SUPPORTSOFT INC
Form 10-Q
November 05, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File No. 000-30901

SUPPORTSOFT, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-3282005**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1900 Seaport Boulevard, 3rd Floor
Redwood City, CA 94063
(Address of Principal Executive Offices)

(Zip Code)

Registrant s Telephone Number, Including Area Code: **(650) 556-9440**

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

On October 31, 2007, 46,157,346 shares of the Registrant s Common Stock, $0.0001 par value, were outstanding.

SUPPORTSOFT, INC.
FORM 10-Q
QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUPPORTSOFT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 22,078	$ 15,369
Marketable securities	92,154	104,522
Accounts receivable, net	8,425	15,144
Prepaid expenses and other current assets	2,241	2,894
Total current assets	124,898	137,929
Property and equipment, net	2,317	937
Goodwill	9,792	9,792
Intangible assets, net	2,338	3,155
Other assets	849	792
Total assets	$ 140,194	$ 152,605
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 426	$ 331
Accrued compensation	2,020	2,112
Other accrued liabilities	3,878	3,813
Deferred revenue, less long-term portion	7,690	13,435
Total current liabilities	14,014	19,691
Deferred revenue long-term portion	134	178
Other long-term liabilities	830	233
Commitments and contingencies		
Stockholders equity:		
Common stock	4	4
Additional paid-in capital	210,735	202,440
Accumulated other comprehensive loss	(770)	(751)
Accumulated deficit	(84,753)	(69,190)
Total stockholders equity	125,216	132,503
Total liabilities and stockholders equity	$ 140,194	$ 152,605

See accompanying notes.

Open items:

Outstanding shares

SUPPORTSOFT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenue:				
License	$ 2,586	$ 4,479	$ 11,725	$ 10,013
Services	4,536	3,462	11,423	9,106
Maintenance	4,201	3,917	12,035	11,740
Total revenue	11,323	11,858	35,183	30,859
Costs and expenses:				
Cost of license	52	119	141	333
Cost of services (including stock-based compensation of $193, $69, $564 and $175)	5,279	3,606	14,933	9,579
Cost of maintenance (including stock-based compensation of $22, $18, $59 and $35)	630	349	1,929	863
Amortization of purchased intangible assets	272	272	817	816
Research and development (including stock-based compensation of $129, $83, $366 and $301)	2,366	2,267	7,071	7,125
Sales and marketing (including stock-based compensation of $493, $219, $1,431 and $592)	6,959	6,013	23,081	16,993
General and administrative (including stock-based compensation of $392, $415, $1,311 and $1,224)	2,211	2,689	7,235	7,677
Total costs and expenses	17,769	15,315	55,207	43,386
Loss from operations	(6,446)	(3,457)	(20,024)	(12,527)
Interest income and other, net	1,636	1,842	5,019	4,705
Loss before income taxes	(4,810)	(1,615)	(15,005)	(7,822)
Provision for income taxes	(212)	(72)	(558)	(333)
Net loss	$ (5,022)	$ (1,687)	$ (15,563)	$ (8,155)
Basic and diluted net loss per share	$ (0.11)	$ (0.04)	$ (0.34)	$ (0.19)
Shares used in computing basic and diluted net loss per share	45,614	44,152	45,449	44,000

See accompanying notes.

SUPPORTSOFT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2007	**2006**
Operating Activities:		
Net loss	$ (15,563)	$ (8,155)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion of premium/discount on securities	226	947
Amortization of intangible assets	817	817
Stock-based compensation	3,731	2,327
Changes in assets and liabilities:		
Accounts receivable, net	6,719	10,399
Prepaid expenses and other current assets	653	(193)
Other long-term assets	(57)	260
Accounts payable	95	(820)
Accrued compensation	(92)	(988)
Other accrued liabilities	65	396
Other long-term liabilities	597	31
Deferred revenue	(5,789)	(4,439)
Other	(15)	(129)
Net cash provided by (used in) operating activities	(8,613)	453
Investing Activities:		
Purchases of property and equipment	(2,367)	(478)
Purchases of marketable securities	(78,781)	(52,946)
Maturities of marketable securities	91,906	46,191
Net cash provided by (used in) investing activities	10,758	(7,233)
Financing Activities:		
Proceeds from issuances of common stock	4,564	1,933
Net cash provided by financing activities	4,564	1,933
Net increase (decrease) in cash and cash equivalents	6,709	(4,847)
Cash and cash equivalents at beginning of period	15,369	23,342
Cash and cash equivalents at end of period	$ 22,078	$ 18,495
Supplemental schedule of cash flow information:		
Income taxes paid	$ 363	$ 253

See accompanying notes.

SUPPORTSOFT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of SupportSoft, Inc. (the Company , SupportSoft or We) and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated. The balance sheet as of September 30, 2007 and the statements of operations for the three and nine months ended September 30, 2007 and 2006 and cash flows for the nine months ended September 30, 2007 and 2006 are unaudited. In the opinion of management, these unaudited interim condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) that are necessary for a fair presentation of the results for, and as of, the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The condensed consolidated financial statement information as of December 31, 2006 is derived from audited financial statements as of that date. These unaudited interim condensed consolidated financial statements should be read with the consolidated financial statements and related notes included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 16, 2007.

Use of Estimates and Reclassifications

The preparation of interim condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates. In addition, certain amounts that were previously reported have been reclassified to conform to the current period presentation.

Revenue Recognition

We recognize revenue in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition,* as amended by SOP 98-4 and SOP 98-9. Revenue is recognized when all of the following criteria are met:

persuasive evidence of an arrangement exists;

delivery has occurred;

collection is considered probable; and

the fees are fixed or determinable.

We consider all arrangements with payment terms longer than 90 days not to be fixed or determinable. If a fee is determined not to be fixed or determinable, revenue is recognized as payments become due from a customer. License revenue is comprised of fees for perpetual and term licenses of our software. Perpetual license revenue is recognized using the residual method, in compliance with SOP 98-9 for arrangements in which licenses are sold with multiple elements. We allocate revenues on these licenses based upon the fair value of each undelivered element including undelivered maintenance, consulting and training. The determination of fair value is based upon vendor specific objective evidence (VSOE). VSOE for maintenance is based upon separate renewals of maintenance from customers. VSOE for consulting and training is based upon separate sales of these services to customers. Assuming all other revenue recognition criteria are met, the difference between the total arrangement fee and the amount deferred for each undelivered element is recognized as license revenue. In perpetual arrangements that include contractual obligations such as rights to unspecified future products, license revenue is recognized ratably over the contract period.

Term licenses are sold with maintenance for which we do not have VSOE to determine fair value for maintenance fees. As a result, license revenue for term licenses is recognized ratably over the duration of the agreement. License revenue in the accompanying financial statements includes maintenance for term licenses. We do not allocate maintenance revenue from term licenses to maintenance revenue, as we do not believe there is an allocation methodology that provides a meaningful and supportable allocation between license and maintenance revenues. Term license revenue was 3% and 5% of total revenue for

the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, term license revenue was 4% and 6% of total revenue, respectively. Services revenue associated with the term licenses are recognized ratably over the term of the license.

We provide resellers with the right to sublicense our software to end user customers. Generally, we recognize revenue from our arrangements with resellers upon persuasive evidence that the reseller has actually sublicensed the software to a named end user (sell-through), assuming all other criteria for revenue recognition have been met. The forms of evidence of sell-through acceptable to us include one or more of the following: i) a copy of the agreement or license between the reseller and the end user, ii) a purchase order from the end user to the reseller, iii) a written communication from the reseller to us specifically identifying the end user, or iv) delivery made directly by us to the end user. Whether the license revenue is then recognized immediately or ratably depends upon the terms of the arrangements with the reseller regarding the sublicense (i.e. perpetual license or term license). If a reseller is not deemed creditworthy, revenue otherwise recognizable is deferred until cash is received. When licensing arrangements with resellers include guaranteed minimum amounts due, revenue is recognized ratably over the term of the arrangement commencing when payments are made or become due.

Maintenance revenue is primarily comprised of revenue from post-contract technical support services, which includes software product updates. Maintenance revenue is recognized ratably over the term of the maintenance period, which is generally one year. We invoice customers who elect to renew their maintenance agreements, at which time an equal amount is recorded as accounts receivable and deferred revenue.

Services revenue is primarily comprised of revenue from professional services such as consulting, hosting and training fees. Arrangements are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. In the event services are considered essential to the functionality of other elements of the arrangement, revenue under the arrangement is recognized using contract accounting. Services that are not essential to the functionality of the software, such as consulting and training revenues are generally recognized as the services are performed or project milestones are accepted by the customer. When non-essential services are bundled in a term licensing arrangement, revenue from the services is recognized ratably over the term of the license.

In connection with licensing arrangements we may also provide hosting of our own software, a service for which we do not currently have VSOE. If hosting services are sold with perpetual licenses, license revenue is recognized ratably over the longest period in the contract. Hosting, consulting and training revenue in such arrangements are also recognized ratably over the longest period in the contract.

Cash, Cash Equivalents and Marketable Securities

We consider all liquid instruments with an original maturity at the date of purchase of ninety days or less to be cash equivalents. At September 30, 2007, cash equivalents and marketable securities consisted primarily of money market funds, commercial paper, auction rate securities, corporate bonds and notes and treasury bills issued by the United States government and its agencies. Our marketable securities are classified as available-for-sale as of the respective balance sheet dates, and are reported at fair value with unrealized gains and losses included in accumulated other comprehensive income within stockholders equity on the consolidated balance sheet. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in other income (expense), net in the consolidated statement of operations.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, both of which are included in interest income. We had net unrealized losses on marketable securities of $55,000 and $54,000 at September 30, 2007 and December 31, 2006, respectively.

We monitor our investments for impairment on a quarterly basis and determine whether a decline in fair value is other-than-temporary by considering factors such as current economic and market conditions, the credit rating of the security s issuer, the length of time an investment s fair value has been below our carrying value, and our ability and intent to hold investments to maturity. If an investment s decline in fair value is deemed to be other-than-temporary, we reduce its carrying value to its estimated fair value, as determined based on quoted market prices or liquidation values. Declines in value judged to be other-than-temporary, if any, are recorded in operations, as incurred.

The following is a summary of cash, cash equivalents and marketable securities at September 30, 2007 (in thousands):

	Amortized Cost	Gross Unrealized Losses	Fair Value
Cash	$ 4,793	$	$ 4,793
Money market funds	7,313		7,313
Commercial paper	24,715	(44)	24,671
Federal agencies securities	7,999	6	8,005
Corporate bonds	27,613	(13)	27,600
Auction rate certificates	41,850		41,850
	$ 114,283	$ (51)	$ 114,232
Classified as:			
Cash and cash equivalents	$ 22,079	$ (1)	$ 22,078
Marketable securities	92,204	(50)	92,154
	$ 114,283	$ (51)	$ 114,232

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, marketable securities and trade accounts receivable. Our investment portfolio is diversified and consists of investment grade securities. Our investment policy limits the amount of credit risk exposure to any one issuer and in any one country, except the United States. We are exposed to credit risks in the event of default by the issuers to the extent of the amount recorded on our balance sheet. The credit risk in our trade accounts receivable is substantially mitigated by our credit evaluation process, reasonably short collection terms and because we sell our products primarily to large organizations in diversified industries.

For the three months ended September 30, 2007, one customer accounted for greater than 10%, or 21%, of our total revenue. For the same period of 2006, one customer accounted for 21% of total revenue. For the nine months ended September 30, 2007, one customer accounted for 18% of our total revenue. For the same period of 2006, no customer accounted for 10% or more of total revenue.

Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount. We perform evaluations of our customers financial condition and generally do not require collateral. We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables for which collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically provided for, provisions are recorded at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current payment trends. If the historical data we use to calculate the allowance for doubtful accounts does not accurately reflect our future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and our future results of operations could be materially affected. At September 30, 2007 and December 31, 2006, we had reserves for credit losses of $326,000 and $373,000, respectively. At September 30, 2007, one customer accounted for 18% of our total accounts receivable. At December 31, 2006, one customer accounted for 15% of our total accounts receivable.

Stock-Based Compensation

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment,* (SFAS 123R) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options and employee stock purchases based on estimated fair values.

The fair value of our stock options granted to employees for the three and nine months ended September 30, 2007 and 2006 was estimated using the following assumptions:

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Stock Option Plan:				
Risk-free interest rate	4.1%	4.7 %	4.7%	5.2%
Expected term	3.8 years	3.9 years	3.8 years	3.9 years
Volatility	51.2%	54.6%	51.2%	50.6%
Estimated forfeitures	8%	8%	8%	8%
Expected dividend	0%	0%	0%	0%
Weighted average fair value	$2.32	$ 1.81	$2.47	$ 1.92
Employee Stock Purchase Plan (ESPP):				
Risk-free interest rate	4.7%	4.7%	4.7%	4.7%
Expected term	0.5 to 2.0 years	0.5 to 2.0 years	0.5 to 2.0 years	0.5 to 2.0 years
Volatility	54.1%	54.1%	54.1%	54.1%
Estimated forfeitures	8%	8%	8%	8%
Expected dividend	0%	0%	0%	0%
Weighted average fair value	$ 1.66	$ 1.66	$ 1.66	$ 1.66

We recorded the following stock-compensation expense for the three and nine months ended September 30, 2007 and 2006:

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Stock option compensation expense recognized in:				
Cost of services	$ 184	$ 47	$ 530	$ 117
Cost of maintenance	21	15	55	30
Research and development	122	65	345	210
Sales and marketing	482	196	1,389	490
General and administrative	387	400	1,291	1,172
	$ 1,196	$ 723	$ 3,610	$ 2,019
ESPP compensation expense recognized in:				
Cost of services	$ 9	$ 22	$ 34	$ 58
Cost of maintenance	1	3	4	5
Research and development	7	18	21	91
Sales and marketing	11	23	42	102
General and administrative	5	15	20	52
	33	81	121	308
Stock-based compensation expense included in total costs and expenses	$ 1,229	$ 804	$ 3,731	$ 2,327

Prior to the adoption of SFAS 123R, our Board of Directors approved the acceleration of vesting of certain unvested and out-of-money stock options with exercise prices equal or greater than $5.00 per share. The acceleration of vesting was effective for stock options outstanding as of December 21, 2005. Approximately 3.0 million stock options or 32% of our outstanding unvested stock options were subject to this acceleration and their weighted average price was $7.02. The options accelerated excluded options previously granted to Board of Directors, employees who had terminations pending, and foreign employees who opted out of the acceleration for tax reasons. For all officers and vice-presidents (non-officers) the acceleration was accompanied by restrictions that prevent the sale of any such shares prior to the date such shares would have

originally vested had the optionee been employed on such date.The purpose of the acceleration was to avoid recognizing compensation expense associated with these options in our Consolidated Statements of Operations upon the adoption of SFAS 123R on January 1, 2006.

The following table represents stock option activity for the nine months ended September 30, 2007:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in 000 s)
Outstanding options at the beginning of the period	13,580,874	$ 5.33		
Granted	1,567,300	5.66		
Exercised	(1,219,134)	3.32		
Forfeited	(1,949,009)	8.09		
Outstanding options at the end of the period	11,980,031	$ 5.14	5.90	$ 13,545
Options vested and expected to vest	11,888,810	$ 5.14	5.90	$ 13,443
Outstanding exercisable at the end of the period	5,479,395	$ 5.62	5.79	$ 6,174

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value that would have been received by the option holders had they all exercised their options on September 30, 2007. This amount will change based on the fair market value of our stock.

During the three and nine months ended September 30, 2007, the aggregate intrinsic value of options exercised under our stock options plans was $89,000 and $1.5 million respectively. During the three and nine months ended September 30, 2006, the aggregate intrinsic value of options exercised under our stock options plans was $147,000 and $538,000. Total fair value of options vested during the three and nine months ended September 30, 2007 was$1.2 million and $3.6 million. Total fair value of options vested during the three and nine months ended September 30, 2006 was $733,000 and $2.1 million, respectively.

At September 30, 2007, there was $14.0 million of unrecognized compensation cost related to existing options outstanding which is expected to be recognized over a weighted average period of 2.9 years.

Net Loss Per Share

Basic and diluted net loss per share are presented in accordance with Statement of Financial Accounting Standards No. 128 *Earnings per Share* (SFAS 128), for all periods presented. In accordance with SFAS 128, basic and diluted net loss per share have been computed using the weighted-average number of common shares outstanding during the period.

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months	Nine Months

	Ended September 30,		Ended September 30,	
	2007	2006	2007	2006
Net loss	$ (5,022)	$ (1,687)	$ (15,563)	$ (8,155)
Shares used in computing basic and diluted net loss per share	45,614	44,152	45,449	44,000
Basic and diluted net loss per share	$ (0.11)	$ (0.04)	$ (0.34)	$ (0.19)

Warranties and Indemnifications

We generally provide a warranty for its software products and services to its customers and accounts for its warranties under the Financial Accounting Standards Board s (FASB s) Statement of Financial Accounting Standards No. 5 *Accounting for Contingencies* (SFAS 5). Our standard warranty period is 90 days, but warranty periods can vary from customer to customer and sometimes be longer. In the event there is a failure of the product in breach of such warranties, we are generally obligated to correct the product or service to conform to the specifications or, if we are unable to do so, the customer is entitled to seek a refund of the purchase price of the defective product or service. We did not provide for a warranty accrual as of September 30, 2007 or December 31, 2006. To date, our product warranty expense has not been significant.

We generally agree to indemnify our customers against legal claims that our software products infringe certain third-party intellectual property rights and account for our indemnification obligations under SFAS 5. To date, we have not been required to make any payment resulting from infringement claims asserted against our customers and have not recorded any related accruals.

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for us beginning in the first quarter of fiscal year 2008, although earlier adoption is permitted. Although we are evaluating the application of SFAS No. 159, we do not currently believe adoption will have a material impact on our results of operations or financial position.

Note 2. Comprehensive Loss

Statement of Financial Accounting Standards No. 130 *Reporting Comprehensive Income* (SFAS 130) establishes standards for reporting and displaying comprehensive net income and its components in stockholders equity. SFAS 130 requires foreign currency translation adjustments and changes in the fair value of available-for-sale securities to be included in comprehensive income or loss.

The following are the components of comprehensive loss (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
In thousands	**2007**	**2006**	**2007**	**2006**
Net loss	$ (5,022)	$ (1,687)	$ (15,563)	$ (8,155)
Net unrealized gain (loss) on available-for-sale securities	25	72	(1)	87
Foreign currency translation gain (loss)	(16)	46	(18)	(118)
Comprehensive loss	$ (5,013)	$ (1,569)	$ (15,582)	$ (8,186)

The components of accumulated other comprehensive income (loss) relate entirely to foreign currency translation adjustment gains and losses and unrealized gains and losses on available-for-sale securities and are $(715,000) and $(55,000), respectively, at September 30, 2007.

Note 3. Income Taxes

The income tax provision was $212,000 and $558,000 for the three and nine months ended September 30, 2007, respectively. For the three and nine months ended September 30, 2006, we recorded a provision for income taxes of approximately $72,000 and $333,000, respectively. The

higher income tax provision for the three and nine month periods ended September 30, 2007 as compared to the same periods in 2006 primarily reflects higher foreign income during the periods in 2007 as compared to 2006.

As of September 30, 2007 and December 31, 2006, our deferred tax assets are fully offset by a valuation allowance. FASB s Statement of Financial Accounting Standards No. 109 *Accounting for Income Taxes* (SFAS 109) provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes SupportSoft s historical operating performance, reported cumulative net losses since inception and difficulty in accurately forecasting our future results, the Company provided a full valuation allowance against our net deferred tax assets. We reassess the need for our valuation allowance on a quarterly basis. If it is later determined that a portion of the valuation allowance should be reversed it will be a benefit to the income tax provision.

Effective January 1, 2007, we adopted Financial Accounting Standards Interpretation, No. 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement guidance for the financial statement reporting of uncertain tax positions taken or expected to be taken in a company s income tax return. FIN 48 also provides guidance related to derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition matters related to uncertain tax positions. FIN 48 utilizes a two-step approach for evaluating uncertain tax positions accounted for in accordance with SFAS 109. Step one, *Recognition*, requires a company to determine if the weight of available evidence indicates that a tax position is more likely than not to be sustained upon audit, including resolution of related appeals or litigation processes, if any. Step two, *Measurement*, is based on the largest amount of benefit, which is more likely than not to be realized on ultimate settlement. The cumulative effect of adopting FIN 48, if any, is recorded as an adjustment to the opening balance of retained earnings as of the adoption date.

As a result of the implementation of FIN 48, SupportSoft recognized no change in the liability for unrecognized tax benefits related to tax positions taken in prior periods. Additionally, SupportSoft reclassified $312,000 from current taxes payable to long-term taxes payable as FIN 48 specifies that tax positions for which the timing of the ultimate resolution is uncertain should be recognized as long-term liabilities.

As of January 1, 2007, the amount of unrecognized tax benefit with respect to which it is reasonably possible that a significant change may occur in the next 12 months is approximately $22,000. The change would result from expiration of the statute of limitations for audits in several foreign jurisdictions.

Upon adoption of FIN 48, the Company s policy to include interest and penalties related to unrecognized tax benefits within the Company s provision for (benefit from) income taxes did not change. At September 30, 2007, the Company had $35,000 accrued for payment of interest and penalties related to unrecognized tax benefits ($23,000 as of the adoption date of FIN 48). For the three and nine months ended September 30, 2007, the Company recognized $4,000 and $11,000, respectively, of interest and penalties related to unrecognized tax benefits in its provision for income taxes.

As of adoption of FIN 48, the Company s total unrecognized tax benefits were $1,867,000 of which $335,000, if recognized, would affect its effective tax rate. At September 30, 2007, the Company s total unrecognized tax benefits were $1,958,000, of which $425,000, if recognized, would affect its effective tax rate. The Company anticipates an increase to the unrecognized tax benefits during 2007 related primarily to tax credits and certain foreign tax exposures. While the increase in the unrecognized tax benefit cannot be estimated at this time, the 2007 changes are not expected to have a material effect on the financial statements. The tax years 1997 through 2006 remain open to examination in several jurisdictions, none of which have individual significance.

Note 4. Contingencies

Legal Matters

In re SupportSoft, Inc. Securities Litigation was a consolidated complaint filed in the United Stated District Court of the Northern District of California against the Company, our former CEO and former CFO. The complaint generally alleged violations of certain federal securities laws and sought unspecified damages. On June 1, 2006 this action was certified to proceed as a class action on behalf of all persons and entities who purchased or otherwise acquired the securities of the Company from January 20, 2004 to October 1, 2004 and who were allegedly damaged thereby. In

May, 2007, the parties reached an agreement in principle to settle the consolidated lawsuit. The court approved the settlement and dismissed the consolidated lawsuit with prejudice on September 28, 2007. The settlement was fully funded by insurance.

White v. Basu et al. is a derivative shareholder complaint filed in the Superior Court of the State of California for the County of San Mateo. This complaint was filed on behalf of the Company as a nominal plaintiff against certain of our directors and former directors and alleges that the director defendants harmed the Company by making or permitting the Company to make false and misleading statements between January 20, 2004 and October 1, 2004. On October 4, 2006, the court denied the defendants demurrer to the plaintiffs First Amended Complaint. Plaintiffs filed a Second Amended Complaint on October 27, 2006, which the defendants answered on November 6, 2006. In September, 2007, the parties reached an agreement in principle to settle the lawsuit. The settlement is expected to be fully funded by insurance and is subject to final approval of the court. A final approval hearing is scheduled for December, 2007. We cannot predict with certainty the outcome of the litigation, and if the settlement is not finally approved by the court, we believe we have meritorious defenses to the claims in the Second Amended Complaint.

In November 2001, a class action lawsuit was filed against us, two of our former officers, and certain underwriters in the United States District Court for the Southern District of New York. The lawsuit alleged that our registration statement and prospectus dated July 18, 2000 for the issuance and initial public offering of 4,250,000 shares of our common stock contained material misrepresentations and/or omissions related to alleged inflated commissions received by the underwriters of the offering. The lawsuit seeks unspecified damages as well as interest, fees and costs. Similar complaints have been filed against 55 underwriters and more than 300 other companies and other individual officers and directors of those companies. All of the complaints against the underwriters, issuers and individuals have been consolidated for pre-trial purposes before U.S. District Court Judge Scheindlin of the Southern District of New York. On June 26, 2003, the plaintiffs announced that a proposed settlement between the issuer defendants and their directors and officers had been reached. Under the proposed settlement, which is subject to court approval, our insurance carrier would be responsible for any payments other than attorneys fees prior to June 1, 2003. A final settlement approval hearing on the proposed issuer settlement was held on April 24, 2006. The district court took the matter under submission. Meanwhile the consolidated case against the underwriters has proceeded. On October 13, 2004, the district court certified a class in the underwriters proceeding. On December 5, 2006, however, the Second Circuit reversed, holding that the proposed class could not be certified, and denied a petition for rehearing on April 6, 2007. On June 25, 2007, the district court entered a stipulated order terminating the proposed issuer settlement. Plaintiffs are proceeding with discovery as to underwriters and issuers, although principally with respect to focus or test cases that do not name the Company as a defendant. The court set a briefing schedule for a new class certification motion, which is expected to be heard in early 2008. While we cannot predict with certainty the outcome of the litigation or whether the settlement will be approved, we believe we and our officers have meritorious defenses to the claims in the litigation.

We are also subject to other routine legal proceedings, as well as demands, claims and threatened litigation, that arise in the normal course of our business, including assertions that we may be infringing patents or other intellectual property rights of others. We currently believe that the ultimate amount of liability, if any, for any pending claims of any type (alone or combined) will not materially affect our financial position, results of operations or cash flows. The ultimate outcome of any litigation is uncertain, however, and either unfavorable or favorable outcomes could have a material negative impact on our financial condition and operating results. Regardless of outcome, litigation can have an adverse impact on us because of defense costs, negative publicity, diversion of management resources and other factors.

Sales Tax Contingencies

We are required to make periodic filings in the states where we are deemed to have a presence for tax purposes. We have undergone state audits in the past and have paid assessments arising from these audits. To date, such amounts have not been material. We evaluate estimated losses that could arise from similar assessments in accordance with SFAS 5. We consider such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss in making such evaluations.

Note 5. Subsequent Events

In the fourth quarter of 2007, we are implementing a reduction in workforce to align our cost structure with anticipated revenue. Approximately 12% of our workforce is affected by this restructuring. Currently, we expect to recognize $1.7 million to $1.9 million in restructuring costs during the fourth quarter of 2007. Actual costs may vary from this estimate. The restructuring charges will include personnel related costs as well as lease restructuring costs.

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

You should read this Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) in conjunction with the unaudited condensed consolidated financial statements and related notes appearing in Item 1 of this report on Form 10-Q and the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2006.

You should note that this MD&A discussion contains forward-looking statements that involve risks and uncertainties. Please see Item 1A in Part II of this Quarterly Report on Form 10-Q for important information to consider when evaluating such statements.

Overview

We are a leading provider of technology problem resolution software and services. Our solutions are designed to reduce technology support costs, improve customer satisfaction and enable new revenue streams for organizations worldwide. In 2007, we expanded our offerings and now provide technology support services directly to consumers.

Our corporate customers are IT organizations and digital service providers (telecommunications and cable companies). Corporate IT departments and managed service providers (IT outsourcing firms) use our software to improve the cost-effectiveness and efficiency of their support through an integrated portfolio of proactive service, self service and assisted service capabilities. Digital service providers use our products to automate the installation, activation and verification of broadband services, to reduce the cost and improve the quality of support for customers, to enable the remote management of devices located at customer premises, and to provide value-added services to consumers.

In addition to these offerings for corporate customers, we are now addressing the consumer technology support market. This offering is an extension of our traditional business and relies upon our products, technology and expertise in technology problem resolution. The new offering provides computer problem resolution for consumers over the phone and the Internet. We offer our consumer technology support services through www.support.com and through consumer-facing companies such as retailers and digital service providers.

Our revenue has historically consisted of software license fees and fees for maintenance, consulting, hosting and training services. In recent years, we have licensed our software to customers predominately on a perpetual basis in which we generally recognize the license revenue up front, assuming all criteria for revenue recognition under the applicable accounting rules have been met. We have experienced a trend of decreasing annual license revenue over the last three fiscal years. Maintenance fees relating to perpetual software licenses result in ratable revenue over the period of the maintenance term, which is generally one year. Consulting and training revenues are generally recognized as the services are performed or in accordance with predefined project milestones. Hosting fees are recognized ratably over the term of the hosting arrangement. Revenues associated with term licenses or arrangements in which we provide hosting services are recognized ratably over the expected period of performance of the contract, as we do not currently have VSOE for term licenses or hosting.

Our total revenue for the three months ended September 30, 2007 was $11.3 million. Our total revenue decreased in the third quarter of 2007 by $2.1 million, or 16%, from the second quarter of 2007, and by $500,000, or 5%, from the same quarter of 2006. The sequential and year-over-year decreases in total revenue were due primarily to the decreases in license revenue, partially offset by the increases in services revenue. The decreases in license revenue were due to closing fewer large licensing transactions in the third quarter of 2007. Historically, a relatively small number of customers have accounted for a substantial portion of our license revenue. Therefore, closure of or delays in closing a few large customer transactions can result in substantial fluctuations in license revenue from quarter to quarter as was the case in the third quarter of 2007. The sequential and year-over-year increases in services revenue were due to higher demand for our implementation consulting services, and to our consumer technology support services.

During 2007, we have also begun offering consumer technology support services to consumers. We do not expect immediate returns from this initiative, but believe it can create sustainable revenue growth over time. Although we are leveraging many of our existing resources, we are making significant incremental investments in furtherance of this initiative, including investments to operate call centers and to promote our consumer offerings. We expect that these additional investments will precede any material revenue increase from our new business initiatives. As a result, we currently expect quarterly net losses from this initiative to offset cost improvements from the reduction in workforce in our traditional business for the foreseeable future. Furthermore, we expect that our net loss for the full year in 2007, will significantly exceed the net losses we incurred during fiscal 2006.

In the fourth quarter of 2007, we are implementing a reduction in workforce to align our cost structure with anticipated revenue. Approximately 12% of our workforce is affected by this restructuring. Currently, we expect to recognize $1.7 million to $1.9 million in restructuring costs during the fourth quarter of 2007; however, the actual costs have not yet been determined and could vary from this estimate. The restructuring charges will include personnel related costs as well as lease restructuring costs.

We intend the following discussion of our financial condition and results of operations to provide information that will assist in understanding our financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted

for those changes, as well as how certain accounting principles, policies and estimates affect our financial statements.

Critical Accounting Policies and Estimates

In preparing our consolidated financial statements in conformity with accounting principles generally accepted in the United States, we make assumptions, judgments and estimates that can have a significant impact on our net revenue and operating results, as well as on the value of certain assets and liabilities on our consolidated balance sheets. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis we evaluate our assumptions, judgments and estimates and make changes accordingly. We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, allowance for doubtful accounts, accounting for income taxes, goodwill, intangible assets and stock-based compensation have the greatest potential impact on our consolidated financial statements, so we consider these to be our critical accounting policies. We discuss below the critical accounting estimates associated with these policies. For further information on the critical accounting policies, see Notes to Consolidated Financial Statements.

Revenue Recognition

We recognize revenue in accordance with generally accepted accounting principles that have been prescribed for the software industry. Revenue recognition requirements in the software industry are very complex. Our revenue recognition policy is one of our critical accounting policies because revenue is a key component of our results of operations and is based on complex rules that require us to make judgments. In applying our revenue recognition policy we must determine which portions of our revenue are recognized currently and which portions must be deferred. In order to determine current and deferred revenue, we make judgments with regard to the expected amount of future services to be performed and the appropriate fair value for those services. We also make judgments as to whether future services are essential to the functionality of other elements of the software arrangement. We do not record revenue on sales transactions when the collection of cash is in doubt at the time of sale. Rather, revenue is recognized from these transactions as cash is collected. The determination of collectibility requires significant judgment.

Allowance for Doubtful Accounts

We make judgments as to our ability to collect outstanding receivables and provide allowances for the appropriate receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically provided for, provisions are recorded at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current payment trends. If the historical data we use to calculate the allowance for doubtful accounts does not accurately reflect our future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and our future results of operations could be materially affected.

Accounting for Income Taxes

We are required to estimate our income taxes in each of the tax jurisdictions in which we operate. This process involves management s estimation of our actual current tax exposures together with an assessment of temporary differences determined based on the difference between the financial statement and tax basis of certain items. These differences result in net deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess, based on the weight of available evidence, the likelihood that the deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or adjust this allowance in a period, we must include a tax expense or benefit within the tax provision in our statements of operations.

Effective January 1, 2007, we adopted Financial Accounting Standards Interpretation, No. 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN48). FIN 48 prescribes a recognition threshold and measurement guidance for the financial statement reporting of uncertain tax positions taken or expected to be taken in a company s income tax return. FIN 48 also provides guidance related to derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition matters related to uncertain tax positions. FIN 48 utilizes a two-step approach for evaluating uncertain tax positions accounted for in accordance with SFAS 109. Step one, *Recognition*, requires a company to determine if the weight of available evidence indicates that a tax position is more likely than not to be sustained upon audit, including resolution of related appeals or litigation processes, if any. Step two, *Measurement*, is based on the largest amount of benefit, which is more likely than not to be realized on ultimate settlement.

Goodwill

We assess the impairment of goodwill annually or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss would be recognized when the sum of the discounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. The estimate of cash flows is based upon, among other things, certain assumptions about expected future operating performance and an appropriate discount rate determined by our management. Our estimates of discounted cash flows may differ from actual cash flows due to, among other things, economic conditions, changes to our business model or changes in operating performance. If we made different estimates, material differences may result in the write down of net long-lived and intangible assets, which would be reflected by charges to our operating results for any period presented. At September 30, 2007, we concluded our annual evaluation for impairment of goodwill and no impairment was recognized. We will continue to test for impairment during the third quarter of each year, or earlier if indicators of impairment exist.

Intangible Assets

We record purchased intangible assets at fair value. The original cost is amortized on a straight-line basis over the estimated useful life of each asset. We assess the impairment of intangible assets whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The assessment considers facts and circumstances, either internal or external, which indicate that the carrying value of the asset cannot be recovered. If and when indicators of impairment exist, we assess the need to record an impairment loss, by comparing the undiscounted net cash flows associated with related assets or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

Stock-based compensation

We account for stock-based compensation in accordance with the provisions of SFAS 123R. We adopted SFAS 123R using the modified prospective transition method which requires the application of the accounting standard starting from January 1, 2006. Under the fair value recognition provisions of SFAS 123R, stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. We estimate the fair value of stock-based awards on the grant date using the Black-Scholes-Merton option-pricing model. Determining the appropriate fair value model and calculating the fair value of stock-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected life. If any of these assumptions used in the option-pricing models changes significantly, stock-based compensation may differ materially in the future from that recorded in our accompanying financial statements.

RESULTS OF OPERATIONS

The following table sets forth the results of operations for the three and nine months ended September 30, 2007 and 2006 expressed as a percentage of total revenue.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
License	23%	38%	33%	32%
Services	40	29	33	30
Maintenance	37	33	34	38
Total revenue	100	100	100	100
Costs and expenses:				
Cost of license	0	1	0	1
Cost of services	47	30	42	31
Cost of maintenance	6	3	5	3
Amortization of intangible assets	2	2	2	2
Research and development	21	19	20	23
Sales and marketing	61	51	66	55
General and administrative	19	23	21	25
Total Costs and Expenses	156	129	156	140
Loss from operations	(56)	(29)	(56)	(40)
Interest and other income, net	14	16	14	15
Loss before income taxes	(42)	(13)	(42)	(25)
Income tax provision	(2)	(1)	(2)	(1)
Net loss	(44)%	(14)%	(44)%	(26)%

Three and Nine Months Ended September 30, 2007 and 2006

License Revenue

In thousands, except percentages	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	$ Change	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	$ Change	% Change
License revenue	$ 2,586	$ 4,479	$ (1,893)	(42)	$ 11,725	$ 10,013	$ 1,712	17

License revenue is comprised of fees for term and perpetual licenses of our software. Perpetual license revenue is recognized using the residual method described in SOP 98-9 for arrangements in which licenses are sold with multiple elements. We allocate revenues in these arrangements

based upon the fair value of each undelivered element including undelivered maintenance, consulting and training. The determination of fair value is based upon vendor specific objective evidence

(VSOE). VSOE for maintenance is based upon separate renewals of maintenance from customers. VSOE for consulting or training is based upon separate sales of these services to customers. Assuming all other revenue recognition criteria are met, the difference between the total arrangement fee and the amount deferred for each undelivered element is recognized as license revenue.

Historically, a relatively small number of customers have accounted for a substantial portion of our license revenue. Therefore, closure of a few large customer transactions can result in fluctuations in license revenue from period to period. The decrease in license revenue for the three months ended September 30, 2007, as compared with the same period in 2006, was due to fewer sizable license transactions with our customers. The increase in license revenue for the nine months period ended September 30, 2007 was due primarily to expansion of license agreements with existing customers in North America and Asia/Pacific. Key transactions that we hoped to close in the third quarter of 2007 remain in our sales pipeline, and as of the filing date of this Form 10-Q, we are in the sales and negotiation process with several companies for the purchase of our products and services. Ultimate closure of these and certain other sizable license transactions prior to December 31, 2007 will have a significant influence on whether we miss, meet or exceed expectations for revenue in the fourth quarter of 2007.

Services Revenue

In thousands, except percentages	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	$ Change	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	$ Change	% Change
Services revenue	$ 4,536	$ 3,462	$ 1,074	31	$ 11,423	$ 9,106	$ 2,317	25

Services revenue is primarily comprised of revenue from professional services, such as consulting, hosting and training, as well as revenue from our consumer technology support services. Services revenue is generally recognized as the services are performed. The increase in services revenue for the three and nine months periods ended September 30, 2007 compared with the same periods in 2006 were due primarily to higher demand for our implementation consulting services, and to our consumer technology support services.

Maintenance Revenue

In thousands, except percentages	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	$ Change	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	$ Change	% Change
Maintenance revenue	$ 4,201	$ 3,917	$ 284	7	$ 12,035	$ 11,740	$ 295	3

Maintenance revenue is comprised primarily of revenue from post-contract technical support services which includes software product updates. Maintenance revenue for the three and nine months ended September 30, 2007, increased slightly over the same periods in 2006 due primarily to maintenance contract renewals and maintenance associated with new licensing contracts.

International Revenue. Revenue from customers outside the North America accounted for approximately 24% and 21% of our total revenue for the three-month and nine-month periods ended September 30, 2007, compared with 19% and

22% for the three-month and nine-month periods ended September 30, 2006. The increase in international revenue as a percentage of total revenue in the three-month period ended September 30, 2007, as compared with the same period in the 2006 was due primarily to higher license revenue from Asia-Pacific customers and higher services revenue from EMEA customers in the third quarter of 2007. The percentage of international revenue of the total revenue for the nine months ended September 30, 2007 was relatively consistent with the comparable period in 2006.

Cost of license

In thousands, except percentages	Three Months Ended September 30, 2007	2006	$ Change	% Change	Nine Months Ended September 30, 2007	2006	$ Change	% Change
Cost of license	$ 52	$ 119	$ (67)	(56)	$ 141	$ 333	$ (192)	(58)

Cost of license consists primarily of costs related to third-party royalty fees under license arrangements for technology embedded in or resold with our products. The decreases in cost of license for the three and nine months ended September 30, 2007 compared with the same periods in 2006 were due primarily to lower third-party royalties.

Cost of services

In thousands, except percentages	Three Months Ended September 30, 2007	2006	$ Change	% Change	Nine Months Ended September 30, 2007	2006	$ Change	% Change
Cost of services	$ 5,279	$ 3,606	$ 1,673	46	$ 14,933	$ 9,579	$ 5,354	56

Cost of services consists primarily of compensation costs, travel costs, and related overhead expenses for our professional services organization, payments made to third parties for subcontracted consulting services, the cost of our call center operations for our consumer technology support offerings and third-party hosting fees. The increases for the three and nine months ended September 30, 2007 as compared to the same periods in 2006 were due primarily to:

- the cost of operating our call centers related to our consumer technology support offerings (there was no comparable cost in 2006);
- salary expense and related employees costs for additional professional services personnel; and
- an increase in hosting expenses.

Cost of maintenance

In thousands, except percentages	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	$ Change	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	$ Change	% Change
Cost of maintenance	$ 630	$ 349	$ 281	81	$ 1,929	$ 863	$ 1,066	124

Cost of maintenance consists primarily of compensation costs, travel costs, and related overhead expenses for customer support personnel. The increases in cost of maintenance for the three and nine months ended September 30, 2007 as compared with the same periods in 2006 were due primarily to increases in salary and related employee costs as a result of an increase in the number of customer support personnel.

Operating Expenses

In thousands, except percentages	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	$ Change	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	$ Change	% Change
Research and development	$ 2,366	$ 2,267	$ 99	4	$ 7,071	$ 7,125	$ (54)	(1)
Sales and marketing	6,959	6,013	946	16	23,081	16,993	6,088	36
General and administrative	2,211	2,689	(478)	(18)	7,235	7,677	(442)	(6)

Research and development. Research and development costs are expensed as incurred. Research and development expense consists primarily of compensation costs, consulting expenses and related overhead costs for research and development personnel. Research and development expenses for the three and nine months ended September 30, 2007, were relatively unchanged from comparable periods in 2006.

Sales and marketing. Sales and marketing expense consists primarily of compensation costs, including salaries, sales commissions and related overhead costs for sales and marketing personnel and promotional expenses, including public relations, advertising and trade shows. The increases for the three and nine months ended September 30, 2007 as compared to the same periods in 2006 were due primarily to:

salary and related expenses associated with additional sales and marketing personnel;

incremental expenditures for marketing programs and advertising in connection with our consumer offerings; and

in the nine months ended September 30, 2007 an increase in commissions associated with higher license revenue.

General and administrative. General and administrative expense consists primarily of compensation costs and related overhead costs for administrative personnel and professional fees for legal, accounting and other professional services. The decreases for the three months and nine months ended September 30, 2007 as compared to the same periods in 2006 were due primarily to lower salaries and related expenses.

Interest income and other, net

In thousands, except percentages	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	$ Change	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	$ Change	% Change
Interest income and other, net	$ 1,636	$ 1,842	$ (206)	(11)	$ 5,019	$ 4,705	$ 314	7

Interest income and other, net decreased slightly in the three months ended September 30, 2007 as compared with the three months ended September 30, 2006 because of a one-time payment of $295,000 received in the third quarter of 2006. The payment related to the settlement of a contractual dispute. The increase for the nine months of 2007 as compared to the same period in 2006 was primarily due to an increase in interest income because of higher interest rates earned on our marketable securities.

Provision for income taxes

In thousands, except percentages	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	$ Change	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	$ Change	% Change
Provision for income taxes	$ (212)	$ (72)	$ (140)	194	$ (558)	$ (333)	$ (225)	68

The increases for the three and nine months ended September 30, 2007 as compared to the same periods in 2006 were primarily due to higher foreign income tax and withholding taxes related to international customer payments.

As of September 30, 2007, our deferred tax assets are fully offset by a valuation allowance. SFAS 109 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes our historical operating performance, reported cumulative net losses since inception and difficulty in accurately forecasting our future long term results, we provided a full valuation allowance against our net deferred tax assets. We reassess the need for our valuation allowance on a quarterly basis. If it is later determined that a portion of the valuation allowance should be reversed, it will be a benefit to the income tax provision.

LIQUIDITY AND CAPITAL RESOURCES

Since our incorporation in December 1997, we have financed our operations primarily through proceeds from our initial public offering, follow-on public offering, cash flows from operations and, to a lesser extent, the private placement of our preferred and common stock, bank borrowings and capital equipment lease financing. There are many variables that impact our business plan including the levels of revenue, costs and expenses, and new capital investments. Actual cash usage could differ from these projections. During the nine months ended September 30, 2007, our cash, cash equivalents and marketable securities, in the aggregate, decreased approximately $5.7 million from $119.9 million at December 31, 2006 to $114.2 million at September 30, 2007.

Operating Activities

Net cash provided by (used in) operating activities was $(8.6) million and $453,000 for the nine months ended September 30, 2007 and 2006, respectively. Net cash used in operating activities for the nine months ended September 30, 2007 was primarily due to the net loss of $15.6 million and a decrease in deferred revenue of $5.8 million, partially offset by non-cash items of $4.8 million. Such items include depreciation, amortization, accretion of premium or discount on securities and stock-based compensation expenses. The net loss during the period was also partially offset by a reduction in accounts receivable of $6.7 million driven by cash collections during the period.

Net cash provided by operating activities for the nine months ended September 30, 2006 was primarily due to cash collections during the period, which contributed to a reduction in accounts receivable of $10.4 million. The reduction in accounts receivable was offset by a net loss of $8.2 million, a decrease in deferred revenue of $4.4 million, and non-cash items of $2.6 million.

Our accounts receivable and deferred revenue balances fluctuate from period to period and are primarily dependent on (i) the timing of the closure of our license agreements, especially larger agreements concluded late in the period, (ii) the related invoicing and payment provisions under those agreements, (iii) the timing of maintenance renewals and related invoicing, and (iv) collections. Accounts receivable decreased to $8.4 million at September 30, 2007 from $15.1 million at December 31, 2006. The reduction of $6.7 million was due to (i) strong collections in the first three quarters of 2007, and (ii) lower license bookings in the third quarter of 2007. Accounts receivable decreased to $7.0 million at September 30, 2006, a reduction of $10.4 million from $17.4 million at December 31, 2005. The reduction of accounts receivable was due to the existence of several significant accounts receivable at December 31, 2005 and collections of much of those receivables during the first quarter of 2006.

Deferred revenue decreased $5.8 million and $4.4 million for the nine month periods ended September 30, 2007 and 2006, respectively. The primary component of deferred revenue is deferred maintenance revenue, which represents amounts billed in advance for maintenance contracts. Deferred maintenance is recognized ratably over the maintenance term, which is typically one year. Although there are a number of factors that could cause deferred revenue to fluctuate from quarter to quarter, we generally expect the December 31 deferred maintenance balance to be higher than at other times during the year because of seasonally strong license sales in the fourth quarter and the initial and renewal maintenance billings associated with such license sales. In the quarters that follow December 31, the amortization of deferred maintenance will

generally result in a decrease in our overall deferred revenue balance.

Investing Activities

Net cash provided by (used in) in investing activities was $10.8 million and $(7.2) million for the nine months ended September 30, 2007 and 2006, respectively. Net cash provided by investing activities for the nine months ended September 30, 2007, was due to net sales of marketable securities of $13.1 million, offset by the purchase of property and equipment of $(2.4) million, primarily computer equipment, furniture, and leasehold improvements for our new headquarters office which we began to occupy in April 2007. Net cash used in investing activities for the nine months ended September 30, 2006, was due primarily to the net purchases of marketable securities of $(6.8) million and property and equipment of $(478,000).

Financing Activities

Net cash generated by financing activities was $4.6 million for the nine months ended September 30, 2007 and $1.9 million for the nine months ended September 30, 2006. Net cash provided by financing activities in both periods was attributable to net proceeds from the exercise of stock options and the purchase of common stock under our employee stock purchase plan.

Working Capital and Capital Expenditure Requirements

At September 30, 2007, we had stockholders equity of $125.2 million and working capital of $110.9 million. Included as a reduction to working capital is deferred revenue of $5.8 million, which will not require cash to settle, but will be recognized as revenue in the future. We believe that our existing cash balances will be sufficient to meet our working capital requirements as well as our planned capital expenditures for at least the next 12 months.

In the near term, we plan to make substantial investments in our consumer technology support services initiative. We believe this investment is essential to creating sustainable growth in our business in the future. Because this investment will likely precede any associated revenues, we expect our working capital to decrease in the near term.

If we require additional capital resources to grow our business internally or to acquire complementary technologies and businesses at any time in the future, we may seek to sell additional equity or debt securities. The sale of additional equity or debt securities could result in more dilution to our stockholders. Financing arrangements may not be available to us, or may not be available in amounts or on terms acceptable to us.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As most sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets.

As of September 30, 2007, we held $22.1 million in cash and cash equivalents consisting of highly liquid investments having original maturity dates of no more than 90 days. A decline in interest rates over time would reduce our interest income from our highly liquid marketable securities. Based upon our balance of cash and cash equivalents, a decrease in interest rates of 100 basis points would cause a corresponding decrease in our annual interest income of approximately $221,000. Due to the nature of our highly liquid cash equivalents, a change in interest rates would not materially change the fair market value of our cash and cash equivalents.

As of September 30, 2007, we held $92.2 million in marketable securities, which consisted primarily of money market funds held by large institutions in the U.S. and commercial paper. Our marketable securities were primarily invested in corporate bonds, government debt securities maturing in less than eighteen months and auction-rate securities resetting in less than ninety days. The weighted average interest rate of our portfolio was approximately 4.47% at September 30, 2007. A decline in interest rates over time would reduce our interest income from our

marketable securities. A decrease in interest rates of 100 basis points would cause a corresponding decrease in our annual interest income of approximately $922,000.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission (the SEC) rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet, and management believes they meet, reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also 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.

As of September 30, 2007 and as previously reported in our Annual Report on Form 10-K, as of December 31, 2006, our Chief Executive Officer and our Chief Financial Officer concluded that we disclosure controls and procedures were not effective due to a material weakness related to not appropriately quantifying the foreign currency translation gain or loss upon liquidation of a foreign subsidiary in 2006.

In response to our identification of the material weakness described above, we have since evaluated the accumulated currency translation adjustments of our foreign subsidiaries in order to determine the accuracy of the entity-specific and consolidated balances. At the conclusion of this review, we determined the balances to be properly stated as of December 31, 2006. In addition, we implemented a monthly review of the reasonableness of our recorded currency translation balances of all of our subsidiaries.

Based on implementation of these additional controls, we believe these additional internal controls will be effective in remediating the material weakness described above. We will continue to monitor the operating effectiveness of these controls.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 4 Contingencies to the financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of legal proceedings.

ITEM 1A. RISK FACTORS

This report contains forward-looking statements regarding our business and expected future performance as well as assumptions underlying or relating to such statements of expectation, all of which are forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We are subject to many risks and uncertainties that may materially affect our business and future performance and cause those forward-looking statements to be inaccurate. All statements in this report, other than statements that are purely historical, are forward-looking statements. Words such as expects, anticipates, intends, plans, believes, forecasts, estimat may result in, continue to, and similar expressions often identify forward-looking statements. In this report, forward-looking statements include, without limitation, the following:

our expectations and beliefs regarding future conduct and growth of the business;

anticipated impact on our business from our consumer technology support initiative from both revenue and expense perspectives;

our expectations regarding our collaboration with consumer technology support partners and the anticipated timing of revenue from these relationships;

our beliefs and expectations regarding the introduction of new products and related services and features;

our assessments and expectations surrounding growth and performance of our professional services organization;

our expectations regarding cash flows and expenses, including sales and marketing, research and development efforts, and administrative expenses;

our beliefs regarding seasonality, mix of revenue, and other trends for our business;

our assessments and beliefs regarding the future outcome of pending legal proceedings and the liability, if any, that we may incur as a result of those proceedings;

our expectations regarding the costs and other effects of acquisition and disposition transactions;

the expected cost and impact on our business of a reduction in our workforce;

the assumptions underlying our Critical Accounting Policies and Estimates, including our assumptions regarding revenue recognition; assumptions used to estimate the fair value of share-based compensation; assumptions regarding the impairment of goodwill and intangible assets; and expected accounting for income taxes; and

the expected effects of the adoption of new accounting standards.

An investment in our stock involves risk, and we caution investors that forward-looking statements are only predictions based on our current expectations about future events and are not guarantees of future performance. We encourage you to read carefully all information provided in this report and in our other filings with the SEC before deciding to invest in our stock or to maintain or change your investment. Forward-looking statements are based on information as of the filing date of this report, and we undertake no obligation to publicly revise or update any forward-looking statement for any reason.

Because forward-looking statements involve risks and uncertainties, there are important factors that may cause actual results to differ materially from our stated expectations. These factors are described below. This list does not include all risks that could affect our business, and if these or any other risks or uncertainties materialize, or if our underlying assumptions prove to be inaccurate, actual results could differ materially from past results and from our expected future results. We encourage you to review our other reports filed periodically with the Securities and Exchange Commission for any further information regarding risks facing our business.

We were not profitable in 2006 or in the first three quarters of 2007 and will continue to sustain a loss in the foreseeable future.

We were not profitable in 2006 or in the first three quarters of 2007. In addition, we intend to make significant investments in support of our business in 2007 and we expect to continue to sustain losses in 2007 and subsequent periods. If we fail to achieve revenue growth as a result of these additional investments or if such revenue growth does not result in our achieving profitability, the market price of our common stock will likely decline. A sustained period of losses would also result in an increased usage of cash to fund our operating activities and a corresponding reduction in our cash balance.

Our quarterly results have in the past, and may in the future, fluctuate significantly.

Our quarterly revenue and operating results have in the past and may in the future fluctuate from quarter to quarter. As a result, we believe that quarter-to-quarter and year-to-year comparisons of our revenue and operating results are not necessarily meaningful, and that these comparisons may not be accurate indicators of future performance.

Several factors that have contributed or may in the future contribute to fluctuations in our operating results include:

- demand for our software and services;
- size and timing of customer orders and our ability to recognize revenue in a given quarter;
- our collaboration with consumer technology support partners and the anticipated timing of revenue from these partnerships;
- our reliance on a small number of customers for a substantial portion of our revenue;
- the price and mix of products and services we or our competitors offer;
- the mix of products and services that generate up-front revenue as opposed to revenue over a period of time;
- our ability to attract and retain customers;

the rate of expansion of our new consumer offerings and our investments therein;

the amount and timing of operating costs and capital expenditures in our business;

seasonal trends resulting from corporate spending patterns;

the exercise of judgment by our management in making accounting decisions in accordance with our accounting policies; and

general economic conditions and their effect on our operations.

In prior years, we licensed a significant portion of our software on a term basis in which revenue was recognized ratably over the length of the agreement with the customer. In recent periods, however, we typically have licensed our software on a perpetual basis in which we recognize the license revenue up front, assuming all criteria for revenue recognition have been met. As a result of our current perpetual licensing model, we have become dependent on a few customer contracts with up-front license revenue for a substantial portion of our revenue in any one quarter. In addition, a significant portion of our total revenue each quarter comes from a number of orders received in the last month of a quarter. In previous quarters, we failed to close expected perpetual licenses with up-front revenue resulting in a revenue shortfall. If in future quarters we fail to close orders expected to be completed by the end of a quarter, particularly if these orders are for perpetual licenses with up-front revenue, our quarterly results would suffer and the market price of our common stock would likely decline.

Our inability to meet future financial performance targets that we announce or that are published by research analysts could cause the market price of our common stock to decline.

From time to time, we provide guidance related to our future financial performance. In addition, financial analysts publish their own expectations of our future financial performance. Because our quarterly revenue and our operating results fluctuate, future financial performance is difficult to predict. In the past, including the third quarter of 2007, we have failed to meet our guidance. As it did following the announcement of our third quarter results, future downward adjustments of our guidance or the failure to meet our guidance or the expectations of research analysts would cause the market price of our common stock to decline.

Management s ability to accurately predict performance is affected in large part by a significant portion of our total revenue being dependent upon the closing of new large customer orders. In addition, our guidance is based in part upon the expectation of new product sales and services offerings with which we have a limited history. In the event we fail to achieve projected revenue levels in any quarter, we will be unable to reduce our expenses for that quarter in a corresponding fashion, and our results will not meet our guidance or the expectations of securities analysts or investors, which would cause the market price of our common stock to decline.

The trading market for our common stock relies in part on the research and reports that industry or financial analysts publish about us or our business. We do not control these analysts. If one or more of the analysts who currently cover us downgrade our stock, our stock price would likely decline rapidly. Furthermore, if one or more of these analysts cease coverage of us, we could lose visibility in the market, which in turn could cause the market price of our stock to decline.

Our consumer technology support initiative will increase operating expenses without any assurance of yielding increased revenue.

We are executing a plan to extend our business by providing consumer technology support services. In addition to continuing to offer our software to corporate customers, we are offering technology support to consumers. We may not be able to offer these new services successfully. We have limited experience in reaching or serving consumers directly or in managing call centers. As a result, we expect to use significant cash and incur increased operating expenses to support this new initiative, including costs of our outsourced call centers, promotional costs associated with reaching consumers and costs of obtaining personnel with the necessary consumer expertise. These investments may not yield increased revenue to offset these expenses. Furthermore, this new business initiative, if not favorably received by consumers, could damage the reputation of our corporate enterprise business as well as strain our management, financial and operational resources necessary to maintain our corporate business. The lack of market acceptance of such efforts or our inability to generate satisfactory revenue from such expanded services would have a material adverse effect on our business, prospects, financial condition and operating results.

Because a small number of customers have historically accounted for and may in future periods account for substantial portions of our revenue, our revenue could decline because of delays or losses of specific customer orders.

A small number of customers have historically accounted for, and may in future periods account for, substantial portions of our revenue. For the quarter ended September 30, 2007, one customer accounted for 21% of our total revenue for the quarter. Transaction structures that involve ratable revenue recognition and our consumer offerings, which typically involve payment on a per transaction basis, could reduce our dependence on large transactions with a small number of customers. However, these transaction structures account for a small portion of our revenue, and in the near term, we are likely to continue to derive a significant portion of our revenue from large transactions with a limited number of customers. Therefore, our revenue could decline because of the loss or delay of a single customer order. Additionally, we may not obtain new customers. The failure to obtain significant new customers, particularly customers that purchase perpetual licenses with up-front payments, the loss or delay of significant customer orders or the failure of existing customers to pay ongoing fees when due would harm our operating results.

Our sales cycle is lengthy and if revenue forecasted for a particular quarter is not realized in that quarter, significant expenses incurred may not be offset by corresponding revenue.

Our sales cycle for our software typically ranges from three to nine months or more and may vary substantially from customer to customer. The purchase of our products and services for corporate customers generally involves a significant commitment of capital and other resources by a customer. This commitment often requires significant technical review, assessment of competitive products and approval at a number of management levels within a customer s organization. In addition, in the wake of the Sarbanes-Oxley Act of 2002, companies have enhanced their approval processes, making sales more difficult or protracted. While our customers are evaluating our products and services, we may incur substantial sales and marketing expenses and spend significant management effort to complete these sales. Any delay in completing sales in a particular quarter or the failure to complete a sale after expending resources during the sales cycle could cause our operating results to suffer.

If our revenue from our international operations does not exceed the expense of establishing and maintaining international operations, our business could suffer.

For the years ended December 31, 2004, 2005, 2006 and the nine-month period ended September 30, 2007, international revenue was 11%, 21%, 23% and 21% of total revenue, respectively. We have limited experience in international operations and may not be able to compete effectively in international markets or effectively manage our operations in various countries. If we do not generate enough revenue from international operations to offset the expense of these operations, our operating results could suffer. Risks we face in conducting business internationally include:

- costs of staffing and managing international operations;
- smaller customers with less ability to pay United States rates for software and services;
- difficulty in reaching geographically dispersed customers;
- differing technology standards, intellectual property protections and other legal considerations;
- longer sales cycles;
- seasonal trends unique to international markets;
- dependence on local vendors, consultants and business partners;
- difficulties in staffing and managing international operations, including the difficulty in managing a geographically dispersed workforce in compliance with diverse local laws and customs;
- potential adverse tax consequences;
- changes in currency exchange rates and controls;

difficulties in maintaining effective internal control over financial reporting and compliance as a result of a geographically-dispersed workforce and customers;

longer collection cycles for accounts receivable; and

the effects of external events such as terrorist acts and any related conflicts or similar events worldwide.

Our operating results will suffer if we do not manage our professional services organization effectively.

Clients that license our software typically engage our professional services organization to assist with installation and implementation of our software and related consulting services. Revenue from professional services represented a substantial portion of our total revenue for the quarter ended September 30, 2007. Although significant improvement occurred in the third quarter, our professional services business did not operate in a profitable manner for the nine months ended September 30, 2007. We are planning to improve the financial performance of this organization; however, no assurance can be given that these plans will be successful. We have generally billed our customers for professional services on a time and material basis, using an agreed upon daily rate. However, customers have increasingly requested various contract structures, including milestone-based contracts and contracts for a fixed total fee. If unanticipated factors in a project are encountered, we may be subject to monetary and other significant penalties, and the profitably of our professional services business would decline further. Furthermore, an estimated loss on a contract is generally required to be recorded in the period in which a loss becomes evident. Recording a loss on a services contract could have a material adverse effect on our operating results for the period in which the loss was recorded.

If our existing customers do not renew maintenance contracts or purchase additional products and services, our operating results could suffer.

Historically, we have derived, and expect to continue to derive, a significant portion of our total revenue from existing customers who purchase additional products and services and renew maintenance contracts. Our customers may not renew maintenance contracts or purchase additional products and services. In addition, as we introduce new products, our current customers may not require or desire the functionality of our new products and may not ultimately purchase these products. If our customers do not renew maintenance contracts or do not purchase additional products and services, our operating results would suffer.

Our failure to establish and expand successful third-party alliances would harm our operating results.

Our consumer offerings require us to establish and maintain relationships with third parties who will direct consumers to us and provide technology support services to consumers based on our technology, as well as with third parties to whom we outsource our call center services. Failure to establish or maintain these relationships on acceptable terms or at all could materially and adversely affect the success of this initiative. In addition, there is the risk that, once established, these alliances may take longer than we expect to produce revenue or may not produce revenue at all. Such risks could significantly harm our operating results.

We have alliances with third parties that are important to our traditional offerings. Our existing relationships include those with hardware vendors and managed service providers who provide outsourced support to corporate customers. If these relationships fail, we may need to devote substantially more resources to the sales and marketing of our products and services than we would otherwise, and our efforts may not be as effective. For example, companies that provide outsourced support and services often have extensive relationships with our existing and potential customers and significant input in the purchase decisions of these customers. In addition, we may establish relationships with third-party resellers and other sales partners as we expand internationally. Our failure to maintain existing relationships, or to establish new relationships with key third parties, could significantly harm our ability to sell our products and services. In addition, our competitors may have strong alliances with other companies, including hardware providers, which could impact our ability to obtain greater market share, participate in deals where hardware and software are sold together, or require us to reduce the price of products and services, which could harm our business, prospects, financial condition and operating results.

We may engage in investments, dispositions, acquisitions or other strategic matters that could divert management attention and prove difficult to integrate with our business.

We may engage in acquisitions or divestitures of certain assets, businesses, products or technologies, or in other strategic initiatives. Acquisitions, divestitures and other strategic transactions are inherently risky. Certain transactions may

be subject to closing conditions, which may not be satisfied, and transactions may not be completed, even after public announcement. Acquisitions may require further use of our cash resources, the issuance of equity or debt securities, or the incurrence of other forms of debt, any of which could harm our financial condition, results of operations, or our interest expense and leverage. If we issue equity securities, current stockholders percentage ownership and earnings per share may be diluted. The process of integrating businesses, technologies, services or products may result in unforeseen operating difficulties and expenditures. Acquisitions and divestitures could involve a number of other potential risks to our business, including the following:

unanticipated costs and liabilities and unforeseen accounting charges or fluctuations;

delays and difficulties in delivery of products and services;

failure to integrate management information systems, personnel, research and development, marketing, sales and support operations;

loss of key employees;

diversion of management s attention from other business concerns and disruption of our ongoing business;

difficulty in maintaining controls and procedures;

uncertainty on the part of our existing customers about our ability to operate after a transaction;

loss of customers;

loss of alliance partners;

failure to realize the potential financial or strategic benefits of the acquisition; and

failure to successfully further develop the combined technology, resulting in the impairment of amounts recorded as goodwill or other intangible assets.

We must compete successfully in the market for software and services that resolve technology problems or our business will suffer.

We compete in markets that are highly competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. We compete with a number of companies in the market for automated delivery of support and service automation and other vendors who may offer products or services with features that compete with specific elements of our software products and services. In addition, our customers and potential customers have developed or may develop internally similar software systems.

The markets for our products are still rapidly evolving, and we may not be able to compete successfully against current and potential competitors. Our ability to expand our business will depend on our ability to maintain our technological advantage, introduce timely enhanced products to meet growing support needs, deliver on-going value to our customers and scale our business. Our potential competitors may have longer operating histories, significantly greater financial, technical and other resources, stronger strategic alliances or greater name recognition than we have. Competition in our markets could reduce our market share or require us to reduce the price of products and services, which could harm our business, financial condition and operating results.

As we further enter the market for consumer technology support, we are competing against a set of competitors different than the competitors against whom we have historically competed, including electronics retailers offering on-site technology support services, companies offering online technology support services and companies offering local technology support services. Certain of these anticipated competitors have longer operating histories, significantly greater financial, technical and other resources, stronger strategic alliances or greater name recognition than we have.

The integration of new management and the loss of key personnel may affect our ability to achieve our business goals.

Our success depends on the skills, experience and performance of our senior management, engineering, sales, marketing and other key personnel. Many members of senior management have been appointed within the last 18 months. Our success will depend to a significant extent on the ability of these executives to function effectively in their new roles and to work together successfully. If these executives do not function and work together successfully, or if we lose the services of one or more of our executives or key employees, our business could be harmed. In addition, we are implementing a reduction in our workforce. Reductions in our workforce could make it difficult to motivate and retain remaining employees or attract needed new employees, and could also affect our ability to deliver products and services in a timely fashion.

Our exposure to the credit risks of our customers and resellers could adversely affect our operating results and financial condition.

To sell to some of our customers, we may be required to take risks of uncollectible accounts. We may be exposed to similar risks relating to third party resellers and other sales partners, as we intend to increasingly utilize such parties as we expand into new geographic regions. Additionally, as we have expanded our business internationally, we have experienced longer payment terms and collection cycles from customers outside the United States. While we monitor these situations carefully and attempt to take appropriate measures to protect ourselves by recognizing revenue upon collection of accounts from customers we deem to have credit risks and upon sell-through by resellers, it is possible that we may have to write down or write off doubtful accounts. Such write-downs or write-offs would negatively affect our operating results for the period in which they occur, and, if large, could have a material adverse effect on our operating results and financial condition.

Our future product and service offerings may not achieve market acceptance.

If we fail to develop enhanced versions of our software in a timely manner or to provide products and services that achieve rapid and broad market acceptance, we may not maintain or expand our market share. We are making significant investments in our consumer technology support initiative, and if our services do not achieve rapid market acceptance, our operating and financial results could be harmed. We may fail to identify new product and service opportunities for our current market or new markets that we enter in the future. In addition, our existing products may become obsolete if we fail to introduce new products or product enhancements that meet new customer demands, support new standards or integrate with new or upgraded versions of packaged applications or operating systems. We have limited control over factors that affect market acceptance of our product and services, including:

- the willingness of companies to transition to automated solutions; and
- customer preferences for competitors solutions or other technologies.

Our products depend on, and work with, products containing complex software; if our products fail to perform properly due to errors in the software, we may need to devote resources to correct the errors or compensate for losses from these errors and our reputation could be harmed.

Our products depend on complex software, both internally developed and licensed from third parties. Also, our customers may use our products with other companies products, which may also contain complex software. Complex software often contains errors and may not perform properly. These errors could result in:

- delays in product shipments;
- unexpected expenses and diversion of resources to identify the source of errors or to correct errors, whether or not the error is later determined to be related to our software;
- damage to our reputation;
- lost sales;
- contractual penalties, demands, claims and litigation and related defense costs; and
- warranty claims.

In our consumer offerings, we generally use our own products to diagnose and resolve consumer technology problems. If our products fail to perform well in this environment, our consumer offerings would suffer and may not be successful.

Our software may not operate with the hardware and software platforms that are used by our customers now or in the future, and, as a result, our business and operating results may suffer.

We currently serve a customer base with a wide variety of constantly changing hardware, software and networking platforms. For example, 64-bit microprocessors are becoming increasingly important to our customer base. If we fail to release versions of our software that are compatible with operating systems, software applications or hardware devices used by our customers, our business and operating results would suffer. Our future success also depends on the continuing ability of our products to inter-operate with multiple platforms and packaged applications used by our customer base and on our management of software being developed by third parties for our customers or for use with our products.

We rely on third-party technologies and our inability to use or integrate third-party technologies could delay product or service development.

We intend to continue to license technologies from third parties, including applications used in our research and development activities and technologies such as third-party search engine technology, which are integrated into our products and services. Our inability to obtain or integrate any of these technologies with our own products could delay product and service development until equivalent compatible technology can be identified, licensed and integrated. These technologies may not continue to be available to us on commercially reasonable terms or at all. We may fail to successfully integrate any licensed technology into our products or services, which would harm our business and operating results. Third-party licenses also expose us to increased risks that include:

- risks of product malfunction after new technology is integrated;
- the diversion of resources from the development of our own proprietary technology; and
- our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs.

Our system security is important to our customers and we may need to spend significant resources to protect against or correct problems caused by security breaches.

A fundamental requirement for online communications, transactions and support is the secure transmission of confidential information. Third parties may attempt to breach our security or that of our customers. We may be liable to our customers for any breach in security and any breach could harm our business and reputation. Also, computers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We recently released a security advisory and a patch for a remote code execution vulnerability in several of our ActiveX components. We may be required to expend significant capital and other resources to further protect against security breaches or to correct problems caused by any breach.

Our reported results of operations will continue to be materially and adversely affected by our adoption of SFAS 123R.

Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R) became effective in our first quarter of 2006, and has resulted in our recognition of substantial compensation expense relating to our employee stock options and employee stock purchase plans. Historically, we generally have not recognized in our statement of operations any compensation expense related to stock option grants we issue under our stock option plans or the discounts we provide under our employee stock purchase plans. Under the new rules, we are required to measure the compensation expense related to employee stock awards on a fair value basis, which leads to substantial additional compensation expense and a material adverse effect on our reported results of operations.

If we are unable to maintain effective disclosure controls and procedures, including our internal control over financial reporting, our ability to report our financial results on a timely and accurate basis may be adversely affected.

We have evaluated our disclosure controls and procedures as such term is defined in Rule 13a-15(e) under the Exchange Act as of September 30, 2007, as well as our internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002 as of December 31, 2006. Our independent registered public accounting firm has performed a similar evaluation of our internal control over financial reporting as of December 31, 2006. Effective controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our operating results would be harmed. For the periods ended September 30, 2007 and December 31, 2006, we concluded that we had a material weakness in our internal control over financial reporting, as further described in Item 4 of Part I of this Quarterly Report, and Item 9A of Part II on Form 10-K, Control and Procedures. Our independent registered public accounting firm reached the same conclusion. In the first quarter of 2007, we implemented corrective actions that we believe will remediate this material weakness. We are monitoring the effectiveness of these controls. However, we cannot be certain that these measures will ultimately be effective in remediating the material weakness. If these actions are not successful in addressing this material weakness or if other weaknesses are identified, our ability to report our financial results on a timely and accurate basis may be adversely affected. In addition, if we cannot establish effective internal control over financial reporting and disclosure controls and procedures, investors may lose confidence in our reported financial information, which could cause the market price of our common stock to decline.

We have recorded long-lived assets, and our results of operations would be adversely affected if their value becomes impaired.

Goodwill and identifiable intangible assets were recorded in part due to our acquisition of substantially all of the assets of Core Networks Incorporated in September 2004. We also have certain intangible assets with an indefinite life. We assess the impairment of goodwill and indefinite life intangible assets annually or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. We assess the impairment of acquired product rights and other finite life intangible assets whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the discounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. Material differences may result in write-downs of net long-lived and intangible assets, which would cause our operating results to suffer.

Failure to resolve litigation or claims asserted against us may lead to continued costs and expenses and divert management s attention from our business, which could cause our revenue and our stock price to decline.

Securities class action lawsuits were filed against us in November 2001 and again in December 2004. In addition, a derivative stockholder lawsuit was filed against us in December 2005. Should these lawsuits linger for a longer period of time, whether ultimately resolved in our favor or not, or further lawsuits be filed against us, coverage limits of our insurance or our ability to pay such amounts may not be adequate to cover the fees and expenses and any ultimate resolution associated with such litigation. The size of these payments, if any, individually or in the aggregate, could seriously impair our cash reserves and financial condition. The continued defense of these lawsuits also could result in diversion of our management s time and attention away from business operations, which could cause our financial results to decline. A failure to resolve definitively current or future material litigation in which we are involved or in which we may become involved in the future, regardless of the merits of the respective cases, could also cast doubt as to our prospects in the eyes of customers, potential customers and investors, which could cause our revenue and stock price to decline.

Privacy concerns and laws or other domestic or foreign regulations may reduce the effectiveness of our solutions or harm our reputation and cause us to lose customers.

Our software contains features that allow our customers and our consumer technology support technicians to control, monitor or collect information from computers running the software. Federal, state and foreign government bodies and agencies, however, have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers and individuals. Liability for violation of, costs of compliance with, and other burdens imposed by such laws and regulations may limit the use and adoption of our solutions and reduce overall demand for them. Even the perception of privacy concerns, whether or not valid, may inhibit adoption of our solutions. In addition, we may face claims about invasion of privacy or inappropriate disclosure, use, storage, or loss of this information. Any imposition of liability could harm our reputation, cause us to lose customers and cause our operating results to suffer.

We may not obtain sufficient patent protection, which could harm our competitive position, increase our expenses and harm our business.

Our success and ability to compete depend to a significant degree upon the protection of our software and other proprietary technology. It is possible that:

- our pending patent applications may not be issued;
- competitors may independently develop similar technologies or design around any of our patents;
- patents issued to us may not be broad enough to protect our proprietary rights; and
- our issued patents could be successfully challenged.

We rely upon patents, trademarks, copyrights and trade secrets to protect our proprietary rights and if these rights are not sufficiently protected, it could harm our ability to compete and to generate revenue.

We rely on a combination of laws, such as those applicable to patents, copyrights, trademarks and trade secrets, and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights. Our ability to compete and grow our business could suffer if these rights are not adequately protected. Our proprietary rights may not be adequately protected because:

- laws and contractual restrictions may not adequately prevent misappropriation of our technologies or deter others from developing similar technologies; and

- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the existence or extent of this unauthorized use.

Also, the laws of other countries in which we market our products may offer little or no protection of our proprietary technologies. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for them, which would harm our competitive position and market share.

We may face intellectual property infringement claims that could be costly to defend and result in our loss of significant rights.

Our business relies upon the use and licensing of technology and software. Other parties may assert intellectual property infringement claims against us or our customers, and our products may infringe the intellectual property rights of third parties. For example, our products may infringe issued patents that may relate to our products. In addition, as is increasingly common in the software industry, we may be confronted with the aggressive enforcement of patents by companies whose primary business activity is to acquire patents for the purpose of offensively asserting them against other companies. From time to time, we have received allegations of intellectual property infringement, and we may receive more claims in the future. Intellectual property litigation is expensive and time-consuming and could divert management s attention from our business. The outcome of any litigation is uncertain and could significantly impact our financial results. If there is a successful claim of infringement, we may be required to develop non-infringing technology or enter into royalty or license agreements, which may not be available on acceptable terms, if at all. Our failure to develop non-infringing technologies or license proprietary rights on a timely basis would harm our business.

If the growth of demand for digital services does not continue, our ability to increase our revenue could suffer.

Our ability to increase our revenue will depend in part on increased demand for digital services. If this demand does not grow as rapidly or to the extent we anticipate, our business could suffer. The growth of digital services is uncertain and will depend in particular upon the availability, at a reasonable price, of such digital services, the building of infrastructure to support such services, the availability of competitive products, and the reliability of such services.

We may experience a decrease in market demand due to uncertain economic conditions in the United States and in international markets, which has been further exacerbated by the concerns of terrorism, war and social and political instability.

The United States and international economies have in the past experienced periods of slow economic growth and this could occur again. In addition, terrorist attacks in the United States and turmoil in certain overseas regions have increased uncertainty and may exacerbate a decline in economic conditions, both domestically and internationally. If the economy declines as a result of economic, political and social turmoil, or if there are further terrorist attacks in the United States or elsewhere, we may experience decreases in the demand for our products and services, which would harm our operating results.

We may be required to change our business practices if there are changes in accounting regulations and related interpretations and policies.

Accounting standards groups and regulators are actively re-examining various accounting policies, guidelines and interpretations related to revenue recognition, income taxes, investments in equity securities, facilities consolidation, accounting for acquisitions, allowance for doubtful accounts and other financial reporting matters. These standards groups and regulators could promulgate interpretations and guidance that could result in material and potentially adverse changes to our business practices and accounting policies.

New rules and regulations for public companies have increased and may continue to increase our administrative costs.

The Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the Securities and Exchange Commission and the Nasdaq Global Select Market, has required changes in corporate governance practices of public companies. These rules and regulations are increasing our legal and financial compliance costs, and making some activities more time-consuming and costly. These rules and regulations make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These new rules and regulations could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers.

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

None

ITEM 6. EXHIBITS

Exhibits.

31.1 Chief Executive Officer Section 302 Certification

31.2 Chief Financial Officer Section 302 Certification

32.1(1) Statement of the Chief Executive Officer under 18 U.S.C. § 1350(1)

32.2(1) Statement of the Chief Financial Officer under 18 U.S.C. § 1350(1)

(1) The certifications filed as Exhibits 32.1 and 32.2 are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of the Company under the Securities Exchange Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof irrespective of any general incorporation by reference language contained in any such filing, except to the extent that the registrant specifically incorporates it by reference.

SIGNATURE

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.

November 02, 2007

SUPPORTSOFT, INC.

By: /s/ KEN OWYANG
Ken Owyang
Chief Financial Officer and
Senior Vice President of Finance and Administration
(Principal Financial Officer, Chief Accounting Officer and Duly Authorized Signatory)

EXHIBIT INDEX TO SUPPORTSOFT, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED September 30, 2007

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