

SABA SOFTWARE INC
Form 10-Q
October 10, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 31, 2007

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

For the transition period from to .

000-30221

(Commission File number)

SABA SOFTWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

2400 Bridge Parkway
Redwood Shores, California

94-3267638
(I.R.S. Employer
Identification No.)

94065-1166

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(Address of principal executive offices)

(650) 581-2500

(Zip Code)

(Registrant's telephone number, including area code)

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 No

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 Accelerated filer Non-Accelerated filer

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

On September 20, 2007, 29,001,029 shares of the registrant's Common Stock, \$.001 par value, were outstanding.

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SABA SOFTWARE, INC.

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QUARTER ENDED AUGUST 31, 2007

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

	August 31, 2007 (Unaudited)	May 31, 2007 *
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,776	\$ 18,088
Restricted cash	500	500
Accounts receivable, net	24,087	20,905
Prepaid expenses and other current assets	3,039	2,767
Total current assets	39,402	42,260
Property and equipment, net	4,093	3,669
Goodwill	38,293	38,293
Purchased intangible assets, net	15,405	16,414
Other assets	1,170	977
Total assets	\$ 98,363	\$ 101,613
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 4,665	\$ 4,772
Accrued compensation and related expenses	5,421	5,746
Accrued expenses	4,615	5,949
Deferred revenue	27,912	27,886
Current portion of debt and lease obligations	2,048	2,664
Total current liabilities	44,661	47,017
Deferred revenue	1,742	1,598
Other long-term liabilities	1,177	
Accrued rent	2,723	2,769
Debt and lease obligations, less current portion	578	2,328
Total liabilities	50,881	53,712
Commitments and contingencies		
Stockholders equity:		
Preferred stock, issuable in series: \$0.001 par value: 5,000,000 authorized shares at August 31, 2007 and May 31, 2007; none issued or outstanding		
Common stock, \$0.001 par value: 50,000,000 authorized; 28,976,058 shares issued and outstanding at August 31, 2007 and 28,908,612 shares issued and outstanding at May 31, 2007	29	29
Additional paid-in capital	253,372	251,408
Treasury stock: 102,997 shares at August 31, 2007 and May 31, 2007, at cost	(232)	(232)

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Accumulated deficit	(205,689)	(203,333)
Accumulated other comprehensive income	2	29
Total stockholders' equity	47,482	47,901
Total liabilities and stockholders' equity	\$ 98,363	\$ 101,613

* Derived from audited financial statements included in the Company's Annual Report on Form 10-K for the year ended May 31, 2007 filed with the United States Securities and Exchange Commission

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share data)****(Unaudited)**

	Three months ended	
	August 31,	August 31,
	2007	2006
Revenues:		
License	\$ 4,730	\$ 6,188
License updates and product support	8,817	7,007
OnDemand	4,427	3,549
Professional services	7,478	6,415
Total revenues	25,452	23,159
Cost of revenues:		
Cost of license	195	215
Cost of license updates and product support	2,221	1,989
Cost of OnDemand	1,631	1,142
Cost of professional services	5,414	4,974
Amortization of acquired developed technology	294	294
Total cost of revenues	9,755	8,614
Gross profit	15,697	14,545
Operating expenses:		
Research and development	4,208	4,232
Sales and marketing	9,267	9,044
General and administrative	3,807	2,992
Amortization of purchased intangible assets	634	634
Total operating expenses	17,916	16,902
Loss from operations	(2,219)	(2,357)
Interest income and other, net	51	66
Interest expense	(70)	(136)
Loss before provision for income taxes	(2,238)	(2,427)
Provision for income taxes	118	164
Net loss	\$ (2,356)	\$ (2,591)
Basic and diluted net loss per share	\$ (0.08)	\$ (0.09)
Shares used in computing basic and diluted net loss per share	28,859	28,210

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**SABA SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(Unaudited)**

	Three months ended	
	August 31,	August 31,
	2007	2006
Operating activities:		
Net loss	\$ (2,356)	\$ (2,591)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	408	345
Amortization of purchased intangible assets	1,009	1,008
Stock-based compensation expense	1,329	509
Changes in operating assets and liabilities:		
Accounts receivable	(3,003)	(4,002)
Prepaid expenses and other current assets	(263)	79
Other assets	(194)	90
Accounts payable	(121)	(2,060)
Accrued compensation and related expenses	(545)	(660)
Accrued expenses	(19)	(591)
Accrued rent	(47)	(26)
Deferred revenue	128	1,190
Net cash used in operating activities	(3,674)	(6,679)
Investing activities:		
Purchases of property and equipment	(816)	(363)
Net cash used in investing activities	(816)	(363)
Financing activities:		
Proceeds from issuance of common stock under employee stock plans	635	306
Borrowings, under credit facility		4,000
Repayments on borrowings under credit facility	(2,341)	(542)
Repayments on note payable	(24)	(42)
Net cash provided by (used in) financing activities	(1,730)	3,772
Effect of exchange rate changes on cash	(92)	(3)
Decrease in cash and cash equivalents	(6,312)	(3,323)
Cash and cash equivalents, beginning of period	18,088	23,029
Cash and cash equivalents, end of period	\$ 11,776	\$ 19,706

See Accompanying Notes to Condensed Consolidated Financial Statements.

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SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The condensed consolidated financial statements include the accounts of Saba Software, Inc. and its wholly owned subsidiaries (Saba or the Company). All intercompany balances and transactions have been eliminated.

The accompanying condensed consolidated balance sheet as of August 31, 2007, the condensed consolidated statements of operations and the condensed consolidated statements of cash flows for the three months ended August 31, 2007 and 2006 are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. In the opinion of management, the unaudited interim condensed consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of the Company s financial position as of August 31, 2007, and the Company s results of operations and cash flows for the three months ended August 31, 2007 and 2006.

These unaudited condensed consolidated financial statements should be read in conjunction with Saba s audited condensed consolidated financial statements included in Saba s Annual Report on Form 10-K filed with the Securities and Exchange Commission on August 13, 2007. The results of operations for the three months ended August 31, 2007 are not necessarily indicative of results for the entire fiscal year ending May 31, 2008 or for any future period.

The condensed consolidated balance sheet at May 31, 2007 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

Certain previously reported amounts have been reclassified to conform to the current presentation. Such reclassifications did not have a significant impact on the Company s gross profit, net loss or net cash used in operating activities.

2. Stock-Based Compensation

The Company accounts for share-based payments to employees, including grants of employee stock options and purchases under employee stock purchase plans in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment, which requires that these awards (to the extent they are compensatory) be recognized in the Company s consolidated statements of operations based on their fair values.

The Company currently uses the Black-Scholes-Merton option pricing model to determine the fair value of stock options and ESPP shares. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the expected term of the awards, the Company s expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The Company estimates the expected term of stock-based awards granted by applying the simplified method in accordance with SAB 107. The Company estimates the volatility of its common stock-based upon its historical stock price volatility over the length of the expected term of the options. The Company bases the risk-free interest rate that it uses in the option valuation model on U.S. Treasury zero-coupon issues with remaining maturities similar to the expected term of the options.

The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. The expected term of employee stock purchase plan shares is the average of the remaining purchase periods under each offering period.

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The following assumptions have been used to value the awards granted during the three months ended August 31, 2007 under the Company's stock option plans and stock purchased under the ESPP:

	Three months ended			
	August 31,		August 31,	
	2007		2006	
Stock Options:				
Expected volatility		49%		66%
Risk-free interest rates		4.2%		4.7%
Expected term (years)		4.1		4.1
Expected dividend yield		0%		0%
Employee Stock Purchase Plan:				
Expected volatility		43%		50%
Risk-free interest rates		4.9%		5.2%
Expected term (years)	0.5	2.0	0.5	2.0
Expected dividend yield		0%		0%

The following table summarizes the stock-based compensation expense for stock options and ESPP shares that was recorded in the Company's results of operations in accordance with SFAS 123R for the three months ended August 31, 2007, and August 31, 2006.

	Three months ended			
	August 31,		August 31,	
	2007		2006	
(in thousands)				
Cost of revenues	\$	115	\$	59
Research and development		148		79
Sales and marketing		250		223
General and administrative		815		148
Stock-based compensation expense included in net loss	\$	1,328	\$	509

Included in the stock-based compensation expense was a one-time non-cash charge of \$632,000 related to an employment agreement amendment which modified the events that trigger accelerated vesting of options and allowed for an extension to standard exercise terms. The modification of terms created incremental compensation costs when remeasured based on current circumstances. The current assumptions ranged as follows: expected volatility of 42% to 49%; risk free interest rates of 4.9% to 5.0%; and expected term (years) of 0.75 to 3.5.

During the three months ended August 31, 2007, the Company's Board of Directors approved an increase to its 2000 Stock Incentive Plan by approximately 1.4 million shares.

3. Basic and Diluted Net Loss Per Share

Basic and diluted net loss per share information for all periods is presented under the requirements of SFAS No. 128, *Earnings per Share*. Basic earnings per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less the weighted-average number of shares that may be repurchased. Basic earnings per share also excludes any dilutive effects of options as well as any contingently issuable shares in escrow for which specific conditions have not yet been met. Potentially dilutive issuances have been

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excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive. The calculations of basic and diluted net loss per share are as follows:

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	Three months ended	
	August 31,	August 31,
	2007	2006
(in thousands, except per share data)		
Net loss	\$ (2,356)	\$ (2,591)
Weighted-average shares of common stock outstanding	28,859	28,210
Weighted-average shares of common stock used in computing basic and diluted net loss per share	28,859	28,210
Basic and diluted net loss per share	\$ (0.08)	\$ (0.09)

For the three months ended August 31, 2007 and 2006, 3.5 million and 2.0 million weighted-average potential common shares, respectively, consisting of outstanding options and shares related to the THINQ Learning Solutions, Inc. (THINQ) acquisition, are excluded from the determination of diluted net loss per share, as the effect of such shares is anti-dilutive.

4. Comprehensive Loss

Saba reports comprehensive loss in accordance with SFAS No. 130, *Reporting Comprehensive Income*. The following table sets forth the calculation of comprehensive loss for all periods presented:

	Three months ended	
	August 31,	August 31,
	2007	2006
(in thousands)		
Net loss	\$ (2,356)	\$ (2,591)
Foreign currency translation gain (loss)	(27)	19
Comprehensive loss	\$ (2,383)	\$ (2,572)

5. Acquisitions**Centra Software, Inc.**

On January 31, 2006, Saba acquired Centra Software, Inc. (Centra), a leading provider of software and services for online learning and training. As part of Saba's strategy to establish itself as the market leader in the enterprise learning software industry, Saba acquired Centra to leverage the Company's collaborative learning offering in order to provide the industry's first complete enterprise learning solution.

The Centra acquisition has been accounted for as a business combination. Assets acquired and liabilities assumed were recorded at their fair values as of January 31, 2006. The results of operations for Centra are included in the statement of operations of the Company beginning on February 1, 2006. The total purchase price was \$62.3 million, including acquisition related transaction costs, and is comprised of \$37.8 million of Saba common stock, \$19.4 million in cash and \$5.1 million of cash to pay various transaction costs. The purchase price was allocated to

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Centra's assets based on fair values at the time of the transaction. Saba allocated \$23.5 million to goodwill, \$18.1 to identifiable intangible assets and assumed \$14.0 million of Centra's liabilities. Saba also received \$27.7 million in cash, \$6.1 million in prepaid and other assets and \$0.9 million of property and equipment.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****6. Goodwill and Purchased Intangible Assets**

Purchased intangible assets consist of intellectual property, customer base and non-competition agreements acquired as part of a purchase business combination. The intangible assets are stated at cost less accumulated amortization and are being amortized on a straight-line basis over their estimated useful lives of three to seven years.

There were no additions to intangible assets during the quarter ended August 31, 2007. The following tables provide a summary of the carrying amounts of purchased intangible assets that continue to be amortized:

	August 31, 2007			Weighted
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Average Useful Life
(in thousands)				
Customer backlog	\$ 740	\$ (581)	\$ 159	2.4 Years
Customer relationships	14,920	(4,260)	10,660	6.3 Years
Tradenames	820	(260)	560	5 Years
Acquired developed technology	5,890	(1,865)	4,025	5 Years
Total	\$ 22,370	\$ (6,965)	\$ 15,404	

	May 31, 2007			Weighted
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Average Useful Life
(in thousands)				
Customer backlog	\$ 740	\$ (500)	\$ 240	2.4 Years
Customer relationships	14,920	(3,666)	11,254	6.3 Years
Tradenames	820	(219)	601	5 Years
Acquired developed technology	5,890	(1,571)	4,319	5 Years
Total	\$ 22,370	\$ (5,956)	\$ 16,414	

The total expected future amortization related to purchased intangible assets will be approximately \$2,946,000, for the remainder of fiscal 2008 and \$3,716,000, \$3,716,000, \$3,268,000 and \$1,759,000 in fiscal years 2009 through 2012, respectively.

Goodwill is reviewed annually for impairment (or more frequently if indicators of impairment arise). The Company completed its annual impairment assessment in fiscal 2007 and concluded that goodwill was not impaired. In the quarter ended August 31, 2007, there were no indicators of impairment of goodwill and intangible assets.

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There were no changes to the carrying amount of goodwill for the three months ended August 31, 2007.

7. Debt and Other Obligations

Notes Payable and other obligations

In connection with the acquisition of THINQ in May 2005, Saba assumed a note payable that represented payments due to a former landlord. At August 31, 2007 and May 31, 2007, the balance on the note payable was \$79,000 and \$88,000, respectively.

Credit Facility

Since August 2002, Saba has maintained a credit facility with a bank. On January 31, 2006, the Company entered into a new credit facility with the bank. The credit facility replaced the Company's existing credit facility with the bank. The credit facility provides for (i) a term loan in a principal amount of \$6,500,000, and (ii) a receivables borrowing base revolving credit line in an aggregate principal amount of up to \$7,500,000 at any time outstanding, which includes a sub-limit of up to \$5,000,000 for letters of credit, cash management and foreign

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exchange services. In November 2006, the Company amended the credit facility to add an equipment facility up to a principal amount of \$3,000,000. Both the term loan and the equipment facility are required to be repaid in 36 equal monthly installments of principal, plus interest. The equipment facility's term begins with the date of each advance under the contract. The Company obtained advances on November 30, 2006 and February 28, 2007. The maturity date of the term loan and the revolving credit line is January 31, 2009. The interest rate applicable to the loans under the credit facility is the bank's prime rate plus 0.50% for the term loan and the bank's prime rate plus 0.25% for borrowings under the revolving credit line and the equipment facility. The Company is required to pay an early termination fee if the credit facility is terminated by the bank due to the occurrence of an event of default or is refinanced by another financial institution, in each case, prior to the second anniversary of the credit facility. As of August 31, 2007 and May 31, 2007, the Company had borrowings on the term loan of \$1.5 million and \$3.8 million, respectively, and outstanding obligations of \$927,000 and \$1.0 million, respectively, on the equipment facility. As of August 31, 2007 there were no borrowings and \$7.4 million was available under the accounts receivable borrowing base portion of the revolving credit line.

The credit facility is secured by all of the Company's personal property other than its intellectual property. The credit facility includes certain negative covenants restricting or limiting the ability of the Company and its subsidiaries to, among other things: encumber its intellectual property; incur additional indebtedness; create liens on its property; make certain investments and acquisitions; merge or consolidate with any other entity; convey, sell, lease, transfer or otherwise dispose of assets; change its business; experience a change of control; pay dividends, distributions or make other specified restricted payments; and enter into certain transactions with affiliates. Such restrictions and limitations are subject to usual and customary exceptions contained in credit agreements of this nature. In addition, the credit facility requires the Company to satisfy a minimum consolidated EBITDA covenant on a quarterly basis and a minimum liquidity covenant on a monthly basis. EBITDA, or earnings before income tax, depreciation and amortization, also excludes stock-based compensation and includes the estimated revenue that would have been recorded related to the Centra deferred revenue fair value adjustment. As of May 31, 2007, the Company was in compliance with the liquidity covenant, but not in compliance with the EBITDA covenant. During the quarter ended August 31, 2007, the Company and the bank entered into a waiver and amendment to the loan agreement providing for (i) a waiver of the Company's non-compliance with the EBITDA covenant at May 31, 2007 and (ii) a reduced EBITDA covenant for the quarter ending August 31, 2007. As of August 31, 2007, the Company was in compliance with the liquidity and EBITDA covenants. If the Company violates any of these amended restrictive covenants or otherwise breaches the credit facility agreement, the Company may be required to repay the obligations under the credit facility prior to their stated maturity date, the Company's ability to borrow under the revolving credit line may be terminated and the bank may be able to foreclose on any collateral provided by the Company.

8. Restructuring

During fiscal 2006, as part of the acquisition of Centra, management approved and initiated a plan to restructure and eliminate duplicative pre-merger activities and reduce the Company's cost structure (the Centra Restructuring). Total restructuring costs associated with exiting activities were estimated to be approximately \$2.4 million. The components of accrued restructuring charges and movements within these components through August 31, 2007 for the Centra Restructuring were as follows:

	Workforce Reduction Charges	Facilities Related Charges	Total
(in thousands)			
Accrual as of May 31, 2006	\$ 927	\$ 593	\$ 1,520
Adjustments	(32)	314	282
Deductions cash payments	(803)	(553)	(1,356)
Accrual as of May 31, 2007	92	354	446
Deductions cash payments	(90)	(87)	(177)

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Accrual as of August 31, 2007

\$ 2 \$ 267 \$ 269

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SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

During fiscal 2006, Saba implemented a restructuring program (the 2006 Restructuring) to consolidate excess facilities as a result of its acquisitions of THINQ and Centra. The restructuring program was implemented under the provisions of SFAS No. 146.

During 2006, the facilities restructuring charge of \$358,000, which was recorded as part of the Company's general and administrative expense in the consolidated statement of operations, was based on the present value of the sum of non-cancelable lease costs, less estimates for future sublease income. In February 2007, the Company amended its remaining lease for these facilities and relinquished all rights in the excess facility. As no further payments were due related to this excess facility, the Company reduced its general and administrative expenses by the amount of the remaining portion of the restructuring accrual of \$211,000.

9. Guarantees

Saba enters into license agreements that generally provide indemnification for its customers against intellectual property claims. To date, Saba has not incurred any costs as a result of such indemnifications and has not accrued any liabilities related to such obligations in its consolidated financial statements.

Saba's license agreements also generally include a warranty that its software products will substantially operate as described in the applicable program documentation for a period of generally 90 days after delivery. To date, Saba has not incurred or accrued any material costs associated with these warranties.

10. Income Taxes

From inception through August 31, 2007, the Company has incurred net losses for federal and state tax purposes. Income tax expense was \$118,000 during the three months ended August 31, 2007 and \$164,000 during the three months ended August 31, 2006. Income tax expense during both of these periods consists primarily of foreign tax expense incurred as a result of local country profits and tax contingencies.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

The Company adopted FIN 48 effective June 1, 2007. As a result of the implementation of FIN 48, the Company did not recognize a cumulative adjustment to the June 1, 2007 balance of retained earnings.

As of June 1, 2007, the Company had unrecognized tax benefits of approximately \$7.4 million, which did not change significantly during the three months ended August 31, 2007. The unrecognized tax benefit is exclusive of accrued interest and penalties. Included in the balance of unrecognized tax benefits as of June 1, 2007, is approximately \$761,000, inclusive of interest and penalties, of tax benefits that, if recognized, would result in an adjustment to our effective tax rate. The amount of unrecognized tax benefits that would result in an adjustment to goodwill is \$637,000.

The Company anticipates an increase to the unrecognized tax benefits during the year ending May 31, 2008 as compared to year ended May 31, 2007 of approximately \$149,000. The anticipated increase will be due primarily to the accrual of additional reserves and interest accrued on existing reserves. The Company has historically classified accruals for tax uncertainties in current taxes payable and, where appropriate, as a reduction to deferred tax assets. As a result of the adoption of FIN 48, the Company has reclassified \$1.2 million from current taxes payable to other long-term liabilities.

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In accordance with FIN 48, paragraph 19, the Company classifies interest and penalties related to uncertain tax positions as a component of its provision for income taxes. Accrued interest and penalties relating to the income tax on the unrecognized tax benefits as of June 1, 2007, was approximately \$588,000.

During the first quarter of fiscal year ending 2008, the unrecognized tax benefit decreased by \$221,000. The decrease is mainly the result of the settlement of tax audits in France for tax years 2000 to 2003 resulting in a reduction of uncertain tax positions of approximately \$275,000.

Due to the Company's taxable loss position since inception, all tax years are subject to examination in the U.S. and state jurisdictions. The Company is also subject to examination in various foreign jurisdictions for tax years 1996 forward, for which the Company believes it has established adequate reserves.

As of August 31, 2007 and May 31, 2007 the Company has established a valuation allowance against the full amount of any net deferred tax assets. The Company currently provides a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all of its deferred tax assets, will not be realized.

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SABA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

11. Segment Information

Saba operates in a single operating segment, providing software and services that drive organizational excellence by bringing a disciplined approach to aligning, developing, and managing people across the entire organization.

12. Litigation

Litigation Relating to Initial Public Offering of Saba

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York (the District Court) against the Company, certain of its officers and directors, and certain underwriters of its initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased the Company s common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by the Company and its officers and directors of Section 11 of the Securities Act of 1933, Section 10(b) of the Exchange Act of 1934, and other related provisions in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints allege that the prospectus and the registration statement for the offering failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some investors in the IPO offering agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of the Company s stock. The complaints were later consolidated into a single action. The complaint seeks unspecified damages, attorney and expert fees, and other unspecified litigation costs.

On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all of the actions, including the action involving the Company. On July 15, 2002, the Company, along with other non-underwriter defendants in the coordinated cases, also moved to dismiss the litigation. On February 19, 2003, the District Court ruled on the motions. The District Court granted the Company s motion to dismiss the claims against it under Rule 10b-5, due to the insufficiency of the allegations against the Company. The District Court also granted the motion of the individual defendants, Bobby Yazdani and Terry Carlitz, the Company s Chief Executive Officer and Chairman of the Board and former Chief Financial Officer and a member of the Company s board of directors, to dismiss the claims against them under Rule 10b-5 and Section 20 of the Exchange Act. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including the Company.

In June 2004, an agreement of settlement was submitted to the Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On

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August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

The plaintiffs have continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007 again moved for class certification.

The Company intends to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect the Company's business, financial condition and results of operations.

Litigation Relating to Initial Public Offering of Centra

Centra, certain of its former officers and directors and the managing underwriters of Centra's initial public offering were named as defendants in an action filed in the United States District Court for the Southern District of New York (the District Court). The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve the Centra defendants on or about March 18, 2002. The original complaint has been superseded by an amended complaint filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, which is being coordinated with an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92, is purportedly brought on behalf of the class of persons who purchased Centra's common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The complaint alleges that, in connection with Centra's initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the after-market at pre-determined prices. The complaint asserts that Centra's registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. The underwriter defendants and the Centra defendants joined in motions to dismiss the above-referenced action on July 3 and July 15, 2002, respectively. On October 9, 2002, the plaintiffs dismissed, without prejudice, the claims against the named Centra officers and directors in the above-referenced action. On February 19, 2003, the District Court issued an order denying the motion to dismiss as to Centra and other defendants. In June 2004, an agreement of settlement was submitted to the Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

The plaintiffs have continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. Centra's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the

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Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007 again moved for class certification.

Saba, on behalf of Centra, intends to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect the Company's business, financial condition and results of operations.

Two individuals in Colorado have excluded themselves from the class action settlement and have each filed individual actions in state court in Colorado. These same individuals have filed similar actions against other issuers and their officers. The actions assert violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as well as common law fraud and intentional infliction of emotional distress. The complaints each seek compensation for a drop in stock price from the time of purchase to the time of sale and for alleged emotional distress. Centra prevailed on a motion to dismiss the complaints, the two individuals appealed the ruling and the motion has been briefed by the parties.

The Company, on behalf of Centra intends to defend the law suit vigorously. However, due to the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect the Company's business, financial condition and results of operations.

Litigation Relating to Claim of Patent Infringement by Centra

On August 19, 2003, a complaint was filed against Centra and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. Centra has filed an answer to the complaint denying all of the allegations. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred. Centra filed a request for reexamination of the patents at issue with the U.S. Patent and Trademark Office. The Company's patent counsel is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the District Court has approved the parties' motion to stay the court proceedings during the re-examination proceedings. A reexamination certificate has issued for one of the patents that canceled all of the patent's claims, thus rendering that patent of no further force or effect. A final office action has issued in the other reexamination proceeding in which all of the patent's original claims were rejected but a handful of newly-added claims were indicated as being allowable. Saba believes that it has meritorious defenses with respect to the other patent and Saba intends to vigorously defend this action.

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

13. Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109 and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax

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positions taken or expected to be taken on a tax return. Additionally, FIN 48 provides guidance on derecognition of tax positions, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, with early adoption permitted. The Company adopted FIN 48 as of June 1, 2007, and no material adjustment to retained earnings was required.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2009. The Company is currently evaluating the requirements of SFAS No. 157 and has not yet determined the impact on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain non-financial instruments that are similar to financial instruments) at fair value (the fair value option). The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, SFAS No. 159 specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the effect that SFAS No. 159 will have on its consolidated financial statements, should the Company decide to adopt its provisions. Should the Company decide to adopt SFAS No. 159, it will do so in the first quarter of fiscal year 2009.

In June 2007, the FASB ratified EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*. EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and will be adopted in the first quarter of fiscal 2009. The Company is currently evaluating the impact of the pending adoption of EITF 07-3 on its consolidated financial statements.

14. Related Party Transactions

For the three months ended August 31, 2007, Saba licensed its software and sold related support and services to Varian Medical Systems, Inc. (Varian) and Masimo Corporation (Masimo) in the aggregate amounts of \$106,000 and \$6,000, respectively. At August 31, 2007, Saba's accounts receivable included \$269,000 due from Varian. All amounts due from Masimo had been collected. The Executive Vice President of Varian and the Chairman and Chief Executive Officer of Masimo serve as directors on Saba's Board of Directors.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes contained herein and the information included in our other filings with the Securities and Exchange Commission. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the Securities Act) and Section 21E of the Securities and Exchange Act of 1934 (the Exchange Act). All statements in this Quarterly Report on Form 10-Q other than statements of historical fact are forward-looking statements. These forward-looking statements involve known and unknown risks and uncertainties. Our actual results may differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under Item 1A: Risk Factors. All forward-looking statements and risk factors included in this document are made as of the date of this report, based on information available to us as of such date. We assume no obligation to update any forward-looking statement or risk factor.

Forward-looking statements include statements regarding:

(i) in Part I, Item 1,

future amortization related to intangible assets,

our anticipation that we will not pay any cash dividends in the foreseeable future,

our estimates of future sublease income and the estimated payments of such income,

the resolution and effect of pending litigation,

the effect of recent accounting changes,

(ii) in Part I, Item 2,

our belief that the acquisition of Centra strengthened our competitive position and provided us with a broader and deeper product offering,

our expectation that the Saba Enterprise Suite and Saba Centra product suite will generate substantially all of our revenues,

our anticipation that we will not pay any cash dividends in the foreseeable future,

our belief that OnDemand revenue will continue to grow,

our belief that license updates and product support revenue will continue to grow due to our expanded customer base,

our anticipation that a substantial majority of our customers will renew their annual contracts and the sale of new licenses will increase the number of customers that purchase license updates and product support,

our expectations that research and development expenses will increase,

our expectation that we will not record additional amounts related to the amendment of an employment agreement,

our expectations relating to future amortization expenses,

our estimate that our unrecognized tax benefits will increase during the fiscal year ending May 31, 2008,

our anticipation that we will continue to experience long sales cycles,

our anticipation that our available cash resources and credit facilities, combined with cash flows generated from revenues, will be sufficient to meet our presently anticipated working capital, capital expense and business expansion requirements, for at least the next 12 months,

(iii) in Part II, Item 1,

the resolution and effect of pending litigation,

(iv) in Part II, Item 1A,

our expectation that we will derive substantially all of our revenues for the foreseeable future from the licensing of the Saba Enterprise Suite and the Saba Centra product suite and providing related services,

our expectation to continue to incur non-cash expenses relating to the amortization of purchased intangible assets along with any potential goodwill impairment,

our expectation that our operating results will fluctuate significantly in the future,

our success depending on our ability to attract and retain additional personnel,

our expectation that competition and the pace of change will increase in the future,

our intention to expand our international presence in the future,

our expectation to continue to acquire complementary businesses or technologies,

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our expectation to regularly release new products and new versions of our existing products,

our belief regarding the Edisync Systems litigation,

our belief that our success depends on our proprietary technology, and

our belief that our success depends on the acceptance and successful integration by customers of our products.

These forward-looking statements involve known and unknown risks and uncertainties. Our actual results may differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are:

defects and other problems with our products,

unanticipated adverse changes in the international markets,

incorrect estimates or assumptions,

unanticipated adverse results for pending litigation,

contraction of the economy and world markets,

lack of demand for information technologies from our customers,

requirements for increased spending in research and development,

unanticipated need for capital for operations,

lack of demand for our products,

*inability to introduce new products, and
the factors detailed under the heading Risk Factors.*

INTRODUCTION

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide readers with an understanding of Saba. The following are included in our MD&A:

Overview;

Critical Accounting Policies;

Results of Operations; and

Liquidity and Capital Resources.

OVERVIEW

General

We help organizations manage their most important asset – their people. We provide the premier software platform for enterprise learning, collaboration, performance, and talent management, as well as license updates and product support, and OnDemand, implementation, training, and consulting services. Our people management solutions drive organizational excellence by bringing a disciplined approach to aligning, developing, and managing people across the entire organization.

By using Saba to manage their extended workforce, our customers achieve demonstrably higher levels of performance through:

Increased productivity, sales and service effectiveness

Reduced personnel development and training costs

Improved organizational agility and execution

Our solutions help our customers through the implementation of a management system for aligning goals, developing and motivating people and measuring results. By implementing our solutions, organizations are better equipped to: align their workforce around the organization’s business objectives; effectively manage growing regulatory requirements; increase sales and channel readiness; accelerate the productivity of new people joining the extended enterprise of employees, customers, partners, and suppliers; increase both the speed of customer acquisition and long-term customer loyalty; shorten time-to-market of new products; and improve visibility into organizational performance.

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Background

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

On May 5, 2005, we completed the acquisition of THINQ Learning Solutions, Inc. (THINQ), a provider of enterprise learning management solutions which allowed us to expand our customer base and provided greater scale to increase our investment in research and development to accelerate innovation and increase stockholder value.

On January 31, 2006, we completed the acquisition of Centra Software, Inc. (Centra), a provider of online learning and training software and services. We believe our acquisition of Centra strengthened our competitive position in the human capital management market and provided us with a broader and deeper product offering. In addition, as a result of the acquisition our customer base substantially increased. The Centra acquisition included total purchase consideration of \$62.3 million.

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

Sources of Revenue

We generate revenues from the sale of software licenses, OnDemand services, annual license updates and product support, and professional services.

Software Licenses

We license our software solutions in multi-element arrangements that include a combination of our software, license updates and product support and/or professional services. A significant amount of our license sales are for perpetual licenses. To date, a substantial majority of our software license revenue has been derived from the Saba Learning product suite. Going forward, we expect the Saba Enterprise Suite and Saba Centra product suite to generate substantially all of our revenues. Our license revenue is affected by the strength of general economic and business conditions, as well as customers' budgetary cycles and the competitive position of our software products. In addition, the sales cycle for our products is long, typically six to twelve months. The timing of a few large software license transactions can substantially affect our quarterly license revenue.

OnDemand

OnDemand revenue includes revenue derived from term-based managed application services. These services are provided pursuant to customer agreements with terms typically ranging from one to three years. The associated OnDemand revenue is recognized ratably over the term of the agreement. We believe that OnDemand revenue will continue to grow as we anticipate that a substantial majority of our customers will renew their contracts on expiration and that we will continue to add new OnDemand customers.

Licenses Updates and Product Support

License updates and product support includes the right to receive future unspecified updates for the applicable software product and technical support. We typically sell license updates and product support for an initial period of one year concurrently with the sale of the related software license. After the initial period, license updates and product support is renewable on an annual basis at the option of the customer. Our license updates and product support revenue depends upon both our sales of additional software licenses and annual renewals of existing license updates and product support agreements. We believe that license updates and product support revenue will continue to grow as we anticipate that a substantial majority of our customers will renew their annual contracts and the sale of new software licenses will increase the number of customers that purchase license updates and product support.

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Professional Services

Our professional services business consists of consulting, education and strategic services. Consulting and education services are typically provided to customers that license software directly from us. These consulting and education services are generally provided over a period of three to nine months after licensing the software. Generally, consulting services related to software implementation are not considered essential to the functionality of the software. Our consulting and education services revenue varies directly with the levels of license revenue generated from our direct sales organization in the preceding three to nine month period. In addition, our consulting and education services revenue varies following our commercial release of significant software updates as our customers generally engage our services to assist with the implementation of their software update. Although we provide consulting services on a time and materials basis, a portion of these services is provided on a fixed fee basis. Strategic services are less dependent than consulting and education services on the sale of our licenses. Strategic services present additional opportunities that arise at different times throughout a customer life cycle.

Cost of Revenue

Our cost of revenue primarily consists of compensation, employee benefits and out-of-pocket travel-related expenses for our employees, including our OnDemand and license update and product support personnel, and the fees of third-party subcontractors, who provide professional services to our clients. Additionally, costs of revenue also includes external hosting fees and depreciation and amortization charges on the necessary OnDemand infrastructure, third-party license royalty costs, and overhead allocated based on headcount and reimbursed expenses. The amortization of acquired developed technology, comprised of the ratable amortization of technological assets acquired in the acquisition of Centra Software, Inc in 2006, is also included in the cost of revenue. Many factors affect our cost of revenue, including changes in the mix of products and services, pricing trends and changes in the amount of reimbursed expenses. Because cost as a percentage of revenues is higher for services than for software licenses, an increase in services, including OnDemand services, as a percentage of our total revenue would reduce gross profit as a percentage of total revenue.

Operating Expenses

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

CRITICAL ACCOUNTING POLICIES

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

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significant include revenue recognition policies, the allowance for doubtful accounts, the assessment of recoverability of goodwill and purchased intangible assets and restructuring costs. We have reviewed the critical accounting policies described in the following paragraphs with the Audit Committee.

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

persuasive evidence of an arrangement exists;

delivery has occurred;

the fee is fixed or determinable; and

collection is probable.

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

License revenues from licenses with a term of three years or more are generally recognized on delivery if the other conditions of SOP 97-2 are satisfied. We do not grant our resellers the right of return and we do not recognize revenue from resellers until an end-user has been identified and the other conditions of SOP 97-2 are satisfied. License revenues from licenses with a term of less than three years are generally recognized ratably over the term of the arrangement. License updates and product support revenue is also recognized ratably over the term of the arrangement, typically 12 months.

Revenue related to professional services is generally recognized as the services are performed. Although we provide professional services on a time and materials basis, a portion of these services is provided on a fixed-fee basis. For services performed on a fixed fee basis, revenues are generally recognized on the proportional performance of the project, with performance measured based on hours of work performed. For contracts that involve significant customization and implementation or consulting services that are essential to the functionality of the software, the license and services revenues are recognized over the service delivery period using the percentage-of-completion method.

Revenue from our OnDemand offerings is recognized as a service arrangement whereby the revenue is recognized ratably over the term of the arrangement or on an as-used basis if defined in the contract. Certain of our OnDemand offerings are integrated offerings pursuant to which the customers' ability to access our software is not separable from the services necessary to operate the software and customers are not allowed to take possession of our software, in which case revenue is recognized under the SEC's Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*. Our OnDemand offerings also include arrangements with customers that have separately licensed and taken possession of our software. When these OnDemand offerings are part of a multiple element arrangement involving licenses, we recognize revenue in accordance with SOP 97-2.

Allowance for doubtful accounts. Accounts receivable are recorded net of allowance for doubtful accounts and totaled \$24.1 million as of August 31, 2007. The allowance for doubtful accounts, which totaled \$413,000 as of August 31, 2007, is based on our assessment of the amount of probable credit losses in the existing accounts receivable. We determine the allowance based on the aging of the accounts receivable, the financial condition of our customers and their payment history, our historical write-off experience and other assumptions. Past due balances based on purchase order terms and other specific accounts as necessary are reviewed monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. If there is a deterioration of a

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major customer's credit worthiness or actual defaults are higher than our historical experience, we may be required to increase the allowance for doubtful accounts.

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Recoverability of goodwill and purchased intangible assets. We account for goodwill and other intangibles under Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. Our goodwill balance at August 31, 2007 and May 31, 2007 was \$38.3 million, including \$23.5 million and \$9.5 million recorded as a result of our acquisitions of Centra and THINQ, respectively. The total expected future amortization related to purchased intangible assets will be approximately \$2,946,000, for the remainder of fiscal 2008 and \$3,716,000, \$3,716,000, \$3,268,000 and \$1,759,000 in fiscal years 2009 through 2012, respectively. As of August 31, 2007, our purchased intangible assets balance was \$15.4 million.

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

Restructuring costs. The total accrued restructuring balance as of August 31, 2007 was \$269,000, which was principally comprised of facilities related charges recorded as part of the purchase accounting in the Centra acquisition. The assumptions we have made are based on the current market conditions in the various areas where we have vacant space and necessarily entail a high level of management judgment. Market conditions can fluctuate greatly due to factors such as changes in property occupancy rates and rental prices charged for comparable properties. These changes could materially affect our accrual. If, in future periods, it is determined that we have over-accrued for restructuring charges for the consolidation of facilities, the reversal of such over-accrual would have a favorable impact on our results of operations in the period this was determined and will be recorded as a credit to restructuring costs. Conversely, if it is determined that our accrual is insufficient, an additional charge would have an unfavorable impact on our results of operations in the period this was determined.

Stock-based compensation. We account for share-based payments to employees, including grants of employee stock options and purchases under employee stock purchase plans in accordance with Financial Accounting Standards Board (FASB) Statement No. 123 (revised 2004) (SFAS 123R), *Share-Based Payment*, which requires that these awards (to the extent they are compensatory) be recognized in our consolidated statements of operations based on their fair values. As required by SFAS 123R, we recognize stock-based compensation expense for awards issued or assumed after June 1, 2006 that are expected to vest. For all awards granted or assumed beginning June 1, 2006, we recognize stock-based compensation expense on a straight-line basis over the service period of the award, which is generally four years. The fair value of the unvested portion of awards granted prior to June 1, 2006 is recognized over the remaining service period using the accelerated expense attribution method, net of estimated forfeitures. SFAS 123R requires us to estimate the awards that we ultimately expect to vest and to reduce stock-based compensation expense for the effects of estimated forfeitures of awards over the expense recognition period. Although we estimated forfeitures based on historical experience, forfeitures in the future may differ. Under Statement 123R, the forfeiture rate must be revised if actual forfeitures differ from our original estimates. Also in connection with our adoption of Statement 123R, we elected to recognize awards granted after our adoption date under the straight-line amortization method.

We estimate the fair value of employee stock options using the Black-Scholes-Merton (BSM) pricing model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their stock options. The risk-free interest rate assumption is based upon United States treasury interest rates appropriate for the expected life of the awards. We estimate the volatility of our common stock based upon our historical stock price volatility over the length of the expected term of the. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. Our expected dividend rate is zero since we do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future.

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Recent Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109 and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Additionally, FIN 48 provides guidance on derecognition of tax positions, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, with early adoption permitted. We adopted FIN 48 as of June 1, 2007, and no material adjustment to retained earnings was required.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2009. We are currently evaluating the requirements of SFAS No. 157 and have not yet determined the impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain non-financial instruments that are similar to financial instruments) at fair value (the fair value option). The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, SFAS No. 159 specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We are currently evaluating the effect that SFAS No. 159 will have on our consolidated financial statements, should we decide to adopt its provisions. Should we decide to adopt SFAS No. 159, we will do so in the first quarter of fiscal year 2009.

In June 2007, the FASB ratified EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*. EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and will be adopted in the first quarter of fiscal 2009. We are currently evaluating the impact of the pending adoption of EITF 07-3 on our consolidated financial statements.

Table of Contents**RESULTS OF OPERATIONS****THREE MONTHS ENDED AUGUST 31, 2007 AND 2006****Revenues**

	Three months ended		Percent	
	August 31,	of Total	August 31,	of Total
	2007	Revenue	2006	Revenue
(dollars in thousands)				
Revenues:				
License	\$ 4,730	19%	\$ 6,188	27%
License updates and product support	8,817	35%	7,007	30%
OnDemand	4,427	17%	3,549	15%
Professional services	7,478	29%	6,415	28%
Total revenues	\$ 25,452	100%	\$ 23,159	100%

Total Revenues. Total revenues increased by \$2.3 million, or 10%, during the three months ended August 31, 2007 compared to the three months ended August 31, 2006. As a percentage of total revenues, revenues from customers outside the United States represented 32% for the three months ended August 31, 2007 and 28% for the three months ended August 31, 2006.

License Revenue. License revenue decreased by \$1.5 million, or 24%, during the three months ended August 31, 2007 compared to the three months ended August 31, 2006. The decrease in license revenue was primarily attributable to several large transactions entered into during the three months ended August 31, 2006 as well as stronger OnDemand bookings relative to license bookings during the three months ended August 31, 2007.

License Updates and Product Support Revenue. License updates and product support revenue increased by \$1.8 million, or 26%, during the three months ended August 31, 2007 compared to the three months ended August 31, 2006. The increase was primarily attributable to a high rate of renewals during the prior 12 months, the addition of license update and product support revenue associated with the sale of new software licenses over the past 12 months and higher revenue recognized upon renewal of contracts assumed in the Centra acquisition. As a result of the Centra acquisition, license update and product support revenue during the three months ended August 31, 2006 reflects a reduction in the amount of license update and product support revenue that would have been recognized by Centra as a standalone entity as required by purchase accounting.

OnDemand Revenue. OnDemand revenue increased by \$0.9 million, or 25%, during the three months ended August 31, 2007 compared to the three months ended August 31, 2006. The increase was due primarily to a high rate of renewals during the prior 12 months, the sale of additional OnDemand services over the past 12 months and higher revenue recognized upon renewal of contracts assumed in the Centra acquisition. As a result of the Centra acquisition, OnDemand revenue during the three months ended August 31, 2006 reflects a reduction in the amount of OnDemand revenue that would have been recognized by Centra as a standalone entity as required by GAAP purchase accounting.

Professional Services Revenue. Professional services revenue increased by \$1.1 million, or 17%, during the three months ended August 31, 2007 compared to the three months ended August 31, 2006. The increase in services revenue during the three months ended August 31, 2007 is primarily attributable to an increase in the number of consulting projects resulting from the increase in upgrade and expansion projects from an overall increasing customer base.

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

Table of Contents**Cost of Revenues**

	Three months ended		Percent	
	August 31,	of Total	August 31,	of Total
	2007	Revenue	2006	Revenue
(dollars in thousands)				
Cost of revenues:				
Cost of license	\$ 195	1%	\$ 215	1%
Cost of license updates and product support	2,221	9%	1,989	9%
Cost of OnDemand	1,631	6%	1,142	5%
Cost of professional services	5,414	21%	4,974	22%
Amortization of acquired developed technology	294	1%	294	1%
Total cost of revenues	\$ 9,755	38%	\$ 8,614	38%

The following table is the summary of gross margin:

	Three months ended	
	August 31, 2007	August 31, 2006
(dollars in thousands)		
Gross margin:		
License (including amortization of acquired developed technology)	\$ 4,241	\$ 5,679
<i>Percentage of license revenue</i>	90%	92%
License updates and product support	6,596	5,018
<i>Percentage of license updates and product support revenue</i>	75%	72%
OnDemand	2,796	2,407
<i>Percentage of OnDemand revenue</i>	63%	68%
Professional services	2,064	1,441
<i>Percentage of professional services revenue</i>	28%	23%
Total	\$ 15,697	\$ 14,545
<i>Percentage of total revenues</i>	62%	63%

Cost of License Revenue. Cost of license revenue includes the cost of manuals and product documentation, production media, shipping costs and royalties to third parties. Cost of license revenue decreased \$20,000, or 9%, during the three months ended August 31, 2007 when compared to the three months ended August 31, 2006. The decrease was primarily attributable to decreased license sales.

Cost of License Updates and Product Support Revenue. Cost of license updates and product support revenue includes salaries and related expenses for our license updates and product support organization. Cost of license updates and product support revenue increased \$232,000, or 12%, during the three months ended August 31, 2007 when compared to the three months ended August 31, 2006. The increase was primarily due to an increase in the salaries and related expenses attributable to additional headcount. Gross margin on license updates and product support increased to 75% in the first quarter of fiscal 2007 from 72% in the first quarter of fiscal 2006. The increase in gross margin was primarily the result of higher revenue recognized upon renewal of contracts assumed in the Centra acquisition against substantially the same cost to deliver the related license update and product support services.

Cost of OnDemand Revenue. Cost of OnDemand revenue includes salaries and expenses related to the provision of the OnDemand offerings as well as external hosting fees and depreciation charges on the necessary infrastructure. Cost of OnDemand revenue increased by \$489,000, or 43%, during the three months ended August 31, 2007 compared to the three months ended August 31, 2006. The increase in the cost of OnDemand revenue was primarily due to increases in salaries and related expenses of \$168,000 due to additional headcount, third party co-location and connectivity fees of \$101,000 and software and equipment maintenance of \$101,000. The OnDemand gross margins decrease in

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the first quarter of fiscal 2008 compared to the first quarter of fiscal 2007, due primarily to additional investment in OnDemand headcount, infrastructure and bandwidth to support increased demand.

Cost of Professional Services Revenue. Cost of professional services revenue includes salaries and related

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expenses for our professional services organization, as well as third-party subcontractors and billed expenses. For the three months ended August 31, 2007, cost of services revenue increased \$440,000, or 9%, compared to the three months ended August 31, 2006. The increase was primarily attributable to an increase in salaries and related expenses of \$530,000 and third party consulting fees required to support the increased professional services revenue and meet our customer's demands. The professional services gross margins increased from 23% in the first quarter of fiscal 2007 to 28% in the first quarter of fiscal 2008. This increase is primarily attributable to higher services realization rates and the creation of a reserve allowance for professional services revenue in the first quarter of fiscal 2007.

Operating Expenses

We classify all operating expenses, except amortization of purchased intangible assets, to the research and development, sales and marketing and general and administrative expense categories based on the nature of the expenses. Each of these three categories includes commonly recurring expenses such as salaries, employee benefits, stock-based compensation, travel and entertainment costs, and allocated communication, rent and depreciation costs. We allocate these expenses to each of the functional areas that derive a benefit from such expenses based upon their respective headcounts. The sales and marketing category of operating expenses also includes sales commissions and expenses related to public relations and advertising, trade shows and marketing collateral materials. The general and administrative category of operating expenses also includes allowance for doubtful accounts and administrative and professional services fees. Certain reclassifications to the statement of operations have been made to the first quarter of fiscal 2007 amounts in order to conform to the fiscal 2008 presentation, none of which affected gross margin, net loss or net loss per share.

	Three months ended		Percent	
	August 31,	of Total	August 31,	of Total
(dollars in thousands)	2007	Revenue	2006	Revenue
Operating expenses:				
Research and development	\$ 4,208	16%	\$ 4,232	18%
Sales and marketing	9,267	36%	9,044	39%
General and administrative	3,807	15%	2,992	13%
Amortization of purchased intangible assets	634	3%	634	3%
Total operating expenses	\$ 17,916	70%	\$ 16,902	73%

Research and development. Research and development expenses decreased \$ 24,000, or 1%, for the three months ended August 31, 2007 compared to the three months ended August 31, 2006. The decrease was primarily due to a decrease in employee payroll and related benefits expenses of \$114,000, including \$69,000 in stock-based compensation. We expect research and development expenses to increase in the foreseeable future.

Sales and marketing. Sales and marketing expenses increased \$223,000, or 3%, for the three months ended August 31, 2007 compared to the three months ended August 31, 2006. This increase was primarily attributable to an increase in marketing programs of \$464,000 due to the global marketing effort offset by a decrease in employee salary and benefits expenses of \$341,000, which included a decrease in sales commissions of \$855,000 and an increase in other salary and benefits expenses of approximately \$487,000 from an increase in sales and marketing headcount. The commission expense decrease was due primarily to a decrease in large license transactions that were recorded in the first quarter of fiscal 2007.

General and administrative. General and administrative expenses increased \$815,000, or 27%, for the three months ended August 31, 2007 compared to the three months ended August 31, 2006. The increase is due primarily to increases in stock-based compensation of \$668,000, professional service fees of \$225,000 and employee salary and benefits expenses of approximately \$213,000, partially offset by a decrease in bad debt expense of \$255,000. Included in the stock-based compensation expense was a one-time non-cash charge of \$632,000 related to an employment agreement amendment which modified the events that trigger accelerated vesting of options and allowed for an extension to standard exercise terms. We do not expect to record additional amounts related to this amendment in future periods.

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Amortization of purchased intangible assets. Amortization of purchased intangible assets was consistent for the three months ended August 31, 2007 compared to the three months ended August 31, 2006. Future amortization expense over each of the next four years is currently expected to be approximately \$2.9 million for the remainder of fiscal 2008 and range from \$4.0 million in fiscal 2009 to \$1.8 million in fiscal 2012. We periodically review our intangible assets and the estimated remaining useful lives of those intangible assets for impairment. Any impairment or reduction in our estimate of remaining useful lives could result in increased amortization expense in future periods.

Interest income and other, net. Interest income and other, net consists of interest income and other non-operating expenses. Interest income and other, net decreased \$15,000, or 23%, for the three months ended August 31, 2007 compared to the three months ended August 31, 2006. This decrease was primarily attributable to a decrease in interest income resulting from the lower average balances of cash held by us.

Interest expense Interest expense was \$70,000 for the three months ended August 31, 2007 and \$136,000 for the three months ended August 31, 2006. The decrease in interest expense during the first quarter of fiscal 2008 compared to the first quarter of fiscal 2007 was primarily due to the interest related to the lower average debt outstanding under the bank credit facility.

Provision for income taxes. From inception through August 31, 2007, we have incurred net losses for federal and state tax purposes. Income tax expense was \$118,000 during the three months ended August 31, 2007 and \$164,000 during the three months ended August 31, 2006. Income tax expense during both of these periods consists primarily of foreign tax expense incurred as a result of local country profits and tax contingencies.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

We adopted FIN 48 effective June 1, 2007. As a result of the implementation of FIN 48, we did not recognize a cumulative adjustment to the June 1, 2007 balance of retained earnings.

As of June 1, 2007, we had unrecognized tax benefits of approximately \$7.4 million, which did not change significantly during the three months ended August 31, 2007. The unrecognized tax benefit is exclusive of accrued interest and penalties. Included in the balance of unrecognized tax benefits as of June 1, 2007, is approximately \$761,000, inclusive of interest and penalties, of tax benefits that, if recognized, would result in an adjustment to our effective tax rate. The amount of unrecognized tax benefits that would result in an adjustment to goodwill is \$637,000.

We anticipate an increase to the unrecognized tax benefits during the year ending May 31, 2008 as compared to year ended May 31, 2007 of approximately \$149,000. The anticipated increase will be due primarily to the accrual of additional reserves and interest accrued on existing reserves. We have historically classified accruals for tax uncertainties in current taxes payable and, where appropriate, as a reduction to deferred tax assets. As a result of the adoption of FIN 48, we have reclassified \$1.2 million from current taxes payable to other long-term liabilities.

In accordance with FIN 48, paragraph 19, we classify interest and penalties related to uncertain tax positions as a component of our provision for income taxes. Accrued interest and penalties relating to the income tax on the unrecognized tax benefits as of June 1, 2007, was approximately \$588,000.

During the first quarter of fiscal year ending 2008, the unrecognized tax benefit decreased by \$221,000. The decrease is mainly the result of the settlement of tax audits in France for tax years 2000 to 2003 resulting in a reduction of uncertain tax positions of approximately \$275,000.

Due to the Company's taxable loss position since inception, all tax years are subject to examination in the U.S. and state jurisdictions. We are also subject to examination in various foreign jurisdictions for tax years 1996 forward, for which we believe we have established adequate reserves.

As of August 31, 2007 and May 31, 2007, we have established a valuation allowance against the full amount of any net deferred tax assets. We currently provide a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all of our deferred tax assets, will not be realized.

Table of Contents**FLUCTUATIONS OF QUARTERLY RESULTS**

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

Factors that could affect our quarterly operating results are described under the caption Item: 1A *Risk Factors*.

LIQUIDITY AND CAPITAL RESOURCES

	Three months ended	
	August 31,	August 31,
(in thousands)	2007	2006
Cash used in operating activities	\$ (3,674)	\$ (6,679)
Cash used in investing activities	\$ (816)	\$ (363)
Cash provided by (used in) financing activities	\$ (1,730)	\$ 3,722

We have funded our operations through financing activities and our operations and our most significant source of operating cash flows stems from customer purchases of our license, license updates and product support, OnDemand and professional services. Our primary uses of cash from operating activities are for personnel and facilities related expenditures. As of August 31, 2007, we had \$11.8 million in available cash and cash equivalents.

Cash Used In Operating Activities

Cash used in operating activities during the months ended August 31, 2007 was \$3.7 million compared to \$6.7 million during the months ended August 31, 2006. Cash used in operating activities during the three months ended August 31, 2007 was primarily attributable to a net loss of \$2.4 million, an increase in accounts receivable of \$3.0 million and decreases in accounts payable and accrued liabilities of \$0.7 million, partially offset by depreciation and amortization of purchased intangible assets of \$1.4 million and stock-based compensation of \$1.3 million. This compares to cash used in operating activities during the three months ended August 31, 2006 primarily attributable to a net loss of \$2.6 million, an increase in accounts receivable of \$4.0 million and a decrease in accounts payable of \$2.1 million, partially offset by depreciation and amortization of purchased intangible assets of \$1.4 million and an increase in deferred revenue of \$1.2 million.

Cash Used In Investing Activities

Cash used in investing activities during the three months ended August 31, 2007 was \$816,000 compared to cash used in investing activities of approximately \$363,000 for the three months ended August 31, 2006 and are wholly attributable to the purchases of property and equipment to support our increased headcount.

Cash Used In Financing Activities

Cash used by financing activities of \$1.7 million during the three months ended August 31, 2007 was primarily attributable to repayment on borrowings under our credit facility of \$2.3 million, partially offset by proceeds from stock issuance of \$0.6 million. Cash provided by financing activities of \$3.7 million during the three months ended August 31, 2006 was primarily attributable to borrowings under our line of credit of \$4.0 million, partially offset by repayments on our credit facility of \$542,000.

Table of Contents***Contractual Obligations and Commitments***

In June 2007, we paid an additional \$1.7 million of principal of the term loan portion of our credit facility. In addition, as of May 31, 2007, we were in compliance with our liquidity covenant, but not in compliance with our EBITDA covenant contained in our loan agreement. In July 2007, Saba and the bank entered into a waiver and amendment to the loan agreement providing for (i) a waiver of our non-compliance with the EBITDA covenant at May 31, 2007 and (ii) a reduced EBITDA covenant for the quarter ended August 31, 2007. As of August 31, 2007, other than previously noted, there were no material changes in our long-term debt obligations, capital leases, operating lease obligations, purchase obligations or any other long-term liabilities reflected on our condensed consolidated balance sheets as compared to such obligations and liabilities as of May 31, 2007. At August 31, 2007, we did not have any material commitments for capital expenses or significant commitments to purchase obligations for goods or services.

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

Off-Balance Sheet Arrangements

As of August 31, 2007, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***Interest Rate Risk***

Our exposure to market risk for changes in interest rates relates primarily to our borrowings and investments. On January 31, 2006, we entered into a credit facility with a bank. The credit facility provides for (i) a term loan in a principal amount of \$6,500,000, and (ii) a receivables borrowing base revolving credit line in an aggregate principal amount of up to \$7,500,000, which includes a sub-limit of up to \$5,000,000 for letters of credit, cash management and foreign exchange services. In November 2006, we amended the credit facility to add an equipment facility up to a principal amount of \$3,000,000. Both the term loan and the equipment facility are required to be repaid in 36 equal monthly installments of principal, plus interest. The equipment facility's term begins with the date of each advance under the contract. We obtained advances on November 30, 2006 and February 28, 2007. The maturity date of the term loan and the revolving credit line is January 31, 2009. The interest rate applicable to the loans under the credit facility is the bank's prime rate (7.75% at August 31, 2007) plus 0.50% for the term loan and the bank's prime rate plus 0.25% for borrowings under the revolving credit line and the equipment facility. Variable interest rates may produce more expense than expected if interest rates rise. A 0.5% change in interest rates would not be significant. We are required to pay an early termination fee if the credit facility is terminated by the bank due to the occurrence of an event of default or is refinanced by another financial institution, in each case, prior to the second anniversary of the credit facility.

The credit facility is secured by all of our personal property other than our intellectual property. The credit facility includes certain negative covenants restricting or limiting the ability of us and our subsidiaries to, among other things: incur additional indebtedness; create liens on its property; make certain investments and acquisitions; merge or consolidate with any other entity; convey, sell, lease, transfer or otherwise dispose of assets; change its business; experience a change of control; pay dividends, distributions or make other specified restricted payments; and enter into certain transactions with affiliates. Such restrictions and limitations are subject to usual and customary exceptions contained in credit agreements of this nature. In addition, the credit facility requires us to satisfy a minimum consolidated EBITDA covenant on a quarterly basis, and a minimum liquidity covenant on a monthly basis. EBITDA, or earnings before income tax, depreciation and amortization, also excludes stock-based compensation and includes the estimated revenue that would have been recorded related to the Centra deferred revenue fair value adjustment.

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The credit facility also contains usual and customary events of default (subject to certain threshold amounts and grace periods). If an event of default occurs and is continuing, we may be required to repay the obligations under the credit facility prior to their stated maturity date, our ability to borrow under the revolving credit line may be terminated, and the bank may be able to foreclose on any collateral provided by us.

As of August 31, 2007 we had \$1.5 million outstanding under the term loan, \$0.9 million outstanding under the equipment facility and no outstanding borrowings under the receivables borrowing base revolving credit line. As of August 31, 2007, we were in compliance with the liquidity and EBITDA covenants.

At August 31, 2007, we had cash and cash equivalents totaling \$11.8 million. Of this amount, approximately \$10.5 million was invested in money market accounts bearing variable interest rates of between 1.00% and 6.50%. The remainder of our cash and cash equivalents is held in non-interest bearing accounts at several banks. Variable interest rate securities may produce less income than expected if interest rates fall. A 0.5% change in interest rates would not be significant.

Foreign Currency Risk

We do not use derivative instruments to manage risks associated with foreign currency transactions in order to minimize the impact of changes in foreign currency exchange rates on earnings. We provide our products and services to customers in the United States, Europe and elsewhere throughout the world. Sales are primarily made in U.S. dollars, and to a lesser but increasing extent, British pounds and Euros; however, as we continue to expand our operations, more of our contracts may be denominated in Australian dollars, Canadian dollars and Japanese yen. A strengthening of the U.S. dollar could make our products less competitive in foreign markets.

Our exposure to foreign exchange rate fluctuations also arises in part from inter-company accounts with our foreign subsidiaries. These inter-company accounts are typically denominated in the functional currency of the foreign subsidiary, and, when re-measured and translated in U.S. dollars, have an impact on our operating results depending upon the movement in foreign currency rates. During the three months ended August 31, 2007, our total realized and unrealized losses due to movements in foreign currencies, primarily British pounds, Japanese yen and Australia dollars, was \$31,000. As exchange rates vary, these foreign exchange results may vary and adversely or favorably impact operating results. An unfavorable change of 10% in foreign currency rates would not have a material impact on our financial statements.

ITEM 4. CONTROLS AND PROCEDURES

As of August 31, 2007, our management evaluated, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in this report. There has been no change in our internal control over financial reporting that occurred during the fiscal quarter ended August 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Litigation Relating to Initial Public Offering of Saba

In November 2001, a complaint was filed in the United States District Court for the Southern District of New York (the District Court) against us, certain of our officers and directors, and certain underwriters of our initial public offering. The complaint was purportedly filed on behalf of a class of certain persons who purchased our common stock between April 6, 2000 and December 6, 2000. The complaint alleges violations by us and our officers and directors of Section 11 of the Securities Act of 1933, Section 10(b) of the Exchange Act of 1934, and other related provisions in connection with certain alleged compensation arrangements entered into by the underwriters in connection with the offering. An amended complaint was filed in April 2002. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998. The complaints allege that the prospectus and the registration statement for the offering failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some investors in the IPO offering agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of our stock. The complaints were later consolidated into a single action. The complaint seeks unspecified damages, attorney and expert fees, and other unspecified litigation costs.

On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all of the actions, including the action involving us. On July 15, 2002, we, along with other non-underwriter defendants in the coordinated cases, also moved to dismiss the litigation. On February 19, 2003, the District Court ruled on the motions. The District Court granted our motion to dismiss the claims against us under Rule 10b-5, due to the insufficiency of the allegations against us. The District Court also granted the motion of the individual defendants, Bobby Yazdani and Terry Carlitz, our Chief Executive Officer and Chairman of the Board and former Chief Financial Officer and a member of our board of directors, to dismiss the claims against them under Rule 10b-5 and Section 20 of the Exchange Act. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including us.

In June 2004, an agreement of settlement was submitted to the District Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006.

The plaintiffs have continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. Our case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007 again moved for class certification.

We intend to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect our business, financial condition and results of operations.

Table of Contents*Litigation Relating to Initial Public Offering of Centra*

Centra, certain of its former officers and directors and the managing underwriters of Centra's initial public offering were named as defendants in an action filed in the United States District Court for the Southern District of New York (the District Court). The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve the Centra defendants on or about March 18, 2002. The original complaint has been superseded by an amended complaint filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, which is being coordinated with an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92, is purportedly brought on behalf of the class of persons who purchased Centra's common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The complaint alleges that, in connection with Centra's initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the after-market at pre-determined prices. The complaint asserts that Centra's registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. The underwriter defendants and the Centra defendants joined in motions to dismiss the above-referenced action on July 3 and July 15, 2002, respectively. On October 9, 2002, the plaintiffs dismissed, without prejudice, the claims against the named Centra officers and directors in the above-referenced action. On February 19, 2003, the District Court issued an order denying the motion to dismiss as to Centra and other defendants. In June 2004, an agreement of settlement was submitted to the Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

The plaintiffs have continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. Centra's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007 again moved for class certification.

We, on behalf of Centra, intend to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect our business, financial condition and results of operations.

Two individuals in Colorado have excluded themselves from the class action settlement and have each filed individual actions in state court in Colorado. These same individuals have filed similar actions against other issuers and their officers. The actions assert violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as well as common law fraud and intentional infliction of emotional distress. The complaints each seek compensation for a drop in stock price from the time of purchase to the time of sale and for alleged emotional distress. Centra prevailed on a motion to dismiss the complaints, the two individuals appealed the ruling and the motion has been briefed by the parties.

We, on behalf of Centra intend to defend the law suit vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome in litigation could materially and adversely affect our business, financial condition and results of operations.

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Litigation Relating to Claim of Patent Infringement by Centra

On August 19, 2003, a complaint was filed against Centra and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. Centra has filed an answer to the complaint denying all of the allegations. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred. Centra filed a request for reexamination of the patents at issue with the U.S. Patent and Trademark Office. Our patent counsel is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the District Court has approved the parties' motion to stay the court proceedings during the re-examination proceedings. A reexamination certificate has issued for one of the patents that canceled all of the patent's claims, thus rendering that patent of no further force or effect. A final office action has issued in the other reexamination proceeding in which all of the patent's original claims were rejected but a handful of newly-added claims were indicated as being allowable. We believe that we have meritorious defenses with respect to the other patent and we intend to vigorously defend this action.

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

ITEM 1A: Risk Factors

Set forth below and elsewhere in this Quarterly Report on Form 10-Q and in other documents we file with the SEC, are risks and uncertainties that could cause actual results to differ materially from the results expressed or implied by the forward-looking statements contained in this Quarterly Report. The fact that some of the risk factors may be the same or similar to our past filings means only that the risks are present in multiple periods. We believe that many of the risks detailed here and in our other SEC filings are part of doing business in our industry and will likely be present in all periods reported. The fact that certain risks are endemic to our industry does not lessen the significance of the risk. There are no material changes to risk factors described under the title "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended May 31, 2007 filed with the SEC.

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

We expect to continue to derive substantially all of our revenues for the foreseeable future from the licensing of the Saba Enterprise Suite and the Saba Centra product suite and providing related services, including license updates and product support, OnDemand, implementation, training and consulting services. Except for one quarter, we have not been profitable and we may not again achieve profitability. We cannot be certain that we will realize sufficient revenues to achieve or sustain profitability, especially if our recurring OnDemand business grows faster than expected relative to license sales. In addition, in the future, we expect to continue to incur non-cash expenses relating to the amortization of purchased intangible assets that will contribute to our net losses, along with any potential goodwill impairment. As of August 31, 2007, we had \$15.4 million of purchased intangible assets to be amortized as a result of our January 2006 acquisition of Centra Software, Inc. (Centra) and May 2005 acquisition of THINQ Learning Solutions, Inc. (THINQ) and our goodwill balance was \$38.3 million. Further, starting with the first quarter of fiscal 2007, we were required to record as an expense charges related to all current outstanding and future grants of stock options in our reported results from operations in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004) (No. 123R), *Share Based Payments*, which was issued by the Financial Accounting Standards Board (FASB) in December 2004. These non-cash expenses have made it and will continue to make it significantly more difficult for us to achieve profitability. If we achieve GAAP profitability, we may not be able to sustain it on a consistent basis.

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Fluctuations in our quarterly results could cause our stock price to experience significant fluctuations or declines.

Our operating results have varied significantly in the past and will likely fluctuate significantly in the future. For instance, in fiscal 2007, 2006 and 2005, our quarterly revenues have fluctuated between approximately \$26.2 million and \$9.3 million and our quarterly results fluctuated between net income of approximately \$131,000 and a net loss of approximately \$3.5 million. Our quarterly operating results are particularly affected by the number of customers licensing our products during any quarter and the size of such licensing transactions. We have limited visibility into our future revenue, especially license revenue, which often has been heavily concentrated in the third month of each quarter. As a result, if we were to fail to close a sufficient number of transactions by the end of our quarter, particularly large license transactions, we would miss our revenue projections. In addition, our operating expenses are based in part on future revenue projections and are relatively fixed in the short-term. If we cannot meet our revenue projections, our business would be seriously harmed and net losses in a given quarter would be even larger than expected.

Other factors that could affect our quarterly operating results include:

The demand for our products and professional services and our efficiency in rendering our professional services;

The variability in the mix of our revenues and bookings in any quarter;

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

The size and complexity of our license transactions and potential delays in recognizing revenue from license transactions;

The amount and timing of our operating expenses and capital expenditures;

The performance of our international business, which accounts for a substantial part of our consolidated revenues; and

Fluctuations in foreign currency exchange rates.

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

Because we recognize revenue from the sale of our OnDemand solutions ratably over the term of the subscription period, a significant downturn in our OnDemand business may not be immediately reflected in our operating results.

We recognize OnDemand revenue over the terms of our customer agreements, which typically range from one to three years. As a result, most of our quarterly OnDemand revenue results from agreements entered into during previous quarters. A decline in new or renewed subscriptions in any one quarter may not impact our financial performance in that quarter, but will negatively affect our revenue in future quarters. If a number of contracts expire and are not renewed in the same quarter, our revenue could decline significantly in that quarter and in subsequent quarters. Accordingly, the effect of significant declines in sales and market acceptance of our solutions may not be reflected in our short-term results of operations, making our results less indicative of our future prospects. It is also difficult for us to rapidly increase our OnDemand revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

Our OnDemand business depends substantially on customers renewing their agreements and purchasing additional products or users from us. Any decline in our customer renewals would harm our future operating results.

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In order for us to improve our operating results, it is important that our OnDemand customers renew their agreements with us when the initial contract term expires and also purchase additional products or additional users. Our OnDemand customers have no obligation to renew their subscriptions after the initial subscription period, and we cannot assure you that customers will renew subscriptions at the same or higher level of service, if at all. In the past, some of our OnDemand customers have elected not to renew their agreements with us. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or

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dissatisfaction with our product offerings, pricing, the prices of competing products or services, completion of customer initiatives, mergers and acquisitions affecting our customer base, or reductions in our customers' spending levels. If our OnDemand customers do not renew their subscriptions, renew on less favorable terms or fail to purchase additional products or users, our revenue may decline, and we may not realize significantly improved operating results from our customer base.

A decline in the price of, or demand for, our products or our related services offerings, would seriously harm our revenues and operating margins.

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

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

The period between our initial contact with a potential customer and the purchase of our products and services is often long. A customer's decision to purchase our products and services requires the commitment to increase performance through human capital management, involves a significant allocation of resources, and is influenced by a customer's budgetary cycles. To successfully sell our products and services, we generally must educate our potential customers regarding the use and benefits of our products and services. We may commit a substantial amount of time and resources to potential customers without assurance that any sales will be completed or revenues generated. Many of our potential customers are large enterprises that generally take longer to make significant business decisions. Our public sector customers, in particular, are subject to extensive procurement procedures that require many reviews and approvals. Our typical sales cycle has been approximately six to 12 months, making it difficult to predict the quarter in which we may recognize revenue. The delay or failure to complete sales in a particular quarter could reduce our revenues in that quarter. If our sales cycle were to unexpectedly lengthen in general or for one or more large orders, it would adversely affect the timing of our revenues. If we were to experience a delay on a large order, it could harm our ability to meet our forecasts for a given quarter.

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

The market for software solutions that automate human capital management is at an early stage of development and rapidly evolving. Substantially all of our revenues are attributable to the suite of products and services in this market. If this market fails to develop or develops more slowly than we expect, our business would be harmed. If the market grows, the prices of our products may decline rapidly as alternative products are introduced into the market. In addition, our products may become obsolete if we fail to anticipate or adapt to evolving technology standards, or if we fail to identify the challenges and risks in this new market or successfully address these risks.

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

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

Reductions in information technology spending could limit our ability to grow our business.

Our operating results may vary based on changes in the information technology spending of our clients. The revenue growth and profitability of our business depend on the overall demand for enterprise application software

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and services. We sell our solutions primarily to large organizations whose businesses fluctuate with general economic and business conditions. As a result, decreased demand for enterprise application software and services, and in particular human capital management solutions, caused by a weakening global economy may cause a decline in our revenue. Historically, economic downturns have resulted in overall reductions in corporate information technology spending. In particular, human capital management software may be viewed by some of our existing and potential clients as a lower priority and may be among the first expenditures reduced as a result of unfavorable economic conditions. In the future, potential clients may decide to reduce their information technology budgets by deferring or reconsidering product purchases, which would negatively impact our operating results.

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

While we believe that we are in compliance with Statement of Position 97-2, *Software Revenue Recognition*, as amended, the accounting profession continues to discuss a wide range of potential interpretations. Additional implementation guidelines, and changes in interpretations of such guidelines, could lead to unanticipated changes in our current revenue accounting practices that could cause us to defer the recognition of revenue to future periods or to recognize lower revenue. In addition, policies, guidelines and interpretations related to accounting for acquisitions, income taxes, facilities consolidation charges, allowance for doubtful accounts and other financial reporting matters require different judgments on complex matters that are often subject to multiple sources of authoritative guidance. To the extent that management's judgment is incorrect, it could result in an adverse impact on our financial statements.

Standards for compliance with Sarbanes-Oxley Section 404 are burdensome, and if we fail to comply in a timely manner, our business could be harmed and our stock price could decline.

Pursuant to Sarbanes-Oxley Section 404, our management is required to report on and our independent registered public accounting firm to attest to, the effectiveness of our internal controls over financial reporting, at least annually. The rules governing the standards that must be met for management to assess our internal controls over financial reporting are complex. Currently, the rules require significant documentation, testing and possible remediation of our internal controls over financial reporting. The process of reviewing, documenting and testing our internal controls over financial reporting will likely continue to result in increased expenses and the devotion of significant management and other internal resources. If we are not successful in attracting and retaining experienced personnel in our accounting and finance organization, we will not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with the Sarbanes-Oxley Act. During this process, if our management identifies one or more material weaknesses in our internal control over financial reporting, we will be unable to assert such internal control is effective and the price of our stock may suffer. In addition, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute assurance that the objectives of the control system are met. Our management does not expect that our internal controls and procedures will prevent all errors and all fraud, if any, because, in addition to resource constraints, there are inherent limitations in all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. If our management is unable to assert that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to attest that our management report is fairly stated or they are unable to express an opinion on the effectiveness of our internal controls) we may not be able to timely file, or file at all, our periodic financial reports and thus we will be subject to delisting. Even if we are able to file such reports, investor confidence in the accuracy and completeness of our financial reports may be lost, leading to an adverse effect on the price of our stock.

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

Our ability to implement a successful long-term strategy, strengthen our competitive position, expand our customer base, and develop and support our products depends to a significant degree on the performance of the senior management team and other key employees, including Bobby Yazdani, our CEO. The loss of any of these individuals could harm our business. Our success will depend in part on our ability to attract and retain additional personnel with the highly specialized expertise necessary to generate revenue and to engineer, design and support our products and services. Like other software companies, we face intense competition for qualified personnel. We may not be able to attract or retain such personnel.

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Intense competition in our target market could impair our ability to grow and achieve profitability on a consistent basis.

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

Companies that offer training, learning, performance, content, resource, talent and staffing management systems, such as SumTotal and other private companies;

Companies that offer collaboration solutions, such as Microsoft and Cisco;

Enterprise software vendors that offer human resources information systems and employee relationship management systems with training and performance modules, such as SAP and Oracle;

Potential customers' internal development efforts;

Companies that operate Internet-based marketplaces for the sale of on-line learning; and

Internet portals that offer learning content, performance support tools or recruiting, talent and staffing management services.

We expect competition from a variety of companies.

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

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

International revenues accounted for 32% and 28% of our revenue for our first quarter ended August 31, 2007, and August 31, 2006, respectively. Although we intend to continue to expand our international presence, in the future we may not be able to successfully market, sell or distribute our products and services in foreign markets. Factors that could materially adversely affect our international operations, and our business and future growth include:

Difficulties in staffing and managing foreign operations, including language barriers;

Difficulties in maintaining control over product development and quality, and timing of product releases;

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

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

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

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Exposure to tax regimes of multiple countries and potential increased tax exposure relating to in-country profits as well as audits and assessments relating to transfer pricing matters;

Costs attributable to development of internationalized versions of our products and marketing and sales materials;

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

Tariffs, export controls and other trade barriers; and

Exposure to geopolitical instability, natural disasters and acts of war or terrorism.

In addition, the reallocation of certain design, development and testing functions from the United States to our lower-cost development centers in India intensifies our exposure to international uncertainties. In recent years, increased growth and development of the technology market in general, and in India specifically, has made it more difficult for us to hire and retain qualified technical employees and other personnel. In addition to the risks inherent in conducting international operations, certain risks are particularly acute in India, such as employee turnover, increasing salaries and less reliable infrastructure.

Future acquisitions may result in disruptions to our business if we fail to adequately integrate acquired businesses.

We acquired Centra Software, Inc. in January 2006 and THINQ Learning Solutions, Inc. in May 2005. As part of our overall business strategy, we expect to continue to acquire complementary businesses or technologies that will provide additional products or services offerings, additional industry expertise or an expanded geographic presence.

These acquisitions could result in the use of significant amounts of cash, the incurrence of debt or potentially dilutive issuances of equity securities which may reduce earnings per share. Acquisitions that we complete expose us to numerous risks, including:

Difficulties in the assimilation of the operations, technologies, products and personnel of the acquired company;

The diversion of management's attention from other business concerns;

Risks of entering markets in which we have no or limited prior experience;

The potential loss of key employees, significant customers and strategic partners of the acquired company; and

Exposure to claims by terminated employees, stockholders of the acquired company or other third parties related to the acquisition. Although we generally obtain indemnification and other contractual protection against such claims, we cannot assure that they will be enforceable or sufficient to protect us.

Any impairment in the value of our goodwill will result in an accounting charge against our earnings, which could negatively impact our stock price.

In June 2001 the FASB issued SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). Under SFAS No. 142 purchased goodwill should not be amortized, but rather, will be periodically reviewed for impairment. Such impairment could be caused by internal factors as well as external factors beyond our control. If future events cause additional impairment of any intangible assets acquired in the Centra acquisition or any other of our past or future acquisitions, we may have to record charges relating to such assets sooner than we expect which would cause our

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profits to decline. The FASB has further determined that at the time goodwill is considered impaired, an amount equal to the impairment loss should be charged as an operating expense in the statement of operations. The timing of such an impairment (if any) of goodwill acquired in past and future transactions is uncertain and difficult to predict. Our results of operations in periods following any such impairment could be materially adversely affected. We are required to determine whether goodwill and any assets acquired in past acquisitions have been impaired in accordance with FAS 142 and, if so, charge such impairment as an expense. We have goodwill of approximately \$38.3 million at August 31, 2007, so if we are required to take such impairment charges in the future, the amounts could have a material adverse effect on our results of operations.

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

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

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

Products as complex as ours often contain unknown and undetected errors or performance problems. Although our products are subject to rigorous testing and quality control processes, serious defects are frequently found during the period immediately following introduction and initial shipment of new products or enhancements to existing products. Although we attempt to resolve all errors that we believe would be considered serious by our customers before shipment to them, our products are not error-free. These errors or performance problems could result in lost revenues or delays in customer acceptance and would be detrimental to our business and reputation. As is typical in the software industry, with each release we have discovered errors in our products after introduction. We will not be able to detect and correct all errors before releasing our products commercially and these undetected errors could be significant. We cannot assure you that undetected errors or performance problems in our existing or future products will not be discovered in the future or that known errors considered minor by us will not be considered serious by our customers, resulting in cancellation of orders, loss of customers, difficulties in achieving our sales goals, increased demands on our support services and a decrease in our revenues. To correct such errors, we may expend considerable time and resources to develop and release modifications to our software.

As a result of such errors, we may be subject to warranty and product liability claims that are costly or difficult to settle. Our products and services enable customers to manage critical business information. If product errors are alleged to cause or contribute to security and privacy breaches or misappropriation of confidential information, we may also be subject to significant liability. Although our license agreements contain provisions intended to limit our exposure to liability, we cannot assure that these limits will be adequate, that they will be enforceable or, if enforceable, that they will be interpreted favorably by a court.

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

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights, particularly in the software and Internet-related industries. We have in the past been and are presently subject to an intellectual property action. On August 19, 2003, EdiSync Systems, LLC filed a complaint against Centra in federal court in Denver, Colorado, alleging infringement of two patents for a remote multiple user editing system and method and seeking to enjoin us from continuing to sell our products, as well as unspecified compensatory damages. Centra filed an answer to the complaint denying all of the allegations, and filed a request for reexamination of the patents at issue with the U.S. Patent and Trademark Office. The reexamination request was accepted by the Patent Office and the District Court has approved the parties' motion to stay the court proceedings during the reexamination proceedings. The Patent Office issued a non-final rejection of all claims in each of the patents. EdiSync elected not to respond to the rejection of the claims in one of the two patents, and the Patent Office has accordingly issued a Notice of Intent to Issue a Reexamination Certificate canceling all of the claims in that patent, thus rendering it of no further force or effect. Although we believe that we have meritorious defenses and intend to vigorously defend this action, we can give no assurance that we will be able to achieve a satisfactory outcome. We could become subject to additional intellectual property infringement claims as the number of our

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competitors grows and our products and services overlap with competitive offerings. Any of these claims, even if not meritorious, could be expensive to defend and could divert management's attention from operating our company. If we become liable to third parties for infringing their intellectual property rights, we could be required to pay a substantial award of damages and to develop non-infringing technology, obtain a license or cease selling the products that contain the infringing intellectual property. We may be unable to develop non-infringing technology or obtain a license on commercially reasonable terms, if at all.

Our products include third party technology, the loss of which could materially harm our business.

We use licensed third party technology components in our products. Future licenses to this technology may not be available to us on commercially reasonable terms, or at all. The loss of or inability to obtain or maintain any of these technology licenses could result in delays in the introduction of new products or could force us to discontinue offering portions of our solutions until equivalent technology, if available, is identified, licensed and integrated.

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

Our success depends upon our proprietary technology. We rely primarily on copyright, trademark and trade secret laws, confidentiality procedures and contractual provisions to establish and protect our proprietary rights. As part of our confidentiality procedures, we enter into non-disclosure agreements with our employees. Despite these precautions, third parties could copy or otherwise obtain and use our technology without authorization, which may represent potential sales and revenue losses that are difficult to quantify. Policing unauthorized use of our technology is difficult, time-consuming and costly. Were we to discover instances of unauthorized use, there can be no assurance that we would be able to enforce our proprietary rights or obtain adequate recovery for our losses. In addition, we have seven patents issued in the United States and five patent applications pending in the United States. We cannot assure you that any patents will be issued for any of the pending patent applications. Even for the issued patents, or any patent issued to us in the future, there can be no assurance that such patent will protect our intellectual property, or will not be challenged by third parties. Furthermore, effective protection of intellectual property rights is unavailable or limited in certain foreign countries. We cannot assure you that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our products and services or design around any patents or other intellectual property rights we hold.

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

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

We outsource the management and maintenance of our OnDemand business to third parties and will depend upon them to provide adequate management and maintenance services.

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

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If our security measures are breached and unauthorized access is obtained to client data, clients may curtail or stop their use of our OnDemand solutions, which would harm our business, operating results and financial condition.

Our OnDemand solutions involve the storage and transmission of confidential information of clients and their existing and potential employees, and security breaches could expose us to a risk of loss of, or unauthorized access to, this information, resulting in possible litigation and possible liability. Although we have never sustained such a breach, if our security measures were ever breached as a result of third-party action, employee error, malfeasance or otherwise, and, as a result, an unauthorized party obtained access to this confidential data, our reputation could be damaged, our business may suffer and we could incur significant liability. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not discovered until launched against a target. As a result, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of our security measures could be harmed and we could lose sales and clients.

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

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

Our stock price may fluctuate substantially.

For example, from the beginning of fiscal 2005 through August 31, 2007, the market price for our common stock has fluctuated between \$7.75 per share and \$3.00 per share. The market price for our common stock may be affected by a number of factors, including those described above and the following:

The announcement of new products and services or product and service enhancements by us or our competitors;

Actual or anticipated quarterly variations in our results of operations or those of our competitors;

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

Developments in our industry, including announcements of significant acquisitions or strategic partnerships; and

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

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

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

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

For example, if a potential acquirer were to make a hostile bid for us, the acquirer would not be able to call a

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

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

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

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

a. Exhibits

See Exhibit Index following the signature page.

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SIGNATURES

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

Dated: October 10, 2007

SABA SOFTWARE, INC.

By:

/s/ BOBBY YAZDANI
Bobby Yazdani
Chief Executive Officer and

Chairman of the Board
(Principal Executive Officer)

By:

/s/ MICHAEL MARTINI
Michael Martini
Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit

Number	Document
2.1 ⁽¹⁾	Agreement and Plan of Merger by and among the Company, Storm Holding Corporation, a Delaware corporation that is a wholly-owned subsidiary of the Company (Holding), Storm Acquisition Corporation, a Delaware corporation that is a wholly-owned subsidiary of Holding (the Subsidiary), THINQ Learning Solutions, Inc, a Delaware corporation and an unaffiliated entity (THINQ), and Daniel H. Bathon, Jr. as representative of the stockholders of THINQ.
2.2 ⁽²⁾	Agreement and Plan of Reorganization, dated October 5, 2005, by and among the Company, Spruce Acquisition Corporation, a Delaware corporation (Merger Sub 1), Spruce Acquisition, LLC, a Delaware limited liability company (Merger Sub 2) and Centra Software, Inc., a Delaware corporation (Centra).
3.1 ⁽³⁾	Amended and Restated Certificate of Incorporation of the Company effective as of April 12, 2000.
3.2 ⁽⁴⁾	Amendment to Amended and Restated Certificate of Incorporation of the Company effective as of May 12, 2003.
3.3 ⁽⁵⁾	Amendment to Amended and Restated Certificate of Incorporation of the Company effective as of November 19, 2004.
3.4 ⁽⁶⁾	Amended and Restated Bylaws of the Company effective as of August 24, 2006.
4.1	Reference is made to Exhibits 3.1, 3.2, 3.3 and 3.4.
10.1 ⁽⁷⁾	Executive Officers Incentive Plan.*
10.2 ⁽⁸⁾	Employment agreement, effective July 9, 2007, by and between the Company and Michael J. Martini.*
10.3 ⁽⁹⁾	Letter agreement, dated July 6, 2007, by and between the Company and Mark D. Frost.*
10.4 ⁽¹⁰⁾	Amendment to employment agreement, dated July 12, 2007, by and between the Company and Peter E. Williams III.*
31.1	Certification of Bobby Yazdani, Chief Executive Officer and Chairman of the Board, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Michael Martini, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Bobby Yazdani, Chief Executive Officer and Chairman of the Board, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Michael Martini, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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- (1) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended February 28, 2005.
(2) Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed October 6, 2005.
(3) Incorporated by reference to Exhibit 3.2 previously filed with the Company's Registration Statement on Form S-1/A (Registration No. 333-95761) filed on March 3, 2000.
(4) Incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 2003.
(5) Incorporated by reference to Exhibit 3.4 to the Company's Quarterly Report on Form 10-Q for the period ended November 30, 2004.
(6) Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed August 28, 2006.
(7) Incorporated by reference to Exhibit 10.20 to the Company's Current Report on Form 8-K filed September 28, 2007.
(8) Incorporated by reference to Exhibit 10.17 to the Company's Annual Report on Form 10-K for the year ended May 31, 2007.
(9) Incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended May 31, 2007.
(10) Incorporated by reference to Exhibit 10.19 to the Company's Annual Report on Form 10-K for the year ended May 31, 2007.
* Management contracts or compensatory plans or arrangements.