# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-K/A

## Amendment No. 1

**(Mark One)**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED MAY 31, 2004**

¨ **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: 000-30221**

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# SABA SOFTWARE, INC.

(Exact Name of Registrant as Specified in its Charter)

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**Delaware** **94-3267638**

| (State or Other Jurisdiction of<br>Incorporation or Organization) | (I.R.S. Employer Identification Number) |
| --- | --- |
| **2400 Bridge Parkway**<br>**Redwood Shores, California**<br>(Address of Principal Executive Offices) | **94065-1166**<br>(Zip Code) |

**(650) 696-3840**

(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, par value $0.001 per share**

(Title of class)

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 and 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 the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of November 28, 2003, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $44,138,252 (based on a closing sale price of $3.85 per share as reported for the Nasdaq National Market). Shares of common stock beneficially held by each executive officer and director and by each person who beneficially owns 5% or more of the outstanding common stock have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the registrant s common stock, $.001 par value per share, outstanding as of October 25, 2004 was 16,119,915.

Documents Incorporated by Reference

Portions of registrant s definitive Proxy Statement for the Annual Meeting of Stockholders to be held on November 4, 2004 are incorporated by reference in Part III of this Form 10-K to the extent stated herein.

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**SABA SOFTWARE, INC.**

**FORM 10-K**

**MAY 31, 2004**

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# PART I

## FORWARD-LOOKING INFORMATION

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the Securities Act ) and Section 21E of the Securities and Exchange Act of 1934 (the Exchange Act ). All statements in this Annual Report other than statements of historical fact are forward-looking statements for purposes of these provisions, including any statements of the plans and objectives for future operations and any statement of assumptions underlying any of the foregoing. Statements that include the use of terminology such as may, will, expects, believes, plans, estimates, potential, or continue, or the negative thereof or other comparabl terminology are forward-looking statements. Forward-looking statements include (i) in Item 1, statements regarding competition, registration of trademarks and the merit of claims in litigation, (ii) in Item 2, statements regarding the adequacy of our existing facilities to meet anticipated needs, (iii) in Item 3, statements regarding the resolution and effect of pending litigation, (iv) in Item 5, statements regarding payment of cash dividends in the future, and (v) in Item 7, statements regarding an increase in operating expenses, including sales and marketing expenses, and research and development and general and administrative expenses remaining flat, recognition of lease expenses, incurrence of non-cash expenses relating to stock compensation, amortization of purchased intangible assets and any potential goodwill impairment, growth of our operations and personnel, fluctuations in operating results from quarter to quarter, long sales cycles, effects of our voluntary stock option exchange program, possible acquisitions and strategic ventures, expansion of our sales and marketing organization, sufficiency of cash resources, credit facilities and cash flows to meet working capital, capital expense and business expansion requirements, development of new or enhanced applications and services, market risk exposure, impact of SFAS No. 143, 144, 146, 148 and 149 and EITF No. 01-14 and 00-21, expansion of our international presence, and the significance of Saba Enterprise Learning Suite and related services, as well as other products, for our revenues. These forward-looking statements involve risks and uncertainties, and it is important to note that our actual results could differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations Factors That May Impact Future Operating Results. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement or risk factor. You should consult the risk factors listed from time to time in our Reports on Form 10-Q.

## ITEM 1: BUSINESS

### Overview

We are a leading provider of human capital development and management solutions, which are designed to increase organizational performance through the implementation of a management system for aligning, developing and measuring the performance of people. Our solutions can help large enterprises to efficiently manage regulatory compliance, increase sales and channel readiness, accelerate time-to-competency of people across the extended enterprise, increase speed of customer acquisition, shorten time-to-market of new products and increase visibility into organizational performance.

We were incorporated in Delaware in April 1997. We have incurred significant losses and negative cash flows from operations since our inception. We have not achieved profitability and cannot be certain that we will realize sufficient revenues to achieve or sustain profitability.

Our headquarters are located at 2400 Bridge Parkway, Redwood Shores, California 94065, and our telephone number is (650) 696-3840.

Our Internet address is *www.saba.com*. On our Investor Relations page on this web site we post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission: our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or

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15(d) of the Securities Exchange Act of 1934. All such filings on our Investor Relations web page are available to be viewed free of charge. Information contained on our web site is not part of this annual report on Form 10-K or our other filings with the Securities and Exchange Commission. We assume no obligation to update or revise any forward-looking statements in this annual report on Form 10-K, whether as a result of new information, future events or otherwise, unless we are required to do so by law. A copy of this annual report on Form 10-K is available without charge upon written request to: Investor Relations, Yvonne Selner, Saba Software, Inc., 2400 Bridge Parkway, Redwood Shores, California 94065.

**Products and Services**

*Saba Enterprise Learning Suite*

The Saba Enterprise Learning Suite is a family of products designed to deliver configurable, targeted functionality in a single solution to address five key enterprise learning areas:

*Sales and Channel Readiness* Designed to enable sales organizations and distributors to gain the skills and knowledge required to rapidly build a sales pipeline and win business for new products.

*Channel Certification* Focuses on qualifying channel partners to consistently represent the organization s products and brand, and deliver quality services.

*Customer Education* Supports organizations ability to generate revenue and increase customer loyalty through the sale and distribution of training.

*Regulatory Compliance* Allows regulated organizations to track required certifications and qualification programs and effectively respond to compliance audits.

*Corporate Universities* Focuses on developing employees to effectively execute organizational objectives and gain competitive advantage.

By implementing multiple enterprise learning solutions in a single system, organizations can lower the overall cost of supporting enterprise wide learning processes, leverage internally-created content in multiple areas and create a common pool of knowledge for and about people. This unified solution also offers the flexibility to change processes and develop new opportunities from a common foundation, while creating the visibility needed to operate as an integrated virtual enterprise.

The Saba Enterprise Learning Suite combines enterprise learning with collaboration for informal learning, synchronous learning, analytics, and content creation and management. It also provides support for blended learning, and supports 16 different languages and locales for global deployments. The Saba Enterprise Learning Suite includes the following applications:

*Saba Enterprise Learning* Designed to enable global organizations to deliver and manage critical knowledge and skills to improve productivity and achieve business results.

*Saba Analytics for Learning* Allows business leaders to analyze, understand and act on critical trends and information related to their enterprise learning initiatives.

*Saba Content* Helps global organizations capture, manage and share critical content through a learning object repository and automated content processes.

*Saba Publisher* Allows users to assemble new courses, or re-purpose courses, and publish them into HTML quickly and efficiently.

*Saba Collaboration* Supports informal collaboration and knowledge sharing between communities of practice through chat rooms, threaded discussions, and document sharing.

*Saba Connectors* Supports an enterprise s ability to leverage external content as well as information from systems such as virtual learning environments, enterprise content management systems and enterprise resource planning systems.

*Languages* Saba Enterprise Learning is available in the following languages: American English, Arabic, Brazilian Portuguese, British/International English, Chinese, Danish, Dutch, French, German, Greek, Italian, Japanese, Norwegian, Polish, Spanish, and Swedish.

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*Saba Enterprise Performance Suite*

Saba Enterprise Performance helps improve organizational performance by aligning the workforce around the organization s most important business objectives. Saba Enterprise Performance provides real-time visibility into an organization s progress against goals, allowing leaders to make ongoing adjustments and respond to changing requirements. With Saba Enterprise Performance, Global 2000 companies and government agencies can automate all the processes associated with managing performance across the extended enterprise of employees, customers, partners and suppliers. These processes include:

*Goal and objective management* Enables the creation, distribution and management of goals and objectives throughout the extended enterprise.

*Goal alignment* Provides line-of-sight visibility to ensure that the organization is executing against its most important objectives.

*Initiative management* Enables the management and tracking of goals in support of a cross-functional initiative.

*Performance appraisals* Provides highly flexible, multi-level appraisal and assessment functionality.

*Development planning* Enables the creation of action plans that combine performance goals, career development goals and recommended learning.

*Saba Services*

We offer comprehensive services to assist in the successful implementation of our products. As of May 31, 2004, we employed approximately 67 people worldwide in services-related activities.

Our global services organization supports multiple offerings, including:

*Strategic workshops*. Saba Strategic Workshops are designed to enable organizations to effectively link human capital development and management to business strategies. Offerings include developing new human capital development and management strategies, change management, developing and deploying competency models, and measurement and evaluation strategies.

*Consulting services*. Our consulting services include the definition of business objectives, the design of phased plans for achieving these objectives, technical solution specifications, establishment of implementation timelines and resource requirements, installation of Saba solutions, systems configuration, data loading, custom report and notification design, website development, enterprise system integration and post-implementation assessment.

*Customer support*. We provide several product support options so that customers may utilize their own resources to the degree desired and leverage their existing investments in customer support. Options include enterprise support, an end-user help desk and on-site

support.

*Education services*. We provide a broad range of education offerings in a variety of formats, including instructor-led training and web- and technology-based training. Course curricula, designed to enable customers to fully exploit the value of the Saba solutions, include product training, project team training, and technology training.

*Hosting services*. We offer hosting services for our software in support of our customers development, testing, and production environments. Our hosting offerings include security administration and backup and recovery services.

**Our Customers**

Our customers include a wide spectrum of large, global organizations in the automotive, communications, computer software and hardware, electronics, consumer package goods, energy, financial services, government, health care, manufacturing, medical equipment, pharmaceutical, professional services and transportation industries. Our customers represent 22% of the Fortune Global 100 and 20% of the FTSE 100. Based on total revenues, our customers also are leaders in their regions, representing two of the top five companies in Europe, the top three

companies in Germany and the largest company in Brazil. In the public sector, our customers include the Army University Access Online, the Federal Law Enforcement Training Center and several branches of the U.S. Government.

**Alliances**

As of May 31, 2004, we have entered into strategic alliance agreements with a number of global and regional consulting firms who act as systems integrators and implementation partners for our solutions. These alliances and the associated training of qualified personnel in these organizations greatly increase the number of consulting professionals trained to implement our solutions. We have several hundred trained consultants including third-party consultants. Additionally, systems integrators provide opportunities for our sales managers to gain entry to executive levels at our target accounts.

We have also entered into several alliance agreements with packaged content providers, custom content developers, and content authoring and learning delivery tool providers in order to increase the range of content offerings available to our customers. The Saba Content Alliance Program helps our content partners create and deliver learning content for use in conjunction with Saba solutions through support of industry standards applicable to a broad variety of media formats, including web-based training, computer-based training, video, and asynchronous and synchronous delivery, as well as through support of traditional forms of learning such as instructor-led classes, seminars, and workshops. In support of this program, we also operate a content developers resource center and testing lab that provides our content partners with direct access to our systems for standards compliance testing.

**Sales and Marketing**

We license our products to organizations through a worldwide direct sales force and global network of alliance partners. Our direct sales efforts target large organizations including Global 2000 businesses and government organizations. As of May 31, 2004, we had 62 sales and marketing professionals located in 11 sales offices, 4 of which are in the United States. Our channel sales efforts involve value-added resellers around the globe, as well as systems-integrator partnerships.

We focus our marketing efforts on establishing market positioning, generating sales leads, supporting proposal and sales efforts, creating market awareness of our solutions and establishing strategic relationships. Our marketing activities include public relations/analyst relations, direct marketing (email, tele-contact and direct mail campaigns), industry trade shows, web and in-person seminar programs, speaking engagements and web presence.

**Technology**

*Product Architecture*

Our J2EE product architecture facilitates the rapid development, deployment and configuration of Internet-based solutions for organizational learning and performance management. Our products share a common platform, a modern environment for developing Web-based applications.

It uses the latest industry standards, including Extensible Markup Language (XML), Simple Object Access Protocol (SOAP), Enterprise Java Beans (EJB) and web services standards, to deliver innovative, configurable features for enterprise learning and enterprise performance.

We provide a fully J2EE-compliant application platform. This helps accelerate application development by leveraging the transaction management, persistence management and resource pooling capabilities of standard J2EE-compliant application servers so application developers can focus on building business logic and user interfaces. Key features of the Saba platform include:

*Configurability*. The Saba platform offers extensive application configurability of both business processes and user experience.

*Web services enabled*. We ship a robust set of predefined web services for business processes as well as an infrastructure for creating new web services. Developers can use these web services to integrate components of Saba functionality, from user and organizational information housed in an HRIS to order processing passed to an accounts receivable system.

*Support for Java Specification Request 168*. Support for Java Specification Request 168 (JSR 168) enables organizations to display portlets, or small windows to business critical Saba processes, within a JSR 168 compliant enterprise portal product.

*Open interfaces*. Published Java application programming interfaces, or APIs, enable developers to build custom Saba application extensions, and public database views allow analysts to design custom reports using standard reporting tools.

*Scalability*. Scalability is accomplished using load-balancing techniques, allowing multiple servers to be deployed to handle peak periods when the largest number of concurrent users is expected on the system.

*Standard relational database server*. We use standard relational database servers. To enhance performance and ensure that users are served efficiently, the Saba platform executes database-stored procedures to optimize intense database processing. The core foundation currently supports Oracle and Microsoft SQL Server databases.

*J2EE application server*. The business and application logic reside on a J2EE application server. This architecture allows us to deploy a site across a farm of servers with diverse operating environments, such as Microsoft Windows NT, Sun Solaris, Linux or HP UX.

*Electronic commerce enabled*. The core foundation includes interfaces to external electronic payment services, enabling real-time electronic commerce.

*Multiple language support*. The core foundation is designed to support multiple languages. Currently our solutions support 16 languages.

*Workflow monitoring of business object changes*. A workflow component applies business rules when business objects change. For example, e-mail can automatically be sent to students when details about their class change.

*Integration with legacy enterprise applications*. The Saba platform is capable of exchanging data with external legacy systems. We provide connectors to the leading human resources and financial systems.

*Research and Development*

Our research and development operations are organized around software platform and applications development initiatives. These two development activities share resources and collaborate on design and development. Core teams are responsible for platform and infrastructure development, application development, user interface and application design, enterprise connectivity, Internet applications and design, quality assurance, documentation and release management. As of May 31, 2004, we had 104 research and development employees in the U.S. and India. We incurred $10.0 million, $11.8 million and $14.6 million in Research and Development expense during the years ended May 31, 2004, 2003 and 2002, respectively.

Our development methodology provides guidelines for planning, controlling and implementing projects. To continue to address market requirements, we consult with our consulting, support, and sales teams, as well as our customers, in the product development cycle. We conduct our development efforts at multiple sites in the United States and India, which enables continuous development 24 hours per day.

**Competition**

The market for our products and services is intensely competitive, dynamic and subject to rapid technological change. The intensity of competition and the pace of change are expected to increase in the future. Competitors vary in size and in the scope and breadth of the products and services they offer. Although we believe that we offer the most comprehensive Internet-based learning and performance management platform, we encounter competition with respect to different aspects of our solutions from a variety of sources including:

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

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

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- Potential customers internal development efforts;
- Companies that operate Internet-based marketplaces for the sale of on-line learning;
- Companies that operate Internet-based marketplaces for the sale of goods and services and could potentially decide to evolve their marketplaces to include content offerings; and
- Internet portals that offer learning content, performance support tools or recruiting services.

We expect additional competition from other established and emerging companies as the market for Internet-based, human capital development and management solutions continues to evolve. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business.

We believe the principal competitive features affecting our market include:

- Breadth and depth of the solution
- A significant installed base of Global 2000 and government customers
- The ability to support all forms of content offerings
- The ability meet the requirements of the world s largest organizations, including support for global deployments
- The ability to support a broad range of extended-enterprise users, including employees, partners, customers and suppliers
- Product quality and performance
- Product features and functions
- Customer service and support
- Ease of implementation
- Core technology

Price to performance ratio

Although we believe that we are a leader in our market space and that our solutions currently compete favorably with respect to these factors, our market is relatively new and is changing rapidly. We may not be able to maintain our competitive position against current and potential competitors, especially those with significantly greater financial, technical, service, support, marketing and other resources.

**Proprietary Rights**

Proprietary rights are important to our success and our competitive position. To protect our proprietary rights, we rely on copyright, trademark, patent and trade secret laws, confidentiality procedures and contractual provisions.

We license rather than sell our software products and require our customers to enter into written license agreements, which impose restrictions on the use, copying and disclosure of our software. In addition, we seek to avoid disclosure of our trade secrets through a number of means, including but not limited to, requiring those persons with access to our proprietary information to execute confidentiality agreements with us. These contractual provisions, however, may be unenforceable under the laws of some jurisdictions and foreign countries.

We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection. In addition, we have three patents issued in the United States and four patent applications pending in the United States. We cannot assure you that any patents will be issued for any of the pending patent applications. Even for the issued patents, or any patent issued to us in the future, there can be no assurance that such patent (i) will protect our intellectual property, or (ii) will not be challenged by third parties. Furthermore, other parties may independently develop similar or competing technologies or design

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around any patents that may be issued to us. It is possible that any patent issued to us may not provide any competitive advantages, that we may not develop future proprietary products or technologies that are patentable, and that the patents of others may seriously limit our ability to do business. In this regard, we have not performed any comprehensive analysis of patents of others that may limit our ability to do business.

We have obtained registration of various trademarks, including Saba and the Saba S-design logo, in the United States and in certain other countries. In addition, we have an additional registration application pending in the United States, and registration applications pending in various foreign countries. We will continue to register additional trademarks as appropriate. There can be no assurance that we will be successful in obtaining registration of the trademarks for which we have applied. Even for any registered trademarks that we have obtained, or will obtain, the trademarks may be successfully challenged by others or invalidated. If the applications are not approved because third parties own the trademarks, or if our registered trademarks are successfully challenged or invalidated, the use of the trademarks will be restricted unless we enter into arrangements with third parties that may be unavailable on commercially reasonable terms.

We cannot assure you that any of our proprietary rights with respect to our products or services will be viable or of value in the future since the validity, enforceability and type of protection of proprietary rights in Internet-related industries are uncertain and still evolving.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult, and while we are unable to determine the extent to which piracy of our software products exists, software piracy can be expected to be a persistent problem. In addition, the laws of some foreign countries do not protect proprietary rights to as great an extent as do the laws of the United States, and effective copyright, trademark and trade secret protection may not be available in those jurisdictions. Our means of protecting our proprietary rights may not be adequate to protect us from the infringement or misappropriation of such rights by others.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights, particularly in the software and Internet-related industries. We could become subject to intellectual property infringement claims as the number of our competitors grows and our products and services overlap with competitive offerings. Any of these claims, even if not meritorious, could be expensive to defend and could divert management s attention from operating our company. If we become liable to third parties for infringing their intellectual property rights, we could be required to pay a substantial award of damages and to develop noninfringing technology, obtain a license or cease selling the products that contain the infringing intellectual property. We may be unable to develop noninfringing technology or obtain a license on commercially reasonable terms, if at all.

**Employees**

As of May 31, 2004, we had a total of 258 employees, including 104 in research and development, 62 in sales and marketing, 67 in services and 25 in administration and finance. Of these employees, 144 were located in North America and 114 were located outside of North America. None of our employees is represented by a collective bargaining agreement, and we have not experienced any work stoppages. We consider our relations with our employees to be good. Our future success depends on our continuing ability to attract and retain highly qualified technical, sales and senior management personnel.

## ITEM 2: PROPERTIES

**Facilities**

Our principal executive offices occupy approximately 36,000 square feet in Redwood Shores, California under a lease that expires in April 2014. We have additional leased facilities in the Chicago, Denver, and Washington D.C. metropolitan areas and in Australia, Brazil, Mexico, France, Germany, India, United Kingdom and Japan. We believe that our facilities are adequate to meet our needs for the foreseeable future.

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## ITEM 3: LEGAL PROCEEDINGS

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York against us, certain of our officers and directors, and certain underwriters of our initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased our common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by us and our officers and directors of the Securities Act of 1933 in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints were later consolidated into a single action. On July 16, 2003, a committee of our board of directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of us and of the individual defendants for the conduct alleged in the action to be wrongful in the amended complaint. We would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims we may have against our underwriters. Any direct financial impact of the proposed settlement is expected to be borne by our insurers. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other issuer defendants in the proposed settlement, the consent of our insurers to the settlement, and the completion of acceptable final settlement documentation. Furthermore, the settlement is subject to a hearing on fairness and approval by the court overseeing the initial public offering litigation. If the settlement is not finalized, we intend to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect our business, financial condition and results of operations.

On May 31, 2002, IP Learn, LLC (IP Learn) filed a complaint against us in the United States District Court for the Northern District of California. The complaint alleged that we infringed four U.S. patents assigned to IP Learn and asked the court for a preliminary and permanent injunction, as well as unspecified damages. IP Learn later amended the complaint to add a fifth patent to the suit. Substantially similar complaints have been filed against at least four other companies in Saba s industry. In September 2003, Saba reached an agreement with IP Learn regarding the settlement of the pending litigation. Under the terms of the settlement agreement, Saba was required to pay $1.1 million over nine months. The remaining balance of $375,000 at May 31, 2004 was paid in full during June 2004. In addition, in October 2003 Saba issued approximately 134,000 shares of its common stock valued as of the settlement date at $576,000.

On March 12, 2004, Docent, Inc. filed a compliant against Saba and two employees in the Circuit Court of Cook County, Illinois. The complaint alleges, among other things, that Saba and the two employees gained an unfair competitive advantage by using Docent confidential employee information to solicit and hire certain Docent employees. In addition, the complaint alleges that Saba and the two employees used certain Docent proprietary information to interfere with Docent s client and prospective client relationships. On October 26, 2004 we entered into a settlement agreement with Docent. Under the terms of the settlement agreement, the litigation was dismissed. The settlement will have no material impact on our financial condition or operations.

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

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### ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

## PART II

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

Since our initial public offering on April 7, 2000, our common stock has traded on the Nasdaq National Market under the symbol SABA. On May 12, 2003, we effected a one-for-four reverse split of our outstanding common stock. The following table sets forth the range of the quarterly high and low closing sales prices of our common stock for the periods indicated. The price per share has been adjusted to give effect to the one-for-four reverse stock split.

| Year ended May 31, 2003 | High | Low |
|---|---|---|
| First Quarter | $ 12.60 | $ 7.40 |
| Second Quarter | $ 11.00 | $ 6.08 |
| Third Quarter | $ 5.80 | $ 3.16 |
| Fourth Quarter | $ 5.04 | $ 2.32 |
| **Year ended May 31, 2004** | **High** | **Low** |
| First Quarter | $ 6.00 | $ 3.80 |
| Second Quarter | $ 4.76 | $ 3.59 |
| Third Quarter | $ 4.60 | $ 3.42 |
| Fourth Quarter | $ 4.47 | $ 3.50 |

We had approximately 213 stockholders of record as of May 31, 2004. We have not declared or paid any cash dividends on our common stock, and presently we intend to retain our future earnings, if any, to fund the development and growth of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future.

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### ITEM 6: SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes to our consolidated financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data for each of the three years ended May 31, 2004, 2003 and 2002 and the consolidated balance sheet data as of May 31, 2004 and 2003 are derived from our audited financial statements included elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data for the years ended May 31, 2001 and 2000 and the balance sheet data as of May 31, 2002, 2001 and 2000 are derived from our audited financial statements previously filed with the SEC.

**Selected Consolidated Financial Data**

**(in thousands, except per share data)**

| | Years ended May 31, | | | | |
|---|---|---|---|---|---|
| | **2004 (1)** | **2003 (1)** | **2002** | **2001** | **2000** |
| **Consolidated Statement of Operations Data:** | | | | | |
| Total revenues | $ 34,471 | $ 44,416 | $ 55,648 | $ 54,955 | $ 18,755 |
| Gross profit | 21,791 | 29,644 | 39,470 | 31,435 | 8,972 |
| Total operating expenses | 34,161 | 47,083 | 64,812 | 96,893 | 64,444 |
| Loss from operations | (12,370) | (17,439) | (25,342) | (65,458) | (55,472) |
| Net loss | (12,683) | (17,207) | (25,467) | (62,791) | (54,441) |
| Basic and diluted net loss per share (2) | (0.95) | (1.35) | (2.19) | (5.95) | (11.74) |
| Shares used in computing basic and diluted net loss per share (2) | 13,411 | 12,775 | 11,623 | 10,556 | 4,637 |

| | May 31, | | | | |
|---|---|---|---|---|---|
| | **2004 (1)** | **2003 (1)** | **2002** | **2001** | **2000** |
| **Consolidated Balance Sheet Data:** | | | | | |
| Cash, cash equivalents and short-term investments | $ 16,778 | $ 21,197 | $ 22,141 | $ 34,333 | $ 78,926 |
| Working capital | 2,606 | 13,318 | 14,325 | 18,956 | 65,090 |
| Total assets | 31,741 | 40,836 | 48,688 | 68,111 | 97,705 |
| Long-term obligations, less current portion | 3,370 | 3,964 | 3,443 | 4,290 | 4,211 |
| Total stockholders equity | 6,521 | 18,460 | 24,346 | 27,959 | 68,704 |

(1) Saba ceased the amortization of goodwill effective June 1, 2002 in accordance with SFAS No. 142.
(2) All share and per share data has been retroactively adjusted to reflect a one-for-four reverse split approved by Saba s stockholders in May 2003.

### ITEM 7: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes contained herein and the information included in our other filings with the Securities and*

*Exchange Commission. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the Securities Act ) and Section 21E of the Securities and Exchange Act of 1934 (the Exchange Act ). All statements in this Annual Report on Form 10-K other than statements of historical fact are forward-looking statements. These forward-looking statements involve known and unknown risks and uncertainties. Our actual results may differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations Factors That May Impact Future Operating*

*Results. All forward-looking statements and risk factors included in this document are made as of the date of this report, based on information available to us as of such date. We assume no obligation to update any forward-looking statement or risk factor.*

OVERVIEW

Business, Principal Products, and Locations

We are a leading provider of human capital development and management solutions, which are designed to increase organizational performance through the implementation of a management system for aligning, developing and managing people. Our solutions can help large enterprises efficiently manage regulatory compliance, increase sales and channel readiness, accelerate time-to-competency of people across the extended enterprise, increase speed of customer acquisition, shorten time-to-market of new products and increase visibility into organizational performance.

We commenced operations in April 1997 and, through March 1998, focused substantially all of our efforts on research activities, developing our products and building our business infrastructure. We shipped our first Saba Enterprise Learning products and began to generate revenues from software license fees, implementation and consulting services fees and support fees in April 1998. In August 2003, we shipped our generally available version of Saba Enterprise Performance.

Substantially all of our revenues are derived from the sale of perpetual licenses of our software products and related product-support and professional services. Specifically, we license our software solutions in multi-element arrangements that include a combination of our software, product support and/or professional services. To date, a substantial majority of our software license revenue has been derived from Saba Enterprise Learning. Our license revenue is affected by the strength of general economic and business conditions, as well as customers budgetary cycles and the competitive position of our software products. In addition, the sales cycle for our products is long, typically 6 to 12 months. The timing of a few large software license transactions can substantially affect our quarterly license revenue.

Product support includes technical support and future updates for the applicable software product. We typically sell support for an initial period of one year concurrently with the sale of the related software license. After the initial period, support is renewable on an annual basis at the option of the customer. Accordingly, our support revenue depends upon both our sale of additional software licenses and annual renewals of existing support agreements. The growth rate of support revenue does not necessarily correlate directly to the growth rate of license revenue as the support renewal rate has a greater impact on support revenue as our installed base of customers grows. For example, if license revenues remained constant, support revenue would continue to grow as a result of the incremental support revenue associated with new license sales, assuming renewal rates stayed relatively constant. We believe that support revenue will continue to grow as we anticipate that a substantial majority of our customers will renew their annual contracts and the sale of new software licenses will increase the number of customers that purchase support.

Our professional services offerings include (i) implementation services, (ii) education services for our customers regarding how to use our software, and (iii) hosting services that enable customers that separately purchase software licenses to access and use the software on computers operated by or for us. Our implementation and education services are typically initiated and provided to customers that license software directly from us over a period of three to nine months after licensing the software. Accordingly, our implementation and education services revenue varies directly with the levels of license revenue generated from our direct sales organization in the preceding three- to nine-month period. In addition, our implementation and education services revenue varies following our commercial release of significant software updates as our customers generally engage our services to assist with the implementation and education of their software upgrade. Although we primarily

provide implementation services on a time and materials basis, a significant portion of these services is provided on a fixed fee basis. Hosting services are generally provided pursuant to annual agreements and the associated revenue is recognized ratably over the hosting term.

Our corporate headquarters are located in Redwood Shores, California. In addition, we have seven non-U.S. subsidiaries through which we conduct various operating activities related to our business. In each of the non-U.S. jurisdictions in which we have subsidiaries, India, France, Japan, Germany, the United Kingdom, Canada and Australia, we have employees or consultants engaged in sales and services activities. In the case of our India subsidiary, our employees primarily engage in software development and quality assurance testing activities.

Significant Trends and Developments in Our Business

Since we began operations in 1997 and continuing throughout fiscal 2001, our business grew rapidly. During fiscal 2002 and continuing through the first three quarters of fiscal 2004, our revenues declined as a result of a deterioration of the overall economy and information technology industry. Beginning in the later part of fiscal 2004, many key indicators began to demonstrate signs of an economic recovery. Consistent with these indicators, our business began to improve during the fourth quarter of fiscal 2004 and the first quarter of fiscal 2005.

During fiscal 2004, fiscal 2003 and fiscal 2002, in response to the global economic slowdown, we implemented restructuring programs to reduce expenses to align our operations and cost structure with market conditions. The restructuring programs included worldwide workforce reductions across all functions and consolidation of excess facilities. Although we do not have any current plans to implement additional restructuring programs, business conditions may require us to reduce or otherwise adjust our workforce or consolidate excess facilities in the future.

Despite these recent improvements in macro-economic trends, we believe many of our customers have not resumed previous levels of expenditures on information technologies, particularly enterprise software. We attribute this continued level of depressed spending on enterprise software to customers concerns regarding the sustainability of the current economic recovery and the current geopolitical environment.

In order to achieve profitability, we will need to generate significantly higher revenue and continue to manage our expenses. Our ability to generate higher revenues and achieve profitability depends on many factors, including the demand for our products and services, the level of product and price competition, market acceptance of our new products and general economic conditions. In this regard, we continue to invest in areas that we believe can accelerate revenue growth and to manage expenses to align our operations and cost structure with market conditions. For example, we recently expanded our worldwide field organizations, particularly our North American sales team, and reduced research and development expenses by reallocating headcount from the U.S. to our lower-cost development center in India. We currently do not have plans to shift any other operations outside of the U.S.

We experience seasonality during our first fiscal quarter as sales are typically lower than sales in the immediately preceding fourth fiscal quarter. Contributing to this seasonality is the timing of our first fiscal quarter that occurs during the summer months when general business activities slow down in a number of territories where we conduct our operations, particularly Europe. Our commission structure and other sales incentives also tend to result in fewer sales in the first fiscal quarter than in the fourth fiscal quarter. We anticipate that the negative impact of seasonality on our first quarter will continue.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported

amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely

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require adjustment. While there are a number of accounting policies, methods and estimates affecting our financial statements, areas that are particularly significant include revenue recognition policies, the allowance for doubtful accounts, the assessment of recoverability of goodwill and purchased intangible assets and restructuring costs. We have reviewed the critical accounting policies described in the following paragraphs with our Audit Committee.

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

- persuasive evidence of an agreement exists;
- delivery of the product has occurred;
- the fee is fixed or determinable; and
- collection of these fees is probable.

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

License revenues from sales of our perpetual licenses are recognized on delivery if the other conditions of SOP 97-2 are satisfied. We do not grant our resellers the right of return and we generally recognize revenue from resellers when an end-user has been identified and the other conditions of SOP 97-2 are satisfied. Revenues from our application service provider offering, from software licenses with terms of less than 3 years and from our hosting services are generally recognized ratably over the term of the arrangement. Support revenue is recognized ratably over the support term, typically 12 months, and revenue related to implementation, consulting, education, and other services is generally recognized as the services are performed. Although we primarily provide implementation and consulting services on a time and materials basis, a significant portion of these services is provided on a fixed-fee basis. We recognized revenue from fixed fee contracts as the services are delivered, using labor hours incurred as a percentage of expected total labor hours as a measure of completion. For contracts that involve significant customization and implementation or consulting services that are essential to the functionality of the software, the license and services revenues are recognized over the service delivery period using the percentage-of-completion method. We use labor hours incurred as a percentage of total expected hours as the measure of progress towards completion.

*Allowance for doubtful accounts.* Accounts receivable are recorded net of allowance for doubtful accounts and totaled $6.6 million as of May 31, 2004. The allowance for doubtful accounts, which totaled $177,000 as of May 31, 2004, is based on our assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. If there is a deterioration of a major customer s credit worthiness or actual defaults are higher than our historical experience, we may be required to increase the allowance for doubtful accounts.

*Recoverability of goodwill and purchased intangible assets.* Effective June 1, 2002, we adopted SFAS No. 142. As such, we ceased amortization of goodwill as of May 31, 2002. In addition, we evaluated our purchased intangible assets and determined that all such assets have determinable lives. Total amortization of goodwill prior to June 1, 2002 was $2.5 million and our remaining goodwill balance at May 31, 2004 was $5.3 million. Amortization of purchased intangible assets, including acquired developed technology, was $540,000 for fiscal 2004 and $2.2 million for 2003. Our remaining purchased intangible assets balance was $2,000 as of May 31, 2004.

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SFAS No. 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment; while the second phase, if necessary, measures the impairment. We consider Saba to be a single reporting unit. Accordingly, all of our goodwill is associated with the entire company. We perform the required impairment analysis of goodwill annually, or on an interim basis if circumstances dictate. Any reduction of enterprise fair value below the recorded amount of stockholders equity could require us to write down the value of goodwill to its fair value and record an expense for the impairment loss.

*Restructuring costs*. The total accrued restructuring balance as of May 31, 2004 was $749,000, which was comprised of $677,000 for facilities related charges and $72,000 for workforce reduction charges. The assumptions we have made are based on the current market conditions in the various areas where we have vacant space and necessarily entail a high level of management judgment. These market conditions can fluctuate greatly due to such factors as changes in property occupancy rates and the rental prices charged for comparable properties. These changes could materially affect our accrual. If, in future periods, it is determined that we have over accrued for restructuring charges for the consolidation of facilities, the reversal of such over accrual would have a favorable impact on our results of operations in the period this was determined and would be recorded as a credit to restructuring costs. Conversely, if it is determined that our accrual is insufficient, an additional charge would have an unfavorable impact on our results of operations in the period this was determined.

RESULTS OF OPERATIONS

YEARS ENDED MAY 31, 2004, 2003 AND 2002

Revenues

| | Year ended | | | | | |
|---|---|---|---|---|---|---|
| | **May 31, 2004** | **Percent of Total Revenue** | **May 31, 2003** | **Percent of Total Revenue** | **May 31, 2002** | **Percent of Total Revenue** |
| | (dollars in thousands) | | | | | |
| Revenues: | | | | | | |
| License | $ 9,838 | 29% | $ 16,440 | 37% | $ 27,277 | 49% |
| Services | 24,633 | 71% | 27,976 | 63% | 28,371 | 51% |
| Total revenues | $ 34,471 | 100% | $ 44,416 | 100% | $ 55,648 | 100% |

Total revenues decreased 22% during fiscal 2004 compared to fiscal 2003 and 20% during fiscal 2003 compared to fiscal 2002. The decreases in total revenues in both fiscal 2004 over fiscal 2003 and fiscal 2003 over fiscal 2002 is primarily attributable to a decrease in license revenues. As a percentage of total revenues, revenues from customers outside the United States represented approximately 44% for fiscal 2004, 28% for fiscal 2003 and 28% for fiscal 2002. In fiscal 2004 and 2002, no customer represented more than 10% of our total revenues. In fiscal 2003, one customer accounted for 12% of our revenues.

*License Revenue*. License revenue decreased 40% during fiscal 2004 compared to fiscal 2003 and 40% during fiscal 2003 compared to fiscal 2002. The decrease in license revenue during fiscal 2004 compared to fiscal 2003 was primarily attributable to a decrease in license revenues in the United States. The decrease in license revenue in fiscal 2003 over fiscal 2002 is primarily attributable to a greater amount of deferred license revenues recognized in fiscal 2002 that were attributable to software licenses sold in prior periods. Revenues from new license sales made in fiscal 2003 were essentially flat in comparison to revenues from new license sales made in fiscal 2002.

*Services Revenue*. Services revenue decreased 12% during fiscal 2004 compared to fiscal 2003 and 1% during fiscal 2003 compared to fiscal 2002. These decreases in services revenue during fiscal 2004 compared to fiscal 2003 and during fiscal 2003 compared to fiscal 2002 were primarily attributable to decreases in consulting revenue of $3.7 million, which were partially offset by increases in support revenue of $1.8 million. The decline in consulting revenue during fiscal 2004 compared to fiscal 2003 was due to a decrease in the number of active projects caused primarily by an increase in the number of implementations performed by third-party systems

integrators. The increase in the use of third-party systems integrators was partially due to an increase in the mix of international customers where third-party resellers and systems integrators are more frequently utilized. The decline in consulting revenue during fiscal 2003 compared to fiscal 2002 was primarily attributable to a reduction in the average project size resulting from implementation efficiencies.

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

Cost of Revenues

| | Year ended | | | | | |
|---|---|---|---|---|---|---|
| | May 31, 2004 | Percent of Total Revenue | May 31, 2003 | Percent of Total Revenue | May 31, 2002 | Percent of Total Revenue |
| | (dollars in thousands) | | | | | |
| Cost of revenues: | | | | | | |
| Cost of license | $ 222 | 1% | $ 156 | 0% | $ 186 | 0% |
| Cost of services | 12,057 | 35% | 13,258 | 30% | 14,456 | 26% |
| Amortization of acquired developed technology | 401 | 1% | 1,358 | 3% | 1,536 | 3% |
| Total cost of revenues | $ 12,680 | 37% | $ 14,772 | 33% | $ 16,178 | 29% |

*Cost of License Revenue*. Our cost of license revenue includes the cost of manuals and product documentation, production media, shipping costs and royalties to third parties. The changes in the cost of license revenue during fiscal years 2004, 2003 and 2002 were primarily attributable to variability in the amount of royalties paid to third parties.

*Cost of Services Revenue*. Our cost of services revenue includes salaries and related expenses for our professional services and support organizations, as well as third-party subcontractors and hosting costs, and billed expenses. The decreases in cost of services revenue in both fiscal 2004 compared to fiscal 2003 and fiscal 2003 compared to fiscal 2002 were primarily attributable to a reduction in consulting personnel in response to a decline in consulting services revenue. Cost of services revenue represented 49% of services revenue for fiscal 2004, 47% of services revenue for fiscal 2003 and 51% services revenue for fiscal 2002. The increase in cost of services as a percentage of services revenue in fiscal 2004 compared to fiscal 2003 is primarily attributable to a 13% reduction in overall consultant utilization rates and a 9% reduction in realized average hourly billing rates for consultants, partially offset by an increased percentage of higher margin support revenues as a percentage of total services revenue. The decrease in the cost of services as a percentage of services revenue in fiscal 2003 compared to fiscal 2002 is primarily attributable to higher consultant utilization rates, as well as an increased percentage of higher margin support revenues as a percentage of total services revenue.

*Amortization of Acquired Developed Technology*. Our cost of services revenue includes amortization of acquired developed technology resulting from our June 2001 acquisition of Ultris Inc. We expect that the unamortized balance of $2,000 will be amortized by the end of the first quarter of fiscal 2005.

Because our cost of services revenue is greater than our cost of license revenue, cost of total revenues as a percentage of total revenues will fluctuate based on the mix of licenses and services sold.

Operating Expenses

We classify all operating expenses, except amortization of stock compensation charges, amortization of purchased intangible assets and settlement of litigation, to the research and development, sales and marketing and general and administrative expense categories based on the nature of the expenses. Each of these three categories includes commonly recurring expenses such as salaries, employee benefits, travel and entertainment costs, and

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allocated communication, rent and depreciation costs. We allocate these expenses to each of the functional areas that derive a benefit from such expenses based upon their respective headcounts. The sales and marketing category of operating expenses also includes sales commissions and expenses related to public relations and advertising, trade shows and marketing collateral materials. The general and administrative category of operating expenses also includes allowances for doubtful accounts and administrative and professional services fees.

| | Year ended | | | | | |
|---|---|---|---|---|---|---|
| | **May 31, 2004** | **Percent of Total Revenue** | **May 31, 2003** | **Percent of Total Revenue** | **May 31, 2002** | **Percent of Total Revenue** |
| | (dollars in thousands) | | | | | |
| Operating expenses: | | | | | | |
| Research and development | $ 9,972 | 29% | $ 11,817 | 27% | $ 14,628 | 26% |
| Sales and marketing | 17,947 | 52% | 26,047 | 59% | 30,360 | 55% |
| General and administrative | 4,357 | 13% | 6,514 | 15% | 6,855 | 12% |
| Amortization of deferred compensation and other stock compensation charges | 45 | 0% | 1,850 | 4% | 7,113 | 13% |
| Amortization of purchased intangible assets | 139 | 0% | 855 | 2% | 1,182 | 2% |
| Amortization of goodwill | | 0% | | 0% | 2,475 | 5% |
| Settlement of litigation | 1,701 | 5% | | 0% | 2,199 | 4% |
| Total operating expenses | $ 34,161 | 99% | $ 47,083 | 107% | $ 64,812 | 117% |

*Research and development*. Research and development expense decreased 16% during fiscal 2004 compared to fiscal 2003. This decrease in research and development expense was as a result of lower employee related costs in the US as a result of the restructuring of our US operations. This resulted in overall headcount savings of approximately $1.3 million. This decrease was partially offset by an increase in employee related expenses of $200,000 as we increased staffing in our lower cost development facility in India.

Research and development expense decreased 19% during fiscal 2003 compared to fiscal 2002. This decrease was as a result of lower employee related expenses of $1.6 million and lower facilities related expense of $561,000 as a result of the restructuring of our US operations and a decrease of $366,000 as a result of lower usage of third party consultants. We expect research and development expenses to remain relatively flat for the foreseeable future.

*Sales and marketing.* Sales and marketing expense decreased 31% during fiscal 2004 compared to fiscal 2003. This decrease in sales and marketing expenditure was as a result of a decrease in salary and employee benefits expense of $3.0 million, due to a reduced number of sales and marketing personnel, a decrease in severance payments of $605,000, a decrease in commissions of $1.6 million due to lower revenues and a decrease of $965,000 due to lower marketing expenditures.

Sales and Marketing expenses decreased 14% during fiscal 2003 compared to 2002. This decrease in sales and marketing expenses was as a result of a decrease of $1.6 million in employee related salary and bonus expense due to lower headcount, a decrease of $457,000 in commission expense due to lower revenues and a decrease of $1.8 million in facility related expenses due to the restructuring of our US operations. Despite these decreases, we expect sales and marketing expenses to increase in fiscal 2005 due to higher commissions and the costs associated with expanding our North American sales organization.

*General and administrative.* General and administrative expense decreased 33% during fiscal 2004 compared to fiscal 2003. This decrease in general and administrative expenses was as a result of a decrease of $813,000 in employee related salary and benefits expenditure due to lower headcount and a decrease of $408,000 as a result of lower legal expenses due to the settlement of a patent infringement case in September 2003.

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General and administrative expenses decreased 5% during fiscal 2003 compared to fiscal 2002. This decrease was primarily a result of a decrease of $551,000 in employee related salary and benefits expense due to lower headcount. This decrease was partially offset by an increase of $255,000 in legal expenses primarily as a result of costs incurred in defending a patent infringement case against us. As discussed below this case was settled in September 2003. We expect general and administrative expenses to remain relatively flat for the foreseeable future.

*Amortization of deferred stock compensation and other stock compensation charges.* During fiscal 2004 we amortized the remaining deferred stock compensation of $45,000. We do not expect to incur future deferred stock compensation charges unless we issue stock options that must be accounted for using a fair value method.

Included in the charges for fiscal 2003 is $741,000 for compensation expense resulting from the acceleration of vesting of common stock for certain terminated employees. This charge was partially offset by a reduction in amortization of deferred stock compensation of $647,000 that resulted from the cancellation of unvested stock options as a result of employee attrition and reductions in workforce. Also included in fiscal 2003 is compensation expense of $171,000 related to the acceleration of amortization of deferred stock compensation for options that were cancelled in accordance with our voluntary stock option exchange program. The exchange program is not expected to result in any additional compensation charges or variable plan accounting.

Included in amortization of deferred stock compensation and other stock charges in fiscal 2002 is $1.9 million related to the post-acquisition amortization of the deferred stock compensation for the intrinsic value of common stock subject to repurchase assumed in connection with the acquisition of Ultris Inc. The estimated intrinsic value of the 49,616 shares subject to repurchase was approximately $2.8 million.

*Amortization of purchased intangible assets.* Amortization of purchased intangible assets related to the noncompetition agreements that resulted from our March 2001 acquisition of Human Performance Technologies, Inc. decreased for the periods presented as we amortized the final $139,000 during fiscal 2004.

*Settlement of litigation.* In September 2003, we reached an agreement regarding the settlement of pending patent litigation and recorded a charge of $1.7 million. Under the terms of the settlement agreement, we were required to pay $1.1 million over nine months. The remaining balance of $375,000 at May 31, 2004 was paid in full during June 2004. In addition, we issued approximately 134,000 shares of our common stock valued as of the settlement date at $576,000.

Restructuring charges

During fiscal 2004, fiscal 2003 and fiscal 2002, we implemented restructuring programs to reduce expenses to align our operations and cost structure with market conditions. The restructurings programs during fiscal 2004 were implemented under the provisions of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, while the restructuring programs during fiscal 2003 and fiscal 2002 were implemented under EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The restructuring programs included worldwide workforce reductions across all functions and consolidation of excess facilities. Workforce reduction charges consist primarily of severance and fringe benefits. The restructuring charges are classified in the statement of operations as follows:

**Years ended May 31,**

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Cost of revenues | $ 154 | $ 145 | $ 633 |
| Research and development | 166 | 577 | 735 |
| Sales and marketing | 73 | 939 | 1,438 |
| General and administrative | 39 | 232 | 387 |
| | $ 432 | $ 1,893 | $ 3,193 |

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During fiscal 2004 we recorded net restructuring charges of $432,000. These charges were comprised of $80,000 for an excess facility that arose after default by a subtenant and $393,000 from the consolidation of an excess facility. These charges were partially offset by a $41,000 decrease to a workforce reduction accrual made in a prior period that resulted from severance payments that were less than previous estimates. The excess facilities charges were based on the present value of the sum of non-cancelable lease costs, less estimates for future sublease income, which will be paid over the estimated vacancy periods through fiscal 2006. During fiscal 2004, Saba recognized accretion expense of $21,000 due to the passage of time in accordance with SFAS No. 146. As a result of these restructurings, we estimate that we will not recognize net lease expenses of approximately $218,000 in fiscal 2005 and $98,000 in fiscal 2006. There will not be any future cash savings from these restructurings.

During fiscal 2003, we recorded workforce reduction charges of $1.2 million and facilities related charges of $676,000. A substantial majority of the workforce reduction charges, which resulted from the reduction of 40 employees across all business functions and geographic regions, were paid by the end of fiscal 2004 and the remaining balance is expected to be paid by the end of fiscal 2005. The annual cost of these employees was approximately $4.0 million. The facilities related charges related to non-cancelable lease costs were paid over the estimated vacancy period which ended in fiscal 2004.

During fiscal 2002, we recorded workforce reduction charges of $1.8 million and facilities related charges of $1.4 million. The workforce reduction charges, which resulted from the reduction of 147 employees across all business functions and geographic regions, were paid by the end of fiscal 2003. The facilities related charges relate to non-cancelable lease costs that will be paid over the estimated vacancy period through fiscal 2005.

Our estimated costs to exit these facilities are based on available commercial rates. The actual loss incurred in exiting these facilities could be different from our estimates.

Interest income and other, net

Interest income and other, net consists of interest income, and other non-operating expenses. Interest income and other, net was a loss of $101,000 in fiscal 2004, income of $604,000 in fiscal 2003 and income of $451,000 in fiscal 2002. The decrease in fiscal 2004 compared to fiscal 2003 was primarily attributable to foreign exchange losses of $221,000 resulting from unfavorable fluctuations in foreign currency denominated receivables compared to a gain of $201,000 in fiscal 2003. The increase in fiscal 2003 compared to fiscal 2002 was primarily attributable a charge for an other than temporary decline in the value of an investment in fiscal 2002 of $250,000.

Interest expense

Interest expense was $104,000 in fiscal 2004, $197,000 in fiscal 2003, and $412,000 in fiscal 2002. The decrease in fiscal 2004 as compared to fiscal 2003 is due to savings realized from our buyout of approximately $1.1 million of capital leases in fiscal 2003. The decrease in fiscal 2003 as compared to fiscal 2002 is primarily due to payments on prior capital lease obligations.

Provision for income taxes

From inception to May 31, 2004, we incurred net losses for federal and state tax purposes. We recorded income tax expense of $108,000 in fiscal 2004 compared to $175,000 in fiscal 2003 and $164,000 in fiscal 2002. The income tax expense consists entirely of foreign income tax expense incurred as a result of local country profits.

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QUARTERLY RESULTS OF OPERATIONS

The following table sets forth consolidated statement of operations data for each of the eight quarters in the period ended May 31, 2004. This information has been derived from our unaudited condensed consolidated financial statements that, in the opinion of our management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of this information. You should read this information in conjunction with our audited consolidated financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. We have experienced and expect to continue to experience fluctuations in operating results from quarter to quarter. We incurred net losses in each quarter since inception and expect to continue to incur losses in the foreseeable future. You should not draw any conclusions about our future results from the results of operations for any quarter, as quarterly results are not necessarily indicative of the results for a full fiscal year or any other period.

| | Three months ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Aug 31, 2002 | Nov 30, 2002 | Feb 28, 2003 | May 31, 2003 | Aug 31, 2003 | Nov 30, 2003 | Feb 29, 2004 | May 31, 2004 |
| | (in thousands, except per share data) | | | | | | | |
| Revenues: | | | | | | | | |
| License | $ 7,450 | $ 2,439 | $ 3,150 | $ 3,401 | $ 1,552 | $ 2,444 | $ 2,320 | $ 3,522 |
| Services | 7,246 | 7,028 | 6,478 | 7,224 | 6,661 | 5,764 | 5,515 | 6,693 |
| Total revenues | 14,696 | 9,467 | 9,628 | 10,625 | 8,213 | 8,208 | 7,835 | 10,215 |
| Cost of revenues | 3,731 | 3,907 | 3,413 | 3,721 | 3,580 | 3,108 | 2,968 | 3,024 |
| Gross profit | 10,965 | 5,560 | 6,215 | 6,904 | 4,633 | 5,100 | 4,867 | 7,191 |
| Operating expenses: | | | | | | | | |
| Research and development | 3,027 | 2,998 | 3,002 | 2,790 | 2,651 | 2,555 | 2,310 | 2,456 |
| Sales and marketing | 6,940 | 7,750 | 6,032 | 5,325 | 4,701 | 3,771 | 3,933 | 5,542 |
| General and administrative | 1,353 | 1,769 | 1,723 | 1,669 | 1,272 | 1,043 | 872 | 1,170 |
| Amortization of deferred stock compensation and other stock charges | 1,351 | 613 | (74) | (40) | 30 | 12 | 3 | |
| Amortization of goodwill and purchased intangible assets | 258 | 259 | 234 | 104 | 42 | 42 | 41 | 14 |
| Settlement of litigation | | | | | 1,701 | | | |
| Total operating expenses | 12,929 | 13,389 | 10,917 | 9,848 | 10,397 | 7,423 | 7,159 | 9,182 |
| Loss from operations | (1,964) | (7,829) | (4,702) | (2,944) | (5,764) | (2,323) | (2,292) | (1,991) |
| Interest income (expense) and other, net | 96 | 26 | 45 | 240 | (79) | 48 | 47 | (221) |
| Loss before provision for income taxes | (1,868) | (7,803) | (4,657) | (2,704) | (5,843) | (2,275) | (2,245) | (2,212) |
| Provision for income taxes | (65) | (88) | (90) | 68 | (45) | (37) | (45) | 19 |
| Net loss | $ (1,933) | $ (7,891) | $ (4,747) | $ (2,636) | $ (5,888) | $ (2,312) | $ (2,290) | $ (2,193) |
| Basic and diluted net loss per share | $ (0.16) | $ (0.62) | $ (0.36) | $ (0.20) | $ (0.44) | $ (0.17) | $ (0.17) | $ (0.16) |

Our results of operations could vary significantly from quarter to quarter. If revenues fall below our expectations, we will not be able to reduce our spending rapidly in response to the shortfall and operating losses will increase. We anticipate that we will continue to experience long sales cycles. Therefore, the timing of future customer contracts could be difficult to predict, making it difficult to predict revenues between quarters.

We are subject to employer payroll taxes, both domestic and foreign, on employee exercises of non-qualified stock options. These taxes are recorded as a charge to operations in the period such options are exercised based on actual gains realized by employees, measured by the difference between the price of our

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common stock on the date of exercise and the exercise price. We receive domestic tax deductions for gains realized by domestic employees on the exercise of non-qualified stock options for which the benefit is recorded as additional paid-in capital when realized. Our taxes and cash flows could vary significantly from quarter to quarter depending on the number of non-qualified stock options exercised by employees in any quarter and, consequently, our results of operations could be adversely impacted.

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

- dependence of our revenues on a small number of large orders and the average order value;
- our ability to attract new customers;
- any changes in revenue recognition rules and interpretations of these rules;
- our ability to license additional products to current customers;
- the announcement or introduction of new products or services by us or our competitors;
- changes in the pricing of our products and services or those of our competitors;
- variability in the mix of our products and services revenues in any quarter;
- technical difficulties or service interruptions of our computer network systems or the Internet generally;
- the amount and timing of operating costs and capital expenditures relating to expansion or contraction of our business; and
- foreign currency fluctuations.

LIQUIDITY AND CAPITAL RESOURCES

As of May 31, 2004, our principal source of liquidity included cash and cash equivalents of $16.6 million and short-term investments of $150,000. At May 31, 2004 our bank facility covenants required us to maintain cash, net of borrowings of $8.0 million.

| | **Year ended** |
|---|---|

| | May 31, 2004 | May 31, 2003 | May 31, 2002 |
|---|---|---|---|
| | (dollars in thousands) | | |
| Cash used in operating activities | $ (7,194) | $ (10,033) | $ (12,916) |
| Cash provided by investing activities | 3,203 | 9,207 | 9,128 |
| Cash provided by financing activities | 3,053 | 8,869 | 1,478 |

Cash Used In Operating Activities

Our largest source of operating cash flows is from our customers upon the purchase of license and support services, support renewals and consulting services. Our primary uses of cash from operating activities are for personnel and facilities related expenditures. Cash used in operating activities was $7.2 million in fiscal 2004 compared to $10 million in fiscal 2003, representing a decrease of 28%. The decrease is primarily as a result of a lower loss for the year as we reduced expenses (including operating expenses) before non cash items such as amortization of intangibles and depreciation by approximately $11 million during fiscal 2004. This was offset by a decrease in revenues of approximately $9.9 million or 22%. Net movements on operating assets and liabilities generated $2.7 million of cash in fiscal 2004 compared to $372,000 during fiscal 2004. The primary source of this increase in both fiscal 2004 and 2003 were reductions in receivables as a result of increased collection efforts during the fourth quarters of both years. In addition during fiscal 2004 deferred revenue increased by $391,000 compared to a decline of $690,000 during fiscal 2003. The primary reason for the increase in deferred revenue was an increase in the level of maintenance bookings, notably in the last two quarters of fiscal 2004, as a result of a higher installed base. During fiscal 2003 the amount generated from collection of receivables was offset by

reductions in accrued expenses of $690,000 and accrued compensation of $627,000. These movements were due to the pay out of amounts related to our fiscal 2003 and 2002 restructuring liabilities and sales commissions, which were accrued as of the end of fiscal 2002.

Overall during fiscal 2004 our net working capital decreased to $2.6 million from $13.3 million at the end of fiscal 2003 or 80%. This decrease arises primarily from a net usage of cash as a result of our loss from operations and lower proceeds from financing activities. Whilst the loss during fiscal 2004 was lower than during fiscal 2003, funds generated from financing activities were primarily from our bank line of credit which affects the level of working capital rather than through the issuance of common stock, which does not.

In August 2004, we were able to generate additional funds from a private placement, which allowed us to repay the balance outstanding on the bank line of credit.

Cash used in operating activities was $10 million in fiscal 2003 compared to $13 million in fiscal 2002, representing a decrease of 23%. Whilst out net loss reduced to $17.2 million in fiscal 2003 from $25.5 million in fiscal 2003 or 32% the reduction was primarily a result in decreases in non-cash expenses, including $5.2 million in stock based compensation, $2.9 million in amortization of goodwill and intangibles and $2.2 million from the write off of acquired in process research and development. Net changes in operating assets and liabilities resulted in positive cash flow of $372,000 in fiscal 2003 compared to a use of operating cash of $5.7 million in fiscal 2002. The decrease is primarily due to net reductions in accounts payable of $2.9 million as we reduced expenditures during fiscal 2002, a decrease of $2.5 million in year-end accruals for commissions, bonus and associated benefits during the 2002 fiscal year as amounts accrued at the end of fiscal 2001 were paid out during fiscal 2002 and a decrease in our employee severance related accruals as we made payments of $2 million during fiscal 2002.

Cash Provided By Investing Activities

Cash provided by investing activities was primarily attributable to proceeds from redemptions and maturities of short-term investments of $3.5 million in fiscal 2004, $9.6 million in fiscal 2003 and $9.9 million in fiscal 2002. Cash provided by investing activities decreased in fiscal 2004 compared to fiscal 2003 due to reduced proceeds from net redemptions and maturities as a result of fewer short-term investments.

Cash Provided By Financing Activities

Cash provided by financing activities decreased in fiscal 2004 compared to fiscal 2003 due primarily to lower proceeds from the issuance of common stock, which, during fiscal 2003, reflects $9.2 million in proceeds from the issuance of common stock in a private placement. This decrease was partially offset by net borrowings under our credit facility of $3.1 million during fiscal 2004. Cash provided by financing activities during fiscal 2002 was primarily attributable to proceeds from the issuance of stock under our stock incentive programs of $3.0 million, partially offset by $1.7 million of payments of principal on capital lease obligations.

Contractual Obligations

As of May 31, 2004, we did not have any material commitments for capital expenses. Our principal commitments consisted of obligations under operating leases and our credit facility. The credit facility was last amended in August 2004. The credit facility, as in effect at May 31, 2004 and prior to the August 2004 amendment, provided for an equipment term loan of up to $1.0 million ( Equipment Line ), a separate term loan of $1.2 million ( Term Loan ), and a revolving line of credit ( Revolving Line ) that allowed Saba to borrow up to $3.5 million. In May 2004, Saba

borrowed $3.5 million against the Revolving Line, which was repaid in June 2004. Saba made borrowings totaling $198,000 during fiscal 2004 and $484,000 during fiscal 2003 under the Equipment Line, which must be repaid in 36 equal monthly installments of principal plus interest. Term loans with principal of $450,000 at May 31, 2004, and $444,000 at May 31, 2003 were outstanding under the Equipment Line that bear interest at fixed rates ranging from 4.90% to 6.80% and maturities from August 2005 to May 2007. Saba had outstanding under the Term Loan principal in the amount of $733,000 at May 31, 2004

and $1.1 million at May 31, 2003. The Term Loan bears interest at a variable rate equal to the banks prime rate plus 1.50% and matures in March 2006.

Under the credit facility, we had to satisfy certain covenants, including a financial covenant, to maintain a balance of unrestricted cash and cash equivalents, net of borrowings, of $8.0 million at each fiscal quarter end and $7.0 million on any date that was not a fiscal quarter end. As of May 31, 2004, we were in compliance with all such covenants. Our amended credit facility requires that we maintain a minimum balance of unrestricted cash and cash equivalents, net of borrowings, of $7.5 million on deposit with the bank at all time. We are required to also meet certain minimum quarterly revenue levels for at least the next three fiscal quarters. The credit facility also restricted our ability to pay cash dividends. We expect to be in compliance with the Covenants associated with the amended facility for the foreseeable future.

The following table summarizes our contractual obligations at May 31, 2004 and the effect these obligations are expected to have on our liquidity and cash flows in future periods. Of the $26.0 million in operating leases, net of sublease income, $222,000 has been included in accrued restructuring charges as of May 31, 2004. Sublease income included in the table below amounted to $316,000 for fiscal 2005 and $206,000 for fiscal 2006.

| | Total | Operating Leases | Capital Leases | Debt Obligations | Patent Settlement |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Fiscal Year Ending May 31,** | | | | | |
| 2005 | $ 3,876 | $ 2,749 | $ 37 | $ 715 | $ 375 |
| 2006 | 3,253 | 2,684 | 7 | 562 | |
| 2007 | 2,420 | 2,321 | | 99 | |
| 2008 | 2,351 | 2,351 | | | |
| 2009 | 2,439 | 2,439 | | | |
| Thereafter | 13,499 | 13,499 | | | |
| | $ 27,838 | $ 26,043 | $ 44 | $ 1,376 | $ 375 |

As of May 31, 2004 we did not have any significant purchase obligations for goods or services that are enforceable and legally binding.

We currently anticipate that our available cash resources and credit facility, combined with cash flows generated from revenues, will be sufficient to meet our presently anticipated working capital, capital expense and business expansion requirements for at least the next 12 months. However, we may be required, or could choose, to raise additional funds at any time. Our future liquidity and capital requirements will depend on numerous factors, including our future revenues, the timing and extent of spending to support product development efforts and expansion of sales and marketing and general and administrative activities, the success of our existing and new product and service offerings and competing technological and market developments. There can be no assurance that additional funding, if needed, will be available on terms acceptable to us, if at all.

RECENT EVENTS

In August 2004, we entered into a common stock purchase agreement with Pequot Private Equity Fund III, L.P. and Pequot Offshore Private Equity Partners III, L.P. providing for the issuance of 2,674,500 shares of our common stock at a price of $3.2841 per share. Total estimated net proceeds from the private placement are $8.6 million. Prior to the closing of the private placement, we received from Nasdaq a letter indicating our non-compliance with the minimum stockholders equity requirement necessary to remain eligible for continued listing on the Nasdaq National Market. As a result of the closing of the private placement, we believe that we comply with Nasdaq s minimum stockholders equity requirement as of the date of this Annual Report. As Nasdaq does with all companies, it will continue to monitor us for ongoing compliance with the minimum stockholders equity requirement. Failure to demonstrate compliance with the minimum stockholder s equity

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requirement in our Quarterly Report for the three months ending August 31, 2004 could subject us to delisting from the Nasdaq National Market.

In August 2004, we amended our credit facility to provide for a $5.0 million non-formula based revolving line of credit and an equipment term loan of up to $400,000. Under the revolving line of credit and equipment term loan, we may make draws through August 2005. Interest on borrowings under the revolving line of credit must be repaid monthly and outstanding principal must be repaid in August 2005. Borrowings under the equipment term loan must be repaid in 36 equal monthly installments of principal plus interest. Outstanding principal under the revolving line of credit bears interest at a rate equal to the bank s prime rate plus 1.50% per annum and outstanding principal under equipment term loan bears interest at either a fluctuating rate equal to the bank s prime rate plus 1.75% or a fixed rate equal to the 36-month U.S. Treasury note plus 4.00%. Other terms of the credit facility, including terms applicable to the existing term loans with outstanding principal of $450,000 at May 31, 2004, remained unchanged. This amended credit facility requires us to satisfy certain covenants including a financial covenant to maintain a minimum balance of unrestricted cash and cash equivalents, net of borrowings, of $7.5 million on deposit with the bank at all times. The credit facility also restricts our ability to pay cash dividends.

**Factors That May Impact Future Operating Results**

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

We have incurred significant losses and negative cash flows from operations since our inception. We have not achieved profitability and cannot be certain that we will realize sufficient revenues to achieve or sustain profitability. We expect to derive substantially all of our revenues for the foreseeable future from the licensing of Saba Enterprise Learning and providing related services. Over the longer term, we expect to derive revenues from new products such as Saba Enterprise Performance and related services. In the future, we expect to continue to incur non-cash expenses relating to the amortization of purchased intangible assets that will contribute to our net losses, along with any potential goodwill impairment. As of May 31, 2004, we had $2,000 of purchased intangible assets to be amortized and our remaining goodwill balance was $5.3 million. As a result of all of the foregoing, we expect to incur losses for the foreseeable future and will need to generate significantly higher revenues in order to achieve profitability. If we achieve profitability, we may not be able to sustain it.

**Fluctuations of our results could cause our stock price to experience significant fluctuations or declines.**

Our operating results have varied significantly in the past and will likely fluctuate significantly in the future. For instance, in the last two fiscal years our quarterly revenues have fluctuated between approximately $14.7 million and $7.8 million and our quarterly net loss has fluctuated between approximately $1.9 million and 7.9 million. Our quarterly operating results are likely to be particularly affected by the number of customers licensing our products during any quarter and the size of such licensing transactions. We have limited visibility into our future revenue, especially license revenue, which often has been heavily concentrated in the third month of each quarter. Since we forecast our expenses based in part on future revenue projections, our operating results would be adversely affected if we cannot meet those revenue projections.

Other factors that could affect our quarterly operating results include:

- the demand for our products and professional services and our efficiency in rendering our professional services;

the variability in the mix of our license and services revenue in any quarter;

the variability in the mix of the type of services delivered in any quarter and the extent to which third party contractors are used to provide such services;

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- the size and complexity of our license transactions and potential delays in recognizing revenue from license transactions;
- the amount and timing of our operating expenses and capital expenditures;
- the performance of our international business, which accounts for a substantial part of our consolidated revenues;
- fluctuations in foreign currency exchange rates

Due to these and other factors, we believe that quarter-to-quarter comparisons of our revenues and operating results are not necessarily meaningful and should not be relied on as indicators of future performance. It is possible that in some future quarter our operating results may be below the expectations of public market analysts or investors, which could cause the market price of our common stock to fall.

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

**Our products have a long sales cycle, which increases the cost of completing sales and renders completion of sales less predictable.**

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

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

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

**We experience seasonality in our sales, which could cause our quarterly operating results to fluctuate from quarter to quarter.**

We experience quarterly seasonality in the licensing of our products and delivery of our services. For example, revenue has through most of our history been lower in our first fiscal quarter than in the immediately preceding fourth fiscal quarter. Contributing to this seasonality is the timing of our first fiscal quarter that occurs during the summer months when general business activities slow down in a number of territories where we conduct our operations, particularly Europe. Our commission structure and other sales incentives also tend to

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result in fewer sales in the first fiscal quarter than in the fourth fiscal quarter. These seasonal variations in our revenue are likely to lead to fluctuations in our quarterly operating results.

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

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

**Changes in accounting regulations and related interpretations and policies, particularly those related to revenue recognition, could cause us to defer recognition of revenue or recognize lower revenue.**

While we believe that we are in compliance with Statement of Position 97-2, *Software Revenue Recognition*, as amended, the American Institute of Certified Public Accountants continues to issue implementation guidelines for these standards and the accounting profession continues to discuss a wide range of potential interpretations. Additional implementation guidelines, and changes in interpretations of such guidelines, could lead to unanticipated changes in our current revenue accounting practices that could cause us to defer the recognition of revenue to future periods or to recognize lower revenue.

In addition, there has been an ongoing public debate whether employee stock option and employee stock purchase plan shares should be measured at their fair value and treated as a compensation expense and, if so, how to properly value such charges. If we were to elect or were required to record an expense for our stock-based compensation plans using the fair value method, we could have significant compensation charges. For example, for fiscal 2004, fiscal 2003, and fiscal 2002, had we accounted for stock-based compensation plans under Financial Accounting Standards Board ( FASB ) Statement No. 123, as amended by FASB Statement No. 148, diluted loss per share would have been increased by $0.89, $1.02, and $1.38 per share, respectively. Although we are currently not required to record any compensation expense using the fair value method in connection with option grants that have an exercise price at or above fair market value and for shares issued under our employee stock purchase plan, it is possible that future laws or regulations will require us to treat all stock-based compensation as a compensation expense using the fair value method. See Note 2 of the Notes to Consolidated Financial Statements.

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

Our success depends to a significant degree on the performance of the senior management team and other key employees. The loss of any of these individuals could harm our business. We do not have employment agreements with any of our executives or other key employees, and we do not maintain key person life insurance for any officers or key employees.

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

The market for our products and services is intensely competitive, dynamic and subject to rapid technological change. The intensity of the competition and the pace of change are expected to increase in the future. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business. Competitors vary in size and in the scope and breadth of the products and services offered. We encounter competition with respect to different aspects of our solution from a variety of sources including:

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

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

- potential customers internal development efforts;

**We expect competition from a variety of companies.**

Many of our competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Competition could seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products and services obsolete, unmarketable or less competitive. Our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other partners, thereby increasing the availability of their services to address the needs of our current and prospective customers. We may not be able to compete successfully against our current and future competitors, and competitive pressures that we encounter may seriously harm our business.

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

International revenues accounted for 44% of our revenues for our fiscal year ended May 31, 2004 and 28% for our fiscal years ended May 31, 2003 and 2002. Although we intend to continue to expand our international presence in the future we may not be able to successfully market, sell or distribute our products and services in foreign markets. Factors that could materially adversely affect our international operations, and, our business and future growth include:

- difficulties in staffing and managing foreign operations, including language barriers;

- seasonal fluctuations in purchasing patterns in other countries, particularly declining sales during July and August in European markets;

- difficulties in collecting accounts receivable in foreign countries, particularly European countries in which collections take considerably more time than the United States and collections are more difficult to effect;

- currency exchange rate fluctuations, particularly in countries where we sell our products in denominations other than U.S. dollars, such as in the United Kingdom, the euro zone, and Japan, or have exposures in intercompany accounts denominated in foreign currencies;

- the need to develop internationalized versions of our products and marketing and sales materials;

- the burdens of complying with a wide variety of foreign laws and reduced protection for intellectual property rights in some countries; and

- tariffs, export controls and other trade barriers.

**Delays in releasing new products or enhanced versions of our existing products could adversely affect our competitive position.**

As part of our strategy, we expect to regularly release new products and new versions of our existing products. Even if our new products or new versions of our existing products contain the features and functionality our customers want, in the event we are unable to timely introduce these new products or product

releases, our competitive position may be harmed. We cannot assure you that we will be able to successfully complete the development of currently planned or future products or product releases in a timely and efficient manner. Due to the complexity of our products, internal quality assurance testing and customer testing of pre-commercial releases may reveal product performance issues or desirable feature enhancements that could lead us to postpone the release of these products. In addition, the reallocation of resources associated with any postponement would likely cause delays in the development and release of other future products or enhancements to our currently available products. Any delay in releasing future products or enhancements of our products could harm our business.

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

Products as complex as ours often contain unknown and undetected errors or performance problems. Many serious defects are frequently found during the period immediately following introduction and initial shipment of new products or enhancements to existing products. Although we attempt to resolve all errors that we believe would be considered serious by our customers before shipment to them, our products are not error-free. These errors or performance problems could result in lost revenues or delays in customer acceptance and would be detrimental to our business and reputation. As is typical in the software industry, with each release we have discovered errors in our products after introduction. We will not be able to detect and correct all errors before releasing our products commercially and these undetected errors could be significant. We cannot assure you that undetected errors or performance problems in our existing or future products will not be discovered in the future or that known errors considered minor by us will not be considered serious by our customers, resulting in a decrease in our revenues.

**Claims by third parties that we infringe their intellectual property rights may result in costly litigation.**

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights, particularly in the software and Internet-related industries. We have in the past been subject to one intellectual property action. In our market, one company initiated patent infringement actions against us in 2002 as well as at least four other companies. In September 2003, we settled the action against us and recorded a charge of $1.7 million. We have paid all amounts due under this settlement. In the future, we could become subject to additional intellectual property infringement claims as the number of our competitors grows and our products and services overlap with competitive offerings. Any of these claims, even if not meritorious, could be expensive to defend and could divert management s attention from operating our company. If we become liable to third parties for infringing their intellectual property rights, we could be required to pay a substantial award of damages and to develop noninfringing technology, obtain a license or cease selling the products that contain the infringing intellectual property. We may be unable to develop noninfringing technology or obtain a license on commercially reasonable terms, if at all.

**We may not be able to adequately protect our proprietary technology, and our competitors may be able to offer similar products and services that would harm our competitive position.**

Our success depends upon our proprietary technology. We rely primarily on copyright, trademark and trade secret laws, confidentiality procedures and contractual provisions to establish and protect our proprietary rights. As part of our confidentiality procedures, we enter into non-disclosure agreements with our employees. Despite these precautions, third parties could copy or otherwise obtain and use our technology without authorization, or develop similar technology independently. In addition, we have three patents issued in the United States and four patent applications pending in the United States. We cannot assure you that any patents will be issued for any of the pending patent applications. Even for the issued patents, or any patent issued to us in the future, there can be no assurance that such patent will protect our intellectual property, or will not be challenged by third parties. Furthermore, effective protection of intellectual property rights is unavailable or limited in certain foreign

countries. We cannot assure you that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our products and services or design around any patents or other intellectual property rights we hold.

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

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

**We outsource the management and maintenance of our hosted and ASP solutions to third parties and will depend upon them to provide adequate management and maintenance services.**

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

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

Our success depends upon the acceptance and successful integration by customers of our products. We often rely on third-party systems integrators to assist with implementation of our products. We will need to continue to rely on these systems integrators even as we increase the size of our professional services group. If large systems integrators fail to continue to support our solution or commit resources to us, if any of our customers are not able to successfully integrate our solution or if we are unable to adequately train our existing systems integration partners, our business, operating results and financial condition could suffer. In addition, we have only limited control over the level and quality of service provided by our current and future third-party integrators.

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

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

are not available on acceptable terms, we may be unable to develop or enhance our products and services, take advantage of future opportunities or respond to competitive pressures.

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**Although we currently meet all testing requirements for the Nasdaq National Market, we must continue to meet those requirements to remain listed.**

In order for our common stock to continue to be quoted on the Nasdaq National Market, we must satisfy various financial requirements established by Nasdaq. At August 31, 2004, we complied with Nasdaq s minimum stockholders equity requirement. As Nasdaq does with all companies, it will continue to monitor us for ongoing compliance with the minimum stockholders equity requirement. Failure to demonstrate compliance with the minimum stockholders equity requirement or other requirements could subject us to delisting from the Nasdaq National Market. Delisting on the Nasdaq National Market, among other things, limit the liquidity and adversely affect the trading price of our stock.

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

In March 2001, we acquired Human Performance Technologies, Inc. and, in June 2001, we acquired Ultris Inc. As part of our overall business strategy, we expect to continue to acquire complementary businesses or technologies that will provide additional products or services offerings, additional industry expertise or an expanded geographic presence. These acquisitions could result in the use of significant amounts of cash, potentially dilutive issuances of equity securities, or the incurrence of debt. In addition, any acquisition may increase the risk of future write-offs for acquired in-process research and development, write-offs for the impairment of goodwill or long-lived assets, or amortization of expenses related to intangible assets, any of which could materially adversely affect our business and our operating results. For example, as of February 29, 2004, our remaining goodwill balance was $5.3 million. Although these two acquisitions are fully integrated, future acquisitions involve numerous risks, including:

- difficulties in the assimilation of the operations, technologies, products and personnel of the acquired company;
- the diversion of management s attention from other business concerns;
- risks of entering markets in which we have no or limited prior experience; and
- the potential loss of key employees of the acquired company.

**Our stock price may fluctuate substantially.**

In the last two fiscal years the market price for our common stock has fluctuated between $12.60 per share and $2.32 per share. The market price for our common stock may be affected by a number of factors, including those described above and the following:

- the announcement of new products and services or product and service enhancements by us or our competitors;
- quarterly variations in our results of operations or those of our competitors;

changes in earnings estimates or recommendations by securities analysts that may follow our stock;

developments in our industry; and

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

In addition, the stock market in general, and the Nasdaq National Market and technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies. Broad market and industry trends may also materially and adversely affect the market price of our common stock, regardless of our actual operating performance. In the past, following periods of volatility in the market price of a company s securities, securities class-action litigation has often been initiated against that company. Class-action litigation could result in substantial costs and a diversion of management s attention and resources.

**The anti-takeover provisions in our charter documents could delay or prevent a change in control.**

Our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws contain provisions that could make it harder for a third-party to acquire us without the consent of our board of directors.

For example, if a potential acquiror were to make a hostile bid for us, the acquiror would not be able to call a special meeting of stockholders to remove our board of directors or act by written consent without a meeting. In addition, our board of directors has staggered terms that make it difficult to remove all directors at once. The acquiror would also be required to provide advance notice of its proposal to remove directors at an annual meeting. The acquiror will not be able to cumulate votes at a meeting, which will require the acquiror to hold more shares to gain representation on the board of directors than if cumulative voting were permitted.

Our board of directors also has the ability to issue preferred stock that would significantly dilute the ownership of a hostile acquiror. In addition, Section 203 of the Delaware General Corporation Law limits business combination transactions with 15% stockholders that have not been approved by the board of directors. These provisions and other similar provisions make it more difficult for a third party to acquire us without negotiation. These provisions may apply even if the offer may be considered beneficial by some stockholders.

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

## ITEM 7A: QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

### *Interest Rate Risk*

In May 2004, we borrowed $3.5 million against the line of credit, which was repaid in June 2004. Therefore, only future borrowings would be affected by changes in the market interest rates. The revolving line of credit portion of our credit facility, as amended in August 2004, allows us to make draws at a variable interest rate using the bank s prime rate plus 1.50%.

At May 31, 2004, we had outstanding equipment term loans of $450,000 that bear interest at fixed rates ranging from 4.90% to 6.80%. The equipment term loan portion of our credit facility allows us to make draws at a either a fluctuating rate equal to the bank s prime rate plus 1.70% or a fixed rate equal to the 36-month U.S. Treasury note plus 4.00%. Therefore, only future borrowings on the equipment term loan portion of our credit facility would be affected by changes in market interest rates.

At May 31, 2004, we also had an outstanding term loan of $733,000 that bears interest at a variable rate based on the bank s prime rate plus 1.25%. If the bank s prime rate were to change by 10% from its level at May 31, 2004, the impact would not be material to our financial position or results of operations.

In order to borrow against the credit facility, as amended in August 2004, we must satisfy certain covenants including a financial covenant to maintain a minimum balance of unrestricted cash and cash equivalents, net of borrowings, of $7.5 million on deposit with the bank at all times. As of May 31, 2004, we were in compliance with the then applicable covenants. The credit facility also restricts our ability to pay cash dividends.

***Foreign Currency Risk***

We provide our products and services to customers in the United States, Europe and elsewhere throughout the world. Sales are primarily made in U.S. Dollars, and to a lesser but increasing extent, British Pounds and Euros; however, as we continue to expand our operations, more of our contracts may be denominated in Australian Dollars, Canadian Dollars and Japanese Yen. A strengthening of the U.S. Dollar could make our products less competitive in foreign markets.

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

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## ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## SABA SOFTWARE, INC.

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS


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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Saba Software, Inc.

We have audited the accompanying consolidated balance sheets of Saba Software, Inc. as of May 31, 2004 and 2003 and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended May 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Saba Software, Inc. at May 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended May 31, 2004, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Palo Alto, California

June 16, 2004,

except for Note 13, as to which the date is

August 20, 2004

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**SABA SOFTWARE, INC.**

**CONSOLIDATED BALANCE SHEETS**

**(in thousands, except share and per share data)**

| | May 31, | |
|---|---|---|
| | **2004** | **2003** |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 16,628 | $ 17,566 |
| Short-term investments | 150 | 3,631 |
| Accounts receivable (net of allowance of $177 at May 31, 2004 and $654 at May 31, 2003) | 6,648 | 9,315 |
| Prepaid expenses and other current assets | 1,030 | 1,218 |
| Total current assets | 24,456 | 31,730 |
| Property and equipment, net | 1,040 | 2,385 |
| Goodwill, net | 5,288 | 5,288 |
| Purchased intangible assets, net | 2 | 542 |
| Other assets | 955 | 891 |
| Total assets | $ 31,741 | $ 40,836 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,625 | $ 1,713 |
| Accrued compensation and related expenses | 2,533 | 2,699 |
| Accrued expenses | 4,175 | 3,828 |
| Deferred revenue | 9,265 | 9,497 |
| Borrowings under bank line of credit | 3,500 | |
| Current portion of debt and lease obligations | 752 | 675 |
| Total current liabilities | 21,850 | 18,412 |
| Deferred revenue | 179 | 31 |
| Accrued rent | 2,520 | 2,691 |
| Debt and lease obligations, less current portion | 671 | 1,242 |
| Total liabilities | 25,220 | 22,376 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock, issuable in series: $0.001 par value; 5,000,000 authorized shares at May 31, 2004 and 2003; none issued or outstanding | | |
| Common stock: $0.001 par value; 200,000,000 authorized shares at May 31, 2004 and 2003; 13,504,417 shares issued at May 31, 2004 and 13,328,680 shares issued at May 31, 2003 | 54 | 53 |
| Additional paid-in capital | 191,925 | 191,241 |
| Deferred stock compensation | | (45) |
| Treasury stock: 102,997 shares at May 31, 2004 and 102,578 shares at May 31, 2003, at cost | (232) | (232) |
| Accumulated deficit | (185,012) | (172,329) |
| Accumulated other comprehensive loss | (214) | (228) |

| | | |
|---|---|---|
| Total stockholders equity | 6,521 | 18,460 |
| Total liabilities and stockholders equity | $ 31,741 | $ 40,836 |

*See Accompanying Notes to Consolidated Financial Statements.*

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**SABA SOFTWARE, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(in thousands, except per share data)**

| | Years ended May 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| Revenues: | | | |
| License | $ 9,838 | $ 16,440 | $ 27,277 |
| Services | 24,633 | 27,976 | 28,371 |
| Total revenues | 34,471 | 44,416 | 55,648 |
| Cost of revenues: | | | |
| Cost of license | 222 | 156 | 186 |
| Cost of services | 12,057 | 13,258 | 14,456 |
| Amortization of acquired developed technology | 401 | 1,358 | 1,536 |
| Total cost of revenues | 12,680 | 14,772 | 16,178 |
| Gross profit | 21,791 | 29,644 | 39,470 |
| Operating expenses: | | | |
| Research and development | 9,972 | 11,817 | 14,628 |
| Sales and marketing | 17,947 | 26,047 | 30,360 |
| General and administrative | 4,357 | 6,514 | 6,855 |
| Amortization of deferred stock compensation and other stock charges | 45 | 1,850 | 7,113 |
| Amortization of purchased intangible assets | 139 | 855 | 1,182 |
| Amortization of goodwill | | | 2,475 |
| Acquired in-process research and development | | | 2,199 |
| Settlement of litigation | 1,701 | | |
| Total operating expenses | 34,161 | 47,083 | 64,812 |
| Loss from operations | (12,370) | (17,439) | (25,342) |
| Interest income and other, net | (101) | 604 | 451 |
| Interest expense | (104) | (197) | (412) |
| Loss before provision for income taxes | (12,575) | (17,032) | (25,303) |
| Provision for income taxes | (108) | (175) | (164) |
| Net loss | $ (12,683) | $ (17,207) | $ (25,467) |
| Basic and diluted net loss per share | $ (0.95) | $ (1.35) | $ (2.19) |
| Shares used in computing basic and diluted net loss per share | 13,411 | 12,775 | 11,623 |

Amortization of deferred stock compensation and other stock charges relates to the following:

| | | | |
|---|---|---|---|
| Cost of services | $ 4 | $ 227 | $ 1,373 |
| Research and development | 6 | 1,273 | 3,556 |
| Sales and marketing | 5 | 249 | 1,503 |
| General and administrative | 30 | 101 | 681 |
| | $ 45 | $ 1,850 | $ 7,113 |

*See Accompanying Notes to Consolidated Financial Statements.*

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**SABA SOFTWARE, INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

**(in thousands, except share data)**

| | Preferred Stock | | Common Stock | | Additional Paid-in | Deferred Stock | Notes Receivable From | Treasury Stock | | Accumulated | Accumulated Other Comprehensive | Total Stockholders |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Capital | Compensation | Stockholders | Shares | Amount | Deficit | Income (Loss) | Equity |
| Balances at May 31, 2001 | | | 11,499,377 | 46 | 165,858 | (7,448) | (806) | (56,250) | (67) | (129,655) | 31 | |