DENTSPLY INTERNATIONAL INC /DE/
Form 8-K
January 11, 2005

FORM 8-K

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report January 10, 2005
(Date of earliest event reported)

DENTSPLY INTERNATIONAL INC
(Exact name of Company as specified in charter)

Delaware	0-16211	39-1434669
(State of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

221 West Philadelphia Street, York, Pennsylvania	17405
(Address of principal executive offices)	(Zip Code)

(717) 845-7511
(Company's telephone number including area code)

Item 5.02. - Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers.

The following information is furnished pursuant to Item 5.02(c) related to the appointment of certain new officers.

On January 10, 2005, the Company appointed Mr. William R. Jellison to the position of Senior Vice President and Chief Financial Officer. The announcement related to this appointment is attached hereto as Exhibit 99.1 and is hereby incorporated by reference. The terms of Mr. Jellison's employment agreement with the Company are hereby incorporated by reference to Exhibit 10.15 of the Company's 1998 Form 10-K filed on March 26, 1999.

Item 9.01. - Financial Statements and Exhibits

(a) Financial Statements - Not applicable.

(b) Exhibits:

99.1 The announcement related to the appointment of Mr. William R. Jellison to Senior Vice President and Chief Financial Officer released on January 10, 2005 as referenced in Item 5.02.

SIGNATURES

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

DENTSPLY INTERNATIONAL INC
(Company)

/s/Brian M. Addison
Brian M. Addison
Vice President, Secretary and
General Counsel

Date: January 11, 2005

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Net loss per share as reported

$

(0.09

)

$

(0.08

)

$

(0.29

)

$

(0.47

)

Add: Amortization of assembled workforce per share

0.00

0.01

Add: Amortization of goodwill per share

0.01

0.04

Adjusted net loss per share

$

(0.09

)

$

(0.07

)

$

(0.29

)

$

(0.42

)

5. Segment Information

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

Geographic Information

The following tables present revenue and long-lived assets information by geographic area (in thousands):

	Total Revenue		Total Revenue	
	Three months ended February 28,		Nine months ended February 28,	
	2003	2002	2003	2002
United States	$ 5,391	$ 9,682	$ 24,616	$ 29,519
International	4,237	3,437	9,175	12,206
Total	$ 9,628	$ 13,119	$ 33,791	$ 41,725

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	Long-Lived Assets	
	As of February 28, 2003	As of May 31, 2002
United States	$ 8,766	$ 12,293
International	251	325
Total	$ 9,017	$ 12,618

6. Credit Facility

In August 2002, Saba entered into a credit facility with a bank that provides for an equipment term loan of up to $1.0 million and a revolving line of credit secured by eligible accounts receivable of up to $6.0 million. Borrowings under the credit facility are secured by certain of Saba s assets. Under the term loan, Saba may make draws through May 2003, borrowings must be repaid in 36 equal monthly installments of principal plus interest and outstanding principal bears interest at either a fluctuating rate equal to the bank s Prime Rate plus 1.25% or a fixed rate equal to the 36-month U.S. Treasury note plus 3.25%. For the nine months ended February 28, 2003, Saba made draws under the equipment term loan of $485,000 at interest rates ranging from 5.29% to 5.81%.

The credit facility requires Saba to satisfy, on a monthly basis, certain financial and other covenants including minimum quick ratio, tangible net worth and liquidity coverage ratio. In addition, the credit facility restricts Saba s ability to pay cash dividends.

7. Restructuring

In December 2002, Saba implemented a restructuring program to reduce expenses to align its operations and cost structure with market conditions. The restructuring charge for the three months ended February 28, 2003 of $940,000 is classified in the statement of operations as follows: cost of revenues $57,000, research and development $411,000, sales and marketing $289,000, general and administrative $183,000. The restructuring program included a worldwide workforce reduction of 16 employees across all functions and consolidation of an excess facility. Workforce reduction charges, which consist primarily of severance and fringe benefits, were $416,000 for the three months ended February 28, 2003. The workforce reduction charges are expected to be paid by the end of fiscal 2003. The charge for the facility consolidation of $524,000 relates to non-cancelable lease costs. Amounts related to the facilities charge will be paid over the estimated vacancy period through fiscal 2004. Saba s estimated costs to consolidate this facility are based on available commercial rates. The actual loss incurred could be different from Saba s estimates. For the three months ended February 28, 2003, the charge for workforce reduction charges includes a decrease to the accrual made in a prior period in the amount of $107,000 resulting from severance payments that were less than previous estimates. For the nine months ended February 28, 2003, the charge for excess facilities includes a decrease to the accrual made in a prior period in the amount of $144,000 as a result of a change in sublease income.

A summary of the restructuring charges along with the respective remaining accruals follows below:

	Workforce Reduction Charges	Facilities Related Charges	Total
		(in thousands)	
Accrual as of May 31, 2002	$ 321	$ 1,108	$ 1,429
Deductions cash payments	(221)	(174)	(395)
Accrual as of August 31, 2002	$ 100	$ 934	$ 1,034
Charges	770	152	922
Reduction of accrual		(144)	(144)
Deductions cash payments	(34)	(118)	(152)
Accrual as of November 30, 2002	$ 836	$ 824	$ 1,660
Charges	416	524	940
Reduction of accrual	(107)		(107)
Deductions cash payments	(850)	(193)	(1,043)
Accrual as of February 28, 2003	$ 295	$ 1,155	$ 1,450
Estimated remaining cash expenditures	$ 295	$ 1,155	$ 1,450

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8. Acquisitions

On June 15, 2001, Saba completed its acquisition of Ultris Inc., a provider of Internet-based real-time knowledge content management and collaborative learning software. In consideration for Ultris Inc., Saba issued approximately 1.0 million shares of Saba s common stock, including 198,465 shares subject to repurchase, with a fair value of approximately $14.1 million and assumed net liabilities of approximately $20,000. The acquisition was accounted for using the purchase method of accounting for business combinations. Accordingly, the fair market value of the acquired assets and liabilities has been included in Saba s consolidated financial statements as of June 15, 2001 and the results of operations of Ultris Inc. have been included thereafter. Pursuant to an independent valuation, the purchase price of Ultris Inc., represented by the 801,500 shares not subject to repurchase, was allocated based on the fair value of specific tangible and intangible assets acquired and liabilities assumed from Ultris Inc. The estimated excess of the purchase price over the fair value of the net liabilities acquired has been valued at $11.4 million, of which $7.8 million has been allocated to goodwill, $2.2 million has been allocated to acquired in-process research and development, $1.2 million has been allocated to developed technology and $176,000 has been allocated to workforce. Saba also recorded a charge to operations of approximately $2.2 million upon consummation of the transaction related to acquired in-process research and development. Saba recorded deferred compensation for the intrinsic value of 198,465 shares of stock subject to repurchase. The estimated intrinsic value of the shares was approximately $2.8 million, which is included as a component of stockholders equity and is being amortized by charges to operations over the four-year repurchase period using the graded vesting method. There is no compensation expense resulting from the acceleration of vesting of common stock for terminated employees for the three months ended February 28, 2003. Included in amortization of deferred stock compensation and other stock charges is compensation expense resulting from the acceleration of vesting of common stock for terminated employees in the amount of $599,000 for the nine months ended February 28, 2003.

9. Recent Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires businesses to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Saba is required to adopt SFAS No. 143 for its fiscal year beginning June 1, 2003. Saba is currently assessing the impact, if any, of SFAS No. 143 on its financial position and results of operations.

In the quarter ended May 31, 2002, Saba adopted Staff Announcement Topic No. D-103, Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred, which was subsequently incorporated in Emerging Issues Task Force (EITF) No. 01-14. EITF No. 01-14 establishes that reimbursements received for out-of-pocket expenses should be characterized as revenue in the statement of operations. Previously, Saba recorded the reimbursement of out-of-pocket expenses as a reduction to cost of services to offset the related cost incurred. The adoption of EITF No. 01-14 does not impact operating or net income in any past or future periods. The adoption increased revenues and cost of revenues by $166,000 for the three months ended February 28, 2003 and $265,000 for the three months ended February 28, 2002 and caused a slight decrease in gross margin percentage. The adoption increased revenues and cost of revenues by $817,000 for the nine months ended February 28, 2003 and $859,000 for the nine months ended February 28, 2002 and caused a slight decrease in gross margin percentage.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or

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disposal activities and nullifies 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). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost as generally defined in EITF No. 94-3 was recognized at the date of an entity s commitment to an exit plan. SFAS No. 146 also establishes that fair value is the objective for initial measurement of the liability. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002 and could result in Saba recognizing the cost of future restructuring activities, if any, over a period of time as opposed to as a single event.

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 elaborates on the existing disclosure requirements for most guarantees and provides new disclosure requirements regarding indemnification provisions, including indemnification provisions typically included in a software license arrangement. Saba enters into license agreements that generally provide indemnification for Saba s customers against intellectual property claims. FIN 45 also clarifies that at the time a guarantee is issued, companies must recognize an initial liability for the fair value of the obligations it assumes under the guarantee and must disclose that information in its financial statements. The provisions related to recognizing a liability at inception of the guarantee do not apply to product warranties or indemnification provisions in Saba s software license arrangements. The initial recognition and measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002, and the disclosure requirements apply to guarantees outstanding as of December 31, 2002. Saba does not expect the adoption of FIN 45 to have a material effect on its financial position and results of operations.

In December 2002, the FASB issued SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure that amends SFAS No. 123, Accounting for Stock-Based Compensation. The standard provides for (1) alternative methods of transition for an entity that voluntarily changes to the fair-value method of accounting for stock-based employee compensation; (2) requires more prominent disclosure of the effects of an entity s accounting policy decisions with respect to stock-based employee compensation on reported income; and (3) amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure of those effects in interim financial information. SFAS No. 148 is effective for fiscal years ending after December 15, 2002, and for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. Saba continues to account for employee stock options using the intrinsic value method in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees and will implement the disclosure requirements of SFAS No. 148 for its fiscal quarter beginning March 1, 2003.

10. Option Exchange Program

In June 2002, Saba announced a voluntary stock option exchange program for employees. Under this program, employees were given the opportunity until June 28, 2002 to make an election to cancel their outstanding stock options with exercise prices greater than $5.93 per share under the 1997 Plan or 2000 Plan, in exchange for an equal number of shares to be granted at least six months and one day from the cancellation date at an exercise price equal to the fair market value on the date of grant. Those employees who elected to participate in the exchange program were required to exchange all options granted during the six-month period prior to the cancellation date. Under this program, options to purchase approximately 1.7 million shares of Saba common stock were tendered by 142 employees. On January 2, 2003, Saba granted options to purchase approximately 1.2 million shares of common stock to replace the tendered options. A certain number of employees terminated their employment in the intervening six months, and were not granted replacement options. The exercise price of each replacement option is $1.05 per share, which was the fair market value of Saba common stock on January 2, 2003, represented by the closing sale price on such date on the Nasdaq National Market. The vesting period of each new option begins on January 2, 2003 and ends 12 months after the end of the vesting period stated in the cancelled options. In no event, however, does the new vesting period exceed four years. The new options vest in equal quarterly installments over the vesting period of the new options (proportionately adjusted for any partial quarter at the end of the new vesting period). Saba incurred compensation expense of $171,000 relative to this program for Saba s first quarter ending August 31, 2002 related to cancelled awards. The exchange program did not result in any additional compensation charges or variable plan accounting. This program was not made available to Saba s executive officers or directors.

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11. Legal Matters

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York against Saba, certain of its officers and directors, and certain underwriters of Saba s initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased Saba common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by Saba and its officers and directors of the Securities Act of 1933 in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints have since been consolidated into a single action. Saba intends to vigorously defend against this action. Although no assurance can be given that this matter will be resolved in Saba s favor, Saba believes that the resolution of this lawsuit will not have a material adverse effect on its financial position, results of operations or cash flows.

On May 31, 2002, IP Learn, LLC (IP Learn) filed a complaint against Saba in the United States District Court for the Northern District of California. The compliant alleged that Saba infringed four U.S. patents assigned to IP Learn and asks the court for a preliminary and permanent injunction, as well as unspecified damages. IP Learn later amended the complaint to add a fifth patent to the suit. Substantially similar complaints have been filed against at least four other companies in Saba s industry. Saba believes that the complaint is without merit and intends to defend against it vigorously. Document and deposition discovery is now underway. The Court has set May 5, 2003 as the date for Saba to file a summary judgment motion. Although no assurance can be given that this matter will be resolved favorably, Saba believes that the resolution of this lawsuit will not have a material adverse effect on its financial position, results of operations or cash flows.

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

12. Private Placement

In October 2002, Saba completed a private placement of 4,302,323 shares of common stock at fair market value for aggregate proceeds of $9.25 million with funds affiliated with Sequoia Capital, a related party. Michael Moritz, a director on Saba s Board of Directors, is a General Partner of Sequoia Capital. Mr. Moritz disclaims beneficial ownership of shares held by these funds except to the extent of his pecuniary interest in these funds. In a simultaneous transaction, Bobby Yazdani, President and Chief Operating Officer, sold 348,836 shares of common stock at $2.15 per share for aggregate proceeds of approximately $750,000 to funds associated with Sequoia Capital.

13. Subsequent Events

In March 2003, Saba modified its existing credit facility and borrowed $1.2 million under a term loan to buy out certain capital leases in the amount of $1.1 million. The loan, which is secured by certain of Saba s assets, must be repaid in 36 equal monthly installments of principal plus interest. The outstanding principal bears interest at a fluctuating rate equal to the greater of 1.50% above the bank s Prime Rate or 5.75%.

In March 2003, Saba s board of directors authorized Saba to seek stockholder approval for a reverse stock split, to be effected at a ratio of between one-for-two (1:2) and one-for-ten (1:10). Stockholders of record as of the close of business on March 21, 2003 will be entitled to attend and vote at the special meeting on May 1, 2003. Assuming approval, the board will determine the final reverse split ratio.

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

The following discussion of financial condition and results of operations should be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended May 31, 2002. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the Securities Act) and Section 21E of the Securities and Exchange Act of 1934 (the Exchange Act). All statements in this Quarterly Report on Form 10-Q other than statements of historical fact are forward-looking statements for purposes of these provisions, including any statements of the plans and objectives for future operations and any statement of assumptions underlying any of the foregoing. Statements that include the use of terminology such as may, will, expects, believes, plans, estimates, potential, or cont negative thereof or other comparable terminology are forward-looking statements. Forward-looking statements include statements regarding an increase in operating expenses, including sales and marketing, research and development, and general and administrative, incurrence of non-cash expenses relating to stock compensation, amortization of purchased intangible assets and any potential goodwill impairment, 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, effects of any pending or future litigation, 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, impact of SFAS No. 143, 144, 146 and 148, FIN 45 and EITF No. 01-14, and the significance of Saba Learning Enterprise Edition and related services, as well as other products, for our revenues. These forward-looking statements involve risks and uncertainties, and it is important to note that our actual results could differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations Factors That May Impact Future Operating Results. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement or risk factor.

OVERVIEW

We are a leading provider of human capital development and management infrastructure software and services. Our software solutions are designed to enable businesses and governments to increase performance by automating the processes necessary to develop and manage the people, or human capital, that comprise their extended enterprise of employees, customers, partners and suppliers. Our offerings are designed to increase the return to the organization on their investment in human capital by cost-effectively meeting the learning and performance management needs of enterprises across geographies and industries. Our solutions provide information and business processes that empower managers to more tightly align organizational capabilities with desired business outcomes.

General

We commenced operations in April 1997 and, through March 1998, focused substantially all of our efforts on research activities, developing our products and building our business infrastructure. We shipped our first Saba Learning products and began to generate revenues from software license fees, implementation and consulting services fees and support fees in April 1998. We began to operate Saba Exchange in December 1999 and our application service provider (ASP) edition of Saba Learning in September 2000, and first shipped our limited release version of Saba Performance in May 2001. To date, we have not generated significant revenues from Saba Exchange, Saba Learning ASP Edition or Saba Performance.

Sources of Revenues and Revenue Recognition

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

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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, generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. Revenue from multiple-element arrangements is recognized using the residual method of accounting, where the revenue for undelivered elements of the arrangement, such as support services, are allocated based on the relative fair values of the elements. Our determination of fair value of each element in multi-element arrangements is based on vendor-specific objective evidence (VSOE). 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.

A substantial majority of our licenses entered into from November 30, 1999 to August 31, 2001 included rights to unspecified additional platform versions of our software, extended payment terms and/or services essential to the functionality of the software. For licenses that included rights to unspecified additional platform versions, we recognized license revenues ratably over the period during which we were required to provide the additional platform versions beginning in the month when all other revenue recognition criteria had been met. Revenue from contracts with extended payment terms are recognized at the lesser of amounts due and payable or the amount of the arrangement fee otherwise recognizable. For contracts that involve significant customization and implementation or consulting services 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. A substantial majority of our licenses entered into after August 31, 2001 do not provide for unspecified additional platform versions, extended payment terms or service essential to the functionality of the software. Revenues derived from these licenses are recognized on delivery if the other conditions of SOP 97-2 are satisfied. Revenues from our application service provider offering and from our hosting services are generally recognized ratably over the term of the arrangement.

Support revenue is recognized ratably over the support term, typically 12 months, and revenue related to implementation, consulting, education and other services is generally recognized as the services are performed. Although we primarily provide implementation and consulting services on a time and materials basis, a significant portion of these services has been provided on a fixed-fee basis.

Cost of Revenues

Our cost of revenues includes cost of our license revenues and cost of our services revenues. Our cost of license revenues includes the cost of manuals and product documentation, production media, shipping costs and royalties to third parties. Our cost of services revenues includes salaries and related expenses for our professional services organization, as well as third-party hosting costs and billed expenses. Because our cost of services revenues is greater than cost of license revenues, cost of total revenues as a percentage of total revenues may fluctuate based on the mix of products and services sold.

Operating Expenses

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

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

In connection with the granting of stock options to, and restricted stock purchases by, our employees, prior to our initial public offering, we recorded deferred stock compensation totaling approximately $38.4 million. This amount represents the difference between the exercise or purchase price, as applicable, and the deemed fair value of our common stock for financial accounting purposes on the date these stock options were granted or purchase agreements for restricted stock were signed. As of February 28, 2003, deferred stock compensation amounted to $146,000 and will result in additional charges to operations through fiscal 2004.

Our March 2001 acquisition of Human Performance Technologies, Inc. resulted in purchased intangible assets of $4.6 million, and our June 2001 acquisition of Ultris Inc. resulted in goodwill and purchased intangible assets of $9.1 million. Purchased intangible assets consist of intellectual property, customer base, assembled workforce and noncompetition agreements. The intangible assets are stated at cost less accumulated amortization and are being amortized on a straight-line basis over their estimated useful lives of six months to three years. Effective June 1, 2002, we adopted SFAS No. 142, Goodwill and Other Intangible Assets. As required by SFAS No. 142, we no longer amortize goodwill, but review it annually (or more frequently if impairment indicators arise) for impairment. Upon initial application of SFAS No. 142, we determined there was no impairment of goodwill. Prior to June 1, 2002, goodwill was being amortized on a straight-line basis over its estimated useful life of three years.

There was no acquisition activity during the three and nine months ended February 28, 2003. Acquired in-process research and development in the nine months ended February 28, 2002 represents the write-off of the fair value of acquired research and development work obtained in connection with the acquisition of Ultris Inc. For the acquisition of Ultris Inc., the write-off was necessary because the acquired in-process research and development had not yet reached technological feasibility and the related products under development had not achieved commercial viability.

We obtained an independent valuation for the allocation of the purchase price of Ultris Inc. Values were assigned to acquired developed technology, in-process research and development, goodwill and workforce. The fair value of the acquired in-process research and development was determined by estimating the projected net cash flows related to the products, including costs to complete the development of the technology and the future revenues to be earned upon commercialization of the products. These cash flows were then discounted back to their net present value. The projected net cash flows from the project were based on management s estimates of future revenues and operating profits.

History of Losses

We have incurred significant losses and negative cash flows from operations since our inception. As of February 28, 2003, we had an accumulated deficit of $169.7 million. We have not achieved profitability and cannot be certain that we will be able to realize sufficient revenues to achieve or, once achieved, sustain profitability. While we have in the recent past and may from time to time in the future reduce operating expenses in response to the downturns in the United States or international economies, we generally expect to incur significantly greater operating expenses in the future. We also expect to incur substantial non-cash expenses relating to stock compensation, amortization of purchased intangible assets and any potential

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goodwill impairment. We expect to incur significant losses for the foreseeable future and will need to generate significantly higher revenues in order to achieve profitability. If we achieve profitability, we may not be able to sustain it.

We had 281 full-time employees as of February 28, 2003. To manage future growth of our operations and personnel, we must continue to invest in scalable operational systems, procedures and controls. We expect any future expansion to continue to challenge our ability to hire, train, manage and retain our employees.

Limited Operating History

We have a limited operating history that makes it difficult to forecast our future operating results. We believe that period-to-period comparisons of our operating results should not be relied upon as predictive of future performance. Our prospects must be considered in light of the risks, expenses and difficulties encountered by companies at an early stage of development, particularly companies in new and rapidly evolving markets, such as human capital development and management, electronic commerce and Internet software. We may not be successful in addressing these risks and difficulties.

RESULTS OF OPERATIONS

THREE AND NINE MONTHS ENDED FEBRUARY 28, 2003 AND 2002

Revenues

Total revenues decreased to $9.6 million for the three months ended February 28, 2003 from $13.1 million for the three months ended February 28, 2002. For the nine months ended February 28, 2003, revenues decreased to $33.8 million from $41.7 million for the nine months ended February 28, 2002. The decreases are primarily attributable to decreased license revenues. As a percentage of total revenues, revenues from customers outside the United States represented approximately 44% for the three months ended February 28, 2003 and 26% for the three months ended February 28, 2002. As a percentage of total revenues, revenues from customers outside the United States represented approximately 27% for the nine months ended February 28, 2003 and 29% for the nine months ended February 28, 2002.

License revenues decreased to $3.2 million, or 33% of total revenues, for the three months ended February 28, 2003, from $6.2 million, or 47% of total revenues, for the three months ended February 28, 2002. For the nine months ended February 28, 2003, license revenues decreased to $13.0 million, or 39% of total revenues, from $20.0 million, or 48% of total revenues, for the nine months ended February 28, 2002. The decreases are primarily attributable to a greater amount of deferred license revenues recognized in the three and nine months ended February 28, 2002 that were attributable to software licenses sold in earlier periods and, to a lesser extent, in the three months ended February 28, 2002, a decrease in new software license sales. The decrease in the nine months ended February 28, 2003 was partially offset by an increase in new software license sales compared to the nine months ended February 28, 2002.

Services revenues decreased to $6.5 million (representing 67% of total revenues) for the three months ended February 28, 2003 from $6.9 million (representing 53% of total revenues) for the three months ended February 28, 2002. For the nine months ended February 28, 2003, services revenues decreased to $20.8 million (representing 61% of total revenues) from $21.7 million (representing 52% of total revenues) for the nine months ended February 28, 2002. The decreases in dollar amount of services revenues are primarily attributable to decreased consulting revenues as a result of a decrease in the average project size resulting from product configuration improvements, as well as an increased number of implementations performed by third-party systems integrators. The decreases in consulting revenues were partially offset by increases in support revenues in both the three and nine months ended February 28, 2003.

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

Cost of Revenues

Total cost of revenues decreased to $3.4 million for the three months ended February 28, 2003 from $3.5 million for the three months ended February 28, 2002. For the nine months ended February 28, 2003, total cost of revenues decreased to $11.1 million from $12.6 million for the nine months ended February 28, 2002. The decreases in the dollar amount of cost of revenues are primarily attributable to a reduction in services personnel in response to fewer active projects, as well as reduction in the average project size resulting from product configuration improvements. Cost of services revenues for the three months ended February 28, 2003 was 46% as a percentage of services revenues as compared to 45% for the three months ended February 28, 2002. Cost of services revenues for the nine months ended February 28, 2003 was 47% as a percentage of services revenues as compared to 52% for the nine months ended February 28, 2002. The decrease in cost of services as a percentage of services revenues for the nine months ended February 28, 2003 is primarily attributable to an increased average billing rate of consultants, as well as an increased utilization of our consultants (billable hours as a percentage of total hours).

Cost of revenues includes amortization of acquired developed technology of $388,000 for the three months ended February 28, 2003 and 2002. Cost of revenues includes amortization of acquired developed technology of $1.2 million for the nine months ended February 28, 2003 and $1.1 million for the nine months ended February 28, 2002. This amortization resulted from our March 2001 acquisition of Human Performance Technologies, Inc. and June 2001 acquisition of Ultris Inc. The developed technology of $2.3 million acquired from Human Performance Technologies, Inc. is being amortized over a two-year useful life and the developed technology of $1.2 million acquired from Ultris Inc. is being amortized over a three-year useful life.

Operating Expenses

Research and development. Research and development expenses decreased to $3.0 million for the three months ended February 28, 2003 from $3.3 million for the three months ended February 28, 2002. Research and development expenses decreased to $9.0 million for the nine months ended February 28, 2003 from $11.3 million for the nine months ended February 28, 2002. The decreases are primarily attributable to reduced personnel costs associated with a decrease in research and development personnel in the U.S. These decreases were partially offset by increased staffing in our lower-cost development center in India.

Sales and marketing. Sales and marketing expenses decreased to $6.0 million for the three months ended February 28, 2003 from $6.1 million for the three months ended February 28, 2002. Sales and marketing expenses decreased to $20.7 million for the nine months ended February 28, 2003 from $23.4 million for the nine months ended February 28, 2002. The decreases are primarily attributable to reduced personnel costs associated with a decrease in sales and marketing personnel, as well as decreases in expenditures for marketing programs.

General and administrative. General and administrative expenses increased to $1.7 million for the three months ended February 28, 2003 from $1.4 million for the three months ended February 28, 2002. The increase is primarily attributable to severance and facilities related charges associated with restructuring costs, as well as an increase in legal fees. General and administrative expenses decreased to $4.8 million for the nine months ended February 28, 2003 from $5.1 million for the nine months ended February 28, 2002. The decrease is primarily attributable to reduced personnel costs associated with a decrease in general administrative personnel, as well as a decrease in bad debt expense.

Amortization (reversal) of deferred stock compensation and other stock charges. For the three months ended February 28, 2003, we had a net reversal of deferred stock compensation of $74,000 as compared to amortization of deferred stock compensation and other stock charges of $1.5

million for the three months ended February 28, 2002. Included in the three months ended February 28, 2003 is a reduction in amortization of deferred stock compensation of $263,000 that resulted from the cancellation of unvested stock options as a result of employee attrition and reductions in workforce. This reduction was partially offset by the amortization of deferred stock compensation of $189,000. For the nine months ended February 28, 2003, amortization of deferred stock compensation and other stock charges decreased to $1.9 million from

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$5.8 million for the nine months ended February 28, 2002. Included in the nine months ended February 28, 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 $524,000 that resulted from the cancellation of unvested stock options as a result of employee attrition and reductions in workforce. Also included in the nine months ended February 28, 2003 is $171,000 for compensation expense related to options 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.

Amortization of purchased intangible assets and goodwill. Amortization of purchased intangible assets was $234,000 for the three months ended February 28, 2003 and $258,000 for the three months ended February 28, 2002. Amortization of purchased intangible assets was $751,000 for the nine months ended February 28, 2003 and $924,000 for the nine months ended February 28, 2002. This amortization resulted from our March 2001 acquisition of Human Performance Technologies, Inc. and June 2001 acquisition of Ultris Inc. As a result of our June 2001 acquisition of Ultris Inc., we recorded amortization of goodwill of $646,000 for the three months ended February 28, 2002 and $1.8 million for the nine months ended February 28, 2002. As a result of our adoption of SFAS No. 141 and No. 142, there was no amortization of goodwill and assembled workforce for the three and nine months ended February 28, 2003.

Acquired in-process research and development. In the nine months ended February 28, 2002, we expensed $2.2 million for in-process research and development based on the value allocated to projects identified as in-process research and development, such as the completion and testing of instant messaging functionality and integration with software of other companies. There was no acquisition activity during the three and nine months ended February 28, 2003.

Restructuring charges

During the three months ended February 28, 2003, we implemented a restructuring program to reduce expenses to align our operations and cost structure with market conditions. The restructuring charge for the three months ended February 28, 2003 of $940,000 is classified in the statement of operations as follows: cost of revenues $57,000, research and development $411,000, sales and marketing $289,000 and general and administrative $183,000. The restructuring program included a worldwide workforce reduction of 16 employees across all functions and consolidation of an excess facility. Workforce reduction charges, which consist primarily of severance and fringe benefits, were $416,000 for the three months ended February 28, 2003. The workforce reduction charges are expected to be paid by the end of fiscal 2003 and will result in a reduction in payroll related expenses for the remainder of fiscal 2003 of approximately $735,000. The charge for the facility consolidation of $524,000 relates to non-cancelable lease costs and will result in a decrease in operating expenses for the remainder of fiscal 2003 of approximately $227,000. Amounts related to the facilities charge will be paid over the estimated vacancy period through fiscal 2004. Our estimated costs to consolidate this facility are based on available commercial rates. The actual loss incurred could be different from our estimates. For the three months ended February 28, 2003, the charge for workforce reduction charges includes a decrease to the accrual made in a prior period in the amount of $107,000 resulting from severance payments that were less than previous estimates.

Interest income (expense) and other, net

Interest income (expense) and other, net consists of interest income, interest expense and other non-operating expenses. Interest income (expense) and other, net changed to income of $45,000 for the three months ended February 28, 2003, from an expense of $7,000 for the three months ended February 28, 2002. Interest income (expense) and other, net changed to income of $167,000 for the nine months ended February 28, 2003, from an expense of $63,000 for the nine months ended February 28, 2002. The changes are primarily attributable to a reduction in interest expense due to payments on prior capital lease obligations.

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Provision for income taxes

From inception through February 28, 2003, we incurred net losses for federal and state tax purposes. We recorded income tax expense of $90,000 for the three months ended February 28, 2003 and $68,000 for the three months ended February 28, 2002. For the nine months ended February 28, 2003, we recorded income tax expense of $243,000 as compared to $113,000 for the nine months ended February 28, 2002. The income tax expense consists entirely of foreign tax expense incurred as a result of local country profits.

FLUCTUATIONS OF QUARTERLY RESULTS

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

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

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

- dependence of our revenues on a small number of large orders and the average order value;
- our ability to attract new customers;
- any changes in revenue recognition policies and provisions and interpretations of these provisions;
- our ability to license additional products to current customers;
- the announcement or introduction of new products or services by us or our competitors;
- changes in the pricing of our products and services or those of our competitors;

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

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

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

LIQUIDITY AND CAPITAL RESOURCES

Since inception, we have funded our operations primarily through the sale of equity securities, through which we have raised net proceeds of $135.8 million through February 28, 2003, equipment leases and other debt. As of February 28, 2003, we had outstanding equipment leases of $711,000, debt of $717,000 and $24.2 million of cash, cash equivalents and short-term investments.

Cash used in operating activities was $6.6 million during the nine months ended February 28, 2003 and $11.6 million during the nine months ended February 28, 2002. Cash used in operating activities during the nine months ended February 28, 2003 was primarily attributable to a net loss of $14.6 million, which was partially offset by a decrease in accounts receivable of $4.4 million, depreciation and amortization of $2.2 million, amortization of acquired developed technology of $1.2 million and amortization of deferred stock compensation of $1.0 million. Cash used in operating activities during the nine months ended February 28, 2002 was primarily attributable to a net loss of $21.7 million, which was partially offset by $5.8 million in

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amortization of deferred stock compensation, $2.8 million in amortization of goodwill and purchased intangible assets and a charge for acquired in-process research and development of $2.2 million.

Cash provided by investing activities during the nine months ended February 28, 2003 was primarily attributable to net redemptions and maturities of short-term investments of $4.0 million. Cash provided by investing activities during the nine months ended February 28, 2002 was primarily attributable to a net redemptions and maturities of short-term investments of $9.3 million.

Cash provided by financing activities during the nine months ended February 28, 2003 was primarily attributable to the proceeds from the issuance of common stock of $9.5 million. Included in this amount are net proceeds of $9.2 million we received from a private placement of common stock at fair market value with funds affiliated with Sequoia Capital, a related party. Michael Moritz, a director on our Board of Directors, is a General Partner of Sequoia Capital. Mr. Moritz disclaims beneficial ownership of shares held by these funds except to the extent of his pecuniary interest in these funds. Cash provided by financing activities during the nine months ended February 28, 2002 was primarily attributable to proceeds from the sale of stock under our stock incentive programs of $3.0 million, partially offset by $1.2 million for payments on capital lease obligations.

As of February 28, 2003, we did not have any material commitments for capital expenses. Our principal commitments consisted of obligations under capital and operating leases and our credit facility. In August 2002, we entered into a credit facility with a bank that provides for an equipment term loan of up to $1.0 million and a revolving line of credit secured by eligible accounts receivable of up to $6.0 million. Borrowings under the credit facility are secured by certain of our assets. Under the term loan, we may make draws through May 2003, borrowings must be repaid in 36 equal monthly installments of principal plus interest and outstanding principal bears interest at either a fluctuating rate equal to the bank s Prime Rate plus 1.25% or a fixed rate equal to the 36-month U.S. Treasury note plus 3.25%.

The following table summarizes our contractual obligations at February 28, 2003 and the effect these obligations are expected to have on our liquidity and cash flows in future periods. Of the $30.0 million in operating leases, net of sublease income, $1.2 million has been included in accrued restructuring charges as of February 28, 2003.

	Total	Capital Leases	Operating Leases	Note Payable	Equipment Term Loans
			(in thousands)		
Fiscal Year Ending May 31,					
2003	$ 1,064	$ 261	$ 747	$ 17	$ 39
2004	3,694	380	3,087	70	157
2005	3,132	63	2,833	70	166
2006	2,902	7	2,750	70	75
2007	2,374		2,321	53	
Thereafter	18,289		18,289		
	$ 31,455	$ 711	$ 30,027	$ 280	$ 437

Subsequent to February 28, 2003, we modified our existing credit facility and borrowed $1.2 million under a term loan to buy out certain capital leases in the amount of $1.1 million. The loan, which is secured by certain of our assets, must be repaid in 36 equal monthly installments of principal plus interest. The outstanding principal bears interest at a fluctuating rate equal to the greater of 1.50% above the bank s Prime Rate or 5.75%.

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

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CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. While there are a number of accounting policies, methods and estimates affecting our financial statements, areas that are particularly significant include revenue recognition policies, the allowance for doubtful accounts, the assessment of recoverability of goodwill and purchased intangible assets and restructuring costs. Our critical accounting policies are described in the following paragraphs.

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

Allowance for doubtful accounts. The allowance for doubtful accounts 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, excluding assembled workforce, have determinable lives. Prior to the adoption of SFAS No. 142, we amortized goodwill on a straight-line basis over its estimated useful life of three years and performed impairment analyses under SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. Total amortization of goodwill prior to June 1, 2002 was $2.5 million and our remaining goodwill balance at February 28, 2003 was $5.3 million.

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 performed the first of the required impairment tests of goodwill as of June 1, 2002. We consider Saba to be a single reporting unit. Accordingly, all of our goodwill is associated with the entire company. As of June 1, 2002, based on our market capitalization, there was no impairment of goodwill recorded upon implementation of SFAS No. 142. Accordingly, the second testing phase was not necessary. During fiscal 2003, we will also perform the required annual impairment analysis of goodwill, or on an interim basis if circumstances dictate. Any reduction of enterprise fair value below the carrying amount of goodwill could require us to write down the value of goodwill to its fair value and record an expense for the impairment loss.

Restructuring costs. During the nine months ended February 28, 2003 and 2002, we implemented restructuring programs to reduce expenses to align our operations and cost structure with market conditions. The restructuring charges included worldwide workforce reductions across all functions and consolidation of excess facilities. We have reduced the amount of the facilities restructuring charge by the estimated amount of sublease income. 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 financial statements 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 financial statements in the period this was determined.

RECENT ACCOUNTING PRONOUNCEMENTS

In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires businesses to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. We are required to adopt SFAS No. 143 for our fiscal year beginning June 1, 2003. We are currently assessing the impact, if any, of SFAS No. 143 on our financial position and results of operations.

In the quarter ended May 31, 2002, we adopted Staff Announcement Topic No. D-103, Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred, which was subsequently incorporated in Emerging Issues Task Force (EITF) No. 01-14. EITF No. 01-14 establishes that reimbursements received for out-of-pocket expenses should be characterized as revenue in the statement of operations. Previously, we recorded the reimbursement of out-of-pocket expenses as a reduction to cost of services to offset the related cost incurred. The adoption of EITF No. 01-14 does not impact operating or net income in any past or future periods. The adoption increased revenues and cost of revenues by $166,000 for the three months ended February 28, 2003 and $265,000 for the three months ended February 28, 2002 and caused a slight decrease in gross margin percentage. The adoption increased revenues and cost of revenues by $817,000 for the nine months ended February 28, 2003 and $859,000 for the nine months ended February 28, 2002 and caused a slight decrease in gross margin percentage.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies 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). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost as generally defined in EITF No. 94-3 was recognized at the date of an entity s commitment to an exit plan. SFAS No. 146 also establishes that fair value is the objective for initial measurement of the liability. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002 and could result in us recognizing the cost of future restructuring activities, if any, over a period of time as opposed to as a single event.

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 elaborates on the existing disclosure requirements for most guarantees and provides new disclosure requirements regarding indemnification provisions, including indemnification provisions typically included in a software license arrangement. We enter into license agreements that generally provide indemnification for our customers against intellectual property claims. FIN 45 also clarifies that at the time a guarantee is issued, companies must recognize an initial liability for the fair value of the obligations it assumes under the guarantee and must disclose that information in its financial statements. The provisions related to recognizing a liability at inception of the guarantee do not apply to product warranties or indemnification provisions in our software license arrangements. The initial recognition and measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002, and the disclosure requirements apply to guarantees outstanding as of December 31, 2002. We do not expect the adoption of FIN 45 to have a material effect on our financial position and results of operations.

In December 2002 the FASB issued SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure that amends SFAS No. 123, Accounting for Stock-Based Compensation. The standard provides for (1) alternative methods of transition for an entity that voluntarily changes to the fair-value method of accounting for stock-based employee compensation; (2) requires more prominent disclosure of the effects of an entity s accounting policy decisions with respect to stock-based employee compensation on reported income; and (3) amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure of those effects in interim financial information. SFAS No. 148 is effective for fiscal years ending after December 15, 2002, and for financial reports containing condensed financial statements for interim periods beginning after

December 15, 2002. We continue to account for employee stock options using the intrinsic value method in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees and will adopt the additional disclosure requirements of SFAS No. 128 for our fiscal quarter beginning March 1, 2003.

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FACTORS THAT MAY IMPACT FUTURE OPERATING RESULTS

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

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

- risks that our revenue forecasts may be incorrect because of our limited sales to date and our long sales process;
- risks associated with our dependence on Saba Learning Enterprise Edition, and related services, for substantially all of our revenues for the foreseeable future;
- risks that our new products, such as Saba Performance and Saba Content, will fail to achieve market acceptance;
- risks that our strategy of establishing Saba Exchange may not be successful;
- risks that fluctuations in our quarterly operating results will be significant relative to our revenues; and
- risks that the current economic downturn will continue to negatively impact the demand for our products and services.

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

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

We have incurred significant losses and negative cash flows from operations since our inception. We have not achieved profitability and cannot be certain that we will realize sufficient revenues to achieve or sustain profitability. We expect to derive substantially all of our revenues for the foreseeable future from the licensing of our Saba Learning Enterprise Edition and providing related services. Over the longer term, we expect to derive revenues from Saba Exchange, which is based on an evolving and unproven business model, and new products such as Saba Learning ASP Edition and Saba Performance, which is in limited release, and services related to these offerings. In the future, we expect to continue to incur substantial non-cash expenses relating to the amortization of deferred compensation and purchased intangible assets that will contribute to our net losses. As of February 28, 2003, we had an aggregate of $146,000 of deferred stock compensation and $840,000 of purchased intangible assets to be amortized. As a result of all of the foregoing, we expect to incur losses for the foreseeable future and will need to generate significantly higher revenues in order to achieve profitability. If we achieve profitability, we may not be able to sustain it.

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

Our operating results have varied significantly in the past and will likely fluctuate significantly in the future. We believe that quarter-to-quarter comparisons of our revenues and operating results are not necessarily meaningful and should not be relied on as indicators of future performance. Our operating expenses are based on our expectations of future revenues and are relatively fixed in the short-term. During fiscal 2002 (ended May 31, 2002) and the nine months ended February 28, 2003, we took actions to reduce our operating expenses and, while we may from time to time reduce operating expenses in response to variability in our revenues, including variabilities caused by downturns in the United States and/or international economies, over the long term we generally expect to increase our operating expenses to expand our sales and marketing operations, fund greater levels of research and development, develop new alliances, increase our services and support capabilities and improve our operational and financial systems. If our revenues do not increase along with these expenses, our business would be seriously harmed and net losses in a given quarter would be even larger than expected. It is possible that in some future quarter our operating results may be below the expectations of public market analysts or investors, which could cause the market price of our common stock to fall.

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

Failure to comply with Nasdaq s listing standards could result in our delisting by Nasdaq from the Nasdaq National Market

Our common stock is quoted on the Nasdaq National Market. In order for our common stock to continue to be quoted on the Nasdaq National Market, we must satisfy certain listing maintenance standards established by Nasdaq. On March 21, 2003, we received a letter from Nasdaq advising us that our common stock has not met Nasdaq s minimum bid price requirement for 30 consecutive trading days and that, if we are unable to regain compliance with this requirement during the 180 calendar days ending September 17, 2003, our common stock would be delisted at that time. The letter also stated that we could appeal any delisting notification received at that time. Our stock has not traded above $1.00 since we received the Nasdaq notice. We are seeking stockholder approval of a reverse stock split, pursuant to which any whole number of outstanding shares of our common stock between and including two and ten will be combined into one share, in an attempt to increase our stock price in excess of Nasdaq s requirements. If the proposed reverse split is not approved by our stockholders, or if it is not successful in increasing our stock price above $1.00 on an ongoing basis, our stock could be delisted from Nasdaq s National Market. Delisting would make our stock more difficult to trade, reduce the trading volume of our stock and further reduce our stock price. In addition, if our stock were delisted from Nasdaq s National Market, it is likely that customers, partners and investors may be less likely to do business with us on terms that we view as reasonable, and our operating results would suffer accordingly.

Our lengthy sales cycle could cause delays in revenue growth

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

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

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

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We are exposed to recent unfavorable economic conditions

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

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

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

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

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

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

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

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

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

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

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

- companies that market and license training, learning, performance, content, resource, talent and staffing management systems;
- enterprise software vendors that offer human resources information systems and employee relationship management systems with training and performance modules;
- potential customers internal development efforts;
- companies that operate Internet-based marketplaces for the sale of on-line learning;
- companies that operate Internet-based marketplaces for the sale of goods and services and could potentially decide to evolve their marketplaces to include content offerings; and
- Internet portals that offer learning content, performance support tools or recruiting services.

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

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

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

International revenues accounted for 44% of our revenues in the three months ended February 28, 2003 and 27% in the nine months ended February 28, 2003. We intend to expand our international presence in the future. Conducting business outside of the United States is subject to certain risks, including:

- changes in regulatory requirements and tariffs;
- language barriers;
- difficulties in staffing and managing foreign operations;
- longer payment cycles and greater difficulty in collecting accounts receivable;
- reduced protection of intellectual property rights;
- potentially harmful tax consequences;
- fluctuating exchange rates;
- price controls and other restrictions on foreign currency;

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- difficulties in obtaining import and export licenses;
- political and social unrest or disturbances;
- the burden of complying with a variety of foreign laws; and
- political or economic constraints on international trade.

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

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

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

- user privacy;
- taxation;
- content;
- right to access personal data;
- copyrights;
- distribution; and
- characteristics and quality of services.

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

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

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

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

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

As part of our strategy, we expect to regularly release new products and new versions of our existing products. Even if our new products or new versions of our existing products contain the features and functionality our customers want, in the event we are unable to timely introduce these new products or product releases, our competitive position may be harmed. We cannot assure you that we will be able to successfully complete the development of currently planned or future products or product releases in a timely and efficient manner. Due to the complexity of our products, internal quality assurance testing and customer testing of pre-commercial releases may reveal product performance issues or desirable feature enhancements that could lead us to postpone the release of these products. In addition, the reallocation of resources associated with any postponement would likely cause delays in the development and release of other future products or enhancements to our currently available products. Any delay in releasing future products or enhancements of our products could cause our stock price to decline.

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

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

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. On May 31, 2002, IP Learn, LLC (IP Learn) filed a lawsuit against us alleging that we infringed a number of patents assigned to IP Learn, and asking the court for a preliminary and permanent injunction as well as unspecified damages. We believe that IP Learn s claims are without merit, and we intend to defend against them vigorously. 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 filed

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nine patent applications in the U.S. We cannot assure you that any patents will be issued or, if issued, such patents will protect our intellectual property or not be challenged by third parties. Furthermore, effective protection of intellectual property rights is unavailable or limited in certain foreign countries. We cannot assure you that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our products and services or design around any patents or other intellectual property rights we hold.

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

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

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

We rely on third parties to provide key components of our networks and systems. For instance, we rely on third-party Internet service providers to host Saba Exchange and Saba Learning Enterprise Edition 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

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acceptable terms, we may be unable to develop or enhance our products and services, take advantage of future opportunities or respond to competitive pressures.

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

In March 2001, we acquired Human Performance Technologies, Inc. and, in June 2001, we acquired Ultris Inc. As part of our overall business strategy, we expect to continue to acquire complementary businesses or technologies that will provide additional products or services offerings, additional industry expertise or an expanded geographic presence. These acquisitions could result in the use of significant amounts of cash, potentially dilutive issuances of equity securities, or the incurrence of debt. In addition, any acquisition may increase the risk of future write-offs for acquired in-process research and development, write-offs for the impairment of goodwill or long-lived assets, or amortization of expenses related to intangible assets, any of which could materially adversely affect our business and our operating results. For example, as of February 28, 2003, we had an aggregate of $840,000 of purchased intangible assets to be amortized as a result of the acquisition of Human Performance Technologies, Inc. and Ultris Inc. Although these two acquisitions are fully integrated, future acquisitions involve numerous risks, including:

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

Our stock price may fluctuate substantially

The market price for our common stock may be affected by a number of factors, including those described above and the following:

- the announcement of new products and services or product and service enhancements by us or our competitors;
- quarterly variations in our results of operations or those of our competitors;
- changes in earnings estimates or recommendations by securities analysts that may follow our stock;
- developments in our industry; and
- general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

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

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

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

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

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

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

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

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

We provide our products and services to customers in the United States, Europe and elsewhere throughout the world. As a result, our financial results could be affected by risks typical of an international business. Such factors include, but are not limited to, changes in foreign currency exchange rates, local regulations and restrictions and political climates, weak economic conditions in foreign markets, differing tax structures and foreign currency rate volatility. Sales are primarily made in U.S. Dollars, 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 overall expected profitability.

Interest Rate Risk

Our investments are made in accordance with an investment policy approved by our board of directors. At February 28, 2003, the average maturity of our investment securities was approximately one month. The majority of our investment securities had maturities of less than one year. Our interest income is sensitive to changes in the general level of U.S. interest rates. Due to the nature of our cash equivalents and investments, which are primarily money market funds, commercial paper, corporate bonds and U.S. government agency bonds, we believe that there is no material market risk exposure.

All investments are carried at market value, which approximates cost. At February 28, 2003, all of our investments were considered available-for-sale securities and the majority had maturities of less than one year. The weighted average interest rate of our portfolio was approximately 1.5% at February 28, 2003.

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The interest payable on our revolving line of credit entered into in August 2002 is based on a variable interest rate using the bank s Prime Rate plus 1%. However, the outstanding balance on the line of credit as of August 31, 2002 was repaid in September 2002. Therefore, only future borrowings on the line of credit would be affected by changes in market interest rates.

The interest payable on our equipment term loans carry a fixed interest rate of 5.81% for the August 2002 loan, 5.53% for the November 2002 loan and 5.29% for the February 2003 loan. Any future draws under the term loan through May 2003, which are limited to the remaining available balance of $515,000 at February 28, 2003, would bear an interest rate at either a fluctuating rate equal to the bank s Prime Rate plus 1.25% or a fixed rate equal to the 36-month U.S. Treasury note plus 3.25%. Therefore, only future borrowings on the equipment term loan would be affected by changes in market interest rates.

ITEM 4. CONTROLS AND PROCEDURES

Within 90 days prior to the filing of this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in this report. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

There have been no significant changes in our internal controls or in other factors which could significantly affect internal controls subsequent to the date we carried out this evaluation.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York against us, certain of our officers and directors, and certain underwriters of our initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased our common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by us and our officers and directors of the Securities Act of 1933 in connection with certain alleged compensation arrangements entered into by the underwriters in 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 have since been consolidated into a single action. We intend to vigorously defend against this action. Although no assurance can be given that this matter will be resolved in our favor, we believe that the resolution of this lawsuit will not have a material adverse effect on our financial position, results of operations or cash flows.

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 compliant alleged that we infringed four U.S. patents assigned to IP Learn and asks the court for a preliminary and permanent injunction, as well as unspecified damages. IP Learn later amended to the complaint to add a fifth patent to the suit. Substantially similar complaints have been filed against at least four other companies in our industry. We believe that the complaint is without merit and intend to defend against it vigorously. Document and deposition discovery is now underway. The Court has set May 5, 2003 as the date for us to file a summary judgment motion. Although no assurance can be given that this matter will be resolved favorably, we believe that the resolution of this lawsuit will not have a material adverse effect on our financial position, results of operations or cash flows.

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

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. Exhibits

See Exhibit Index following the signature page.

b. Reports on Form 8-K.

None.

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SIGNATURES

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

	SABA SOFTWARE, INC.	
Dated: April 14, 2003	By:	/s/ GENO P. TOLARI
		Geno P. Tolari
		Chief Executive Officer and
		Chairman of the Board
		(Principal Executive Officer)
	By:	/s/ RONALD W. KISLING
		Ronald W. Kisling
		Chief Financial Officer (Principal
		Financial and Accounting Officer)

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CERTIFICATION

I, Geno Tolari, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Saba Software, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 14, 2003

By: /s/ GENO P. TOLARI

Geno Tolari

Chief Executive Officer and

Chairman of the Board

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CERTIFICATION

I, Ronald Kisling, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Saba Software, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 14, 2003

By: /s/ RONALD W. KISLING

Ronald Kisling

Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Document
3.1[(1)]	Amended and Restated Certificate of Incorporation of the Company as effective as of April 12, 2000.
3.2[(2)]	Amended and Restated Bylaws of the Company.
4.1	Reference is made to Exhibits 3.1 and 3.2.
99.1	Certification of Geno P. Tolari, Chief Executive Officer and Chairman of the Board, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification of Ronald W. Kisling, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference to Exhibit 3.2 to the Company s Registration Statement on Form S-1 (Registration No. 333-95761) previously filed with the SEC.

(2) Incorporated by reference to Exhibit 3.3 to the Company s quarterly report on Form 10-Q for the period ended August 31, 2002, previously filed with the SEC.

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