cost of revenues). Amortization of intangible assets was $1.1 million for the year ended September 30, 2005 compared to $1.8 million for the year ended September 30, 2004. The amortization expense in the year ended September 30, 2004 primarily related to intangibles associated with the acquisition of OnDemand in April 2002. Intangibles associated with the acquisitions of certain assets from ActionPoint and ASP Outfitter in May 2001 became fully amortized during calendar 2004. On December 21, 2004, we recorded, and began to amortize, aggregate additions of $6.1 million of intangible assets related to the acquisition of KiQ. Amortization of intangible assets attributable to the acquisition of KiQ will be expensed through December 2009. In addition, beginning in the quarter ended September 30, 2005, quarterly amortization expense increased $0.2 million relating to an internally developed banking product that was completed and available for general release. These costs are being amortized over a three-year period.

Operating Expenses

Sales and marketing. Sales and marketing expenses increased $5.2 million, or 21%, to $29.6 million for the year ended September 30, 2005 compared to $24.4 million for the year ended September 30, 2004. The $5.2 million increase in these expenses was mainly attributable to an increase of $3.9 million in personnel related expenses and an $0.8 million increase in travel costs due to a higher number of sales representatives. Recruiting fees also increased $0.3 million over the prior period.

Research and development. Research and development expenses increased $1.7 million, or 9%, to $20.3 million for the year ended September 30, 2005 compared to $18.6 million for the year ended September 30, 2004. This $1.7 million increase was mainly attributable to an increase of approximately $1.9 million in research and development consulting expenses related to our outsourcing of technical support and certain sustaining engineering functions. Personnel costs also increased $0.6 million, in part due to the addition of KiQ employees. Offsetting these increases was an increase to the capitalization of internal salary and fringe benefit costs of approximately $0.8 million associated with the development of a banking product. The development of this product was completed in July 2005 and no additional costs are expected to be capitalized.

General and administrative. General and administrative expenses increased $9.2 million, or 100%, to $18.5 million for the year ended September 30, 2005 compared to $9.3 million for the year ended September 30, 2004. The increase in these expenses was mainly attributable to an increase of $5.1 million in consulting related expenses associated with efforts to comply with SOX and fill vacant accounting positions. Professional service fees also increased $1.9 million primarily due to the accounting and legal fees associated with SOX, additional procedures required in conjunction with the material weaknesses identified at June 30, 2004 and September 30, 2004 and additional fees related to the restatement of our prior year results. Higher costs associated with efforts to comply with SOX continued for the first quarter of fiscal year 2006. In conjunction with new hires in the accounting and finance areas, personnel related costs and recruiting fees increased $1.0 million and $0.5 million, respectively. Due to the higher general and administrative headcounts, the allocation of common costs and facilities costs to the department also increased by $0.6 million.

Amortization of intangible assets (included in operating expenses). Amortization of intangible assets included in operating expenses was $0.1 million for the year ended September 30, 2005 compared to $0.2 million for the year ended September 30, 2004. Amortization expense classified in operating expenses for these periods is mainly attributable to the acquisition of Prime Response in March 2001. These intangibles were fully amortized as of

September 30, 2005.

Purchased in-process research and development. In-process research and development expense represents acquired technology that, on the date of acquisition, had not achieved technological feasibility and did not have an alternative future use, based on the state of development. Because the product under development may not achieve commercial viability, the amount of acquired in-process research and development was immediately expensed. The nature of the efforts required to develop the purchased in-process research and development into a commercially viable product principally relate to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its designed specifications, including functions, features and technical performance requirements. For the year ended September 30, 2005, we recorded an expense of $1.9 million related to acquired in-process technology attributable to the acquisition of KiQ. There was no purchased in-process research and development expense for the year ended September 30, 2004.

Restructuring expenses. In July 2005, we announced a reduction in workforce and incurred a one-time cash charge of approximately $1.1 million in the year ended September 30, 2005. During the year ended September 30, 2004, we announced plans to reallocate staff between our North American and European operations to better support our growth in North America, and an associated restructuring expense was recorded. Please refer to Note 7 to the Consolidated Financial Statements, “Restructuring.”

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Stock-based compensation (included in individual operating expense and cost of revenue categories). The following table sets fourth our stock-based compensation expense in terms of absolute dollars and functional breakdown for the twelve months ended September 30, 2005 and 2004 (in thousands):

The related functional breakdown of total stock-based compensation is outlined below (in thousands):

	Year Ended September 30, 2005 (Restated) (1)	Year Ended September 30, 2004 (Restated) (1)
Stock-based compensation expense:		
Cost of revenues	$ 690	$ 825
Sales and marketing	986	887
Research and development	843	1,175
General and administrative	512	1,218
Total stock-based compensation expense	$ 3,031	$ 4,105

(1) - See Note 3 - “Restatement of Previously Issued Consolidated Financial Statements” to our Consolidated Financial Statements for a discussion of these adjustments.

For the year ended September 30, 2005, the aggregate stock-based compensation cost included in cost of revenues and in operating expenses was $3.0 million which was a combination of a $0.4 million benefit related to stock options and $3.4 million expense associated with restricted stock awards. Included in the restricted stock award compensation expense of $3.4 million is $2.7 million associated with the amortization of restricted stock awards attributable to the KiQ acquisition which occurred in December 2004. The $0.4 million benefit is partially due to the decrease in our stock price during the period which affects the variable accounting calculation to which some restricted stock and outstanding stock options are subject. Also included in these costs for the year ended September 30, 2005 were charges associated with the issuance of 450,000 shares of restricted stock to certain officers of the Company. Amortization of deferred stock-based compensation attributable to the acquisition of KiQ will be expensed through June 2007.

Interest income, net. Interest income, net, consists primarily of interest income generated from our cash, cash equivalents and short-term investments, offset by interest expense incurred in connection with outstanding borrowings and letters of credit. Interest income, net, increased to approximately $0.8 million for the year ended September 30, 2005 from $0.5 million for the year ended September 30, 2004. This increase is primarily due to improved interest rates related to interest-bearing cash, cash equivalents and short-term investment accounts.

Other expense, net. Realized foreign currency gains and losses and other non-operating income and expenses resulted in a net loss of $0.1 million for the year ended September 30, 2005 as compared to net income of less than $0.1 million for the same period in the prior year. The change is primarily attributable to currency exchange gains and losses recognized during the years ended September 30, 2005 and 2004. These gains and losses are primarily associated with our U.S. dollar account balances held in Europe and the U.S. dollar’s fluctuations in value against the Euro and U.K. Pound Sterling.

Provision for income taxes. Our provisions for income taxes were $0.4 million and $0.9 million for the years ended September 30, 2005 and 2004, respectively. The provisions were attributable to taxes on earnings from our foreign subsidiaries and certain state income taxes.

Our deferred tax assets primarily consist of net operating loss carryforwards, nondeductible allowances and research and development tax credits. We have recorded a valuation allowance for the full amount of our net deferred tax assets, as the future realization of the tax benefit is not considered by management to be more-likely-than-not.

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Quarterly Financial Information

The following table presents the Company’s condensed consolidated balance sheets (unaudited, in thousands):

	September 30, 2006	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,278	$ 42,664
Restricted cash	185	175
Accounts receivable	19,025	22,233
Prepaid expenses and other current assets	5,210	4,864
Total current assets	69,698	69,936
Restricted cash	334	341
Property and equipment, net	2,630	2,607
Goodwill	32,044	32,044
Intangible assets, net	3,937	4,239
Other assets	2,860	2,789
Total assets	$ 111,503	$ 111,956
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ 7,665	$ 7,787
Accrued expenses	15,706	13,781
Deferred revenue	23,909	21,060
Current portion of capital lease obligations	95	150
Total current liabilities	47,375	42,778
Deferred revenue—long-term	5,596	3,976
Restructuring costs, net of current portion	1,239	1,331
Other long-term liabilities	68	75
Total liabilities	54,278	48,160
Stockholders’ equity:		
Preferred stock		