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FORM 10-Q

SWK Holdings Corp - SWKH

Filed: May 28, 2009 (period: March 31, 2009)

Quarterly report which provides a continuing view of a company's financial position

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2009

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

For the transition period from _____ to _____

Commission File number 000-27163

Kana Software, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

77-0435679
(I.R.S. Employer
Identification No.)

181 Constitution Drive
Menlo Park, California 94025
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: (650) 614-8300

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

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

On April 30, 2009, 41,214,666 shares of the registrant's Common Stock, \$0.001 par value per share, were outstanding.

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Kana Software, Inc.
Form 10-Q
Quarter Ended March 31, 2009

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

KANA SOFTWARE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	March 31, 2009	December 31, 2008
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,494	\$ 6,988
Restricted cash	746	—
Accounts receivable, net of allowance of \$134 and \$217 at March 31, 2009 and December 31, 2008, respectively	6,355	7,556
Prepaid expenses and other current assets	1,780	2,030
Total current assets	11,375	16,574
Restricted cash, long-term	305	751
Property and equipment, net	1,674	1,923
Goodwill	12,415	12,415
Acquired intangible assets, net	1,601	1,726
Other assets	177	428
Total assets	\$ 27,547	\$ 33,817
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Line of credit	\$ 2,753	\$ 6,000
Notes payable	1,547	1,821
Accounts payable	3,719	3,618
Accrued liabilities	4,813	5,084
Accrued restructuring	793	946
Deferred revenue	13,668	12,946
Total current liabilities	27,293	30,415
Deferred revenue, long-term	47	86
Accrued restructuring, long-term	84	234
Notes payable, long-term	7	13
Other long-term liabilities	495	479
Total liabilities	27,926	31,227
Commitments and contingencies (Note 6)		
Stockholders' equity (deficit):		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.001 par value; 250,000,000 shares authorized; 41,214,666 and 41,212,791 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	41	41
Additional paid-in capital	4,319,314	4,320,743
Accumulated other comprehensive loss	(714)	(684)
Accumulated deficit	(4,319,020)	(4,317,510)
Total stockholders' equity (deficit)	(379)	2,590
Total liabilities and stockholders' equity (deficit)	\$ 27,547	\$ 33,817

See accompanying notes to unaudited condensed consolidated financial statements.

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KANA SOFTWARE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended	
	March 31,	
	2009	2008
	(unaudited)	
Revenues:		
License fees	\$ 1,199	\$ 5,723
Services	9,693	12,562
Total revenues	<u>10,892</u>	<u>18,285</u>
Costs and expenses (1):		
Cost of license fees	188	412
Cost of services	4,478	5,418
Amortization of acquired intangible assets	125	125
Sales and marketing	3,002	6,244
Research and development	3,663	3,334
General and administrative	2,600	3,184
Restructuring recovery	—	(482)
Total costs and expenses	<u>14,056</u>	<u>18,235</u>
(Loss) income from operations	(3,164)	50
Interest and other income (expense), net	(86)	(103)
Loss before income tax expense	(3,250)	(53)
Income tax expense	(16)	(26)
Net loss	<u>\$ (3,266)</u>	<u>\$ (79)</u>
Basic and diluted net loss per share	<u>\$ (0.08)</u>	<u>\$ (0.00)</u>
Shares used in computing basic and diluted net loss per share	<u>41,214</u>	<u>41,211</u>

(1) Stock-based compensation included in the expense line items:

Cost of services	\$ 83	\$ 103
Sales and marketing	111	164
Research and development	63	77
General and administrative	177	217

See accompanying notes to unaudited condensed consolidated financial statements.

KANA SOFTWARE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Three Months Ended	
	March 31,	
	2009	2008
	(unaudited)	
Cash flows from operating activities:		
Net loss	\$ (3,266)	\$ (79)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	337	300
Amortization of acquired intangible assets	125	125
Stock-based compensation	434	561
Provision for doubtful accounts	—	16
Change in fair value of warrant liability	(6)	—
Restructuring recovery	—	(482)
Non-cash interest accretion	12	50
Changes in operating assets and liabilities:		
Accounts receivable	1,069	2,001
Prepaid expenses and other assets	501	444
Accounts payable and accrued liabilities	(238)	305
Accrued restructuring	(303)	(406)
Deferred revenue	891	(767)
Net cash provided by (used in) operating activities	<u>(444)</u>	<u>2,068</u>
Cash flows from investing activities:		
Purchases of property and equipment	(90)	(467)
Increase in restricted cash	(300)	—
Net cash used in investing activities	<u>(390)</u>	<u>(467)</u>
Cash flows from financing activities:		
(Repayments) borrowings on line of credit, net	(3,247)	385
Repayments on notes payable	(280)	(634)
Net cash used in financing activities	<u>(3,527)</u>	<u>(249)</u>
Effect of exchange rate changes on cash and cash equivalents	(133)	27
Net increase (decrease) in cash and cash equivalents	(4,494)	1,379
Cash and cash equivalents at beginning of period	6,988	4,306
Cash and cash equivalents at end of period	<u>\$ 2,494</u>	<u>\$ 5,685</u>

See accompanying notes to unaudited condensed consolidated financial statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Kana Software, Inc. and Summary of Significant Accounting Policies

Nature of Operations

Kana Software, Inc. (together with its subsidiaries, "the Company" or "KANA") was incorporated in July 1996 in California and reincorporated in Delaware in September 1999. KANA develops, markets, sells and supports customer communications software products. The Company sells its products primarily in North America, Europe and Asia, through its direct sales force and third party integrators.

Liquidity/Basis of Presentation

The condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As of March 31, 2009, the Company had an accumulated deficit of \$4.3 billion and has experienced recurring losses. Historically, the Company has financed its operations through a combination of debt financings, proceeds from common stock offerings, and sales of its products. The Company expects to finance future cash needs primarily through sales of its products and from proceeds from equity or debt financings; however, it cannot be assured that such financings will be available on acceptable terms, or at all. The Company continues to take steps to lower the expenses related to cost of revenues, sales and marketing, research and development, and general and administrative areas of the Company.

Since 1997 the Company has incurred substantial costs to develop its products and to recruit, train and compensate personnel for its engineering, sales, marketing, client services, and administration departments. As a result, the Company has incurred substantial losses since inception. On March 31, 2009, the Company had cash and cash equivalents of \$2.5 million and borrowings outstanding under a line of credit of \$2.8 million due in February 2010 and borrowings outstanding under notes payable of \$1.5 million due in 2009. As of March 31, 2009, the Company had an accumulated deficit of \$4.3 billion, negative working capital of \$15.9 million, which includes \$13.7 million of deferred revenue, and stockholders' deficit of \$379,000. Loss from operations was \$3.2 million for the three months ended March 31, 2009. Net cash used for operating activities was \$444,000 for the three months ended March 31, 2009. These conditions, among others, raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not reflect any adjustments that might be required as a result of this uncertainty.

During the third quarter of 2008, the Company reduced headcount by 14 employees to reduce expenses. Additionally, during the second quarter of 2009, the Company reduced headcount by 25 employees to better align its cost structure with its revenues. The Company is continuing to find ways to lower costs without materially changing support for its customers. The Company's management believes that based on its current plans, the Company will require additional financing to fund the Company's working capital and capital expenditure requirements through March 31, 2010. However, if the Company experiences lower than anticipated demand for its products, it will need to further reduce costs, issue equity securities or borrow money to meet its cash requirements. Any such equity issuances could be dilutive to the Company's stockholders, and any equity or debt financings may be on unfavorable terms, if at all.

Unaudited Interim Financial Information

The unaudited condensed consolidated financial statements have been prepared by KANA and reflect all normal, recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the interim financial information. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2009. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted under the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with KANA's audited consolidated financial statements and notes included in KANA's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on May 15, 2009. The year-end condensed consolidated balance sheet data was derived from the Company's audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Use of Estimates

The preparation of the condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, stock-based compensation, provision for doubtful accounts, fair value of acquired intangible assets and goodwill, useful lives of property and equipment, income taxes, restructuring costs, and contingencies and litigation, among others. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from those estimates under different assumptions or conditions.

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Stock-based Compensation

Employee stock-based compensation expense recognized under Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123(R)”), in the condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 related to stock options was \$434,000 and \$564,000, respectively. The estimated fair value of the Company’s stock-based awards, less expected forfeitures, is amortized over the awards’ vesting period on a straight-line basis. As a result of SFAS 123(R), the Company’s loss before income taxes and net loss for each of the three month periods ended March 31, 2009 and 2008 was increased by \$434,000 and \$564,000, respectively. SFAS 123(R) increased basic and diluted net loss per share by \$0.01 for each of the three months ended March 31, 2009 and 2008. SFAS 123(R) did not have an impact on cash flows from operations during each of the three month periods ended March 31, 2009 and 2008.

In addition, the Company granted stock options to non-employees who had agreements to provide consulting services. As a result of these stock option grants to consultants, the Company recorded no expense and a credit of \$3,000 of non-employee stock-based compensation included in general and administrative expense for the three months ended March 31, 2009 and 2008, respectively.

Net Loss per Share

Basic net loss per share is computed using the weighted average number of outstanding shares of common stock. Diluted net loss per share is computed using the weighted average number of outstanding shares of common stock and, when dilutive, shares of common stock issuable upon exercise of options and warrants deemed outstanding using the treasury stock method.

For the three month period ended March 31, 2009 and 2008, outstanding stock options and warrants to purchase common stock in an aggregate of approximately 9,646,000 shares and approximately 12,656,000 shares, respectively, have been excluded from the calculation of diluted net loss per share as all such securities were anti-dilutive.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position (“FSP”) FAS 107-1 and APB 28-1 “Interim Disclosures About Fair Value of Financial Instruments” (FSP FAS 107-1 and APB 28-1). The FSP amends SFAS No. 107 “Disclosures about Fair Value of Financial Instruments” to require an entity to provide disclosures about fair value of financial instruments in interim financial information. This FSP is to be applied prospectively and is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the potential impact of the provisions of FSP FAS 107-1 and APB 28-1.

In June 2008, the FASB ratified Emerging Issue Task Force (“EITF”) Issue No. 07-5, “Determining whether an Instrument (or Embedded Feature) is Indexed to an Entity’s Own Stock” (“EITF 07-5”). EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer’s own stock and thus able to qualify for the SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”, paragraph 11(a) scope exception. The adoption of EITF 07-5 resulted in a decrease of \$1.9 million to additional paid-in capital and a decrease to accumulated deficit of \$1.8 million and an increase to accrued liabilities of \$102,000 on the Company’s condensed consolidated balance sheet. There was no material impact on the Company’s results of operations or cash flows and net loss per share. See further analysis at Note 10.

In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, “Effective Date of FASB Statement No. 157” (“FSP 157-2”), to partially defer SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). FSP 157-2 deferred the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. The adoption of FSP 157-2 did not have a material impact on the Company’s results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), “Business Combinations” (“SFAS 141R”). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity’s first fiscal year beginning after December 15, 2008. SFAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The Company adopted SFAS 141R in the first quarter of 2009 and expects that SFAS 141R will have an impact on its accounting for future business combinations but the effect is dependent upon the acquisitions that are made in the future.

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Note 2. Fair Value Measurement

On January 1, 2008, the Company adopted SFAS 157 which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. SFAS 157 applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS 157 is effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, for which application is effective for fiscal years beginning after November 15, 2008.

SFAS 157 includes a fair value hierarchy that is intended to increase the consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The fair value hierarchy consists of the following three levels:

Level 1 - instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets.

Level 2 - instrument valuations are obtained from readily-available pricing sources for comparable instruments.

Level 3 - instrument valuations are obtained without observable market values and require a high level of judgment to determine the fair value.

The following table summarizes the Company's financial assets and liabilities measured at fair value on a recurring basis in accordance with SFAS No. 157 as of March 31, 2009 (in thousands):

	Fair Value at March 31, 2009			
	Total	Level 1	Level 2	Level 3
Assets:				
Money market funds	\$ 117	\$ 117	\$ —	\$ —
Liabilities:				
Warrant liability (see Note 10)	\$ 102	\$ —	\$ 102	\$ —

Note 3. Goodwill and Intangible Assets

Purchased intangible assets are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the assets, which is five years. The Company reported amortization expense on purchased intangible assets of \$125,000 for each of the three months ended March 31, 2009 and 2008, respectively. The components of goodwill and other intangible assets are as follows (in thousands):

	March 31, 2009	December, 31 2008
Goodwill	\$ 12,415	\$ 12,415
Intangibles:		
Customer relationships	\$ 2,650	\$ 2,650
Purchased technology	14,650	14,650
Less: accumulated amortization	(15,699)	(15,574)
Intangibles, net	\$ 1,601	\$ 1,726

The estimated future amortization expense of purchased intangible assets as of March 31, 2009 is as follows (in thousands):

Remainder of year ending December 31, 2009	\$ 375
Year ending December 31, 2010	500
Year ending December 31, 2011	500
Year ending December 31, 2012	226
Total	\$1,601

Note 4. Stockholders' Equity (Deficit)

Stock Compensation Plans

The Company's 1999 Stock Incentive Plan (the "1999 Stock Incentive Plan"), as successor to the 1997 Stock Option Plan (the "1997 Stock Option Plan"), provides for shares of the Company's common stock to be granted to employees, independent contractors,

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officers, and directors. Options are granted at an exercise price equivalent to the closing fair market value on the date of grant. All options are granted at the discretion of the Company's Board of Directors and have a term not greater than 10 years from the date of grant. Options are immediately exercisable when vested and generally vest monthly over four years.

The following table summarizes activities under all of the Company's equity incentive plans, including the 1999 Stock Incentive Plan and equity incentive plans assumed by the Company pursuant to the acquisition of certain companies, for the indicated periods:

	Options Outstanding			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balances, December 31, 2008	8,026,161	\$ 4.96		
Options cancelled and forfeited	(743,925)	3.10		
Options exercised	(1,875)	0.10		\$ 1,217
Options granted	51,500	0.74		
Balances, March 31, 2009	7,331,861	5.12	7.22	\$ 3,662
Options vested and exercisable and expected to be vested and exercisable at March 31, 2009	6,333,580	\$ 5.36	7.07	\$ 3,443
Options vested and exercisable at March 31, 2009	5,043,197	\$ 5.29	6.79	\$ 2,984

At March 31, 2009, the Company had 16,594,726 options available for grant under its equity incentive plans, which expire during 2009. Any replacement plans will require shareholder approval.

At March 31, 2009, the Company had \$2.1 million of total unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options that will be recognized over the weighted average remaining period of 2.1 years. This amount excludes unrecognized stock-based compensation expense that relates to non-employee stock options, which cannot be estimated prior to the measurement date.

The following table summarizes significant ranges of outstanding and exercisable options as of March 31, 2009:

Range of Exercise Prices	Options Outstanding			Options Vested and Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price Per Share	Number Exercisable	Weighted Average Exercise Price Per Share
\$ 0.10 - 1.59	1,171,848	8.16	\$ 1.35	543,498	\$ 1.47
1.63 - 2.81	657,197	7.22	2.03	473,732	1.99
2.95 - 2.95	2,959,314	7.28	2.95	2,421,071	2.95
3.00 - 3.10	1,087,917	7.96	3.09	531,316	3.09
3.13 - 4.74	1,111,970	6.89	3.63	764,650	3.78
5.75 - 566.25	342,615	2.21	51.76	307,930	40.69
735.00 - 735.00	1,000	0.67	735.00	1,000	735.00
Total	7,331,861	7.22	\$ 5.12	5,043,197	\$ 5.29

Employee stock-based compensation is calculated using the Black-Scholes option pricing model for estimating the fair value of options granted under the Company's equity incentive plans. The weighted average assumptions that were used to calculate the grant date fair value of the Company's employee stock option grants for the three months ended March 31, 2009 and 2008 were as follows:

	Three Months Ended March 31,	
	2009	2008
Risk-free interest rate	1.34%	2.56%
Expected volatility	69%	49%
Expected life (in years)	4	5
Dividend yield	0%	0%

Risk-free interest rates for the options were taken from the Daily Federal Yield Curve Rates on the grant dates for the expected life of the options as published by the Federal Reserve.

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The expected volatility of the stock options was based upon historical data and other relevant factors such as the Company's changes in historical volatility and its capital structure in addition to mean reversion.

In the analysis of expected life the Company used an approach that determines the time from grant to exercise for options that have been exercised and adjusts this number for the expected time to exercise for options that have not yet been exercised. The expected time to exercise for options that have not yet been exercised is calculated from grant as the midpoint of contractual termination of the option and the later of measurement date or vesting date. All times are weighted by number of option shares in developing the expected life assumption.

The weighted-average fair value of options granted during the three months ended March 31, 2009 was \$0.41 per share.

The forfeiture rate of employee stock options for 2009 was calculated using the Company's historical terminations data.

Note 5. Comprehensive Loss

Comprehensive loss is comprised of net loss and foreign currency translation adjustments. The total changes in comprehensive loss during the three month periods ended March 31, 2009 and 2008 were as follows (in thousands):

	Three Months Ended March 31,	
	2009	2008
Net loss	\$ (3,266)	\$ (79)
Foreign currency translation loss	(30)	(154)
Comprehensive loss	\$ (3,296)	\$ (233)

Note 6. Commitments and Contingencies

(a) Litigation

On January 24, 2007, RightNow Technologies, Inc. ("RightNow") filed a suit in the Eighteenth Judicial District Court of Gallatin County, Montana against the Company and four former RightNow employees who had joined the Company. The suit alleges violation of certain provisions of employment agreements, misappropriation of trade secrets, as well as other claims, and seeks damages. We believe the Company has meritorious defenses to these claims and intend to defend against this action vigorously.

The underwriters for the Company's initial public offering, Goldman Sachs & Co., Lehman Bros., Hambrecht & Quist LLC, Wit Soundview Capital Corp., as well as the Company and certain of the Company's current and former officers were named as defendants in federal securities class action lawsuits filed in the U.S. District Court for the Southern District of New York (the "District Court"). The cases allege violations of various securities laws by more than 300 issuers of stock, including the Company, and the underwriters for such issuers, on behalf of a class of plaintiffs who, in the Company's case, purchased the Company's stock between September 21, 1999 and December 6, 2000 in connection with the Company's initial public offering. Specifically, the complaints allege that the underwriter defendants engaged in a scheme concerning sales of the Company's and other issuers' securities in the initial public offering and in the aftermarket. In July 2003, the Company decided to join a settlement negotiated by representatives of a coalition of issuers named as defendants in this action and their insurers. In April 2005, the court requested a modification to the original settlement arrangement which was approved by the Company. Although the Company believes that the plaintiffs' claims had no merit, the Company decided to accept the settlement proposal to avoid the cost and distraction of continued litigation. The Company was a party to a global settlement with the plaintiffs that would have disposed of all claims against it with no admission of wrongdoing by the Company or any of its present or former officers or directors. The settlement agreement had been preliminarily approved by the District Court. However, while the settlement was awaiting final approval by the District Court, in December 2006, the Court of Appeals reversed the District Court's determination that six focus cases could be certified as class actions. In April 2007, the Court of Appeals denied the plaintiffs' petition for rehearing, but acknowledged that the District Court might certify a more limited class. At a September 26, 2007 status conference, the District Court approved a stipulation withdrawing the proposed settlement. On August 14, 2007, the plaintiffs filed an amended complaint in the six focus cases to test the sufficiency of their class allegations. On September 27, 2007, the plaintiffs filed a motion for class certification in the six focus cases, which was withdrawn on October 10, 2008. On November 13, 2007, the defendants filed a motion to dismiss the complaint for failure to state a claim, which the District Court denied in March 2008. Plaintiffs, the issuer defendants (including the Company) and underwriter defendants and the insurance carriers for the defendants have engaged in mediation and settlement negotiations. The parties have entered into a written settlement agreement. As part of this settlement, the Company's insurance carrier has agreed to assume the Company's entire payment obligation under the terms of the settlement. The proposed settlement was submitted to the District Court for preliminary approval on April 2, 2009, but there can be no guarantee that it will receive approval from the District Court. The Company believes that it has meritorious defenses to these claims. If the proposed settlement is not approved and the litigation continues against the Company, the Company would continue to defend against this action vigorously.

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In October 2007, a lawsuit was filed in the U.S. District Court for the Western District of Washington by Ms. Vanessa Simmonds against certain of the underwriters of the Company's initial public offering. The plaintiff alleges that the underwriters violated Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. section 78p(b), by engaging in short-swing trades, and seeks disgorgement of profits from the underwriters in amounts to be proven at trial. On February 25, 2008, Ms. Simmonds filed an amended complaint. The suit names the Company as a nominal defendant, contains no claims against the Company, and seeks no relief from the Company. This lawsuit is one of more than fifty similar actions filed in the same court. On July 25, 2008, the underwriter defendants in the various actions filed a joint motion to dismiss the complaints. In addition, certain issuer defendants filed a joint motion to dismiss the complaints. The parties entered into a stipulation, entered as an order by the Court, that the Company was not required to answer or otherwise respond to the amended complaint. Accordingly, the Company did not join in the motions to dismiss. This matter was dismissed with prejudice on March 12, 2009.

Other third parties have from time to time claimed, and others may claim in the future that the Company has infringed their past, current or future intellectual property rights. The Company has in the past been forced to litigate such claims. These claims, whether meritorious or not, could be time-consuming, result in costly litigation, require expensive changes in the Company's methods of doing business or could require the Company to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

The ultimate outcome of any litigation is uncertain, and either unfavorable or favorable outcomes could have a material negative impact on the Company's consolidated results of operations, balance sheets and cash flows due to defense costs, and divert management resources.

(b) Indemnification

Many of the Company's software license agreements require the Company to indemnify its customers for any claim or finding of intellectual property infringement. KANA periodically receives notices from customers regarding patent license inquiries they have received which may or may not implicate these indemnity obligations. Any litigation, brought by others, or the Company could result in the expenditure of significant financial resources and the diversion of management's time and efforts. In addition, litigation in which the Company is accused of infringement might cause product shipment delays, require KANA to develop alternative technology or require KANA to enter into royalty or license agreements, which might not be available on acceptable terms, or at all. If a successful claim of infringement was made against the Company and it could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, the Company's business could be significantly harmed. Such indemnification provisions are accounted for in accordance with SFAS No. 5 "Accounting for Contingencies" ("SFAS 5"). In prior periods, the Company has incurred minimal costs related to such claims under such indemnifications provisions; accordingly, the amount of such obligations cannot be reasonably estimated. The Company did however record a settlement charge resulting from a settlement of an infringement claim on the Company's consolidated statement of operations for the year ended December 31, 2006, which was not considered material. There were no outstanding claims of infringement at March 31, 2009.

As permitted by Delaware law, the Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer is, or was, serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and enables the Company to recover a portion of any such amounts. As a result of the Company's insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is insignificant. Accordingly, the Company has no liabilities recorded for these agreements as of March 31, 2009.

(c) Warranties

The Company generally provides a warranty for its software products and services to its customers. The Company's products are generally warranted to perform substantially as described in the associated product documentation for a period of 90 days. The Company's services are generally warranted to be performed consistent with industry standards for a period of 90 days from delivery. In the event there is a failure of such warranties, the Company generally is obligated to correct the product or service to conform to the warranty provision or, if the Company is unable to do so, the customer is entitled to seek a refund of the purchase price of the product or service. Such warranties are accounted for in accordance with SFAS 5. The Company has not provided for a warranty accrual as of March 31, 2009 or December 31, 2008 because, to date, the Company's product warranty expense has not been significant. The Company assesses the need for a warranty reserve on a quarterly basis and there can be no guarantee that a warranty reserve will not become necessary in the future.

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The following table provides a summary of restructuring activity during the three months ended March 31, 2009 and 2008 (in thousands):

	<u>Facilities</u>
Restructuring accruals:	
Accrual as of December 31, 2007	\$ 2,752
Restructuring recovery	(482)
Payments made	(490)
Sublease payments received	<u>84</u>
Accrual as of March 31, 2008	\$ 1,864
Accrual as of December 31, 2008	\$ 1,180
Payments made	(374)
Sublease payments received	<u>71</u>
Accrual as of March 31, 2009	\$ 877

In March 2008, the Company was notified by the subtenant of one of the facilities included in the restructuring accrual of the subtenant's intent to lease additional space and extend its sublease through the end of the Company's lease term. As a result of this agreement, the Company recorded a restructuring recovery of approximately \$482,000. The agreement was executed in May 2008.

In April 2009, the Company signed a Settlement and Release Agreement with RMJM Group, Inc. ("RMJM"), the sub landlord for one of the properties included in the restructuring accrual that provided for RMJM to draw down a letter of credit held by RMJM as security for RMJM's lease. The proceeds of the draw down and current cash deposit held by RMJM would be applied to all remaining lease payments and estimated additional operating costs for the remainder of the lease that expires in January 2010. The funds in excess of the remaining rent and estimated additional operating costs would be returned to the Company. The Company remains responsible for any additional charges over the estimate through the remaining lease term.

Note 8. Information About Geographic Areas

The Company's chief operating decision maker reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region for purposes of making operating decisions and assessing financial performance. Accordingly, the Company considers itself to be in a single industry segment: specifically the licensing and support of its software applications. Revenue classification is based upon customer location.

Geographic information on revenues for the three months ended March 31, 2009 and 2008 is as follows (in thousands):

	<u>Three Months Ended</u>	
	<u>March 31,</u>	
	<u>2009</u>	<u>2008</u>
North America	\$ 7,686	\$ 14,201
Europe	2,978	3,667
Asia Pacific	228	417
Total	<u>\$ 10,892</u>	<u>\$ 18,285</u>

During the three months ended March 31, 2009, no customer accounted for greater than 10% of total revenues. During the three months ended March 31, 2008, two customers accounted for 16% and 10% of total revenues. As of March 31, 2009, receivables from no customer represented greater than 10% of our gross accounts receivable.

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Geographic information on the Company's long-lived assets (Property and Equipment, net, and Other Assets), based on physical location, is as follows (in thousands):

	March 31, 2009	December, 31 2008
United States	\$ 1,820	\$ 2,306
International (primarily Europe)	31	45
Total	\$ 1,851	\$ 2,351

Note 9. Line of Credit and Note Payable

(a) Line of Credit

On November 30, 2005, the Company established a banking relationship with Bridge Bank N.A. ("Bridge") entering into a Business Financing Agreement and Intellectual Property Security Agreement with Bridge under which the Company had access to a loan facility of \$7.0 million. The Company has since amended the agreement with Bridge, most recently on March 28, 2008, when the Company entered into a Second Amended and Restated Loan and Security Agreement with Bridge under which the Company has access to a loan facility of \$10.0 million ("March Loan Facility"). The March Loan Facility is a formula-based revolving line of credit based on 80% of eligible receivables subject to a sublimit of \$2.5 million that is available for stand-by letters of credit, foreign exchange contracts or cash management products. Existing equipment advances under the line of credit were converted into a term loan as of March 26, 2008 in the amount of \$1.6 million, which is payable in 33 monthly installments of principal plus interest. An additional \$500,000 borrowed under the additional equipment financing provision was converted into a 36 month term loan on September 30, 2008. The total combined borrowing under the March Loan Facility and sublimits cannot exceed \$10.0 million. The March Loan Facility is collateralized by all of the Company's assets and expires February 27, 2010 at which time the entire balance under the formula-based line of credit will be due. Interest for the formula based revolving line of credit, the existing equipment advances and the additional equipment financing accrues at the Wall Street Journal's ("WSJ") Prime Lending Rate (with a floor rate set at 4%) plus 2.50%, which was 6.50% as of March 31, 2009. The March Loan Facility contains certain restrictive covenants including, but not limited to, certain financial covenants such as maintaining profitability net of stock-based compensation and maintenance of certain key ratios. If the Company is not in compliance with the covenants of the March Loan Facility, Bridge has the right to declare an event of default and all of the outstanding balances owed under the March Loan Facility would become immediately due and payable. On March 17, 2009, the Company entered into a Loan and Security Modification Agreement to the March Loan Facility that provided a one-time waiver of these financial covenants for the quarter ended December 31, 2008, and temporarily increased the interest rate to WSJ Prime (with a floor rate of 4%) plus 2.50% until certain financial covenants are met. On May 26, 2009, the Company entered into a Loan and Security Modification Agreement ("May Amendment") with Bridge that modifies the March Loan Facility by providing a one-time waiver of these financial covenants for the quarter ended March 31, 2009 and the month ended April 30, 2009. The May Amendment sets the total loan facility amount to \$6.0 million and extends the maturity date to June 30, 2010. As a requirement of the May Amendment, availability under the existing revolving line of credit will be used to prepay all amounts currently outstanding under the existing term loans for equipment. Additionally, modifications were made to the existing restrictive covenants and certain covenants were added related to raising additional capital. In addition, the Company's existing credit facilities prohibit the payment of cash or stock dividends on its capital stock without the lender's prior written consent.

As of March 31, 2009, the Company had \$994,000 outstanding under the March Loan Facility equipment loan. This amount is repayable in 21 remaining monthly installments of principal and interest. The Company had \$417,000 outstanding under the additional equipment financing facility. This amount is repayable in 30 remaining monthly installments of principal and interest. These loans are included with other non-bank debt under the heading of notes payable in the condensed consolidated balance sheets. These loans are included in current liabilities based on the terms of the May 13, 2009 proposal that waived out of compliance conditions of certain covenants and requires the Company to prepay the term loans from availability under the existing line of credit. The Company has also drawn \$2.8 million against the formula based revolving line of credit. The available balance of the March Loan Facility was also lowered by \$116,000 to secure a letter of credit related to a building lease, leaving an available balance of \$1.7 million as of March 31, 2009.

(b) Notes Payable

As of March 31, 2009, there was \$1.5 million classified as current portion of notes payable and \$7,000 classified as long-term. The notes payable consist of four obligations: (1) An equipment loan from Bridge with interest at prime plus 2.50% (as discussed above); (2) A promissory note for the financing of software license and support purchased and has a fixed interest rate of 3.15%, payable in two remaining monthly installments of principal and interest; (3) A capital lease obligation for office furniture and

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equipment, which had a 5 year term, of which 15 months were remaining as of March 31, 2009, and an annual interest rate of 8.58%; and (4) A short-term financing of Directors and Officers insurance and has a fixed interest rate of 9.87%, payable in 6 remaining monthly installments of principal and interest.

Note 10. Warrants

Effective January 1, 2009 the Company adopted the provisions of EITF 07-5. As a result of adopting EITF 07-5, warrants to purchase 1,914,586 of the Company's common stock previously treated as equity pursuant to the derivative treatment exemption were no longer afforded equity treatment. These warrants have exercise prices ranging from \$1.97 to \$2.45 and expire in September 2010 and October 2010. Effective January 1, 2009 the Company reclassified the fair value of these common stock purchase warrants, from equity to liability status, as if these warrants were treated as a derivative liability since their date of issue. On January 1, 2009, the Company reclassified the effects of prior accounting for the warrants in the amount of \$1.8 million from additional paid-in capital to accumulated deficit, and \$108,000 from additional paid-in capital to warrant liability. The fair value of these common stock purchase warrants decreased to \$102,000 as of March 31, 2009, and is included with accrued liabilities on the condensed consolidated balance sheets. Accordingly, the Company recognized a \$6,000 gain from the change in fair value of these warrants for the three months ended March 31, 2009. The fair value was calculated using the Black-Scholes option pricing model. The assumptions that were used to calculate fair value as of January 1, 2009 and March 31, 2009 were as follows:

	Expiration Date	
	September 2010	October 2010
Assumptions as of January 1, 2009:		
Risk-free interest rate	2.27%	2.27%
Expected volatility	68%	66%
Expected life (in years)	1.75	1.83
Dividend yield	0%	0%

	Expiration Date	
	September 2010	October 2010
Assumptions as of March 31, 2009:		
Risk-free interest rate	1.34%	1.34%
Expected volatility	74%	72%
Expected life (in years)	1.50	1.58
Dividend yield	0%	0%

Note 11. Subsequent Event

On May 26, 2009, the Company entered into a Loan and Security Modification Agreement ("May Amendment") with Bridge for a modification of the March Loan Facility which provides a one-time waiver of certain financial covenants for the quarter ended March 31, 2009 and the month ended April 30, 2009. The May Amendment set the total loan facility amount to \$6.0 million and extends the maturity date to June 30, 2010. As a requirement of the May Amendment, availability under the existing revolving line of credit will be used to prepay all amounts currently outstanding under the existing term loans for equipment. Additionally, modifications were made to the existing restrictive covenants and certain covenants related to raising additional capital were added.

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

In addition to historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The forward-looking statements are not historical facts but rather are based on current expectations, estimates and projections about our business and industry, and our beliefs and assumptions. Words such as "anticipate," "believe," "estimate," "expects," "intend," "plan," "will" and variations of these words and similar expressions identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, many of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. These risks and uncertainties include, but are not limited to, those described in "Risk Factors" and elsewhere in this report. Forward-looking statements that were believed to be true at the time made may ultimately prove to be incorrect or false.

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The following discussion should be read in conjunction with our Annual Report on Form 10-K filed on May 15, 2009, and the consolidated financial statements and notes thereto. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Overview

We offer an innovative approach to customer service with cost-effective solutions that enhance the quality of multi-channel customer interactions. Built on open standards for a high degree of adaptability and integration, our solutions intelligently automate the processes needed to successfully serve our clients' customers, so that our clients can deliver higher value service at lower cost, increasing customer retention and loyalty. We provide an integrated solution that enables organizations to deliver consistent, managed service across all channels, including e-mail, chat, call centers and Web self-service, ensuring a consistent service experience across communication channels.

Our revenues are primarily derived from the sale of our software and related maintenance and support of the software. We also derive revenues from consulting, training and other services. Our products are generally installed by our customers using either a systems integrator, such as IBM or Accenture, or our professional services group. Our professional services group assists the integrators as subject matter experts and in some cases will act as the prime contractor for implementation of our software. In June 2007 we acquired eVergance Partners LLC ("eVergance") which expanded our professional services group's capabilities and resources. We also rely on IBM and other systems integrators to recommend and install our software. This provides leverage in the selling phase, and also allows us to realize higher gross margins by selling primarily software licenses and support, which typically have higher margins than consulting and implementation services. In the past, we supplied specialists (who were subject matter experts) to work with IBM and other systems integrators. While we continue this practice, we are increasingly providing consulting and implementation services directly to our customers especially following our acquisition of eVergance. These services may be provided to our existing customers who would like us to review their implementations or to new customers who are not quite large enough to gain the interest of a large systems integrator to provide such services. However, in the case of most of the initial installations of our applications that are generally installed by our customers using a systems integrator; these services generally increase the cost of the project substantially and subject their purchase to more levels of required approvals and scrutiny of projected cost savings in their customer service and marketing departments. This contributes to the difficulty that we face in predicting the quarter in which sales to expected customers will occur and to the uncertainty of our future operating results. To the extent that significant sales occur earlier or later than anticipated, revenues for subsequent quarters may be lower or higher, respectively, than expected.

We have incurred substantial costs to develop our products and to recruit, train and compensate personnel for our engineering, sales, marketing, client services and administration departments. As a result, we have incurred substantial losses since inception. On March 31, 2009, we had cash and cash equivalents of \$2.5 million. As of March 31, 2009, we had an accumulated deficit of \$4.3 billion and negative working capital of \$15.9 million, of which \$13.7 million relates to deferred revenue. We recorded a loss from operations of \$3.2 million for the three month period ended March 31, 2009. We recorded a profit from operations of \$50,000 for the three month period ended March 31, 2008. Net losses were \$3.3 million and \$79,000 for the three month periods ended March 31, 2009 and 2008, respectively. Net cash used in operating activities was \$444,000 the three months ended March 31, 2009. Net cash provided by operating activities was \$2.1 million the three months ended March 31, 2008. As of March 31, 2009, we had 229 full-time employees, which represents no change from the 229 employees at December 31, 2008 and an increase from 235 employees at March 31, 2008.

Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are described in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission on May 15, 2009. We believe there have been no material changes to our critical accounting policies and estimates during the three months ended March 31, 2009 compared to those discussed in our Annual Report on Form 10-K for the year ended December 31, 2008.

Recent Accounting Pronouncements

Information with respect to Recent Accounting Pronouncements may be found in Note 1 to the Notes to the Unaudited Condensed Consolidated Financial Statements in "Part I. Financial Information — Item 1. Financial Statements" of this Quarterly Report on Form 10-Q.

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Results of Operations

The following table sets forth selected data for the indicated periods. Percentages are expressed as a percentage of total revenues.

	Three Months Ended March 31,	
	2009	2008
	(unaudited)	
Revenues:		
License fees	11%	31%
Services	89	69
Total revenues	<u>100</u>	<u>100</u>
Costs and expenses:		
Cost of license fees	2	2
Cost of services	41	30
Amortization of acquired intangible assets	1	*
Sales and marketing	28	34
Research and development	34	18
General and administrative	24	17
Restructuring recovery	—	(3)
Total costs and expenses	<u>129</u>	<u>100</u>
Loss from operations	(29)	*
Interest and other income (expense), net	(1)	*
Loss before income tax expense	(30)	*
Income tax expense	*	*
Net loss	<u>(30)%</u>	<u>*%</u>

* Less than 1%

Revenues

Total revenues decreased by 40% to \$10.9 million for the three months ended March 31, 2009 from \$18.3 million for the three months ended March 31, 2008, as a result of lower license and services revenues in the first quarter of 2009 than in 2008.

License revenues include licensing fees only, and exclude associated support and consulting revenue. The majority of our licenses to customers are perpetual and associated revenues are recognized upon delivery provided that all revenue recognition criteria are met as discussed in "Revenue Recognition" under Note 1 to the unaudited condensed consolidated financial statements of this Quarterly Report on Form 10-Q. License revenues decreased by 79% to \$1.2 million for the three months ended March 31, 2009 from \$5.7 million for the same period in the prior year. The decrease in license revenues was due to closing no large revenue transactions during the three months ended March 31, 2009 while there were two large transactions included in the revenue for the three months ended March 31, 2008. While we are focused on increasing license revenues, we are unable to predict such revenues from period to period with any degree of accuracy because, among other things, the market for our products is unpredictable and intensely competitive, and our sales cycle is long and unpredictable. The length of our sales cycle has increased in recent periods due to uncertain economic conditions.

Our services revenues consist of support revenues and professional services fees. Support revenues relate to providing customer support, product maintenance and updates to our customers. Support revenues are the largest component of services revenues. Professional services revenues relate to providing consulting, training and implementation services to our customers including enterprise on-demand. Services revenues decreased 23% to \$9.7 million for the three months ended March 31, 2009, compared to \$12.6 million for the same period in 2008. The decrease primarily resulted from lower consulting services as there were revenues from two large projects in the three months ended March 31, 2008 that did not reoccur in 2009. Additionally, certain support contracts did not renew during the quarter. Customers who purchase licenses frequently purchase support, consulting and training services, which usually occur subsequent to the license sales. Given the decrease in new license sales, these service revenues also decreased.

Revenues from domestic sales were \$7.7 million and \$14.2 million for the three months ended March 31, 2009 and 2008, respectively. Revenues from international sales were \$3.2 million and \$4.1 million for the three months ended March 31, 2009 and 2008, respectively. Our international revenues were derived from sales in Europe and Asia Pacific.

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Costs and Expenses

Total cost of revenues decreased by 20% to \$4.8 million for the three months ended March 31, 2009 from \$6.0 million for the same period in 2008.

License Fees. Cost of license fees consists of third party software royalties, referral fees, and costs of documentation. Cost of license fees as a percentage of license fees was 16% for the three months ended March 31, 2009, compared to 7% for the same period in the prior year. While the absolute dollar amount of cost of license fees decreased the percentage of license fees increased due to the significantly lower license revenue during the three months ended March 31, 2009. We expect that our cost of license fees as a percentage of sales will vary based on changes in the mix of products we sell and the timing of upgrades and that cost of license fees will generally range from approximately 5% to 10% of license revenue. We are continuing to look at alternatives for some original equipment manufacturer (“OEM”) products embedded in KANA products.

Services. Cost of services consists primarily of compensation and related expenses for our customer support, consulting and training and enterprise on-demand services organizations, and allocation of facility costs and system costs incurred in providing customer support. Cost of services increased to 46% of service revenues, or \$4.5 million, for the three months ended March 31, 2009 compared to 43% of service revenues, or \$5.4 million, for the same period in 2008. While the absolute dollar amount of cost of services decreased in the three months ended March 31, 2009 compared to the same period in 2008, the cost of services percentage of service revenues increased as we had excess capacity that could support a higher level of expected revenue. As of March 31, 2009, we had 79 employees in the support, consulting, training and enterprise on-demand organizations compared to 74 employees as of March 31, 2008, a increase of 7%. The increase was partially due to the transfer of seven employees from the sales organization who are now primarily performing consulting work on an hourly billable basis or performing customer support functions.

Cost of services may increase or decrease depending on the demand for these services, and the revenue mix of such services. The expenses may also be affected by the amount, type and valuation of stock options granted as well as the amount of stock options cancelled due to employees and consultants leaving the Company.

Amortization of Acquired Intangible Assets. The amortization of acquired intangible assets recorded in the three month periods ended March 31, 2009 and 2008 related to \$2.5 million of identifiable intangibles purchased in connection with the eVergance acquisition in June 2007. Acquired intangible assets are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the assets (five years).

Sales and Marketing. Sales and marketing expenses consist primarily of compensation and related costs for sales and marketing personnel and promotional expenditures, including public relations, advertising, trade shows and marketing materials. Sales and marketing expenses decreased by 52% to \$3.0 million for the three months ended March 31, 2009, from \$6.2 million for the same period in 2008. This was primarily due to lower compensation costs as a result of decreased headcount, lower commissions as a result of lower revenue and a reduction in our marketing programs. As of March 31, 2009, we had 44 employees in sales and marketing compared to 62 employees as of March 31, 2008, a decrease of 29%. The decrease was partially due to the transfer of seven employees to cost of services as discussed above.

Sales and marketing expenses may increase or decrease, depending primarily on the amount of future revenues and our assessment of market opportunities and sales channels. The expenses may also be impacted by the amount, type and valuation of stock options granted as well as the amount of stock options cancelled due to employees and consultants leaving the Company.

Research and Development. Research and development expenses consist primarily of compensation and related costs for research and development employees and contractors and enhancement of existing products and quality assurance activities. Research and development expenses increased by 10% to \$3.7 million for the three months ended March 31, 2009 from \$3.3 million for the same period in 2008. The increase was attributable primarily to higher compensation and related costs as a result of an increase in head count and a minimum royalty fee partially offset by a reduction in the use of outside consultants. As of March 31, 2009, we had 71 employees in research and development compared to 59 employees as of March 31, 2008, an increase of 20%.

Research and development expenses including related head count may increase or decrease, depending primarily on the amount of future revenues, customer needs, and our assessment of market demand. The expenses may also be impacted by the amount, type and valuation of stock options granted as well as the amount of stock options cancelled due to employees and consultants leaving the Company.

General and Administrative. General and administrative expenses consist primarily of compensation and related costs for finance, legal, human resources, corporate governance, and bad debt expense. Information technology and facilities costs are allocated among all operating departments. General and administrative expenses decreased by 18% to \$2.6 million for the three months ended March 31, 2009 from \$3.2 million for the three months ended March 31, 2008. The decrease in expenses during the three months ended March 31, 2009 was primarily due to lower compensation and related costs as a result of a decrease in head count and lower auditing fees as we were not required to have an audit of internal control over financial reporting. As of March 31, 2009, we had 35 employees in general and administrative and information technology combined compared to 40 employees as of March 31, 2008, a 13% decrease.

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General and administrative expenses may increase or decrease, depending primarily on the amount of future revenues and corporate infrastructure requirements including insurance, professional services, taxes, bad debt expense, and other administrative costs. The expenses may also be impacted by the amount, type and valuation of stock options granted as well as the amount of stock options cancelled due to employees and consultants leaving the Company.

Restructuring Recovery. There was no restructuring activity during the three months ended March 31, 2009. During the three months ended March 31, 2008, there was a restructuring recovery of \$482,000 based on an extension of a sublease for one of the restructured properties.

Interest and Other Income (Expense), Net

Interest and other income (expense), net consists primarily of interest income, interest expense and the change in fair value of warrant liability. Interest income and other income consists primarily of interest earned on cash and cash equivalents and was approximately \$4,000 and \$11,000 for the three months ended March 31, 2009 and 2008. The decrease in interest income related to lower cash and cash equivalents balances in the three ended March 31, 2009 compared to the same period in 2008. Interest expense and other expense relates primarily to interest expense on our line of credit and notes payable and was approximately \$96,000 and \$114,000 for the three months ended March 31, 2009 and 2008, respectively. Interest expense varies from period-to-period based on the timing of borrowings and repayments.

Provision for Income Taxes

We have a history of net losses on a consolidated basis from inception through March 31, 2009. Accordingly, we have recorded a valuation allowance for the full amount of our gross deferred tax assets, as the future realization of the tax benefit is not currently more likely than not. During the three months ended March 31, 2009 and 2008, certain of our foreign subsidiaries were profitable, based upon application of our intercompany transfer pricing agreements, which resulted in us reporting income tax expense totaling approximately \$16,000 and \$26,000 for the three months ended March 31, 2009 and 2008, respectively, in those foreign jurisdictions.

Liquidity and Capital Resources

As of March 31, 2009, we had \$2.5 million in cash and cash equivalents, compared to \$7.0 million in cash and cash equivalents at December 31, 2008. As of March 31, 2009, we had negative working capital of \$15.9 million, compared to negative working capital of \$13.8 million as of December 31, 2008. As of March 31, 2009, our current liabilities included \$13.7 million of deferred revenue (primarily reflecting payments received for future maintenance services to be provided to our customers). The timing of accounts receivable collections can significantly impact our cash balance from quarter to quarter.

Primary Driver of Cash Flow

Our ability to generate cash in the future depends upon our success in generating sufficient sales transactions, especially new license transactions. Since our new license transactions are relatively small in number and are difficult to predict, we may not be able to generate new license transactions as anticipated in any particular future period. From time to time, changes in assets and liabilities, such as changes in levels of accounts receivable and accounts payable, may also affect our cash flows.

Operating Cash Flow

Our operating activities used \$444,000 of cash for the first three months of 2009, which included a \$3.3 million net loss and net payments of \$303,000 against accrued restructuring partially offset by a \$1.1 million decrease in accounts receivable, an \$891,000 increase in deferred revenue, non-cash charges of \$434,000 for stock-based compensation expense, and \$337,000 of depreciation. We had positive cash flow from operating activities of \$2.1 million for the first three months of 2008, which included a \$79,000 net loss, net payments of \$406,000 against accrued restructuring and a \$767,000 decrease in deferred revenue, which partially offset a \$2.0 million decrease in accounts receivable and a \$305,000 increase in accounts payable, non-cash charges of \$561,000 for stock-based compensation expense, and \$300,000 of depreciation.

Investing Cash Flow

Our investing activities used \$390,000 and \$467,000 of cash for the first three months of 2009 and 2008, respectively, which consisted primarily of an increase in restricted cash during 2009 and purchases of property and equipment.

Financing Cash Flow

Our financing activities used \$3.5 million of cash for the three months ended March 31, 2009, which consisted of \$3.2 million of payments on the line of credit and the repayment of \$280,000 on notes payable. Our financing activities used \$249,000 of cash for the three months ended March 31, 2008, which consisted of the repayment of \$634,000 on notes payable partially offset by \$385,000 of borrowings under the line of credit.

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Existence and Timing of Contractual Obligations

On November 30, 2005, we established a banking relationship with Bridge Bank N.A. ("Bridge") entering into a Business Financing Agreement and Intellectual Property Security Agreement with Bridge under which we had access to a loan facility of \$7.0 million. We have since amended our agreement with Bridge, most recently on March 28, 2008, when we entered into a Second Amended and Restated Loan and Security Agreement with Bridge increasing the loan facility to \$10.0 million ("March Loan Facility"). The March Loan Facility is a formula based revolving line of credit that is limited to 80% of eligible receivables subject to a sublimit of \$2.5 million that is available for stand-by letters of credit, foreign exchange contracts or cash management products. Existing equipment advances under our line of credit were converted into a term loan as of March 26, 2008 in the amount of \$1.6 million which is payable in 33 monthly installments of principal plus interest. An additional \$500,000 borrowed under the additional equipment financing provision was converted into a 36 month term loan on September 30, 2008. The total combined borrowing under the March Loan Facility and sublimits cannot exceed \$10.0 million. The March Loan Facility is secured by all of our assets and expires February 27, 2010 at which time the entire balance under the formula-based line of credit will be due. Interest for the formula-based revolving line of credit, the existing equipment advances and the additional equipment financing accrues at the Wall Street Journal's ("WSJ") Prime Lending Rate plus 1.25%. The March Loan Facility contains certain restrictive covenants including but not limited to certain financial covenants such as maintaining profitability net of stock-based compensation and maintenance of certain key ratios. If we are not in compliance with the covenants of the March Loan Facility, Bridge has the right to declare an event of default and all of the outstanding balances owed under the March Loan Facility would become immediately due and payable. On March 17, 2009, we entered into a Loan and Security Modification Agreement to the March Loan Facility that provided a one-time waiver of certain financial covenants for the quarter ended December 31, 2008, and temporarily increased the interest rate to WSJ Prime (with a floor of 4%) plus 2.5% until certain financial covenants are met. On May 26, 2009, we entered into a Loan and Security Modification Agreement ("May Amendment") with Bridge that modifies the March Loan Facility by providing a one-time waiver of certain financial covenants for the quarter ended March 31, 2009 and the month ended April 30, 2009. The May Amendment sets the total loan facility amount to \$6.0 million and extends the maturity date to June 30, 2010. As a requirement of the May Amendment, availability under the existing revolving line of credit will be used to prepay all amounts currently outstanding under the existing term loans for equipment. Additionally, modifications were made to the existing restrictive covenants and certain covenants were added related to raising additional capital.

As of March 31, 2009, we had \$994,000 outstanding under the March Loan Facility equipment loan. This amount is repayable in 21 remaining monthly installments of principal and interest. We had \$417,000 outstanding under the additional equipment financing facility. This amount is repayable in 30 remaining monthly installments of principal and interest. These loans are included with other non-bank debt under the heading of notes payable in the condensed consolidated balance sheet. These loans are included in current liabilities based on the terms of the May 13, 2009 proposal that waived out of compliance conditions of certain covenants and requires us to prepay the term loans from availability under the existing line of credit. We have also drawn \$2.8 million against the formula based revolving line of credit. The available balance of the March Loan Facility was also lowered by \$116,000 to secure a letter of credit related to a building lease, leaving an available balance of \$1.7 million as of March 31, 2009.

Our future payments due under debt and lease obligations and other contractual commitments as of March 31, 2009 are as follows (in thousands):

	Payments Due By Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Line of credit (1)	\$ 2,753	\$ 2,753	\$ —	\$ —	\$ —
Notes payable	1,554	1,547	7	—	—
Non-cancelable operating lease obligations (2)	3,030	2,371	659	—	—
Less: Sublease income (3)	(843)	(453)	(390)	—	—
Other contractual obligations (4)	6,817	1,377	3,244	2,196	—
Total	<u>\$ 13,311</u>	<u>\$ 7,595</u>	<u>\$ 3,520</u>	<u>\$ 2,196</u>	<u>\$ —</u>

- (1) Includes receivables-based loans under our revolving line of credit which matures in 2010 but which may be payable sooner if we experience a decrease in receivables.
- (2) Includes leases for properties included in the restructuring liability.
- (3) Includes subleases that are under contract as of March 31, 2009.
- (4) Represents payments on a legal settlement, minimum payments to vendors for future royalty fees, marketing services, training services, consulting services, engineering services and sales events.

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Off-Balance-Sheet Arrangements

As of March 31, 2009, we did not have any significant off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Outlook

We believe that based on our current plans, we will require additional financing to fund our operations through March 31, 2010. In addition, if we do not experience anticipated demand for our products, we will need to further reduce costs, or raise further financing to meet our cash requirements. We can give no assurances as to whether we will be able to implement cost reduction initiatives, increase revenues, or obtain debt or equity financing, in order to provide sufficient liquidity for us to continue as a going concern.

If adequate funds were not available on acceptable terms, our ability to achieve or sustain positive cash flows, maintain current operations, fund any potential expansion, take advantage of unanticipated opportunities, develop or enhance products or services, or otherwise respond to competitive pressures would be significantly limited. Our expectations as to our future cash flows and our future cash balances are subject to a number of assumptions, including anticipated increases in our revenues, improvements in general economic conditions and customer purchasing and payment patterns, many of which are beyond our control.

Risk Factors That Could Affect Future Results

We operate in a dynamic and rapidly changing business environment that involves substantial risks and uncertainty, including but not limited to the specific risks identified below. The risks described below are not the only ones facing our company. Additional risks not presently known to us, or that we currently deem immaterial, may become important factors that impair our business operations. Any of these risks could cause, or contribute to causing, our actual results to differ materially from expectations. Prospective and existing investors are strongly urged to carefully consider the various cautionary statements and risks set forth in this report and our other public filings.

Risks Related to Our Business and Industry

Current uncertainty in global economic conditions makes it particularly difficult to predict demand and other related matters and makes it more likely that our actual results could differ materially from expectations.

Our operations and performance depend on worldwide economic conditions, which have recently deteriorated significantly in the United States and other countries, and may remain depressed for the foreseeable future. These conditions make it difficult for our customers and potential customers to accurately forecast and plan future business activities, and could cause our customers and potential customers to slow or reduce spending on our products and services. Furthermore, during challenging economic times, our customers may face issues gaining timely access to sufficient credit, which could impact their willingness to make purchases or their ability to make timely payments to us. If that were to occur, we may experience decreased sales, be required to increase our allowance for doubtful accounts and our days sales outstanding could be negatively impacted. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, worldwide, in the United States, or in our industry. These and other economic factors could have a material adverse effect on demand for our products and services, on our ability to predict future operating results, and on our financial condition and operating results.

In periods of worsening economic conditions, our exposure to credit risk and payment delinquencies on our accounts receivable significantly increases.

A substantial majority of our outstanding accounts receivables are not covered by collateral. In addition, our standard terms and conditions permit payment within a specified number of days following the receipt of our product. While we have procedures to monitor and limit exposure to credit risk on our receivables, there can be no assurance such procedures will effectively limit our credit risk and avoid losses. As economic conditions deteriorate, certain of our customers have faced and may face liquidity concerns and have delayed and may delay or may be unable to satisfy their payment obligations, which would have a material adverse effect on our financial condition and operating results.

We have a history of losses and may not be able to generate sufficient revenues to achieve and maintain profitability.

Since we began operations in 1997, our revenues have not been sufficient to support our operations, and we have incurred substantial operating losses every year. As of March 31, 2009, our accumulated deficit was approximately \$4.3 billion, which includes approximately \$2.7 billion related to goodwill impairment charges. Our stockholders' deficit at March 31, 2009 was \$379,000. We continue to commit a substantial investment of resources to sales, product marketing and developing new products and enhancements, and we will need to increase our revenues to achieve profitability and positive cash flows. Our expectations as to when we can achieve positive cash flows, and as to our future cash balances, are subject to a number of assumptions, including assumptions regarding

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improvements in general economic conditions and customer purchasing and payment patterns, many of which are beyond our control. Our history of losses has previously caused some of our potential customers to question our viability, which has in turn hampered our ability to sell some of our products. Additionally, our revenues have been affected by the current downturn in economic conditions, both generally and in our market. As a result of these conditions, we have experienced and expect to continue to experience difficulties in attracting new customers, which means that, even if sales of our products and services grow, we may continue to experience losses, which may cause the price of our stock to decline.

Our ability to continue as a going concern is at risk.

Our independent registered public accounting firm has issued an opinion on our consolidated financial statements that states that the consolidated financial statements were prepared assuming we will continue as a going concern and further states that our recurring losses from operations, negative working capital, negative cash flow from operations and accumulated deficit raise substantial doubt about our ability to continue as a going concern. The global economic downturn created a substantially more difficult business environment in 2008 and thus far in 2009, affecting our liquidity and operating performance. If our revenues do not improve and we are unable to reduce operating expenses sufficiently and we do not obtain additional financing, we may become unable to pay our operating expenses on a timely basis due to a lack of sufficient liquidity. We can give no assurances as to whether we will be able to implement cost reduction initiatives, increase revenues, or obtain debt or equity financing, in order to provide sufficient liquidity for us to continue as a going concern.

The relatively large size of many of our expected license transactions could contribute to our failure to meet expected sales in any given quarter and could materially harm our operating results.

Our revenues and results of operations may fluctuate as a result of a variety of factors. Our revenues are especially subject to fluctuation because they depend on the completion of relatively large orders for our products and related services. The average size of our license transactions is generally large relative to our total revenues in any quarter, particularly as we have focused on larger enterprise customers, on licensing our more comprehensive integrated products, and have involved systems integrators in our sales process. If sales expected from a specific customer in a particular quarter are not realized in that quarter, we are unlikely to be able to generate revenue from alternate sources in time to compensate for the shortfall. Fluctuations in our results of operations may be due to a number of additional factors, including, but not limited to, our ability to retain and increase our customer base, changes in our pricing policies or those of our competitors, the timing and success of new product introductions by us or our competitors, the sales cycle for our products, our fixed expenses, the purchasing and budgeting cycles of our clients, and the decline in general economic, industry and market conditions.

This dependence on large orders makes our revenues and operating results more likely to vary from quarter to quarter, and more difficult to predict, because the loss of any particular large order is significant. In recent periods, we have experienced increases in the length of a typical sales cycle. This trend may add to the uncertainty of our future operating results and reduce our ability to anticipate our future revenues. Moreover, to the extent that significant sales occur earlier than anticipated, revenues for subsequent quarters may be lower than expected. As a result, our operating results could suffer if any large orders are delayed or canceled in any future period. In part as a result of this aspect of our business, our quarterly revenues and operating results may fluctuate in future periods and we may fail to meet the expectations of investors and public market analysts, which could cause the price of our common stock to decline.

We may not be able to forecast our revenues accurately because our products have a long and variable sales cycle and we rely on systems integrators for sales.

The long sales cycle for our products may cause license revenues and operating results to vary significantly from period to period. To date, the sales cycle for most of our product sales has taken anywhere from 6 to 9 months. Our sales cycle typically requires pre-purchase evaluation by a significant number of individuals within our customers' organizations. Along with third parties that often jointly market our software with us, we invest significant amount of time and resources educating and providing information to prospective customers regarding the use and benefits of our products. Many of our customers evaluate our software slowly and deliberately, depending on the specific technical capabilities of the customer, the size of the deployment, the complexity of the customer's network environment, and the quantity of hardware and the degree of hardware configuration necessary to deploy our products.

Furthermore, we rely to a significant extent on systems integrators to identify, influence and manage large transactions with customers, and we expect this trend to continue as our industry consolidates. Selling our products in conjunction with our systems integrators who incorporate our products into their offerings can involve a particularly long and unpredictable sales cycle, as it typically takes more time for the prospective customer to evaluate proposals from multiple vendors. In addition, when systems integrators propose the use of our products to their customers, it is typically part of a larger project, which can require additional levels of customer approvals. We have little or no control over the sales cycle of an integrator-led transaction or our customers' budgetary constraints and internal decision-making and acceptance processes.

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As a result of increasingly long sales cycles, we have faced increased difficulty in predicting our operating results for any given period, and have experienced significant unanticipated fluctuations in our revenues from period to period. Any failure to achieve anticipated revenues for a period could cause our stock price to decline.

If we fail to generate sufficient revenues to support our business and require additional financing, failure to obtain such financing would affect our ability to maintain our operations and to grow our business, and the terms of any financing we obtain may impair the rights of our existing stockholders.

If we fail to generate sufficient revenues to support our business, we may need to seek additional financing to fund our operations or growth. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders would be reduced and the securities we issue might have rights, preferences and privileges senior to those of our current stockholders. Moreover, because of current volatility in the global capital markets and among financial institutions, including a tightening in the capital and credit markets, if we were to seek funding from the capital or credit markets, we may not be able to secure funding on terms acceptable to us or at all.

If adequate funds were not available on acceptable terms, our ability to achieve or sustain positive cash flows, maintain current operations, fund any potential expansion, take advantage of unanticipated opportunities, develop or enhance products or services, or otherwise respond to competitive pressures would be significantly limited. Furthermore, any failure to raise sufficient capital in a timely fashion could prevent us from growing or pursuing our strategies or cause us to limit our operations and cause potential customers to question our financial viability. We had cash and cash equivalents of \$2.5 million at March 31, 2009, and as of such date, had contractual commitments of \$7.6 million in the remainder of 2009. It is possible that our cash position could decrease over the next few quarters and some customers could become increasingly concerned about our cash situation and our ongoing ability to update and maintain our products. This could significantly harm our sales efforts.

Our cash and cash equivalents could be adversely affected if the financial institutions in which we hold our cash and cash equivalents fail.

Our cash and cash equivalents are highly liquid investments with original maturities of three months or less at the time of purchase. We maintain the cash and cash equivalents with reputable major financial institutions. Deposits with these banks exceed the Federal Deposit Insurance Corporation ("FDIC") insurance limits or similar limits in foreign jurisdictions. While we monitor daily the cash balances in the operating accounts and adjust the balances as appropriate, these balances could be impacted if one or more of the financial institutions with which we deposit fails or is subject to other adverse conditions in the financial or credit markets. To date we have experienced no loss or lack of access to our invested cash or cash equivalents; however, we can provide no assurance that access to our invested cash and cash equivalents will not be impacted by adverse conditions in the financial and credit markets.

Our business relies heavily on customer service solutions, and these solutions may not gain market acceptance.

We have made customer service solutions our main focus and, have allocated a significant portion of our research and development and marketing resources to the development and promotion of such products. If these products are not accepted by potential customers, our business would be materially adversely affected. For our current business model to succeed, we believe that we will need to convince new and existing customers of the merits of purchasing our customer service solutions over traditional CRM solutions and competitors' customer service solutions. Many of these customers have previously invested substantial resources in adopting and implementing their existing CRM products, whether such products are ours or are those of our competitors. We may be unable to convince customers and potential customers of the benefits of purchasing substantial new software packages that provide our specific customer service capabilities. If our strategy of offering customer service solutions fails, we may not be able to sell sufficient quantities of our product offerings to generate significant license revenues, and our business could be harmed.

Our expenses are generally fixed and we will not be able to reduce these expenses quickly if we fail to meet our revenue expectations.

Most of our expenses, such as employee compensation, are relatively fixed in the short term. Other expenses like leases are fixed and are more long term. Moreover, our forecast is based, in part, upon our expectations regarding future revenue levels. As a result, in any particular quarter our total revenues can be below expectation and we could not proportionately reduce operating expenses for that quarter. Accordingly, such a revenue shortfall would have a disproportionate negative effect on our expected operating results for that quarter.

If we fail to grow our customer base or generate repeat business, our operating results could be harmed.

Our business model generally depends on the sale of our products to new customers as well as on expanded use of our products within our customers' organizations. If we fail to grow our customer base or generate repeat and expanded business from our current and future customers, our business and operating results will be seriously harmed. In some cases, our customers initially make a limited purchase of our products and services for pilot programs. These customers may not purchase additional licenses to expand

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their use of our products. If these customers do not successfully develop and deploy initial applications based on our products, they may choose not to purchase deployment licenses or additional development licenses. In addition, as we introduce new versions of our products, new product lines or new product features, our current customers might not require the additional functionality we offer and might not ultimately license these products. Furthermore, because the total amount of maintenance and support fees we receive in any period depends in large part on the size and number of licenses that we have previously sold, any downturn in our software license revenues would negatively affect our future services revenue. Also, if customers elect not to renew their support agreements, our services revenue could decline significantly. If customers are unable to pay for their current products or are unwilling to purchase additional products, our revenues would decline. Additionally, a substantial percentage of our sales come from repeat customers. If a significant existing customer or a group of existing customers decide not to repeat business with us, our revenues would decline and our business would be harmed.

We face substantial competition and may not be able to compete effectively.

The market for our products and services is intensely competitive, evolving, and subject to rapid technological change. From time to time, our competitors reduce the prices of their products and services (substantially in certain cases) to obtain new customers. Competitive pressures could make it difficult for us to acquire and retain customers and could require us to reduce the price of our products. Any such changes would likely reduce margins and could adversely affect operating results.

Our customers' requirements and the technology available to satisfy those requirements are continually changing. Therefore, we must be able to respond to these changes in order to remain competitive. Changes in our products may also make it more difficult for our sales force to sell effectively. In addition, changes in customers' demand for the specific products, product features and services of other companies may result in our products becoming uncompetitive. We expect the intensity of competition to increase in the future. Furthermore, we could lose market share if our competitors introduce new competitive products, add new functionality, acquire competitive products, reduce prices or form strategic alliances with other companies. We may not be able to compete successfully against current and future competitors, and competitive pressures may seriously harm our business.

Our competitors vary in size and in the scope and breadth of products and services offered. We currently face competition with our products from systems designed in-house and by our competitors. We expect that these systems will continue to be a major source of competition for the foreseeable future. Our primary competitors for electronic CRM platforms are larger, more established companies such as Oracle. We also face competition from Chordiant Software, Salesforce.com, Consona, eGain, RightNow, Inquire and Pegasystems with respect to specific applications we offer. We may face increased competition upon introduction of new products or upgrades from competitors, or if we expand our product line through acquisition of complementary businesses or otherwise. As we have combined and enhanced our product lines to offer a more comprehensive software solution, we are increasingly competing with large, established providers of customer management and communication solutions as well as other competitors. Our combined product line may not be sufficient to successfully compete with the product offerings available from these companies, which could slow our growth and harm our business.

Many of our competitors have longer operating histories, significantly greater financial, technical, marketing and other resources, significantly greater name recognition and a larger installed base of customers than we have. As a result, our competitors may be able to respond more quickly than we can to new or changing opportunities, technologies, standards or client requirements or devote greater resources to the promotion and sale of their products and services than we can. In addition, many of our competitors have well-established relationships with our current and potential customers and have extensive knowledge of our industry. We may lose potential customers to competitors for various reasons, including the ability or willingness of competitors to offer lower prices and other incentives that we cannot match. It is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share. We also expect that competition will increase as a result of recent industry consolidations, as well as anticipated future consolidations.

We rely on marketing, technology and distribution relationships for the sale, installation and support of our products that may generally be terminated at any time, and if our current and future relationships are not successful, our growth might be limited.

We rely on marketing and technology relationships with a variety of companies, including systems integrators and consulting firms that, among other things, generate leads for the sale of our products and provide our customers with implementation and ongoing support. If we cannot maintain successful marketing and technology relationships or if we fail to enter into such additional relationships, we could have difficulty expanding the sales of our products and our growth might be limited.

A portion of our revenues depends on leads generated by systems integrators and their recommendations of our products. If systems integrators do not successfully market our products, our operating results will be materially harmed. In addition, many of our direct sales are to customers that will be relying on systems integrators to implement our products, and if systems integrators are not familiar with our technology or able to successfully implement our products, our operating results will be materially harmed. We expect to continue increasing our leverage of systems integrators as indirect sales channels and, if this strategy is successful, our dependence on the efforts of these third parties for revenue growth and customer service will remain high. Our reliance on third parties for these functions has reduced our control over such activities and reduced our ability to perform such functions internally. If we come to rely primarily on a single systems integrator that subsequently terminates its relationship with us, becomes insolvent or is

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acquired by another company with which we have no relationship, or decides not to provide implementation services related to our products, we may not be able to internally generate sufficient revenues or increase the revenues generated by our other systems integrator relationships to offset the resulting lost revenues. Furthermore, systems integrators typically suggest our solution in combination with other products and services, some of which may compete with our solution. Systems integrators are not required to promote any fixed quantities of our products, are not bound to promote our products exclusively and may act as indirect sales channels for our competitors. If systems integrators choose not to promote our products or if they develop, market or recommend software applications that compete with our products, our business will be harmed.

In addition to relying on systems integrators to recommend our products, we also rely on systems integrators and other third-party resellers to install and support our products. If the companies providing these services fail to implement our products successfully for our customers, the customer may be unable to complete implementation on the schedule that it had anticipated and we may have increased customer dissatisfaction or difficulty making future sales as a result. We might not be able to maintain our relationships with systems integrators and other indirect sales channel partners and enter into additional relationships that will provide timely and cost-effective customer support and service. If we cannot maintain successful relationships with our indirect sales channel partners, we might have difficulty expanding the sales of our products and our growth could be limited. In addition, if such third parties do not provide the support our customers need, we may be required to hire subcontractors to provide these professional services. Increased use of subcontractors would harm our margins because it costs us more to hire subcontractors to perform these services than it would to provide the services ourselves.

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

During the three months ended March 31, 2009, no customer represented 10% or more of our total revenues. During the three months ended March 31, 2008, two customers accounted for 16% and 10% of total revenues, respectively. However, if we lose a number of major customers, or if contracts are delayed or cancelled or we do not contract with new major customers, our revenues and net loss would be adversely affected. In addition, customers that have accounted for significant revenues in the past may not generate revenues in any future period, and our failure to obtain new significant customers or additional orders from existing customers could materially affect our operating results.

We may not receive significant revenues from our current research and development efforts for several years, if at all.

Developing and localizing software is expensive and the investment in product development often involves a long payback cycle. We have and expect to continue making significant investments in software research and development and related product opportunities. Enhancing our products and pursuing new product developments require high levels of expenditures for research and development that could adversely affect our operating results if not offset by revenue increases. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. However, we do not expect to receive significant revenues from these investments for several years, if at all.

If our cost reduction and restructuring efforts are ineffective, our revenues and profitability may be hurt.

During the year ended December 31, 2008 we implemented various cost reduction and restructuring activities to reduce operating costs. The expense related to our reduction in work force was approximately \$737,000 and expense related to ceasing use of two of our offices was approximately \$64,000. We also wrote off approximately \$263,000 of capitalized costs related to an internal use software project that was abandoned. Additionally, during the year ended December 31, 2008 we recorded a restructuring recovery of \$482,000 as a result of the extension of a sublease on one of the properties in our restructuring accrual. In September 2007, we agreed with the landlord of one of the facilities included in our restructuring accrual to surrender the remaining term of the lease in exchange for a lump sum cash payment. As a result of this agreement, we recorded additional restructuring expense of approximately \$319,000. We also undertook various cost reduction and restructuring activities in July 2007. The expense related to our reduction in work force was approximately \$240,000 and expense related to ceasing use of one of our offices was approximately \$8,000. These cost reduction and restructuring activities may not produce the full efficiencies and benefits we expect or the efficiencies and benefits might be delayed. There can be no assurance that these efforts, as well as any potential future cost reduction and restructuring activities, will not adversely affect our business, operations or customer perceptions, or result in additional future charges.

We may be unable to hire and retain the skilled personnel necessary to develop and grow our business.

We rely on the continued service of our senior management and other key employees and the hiring of new qualified employees. In the software industry, there is substantial and continuous competition for highly skilled business, product development, technical and other personnel. Given the concern over our long-term financial strength, we may not be successful in recruiting and integrating new personnel and retaining and motivating existing personnel, which could lead to increased turnover and reduce our ability to meet the needs of our current and future customers. Because our stock price declined drastically in recent years, and has not experienced any sustained recovery from the decline, stock-based compensation, including options to purchase our common stock, may have diminished the effectiveness as employee hiring and retention devices. If we are unable to retain qualified personnel, we could face disruptions to operations, loss of key information, expertise or know-how and unanticipated additional recruitment and training costs. If employee turnover increases, our ability to provide customer service and execute our strategy would be negatively affected.

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For example, our ability to increase revenues in the future depends considerably upon our success in training and retaining effective direct sales personnel and the success of our direct sales force. We might not be successful in these efforts. Our products and services require sophisticated sales efforts. We have experienced significant turnover in our sales force including domestic senior sales management, and may experience further turnover in future periods. It generally takes a new salesperson nine or more months to become productive, and they may not be able to generate new sales. Our business will be harmed if we fail to retain qualified sales personnel, or if newly hired salespeople fail to develop the necessary sales skills or develop these skills more slowly than anticipated. Additionally, we continue to need to recruit experienced developers as a result of our back-shoring initiative.

If we fail to respond to changing customer preferences in our market, demand for our products and our ability to enhance our revenues will suffer.

If we do not continue to improve our products and develop new products that keep pace with competitive product introductions and technological developments, satisfy diverse and rapidly evolving customer requirements, and achieve market acceptance, we might be unable to attract new customers. Our industry is characterized by rapid and substantial developments in the technologies and products that enjoy widespread acceptance among prospective and existing customers. The development of proprietary technology and necessary service enhancements entails significant technical and business risks and requires substantial expenditures and lead-time. We might not be successful in marketing and supporting our products or developing and marketing other product enhancements and new products that respond to technological advances and market changes, on a timely or cost-effective basis. In addition, even if these products are developed and released, they might not achieve market acceptance. We have experienced delays in releasing new products and product enhancements in the past and could experience similar delays in the future. These delays or problems in the installation or implementation of our new releases could cause us to lose customers.

Our failure to manage multiple technologies and technological change could reduce demand for our products.

Rapidly changing technology and operating systems, changes in customer requirements, and evolving industry standards might impede market acceptance of our products. Our products are designed based upon currently prevailing technology to work on a variety of hardware and software platforms used by our customers. However, our software may not operate correctly on evolving versions of hardware and software platforms, programming languages, database environments and other systems that our customers use. If new technologies emerge that are incompatible with our products, or if competing products emerge that are based on new technologies or new industry standards and that perform better or cost less than our products, our key products could become obsolete and our existing and potential customers could seek alternatives to our products. We must constantly modify and improve our products to keep pace with changes made to these platforms and to database systems and other back-office applications and Internet-related applications. Furthermore, software adapters are necessary to integrate our products with other systems and data sources used by our customers. We must develop and update these adapters to reflect changes to these systems and data sources in order to maintain the functionality provided by our products. As a result, uncertainties related to the timing and nature of new product announcements, introductions or modifications by vendors of operating systems, databases, CRM software, Web servers and other enterprise and Internet-based applications could delay our product development, increase our product development expense or cause customers to delay evaluation, purchase and deployment of our analytics products. If we fail to modify or improve our products in response to evolving industry standards, our products could rapidly become obsolete.

Our success depends upon our ability to develop new products and enhance our existing products on a timely basis.

The challenges of developing new products and enhancements require us to commit a substantial investment of resources to development, and we might not be able to develop or introduce new products on a timely or cost-effective basis, or at all, which could be exploited by our competitors and lead potential customers to choose alternative products. To be competitive, we must develop and introduce on a timely basis new products and product enhancements for companies with significant e-business customer interactions needs. Our ability to deliver competitive products may be negatively affected by the diversion of resources to development of our suite of products, and responding to changes in competitive products and in the demands of our customers. If we experience product delays in the future, we may face:

- customer dissatisfaction;
- cancellation of orders and license agreements;
- negative publicity;
- loss of revenues; and
- slower market acceptance.

Furthermore, delays in bringing new products or enhancements to market can result, for example, from loss of institutional knowledge through reductions in force, or the existence of defects in new products or their enhancements.

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Failure to license necessary third-party software incorporated in our products could cause delays or reductions in our sales.

We license third-party software that we incorporate into our products. These licenses may not continue to be available on commercially reasonable terms or at all. Some of this technology would be difficult to replace. The loss of any of these licenses could result in delays or reductions of our applications until we identify, license and integrate, or develop equivalent software. If we are required to enter into license agreements with third parties for replacement technology, we could face higher royalty payments and our products may lose certain attributes or features. In the future, we might need to license other software to enhance our products and meet evolving customer needs. If we are unable to do this, we could experience reduced demand for our products.

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

The effective implementation of our products depends upon the successful operation of third-party products in conjunction with our products. Any undetected defects in these third-party products could prevent the implementation or impair the functionality of our products, delay new product introductions or injure our reputation.

Given that our stock price is near its historical low, we may be subject to takeover overtures that will divert the attention of our management and Board, and require us to incur expenses for outside advisors.

Given that our stock price is near its historical low, we may be subject to takeover overtures. Evaluating and addressing these overtures would require the time and attention of our management and Board, divert them from their focus on our business, and require us to incur additional expenses on outside legal, financial and other advisors, all of which could materially and adversely affect our business, financial condition and results of operations.

Our common stock is currently quoted on the OTCBB.

Our common stock was delisted from The NASDAQ Stock Market effective at the opening of business on October 17, 2005. From October 17, 2005 to December 4, 2006, our common stock was quoted on the "Pink Sheets" and since December 5, 2006, our common stock has been quoted on Over the Counter Bulletin Board ("OTCBB"). The OTCBB is generally considered less efficient than The NASDAQ Stock Market. Quotation of our common stock on the OTCBB may reduce the liquidity of our securities, limit the number of investors who trade in our securities, result in a lower stock price and larger spread in the bid and ask prices for shares of our common stock and could have an adverse effect on us. Additionally, we may become subject to the SEC rules that affect "penny stocks," which are stocks below \$5.00 per share that are not quoted on The NASDAQ Stock Market. These SEC rules would make it more difficult for brokers to find buyers for our securities and could lower the net sales prices that our stockholders are able to obtain. If our price of common stock remains low, we may not be able to raise equity capital.

Our listing on the OTCBB and the declines in our stock price may greatly impair our ability to raise additional necessary capital through equity or debt financing, and significantly increase the dilution to our current stockholders caused by any issuance of equity in financing or other transactions. The price at which we would issue shares in such transactions is generally based on the market price of our common stock and a decline in the stock price could result in our need to issue a greater number of shares to raise a given amount of funding.

In addition, because our common stock is not listed on a principal national exchange, we are subject to Rule 15c-9 under the Exchange Act, which imposes additional sales practice requirements on broker-dealers that sell low-priced securities to persons other than established customers and institutional accredited investors. For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to sale. Consequently, the rule may affect the ability of broker-dealers to sell our common stock and affect the ability of holders to sell their shares of our common stock in the secondary market. Moreover, investors may be less interested in purchasing low-priced securities because the brokerage commissions, as a percentage of the total transaction value, tend to be higher for such securities, and some investment funds will not invest in low-priced securities (other than those which focus on small-capitalization companies or low-priced securities).

Our stock price has been highly volatile and has experienced a significant decline, and may continue to be volatile and decline.

The trading price of our common stock has fluctuated widely in the past and we expect that it will continue to do so in the future, as a result of a number of factors, many of which are outside our control, such as:

- price and volume fluctuations in the overall stock market;
- the impact of announcements related to the effects of the global economic downturn and programs intended to address it;
- variations in our actual and anticipated operating results;
- changes in our earnings estimates by analysts;
- the volatility inherent in stock prices within the emerging sector within which we conduct business; and

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- the volume of trading in our common stock, including sales of substantial amounts of common stock issued upon the exercise of outstanding options and warrants.

In addition, stock markets in general have, and particularly The NASDAQ Stock Market and the OTCBB have, experienced extreme price and volume fluctuations that have affected the market prices of many technology and computer software companies, particularly Internet-related companies. Such fluctuations have often been unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations could adversely affect the market price of our common stock. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. Securities class action litigation could result in substantial costs and a diversion of our management's attention and resources.

Since becoming a publicly traded security listed on The NASDAQ Stock Market in September 1999, our common stock has reached a sales price high of \$1,698.10 per share and a sales price low of \$0.46 per share. Our common stock is currently quoted on the OTCBB and the last reported sales price of our shares on May 14, 2009 was \$0.72 per share.

Our pending patents may never be issued and, even if issued, may provide little protection.

Our success and ability to compete depend upon the protection of our software and other proprietary technology rights. We currently have five issued U.S. patents, three of which expire in 2018 and two of which expire in 2020, and multiple U.S. patent applications pending relating to our software. None of our technology is patented outside of the United States. It is possible that:

- our pending patent applications may not result in the issuance of patents;
- any issued patents may not be broad enough to protect our proprietary rights;
- any issued patents could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in those patents;
- current and future competitors may independently develop similar technology, duplicate our products or design around any of our patents; and
- effective patent protection may not be available in every country in which we do business.

We rely upon trademarks, copyrights and trade secrets to protect our proprietary rights, which may not be sufficient to protect our intellectual property.

In addition to patents, we rely on a combination of laws, such as copyright, trademark and trade secret laws, and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights. However, despite the precautions that we have taken:

- laws and contractual restrictions may not be sufficient to prevent misappropriation of our technology or deter others from developing similar technologies;
- current federal laws that prohibit software copying provide only limited protection from software "pirates," and effective trademark, copyright and trade secret protection may be unavailable or limited in foreign countries;
- other companies may claim common law trademark rights based upon state or foreign laws that precede the federal registration of our marks; and
- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the extent of this unauthorized use.

Also, the laws of some other countries in which we market our products may offer little or no effective protection of our proprietary technology. Consequently, we may be unable to prevent our proprietary technology from being exploited abroad, which could diminish international sales or require costly efforts to protect our technology. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it, which would significantly harm our business.

We may become involved in litigation over proprietary rights, which could be costly and time consuming.

The software industry is characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights, and our technologies may not be able to withstand any third-party claims or rights against their use. Some of our competitors in the market for customer communications software may have filed or may intend to file patent applications covering aspects of their technology that they may claim our technology infringes. Such competitors could make a claim of infringement against us with respect to our products and technology. Additionally, third parties may currently have, or may eventually be issued, patents upon which our current or future products or technology infringe and any of these third parties might make a claim of infringement against us. For example, during 2006 and 2007, we were involved in litigation brought by Polaris IP, LLC against us and certain of our customers that claimed that certain of our products violate patents held by them.

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As we grow, the possibility of intellectual property rights claims against us increases. We may not be able to withstand any third-party claims and regardless of the merits of the claim, any intellectual property claims could be inherently uncertain, time-consuming and expensive to litigate or settle. Many of our software license agreements require us to indemnify our customers from any claim or finding of intellectual property infringement. We periodically receive notices from customers regarding patent license inquiries they have received which may or may not implicate our indemnity obligations. Any litigation, brought by others, or us could result in the expenditure of significant financial resources and the diversion of management's time and efforts. In addition, litigation in which we are accused of infringement might cause product shipment delays, require us to develop alternative technology or require us to enter into royalty or license agreements, which might not be available on acceptable terms, or at all. If an infringement claim is made against us, we may not be able to develop non-infringing technology or license the infringing or similar technology on a timely and cost-effective basis. As a result, our business could be significantly harmed.

We may face liability claims that could result in unexpected costs and damages to our reputation.

Our licenses with customers generally contain provisions designed to limit our exposure to potential product liability claims, such as disclaimers of warranties and limitations on liability for special, consequential and incidental damages. In addition, our license agreements generally limit the amounts recoverable for damages to the amounts paid by the licensee to us for the product or service giving rise to the damages. However, some domestic and international jurisdictions may not enforce these contractual limitations on liability. We may be subject to claims based on errors in our software or mistakes in performing our services including claims relating to damages to our customers' internal systems. A product liability claim could divert the attention of our management and key personnel, could be expensive to defend and could result in adverse settlements and judgments.

We may face higher costs and lost sales if our software contains errors.

We face the possibility of higher costs as a result of the complexity of our products and the potential for undetected errors. Due to the critical nature of many of our products and services, errors could be particularly problematic. In the past, we have discovered software errors in some of our products after their introduction. We only have a few "beta" customers that test new features and functionality of our software before we make these features and functionalities generally available to our customers. If we are not able to detect and correct errors in our products or releases before commencing commercial shipments, we could face:

- loss of or delay in revenues expected from new products and an immediate and significant loss of market share;
- loss of existing customers that upgrade to new products and of new customers;
- failure to achieve market acceptance;
- diversion of development resources;
- injury to our reputation;
- increased service and warranty costs;
- legal actions by customers; and
- increased insurance costs.

Any of the foregoing potential results of errors in our software could adversely affect our business, financial condition and results of operations.

Our security could be breached, which could damage our reputation and deter customers from using our services.

We must protect our computer systems and network from physical break-ins, security breaches, and other disruptive problems caused by the Internet or other users. Computer break-ins could jeopardize the security of information stored in and transmitted through our computer systems and network, which could adversely affect our ability to retain or attract customers, damage our reputation, and subject us to litigation. We have been in the past, and could be in the future, subject to denial of service, vandalism, and other attacks on our systems by Internet hackers. Although we intend to continue to implement security technology and establish operational procedures to prevent break-ins, damage and failures, these security measures may fail. Our insurance coverage in certain circumstances may be insufficient to cover losses that may result from such events.

We have significant international sales and are subject to risks associated with operating in international markets.

A substantial proportion of our revenues are generated from sales outside North America, exposing us to additional financial and operational risks. Sales outside North America represented 29% of our total revenue for the three months ended March 31, 2009. Sales outside North America represented 25%, 25% and 32% of our total revenues for 2008, 2007 and 2006, respectively. We have established offices in the United States, Europe and Japan. Sales outside North America could increase as a percentage of total revenues as we attempt to expand our international operations. In addition to the additional costs and uncertainties of being subject to

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international laws and regulations, international operations require significant management attention and financial resources, as well as additional support personnel. To the extent our international operations grow, we will also need to, among other things, expand our international sales channel management and support organizations and develop relationships with international service providers and additional distributors and systems integrators. International operations are subject to many inherent risks, including:

- political, social and economic instability, including conflicts in the Middle East and elsewhere abroad, terrorist attacks and security concerns in general;
- adverse changes in tariffs, duties, price controls and other protectionist laws and business practices that favor local competitors;
- fluctuations in currency exchange rates;
- longer collection periods and difficulties in collecting receivables from foreign entities;
- exposure to different legal standards and burdens of complying with a variety of foreign laws, including employment, tax, privacy and data protection laws and regulations;
- reduced protection for our intellectual property in some countries;
- increases in tax rates;
- greater seasonal fluctuations in business activity;
- expenses associated with localizing products for foreign countries, including translation into foreign languages;
- difficulty and cost of staffing and managing international operations; and
- import and export license requirements and restrictions of the United States and each other country in which we operate.

We believe that international sales will continue to represent a significant portion of our revenue for the foreseeable future. Any of these factors may adversely affect our future international sales and, consequently, affect our business, financial condition and results of operations.

We may suffer foreign exchange rate losses.

Our international revenues and expenses are denominated in local currency. Therefore, a weakening of the U.S. dollar to other currencies could make our products more costly to sell in foreign markets and could negatively affect our operating results and cash flows. The volatility of foreign currencies in certain regions, most notably the Japanese yen, European Union euro and British pound have had, and may in the future have, a harmful effect on our revenue or operating results. To the extent the international component of our revenues grows, our results of operations will become more sensitive to foreign exchange rate fluctuations.

If we acquire companies, products, or technologies, we may face risks associated with those acquisitions.

In June 2007, we acquired all of the membership interests of eVergance. We may not realize the anticipated benefits of the eVergance acquisition or any other acquisition or investment. For example, since our inception, we have recorded \$2.7 billion of impairment charges for the cost of goodwill obtained from acquisitions. If we acquire another company, we will likely face risks, uncertainties and disruptions associated with the integration process, including, among other things, difficulties in the integration of the operations, technologies and services of the acquired company, the diversion of our management's attention from other business concerns, the potential loss of key employees of the acquired businesses, and the failure of the acquired businesses, products or technologies to generate sufficient revenue to offset acquisition costs. If we fail to successfully integrate other companies that we may acquire, our business could be harmed. Also, acquisitions, including the acquisition of eVergance, can expose us to liabilities and risks facing the company we acquire, such as lawsuits or claims against us that are unknown at the time of the acquisition. Furthermore, we may have to incur debt or issue equity securities to pay for any additional future acquisitions or investments, the issuance of which could be dilutive to our existing stockholders. In addition, our operating results may suffer because of acquisition-related costs or amortization expenses or charges relating to acquired goodwill and other intangible assets. These factors could have an adverse effect on our business, results of operations, financial condition or cash flows.

Compliance with regulations governing public company corporate governance and reporting will result in additional costs.

Our continuing preparation for and implementation of various corporate governance reforms and enhanced disclosure laws and regulations adopted in recent years requires us to incur significant additional accounting and legal costs. We are subject to accounting disclosures required by laws and regulations adopted in connection with the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"). In particular, we are required to provide a report on our internal control over financial reporting required by Section 404 of the Sarbanes-Oxley Act. Any unanticipated difficulties in preparing for and implementing these and other corporate governance and reporting reforms could result in material delays in compliance or significantly increase our costs. Any failure to timely prepare for and implement the reforms required by new laws and regulations could significantly harm our business, operating results and financial condition.

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We have adopted anti-takeover defenses that could delay or prevent an acquisition of the Company.

Our Board of Directors has the authority to issue up to 5,000,000 shares of preferred stock. Without any further vote or action on the part of the stockholders, the Board of Directors has the authority to determine the price, rights, preferences, privileges, and restrictions of the preferred stock. This preferred stock, if issued, might have preference over and harm the rights of the holders of common stock. Although the ability to issue this preferred stock provides us with flexibility in connection with possible acquisitions and other corporate purposes, it can also be used to make it more difficult for a third party to acquire a majority of our outstanding voting stock. We currently have no plans to issue preferred stock. Similarly, we have established a stockholder rights plan that is intended to protect our ability to utilize our net operating losses and which would also make it difficult for a third party to acquire a significant number of shares of our common stock.

Our certificate of incorporation, bylaws and equity compensation plans include provisions that may deter an unsolicited offer to purchase us. These provisions, coupled with the provisions of the Delaware General Corporation Law, may delay or impede a merger, tender offer or proxy contest. Furthermore, our Board of Directors is divided into three classes, only one of which is elected each year. In addition, directors are only removable by the affirmative vote of at least two-thirds of all classes of voting stock. These factors may further delay or prevent a change of control of us.

Risks Related to Our Industry

Future regulation of the Internet may slow our growth, resulting in decreased demand for our products and services and increased costs of doing business.

State, federal and foreign regulators could adopt laws and regulations that impose additional burdens on companies that conduct business online. These laws and regulations could discourage communication by e-mail or other web-based communications, particularly targeted e-mail of the type facilitated by our products, which could reduce demand for our products and services.

The growth and development of the market for online services may prompt calls for more stringent consumer protection laws or laws that may inhibit the use of Internet-based communications or the information contained in these communications. The adoption of any additional laws or regulations may decrease the expansion of the Internet. A decline in the growth of the Internet, particularly as it relates to online communication, could decrease demand for our products and services and increase our costs of doing business, or otherwise harm our business. Any new legislation or regulations, application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or application of existing laws and regulations to the Internet and other online services could increase our costs and harm our growth.

The imposition of sales and other taxes on products sold by our customers over the Internet could have a negative effect on online commerce and the demand for our products and services.

The imposition of new sales or other taxes could limit the growth of Internet commerce generally and, as a result, the demand for our products and services. Federal legislation that limits the imposition of state and local taxes on Internet-related sales will expire on November 1, 2014. Congress may choose to modify this legislation or to allow it to expire, in which case state and local governments would be free to impose taxes on electronically purchased goods. We believe that most companies that sell products over the Internet do not currently collect sales or other taxes on shipments of their products into states or foreign countries where they are not physically present. However, one or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies that engage in e-commerce within their jurisdiction. A successful assertion by one or more states or foreign countries that companies that engage in e-commerce within their jurisdiction should collect sales or other taxes on the sale of their products over the Internet, even though not physically in the state or country, could indirectly reduce demand for our products.

Privacy concerns relating to the Internet are increasing, which could result in legislation that negatively affects our business in reduced sales of our products.

Businesses using our products capture information regarding their customers when those customers contact them on-line with customer service inquiries. Privacy concerns could cause visitors to resist providing the personal data necessary to allow our customers to use our software products most effectively. More importantly, even the perception of privacy concerns, whether or not valid, may indirectly inhibit market acceptance of our products. In addition, legislative or regulatory requirements may heighten these concerns if businesses must notify website users that the data captured after visiting certain websites may be used by marketing entities to unilaterally direct product promotion and advertising to that user. If consumer privacy concerns are not adequately resolved, our business could be harmed. Government regulation that limits our customers' use of this information could reduce the demand for our products. A number of jurisdictions have adopted, or are considering adopting, laws that restrict the use of customer information from Internet applications. The European Union has required that its member states adopt legislation that imposes restrictions on the collection and use of personal data, and that limits the transfer of personally identifiable data to countries that do not impose equivalent restrictions. In the United States, the Children's Online Privacy Protection Act was enacted in October 1998. This legislation directs the Federal Trade Commission to regulate the collection of data from children on commercial websites. In addition, the Federal Trade Commission has investigated the privacy practices of businesses that collect information on the Internet. These and other privacy-related initiatives could reduce demand for some of the Internet applications with which our products operate, and could restrict the use of these products in some e-commerce applications. This could, in turn, reduce demand for these products.

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The success of our products depends on the continued growth and acceptance of the Internet as a business and communications tool, and the related expansion of the Internet infrastructure.

The future success of our products depends upon the continued and widespread adoption of the Internet as a primary medium for commerce, communication and business applications. Our business growth would be impeded if the performance or perception of the Internet was harmed by security problems such as "viruses," "worms" and other malicious programs, reliability issues arising from outages and damage to Internet infrastructure, delays in development or adoption of new standards and protocols to handle increased demands of Internet activity, increased costs, decreased accessibility and quality of service, or increased government regulation and taxation of Internet activity.

The Internet has experienced, and is expected to continue to experience, significant user and traffic growth, which has, at times, caused user frustration with slow access and download times. If Internet activity grows faster than Internet infrastructure or if the Internet infrastructure is otherwise unable to support the demands placed on it, our business growth may be adversely affected.

General economic conditions could adversely affect our customers' ability or willingness to purchase our products, which could materially and adversely affect our results of operations.

Our customers consist of large and small companies in nearly all industry sectors and geographies. Potential new clients or existing clients could defer purchases of our products because of unfavorable macroeconomic conditions, such as rising interest rates, fluctuations in currency exchange rates, industry or national economic downturns, industry purchasing patterns, and other factors. Our ability to grow revenues may be adversely affected by unfavorable economic conditions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We develop products in the United States and sell these products in North America, Europe, and Asia. In the three months ended March 31, 2009 revenues from customers outside of the United States approximated 29% of total revenues. In the years ended December 31, 2008, revenues from customers outside of the United States was approximately 25% of total revenues. Generally, our sales are made in the local currency of our customers. As a result, our financial results and cash flows could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. We rarely use derivative instruments to hedge against foreign exchange risk. As such, we are exposed to market risk from fluctuations in foreign currency exchange rates, principally from the exchange rate between the U.S. dollar and the Euro and the British pound. We manage exposure to variability in foreign currency exchange rates primarily due to the fact that liabilities and assets, as well as revenues and expenses, are denominated in the local currency. However, different durations in our funding obligations and assets may expose us to the risk of foreign exchange rate fluctuations. We have not entered into any derivative instrument transactions to manage this risk. Based on our overall foreign currency rate exposure at March 31, 2009, we do not believe that a hypothetical 10% change in foreign currency rates would materially adversely affect our financial position or results of operations. Based on our overall debt position at March 31, 2009, we do not believe that changes in interest rates would materially adversely affect our financial position or results of operations. We do not consider our cash equivalents to be subject to interest rate risk due to their short maturities.

ITEM 4T. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Interim Chief Financial Officer, to allow timely decisions regarding required disclosures.

In connection with the preparation of this report, our management, under the supervision and with the participation of the Chief Executive Officer and Interim Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation our Chief Executive Officer and Interim Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of March 31, 2009 due to the untimeliness of the filing of our Annual Report on Form 10-K for the year ended December 31, 2008 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the three months ended March 31, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On January 24, 2007, RightNow Technologies, Inc. (“RightNow”) filed a suit in the Eighteenth Judicial District Court of Gallatin County, Montana against the Company and four former RightNow employees who had joined the Company. The suit alleges violation of certain provisions of employment agreements, misappropriation of trade secrets, as well as other claims, and seeks damages. We believe we have meritorious defenses to these claims and intend to defend against this action vigorously.

The underwriters for our initial public offering, Goldman Sachs & Co., Lehman Bros., Hambrecht & Quist LLC, Wit Soundview Capital Corp., as well as us and certain of our current and former officers were named as defendants in federal securities class action lawsuits filed in the U.S. District Court for the Southern District of New York (the “District Court”). The cases allege violations of various securities laws by more than 300 issuers of stock, including us, and the underwriters for such issuers, on behalf of a class of plaintiffs who, in our case, purchased our stock between September 21, 1999 and December 6, 2000 in connection with our initial public offering. Specifically, the complaints allege that the underwriter defendants engaged in a scheme concerning sales of our and other issuers’ securities in the initial public offering and in the aftermarket. In July 2003, we decided to join a settlement negotiated by representatives of a coalition of issuers named as defendants in this action and their insurers. In April 2005, the court requested a modification to the original settlement arrangement which was approved by us. Although we believed that the plaintiffs’ claims had no merit, we had decided to accept the settlement proposal to avoid the cost and distraction of continued litigation. We were a party to a global settlement with the plaintiffs that would have disposed of all claims against it with no admission of wrongdoing by us or any of its present or former officers or directors. The settlement agreement had been preliminarily approved by the District Court. However, while the settlement was awaiting final approval by the District Court, in December 2006, the Court of Appeals reversed the District Court’s determination that six focus cases could be certified as class actions. In April 2007, the Court of Appeals denied the plaintiffs’ petition for rehearing, but acknowledged that the District Court might certify a more limited class. At a September 26, 2007 status conference, the District Court approved a stipulation withdrawing the proposed settlement. On August 14, 2007, the plaintiffs filed an amended complaint in the six focus cases to test the sufficiency of their class allegations. On September 27, 2007, the plaintiffs filed a motion for class certification in the six focus cases, which was withdrawn on October 10, 2008. On November 13, 2007, the defendants filed a motion to dismiss the complaint for failure to state a claim, which the District Court denied in March 2008. Plaintiffs, the issuer defendants (including us) and underwriter defendants and the insurance carriers for the defendants have engaged in mediation and settlement negotiations. The parties have entered into a written settlement agreement. As part of this settlement, our insurance carrier has agreed to assume our entire payment obligation under the terms of the settlement. The proposed settlement was submitted to the District Court for preliminary approval on April 2, 2009, but there can be no guarantee that it will receive approval from the District Court. We believe that we have meritorious defenses to these claims. If the proposed settlement is not approved and the litigation continues against us, we would continue to defend against this action vigorously.

In October 2007, a lawsuit was filed in the U.S. District Court for the Western District of Washington by Ms. Vanessa Simmonds against certain of the underwriters of our initial public offering. The plaintiff alleges that the underwriters violated Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. section 78p(b), by engaging in short-swing trades, and seeks disgorgement of profits from the underwriters in amounts to be proven at trial. On February 25, 2008, Ms. Simmonds filed an amended complaint. The suit names us as a nominal defendant, contains no claims against us, and seeks no relief from us. This lawsuit is one of more than fifty similar actions filed in the same court. On July 25, 2008, the underwriter defendants in the various actions filed a joint motion to dismiss the complaints. In addition, certain issuer defendants filed a joint motion to dismiss the complaints. The parties entered into a stipulation, entered as an order by the Court, that we are not required to answer or otherwise respond to the amended complaint. Accordingly, we did not join in the motions to dismiss. This matter was dismissed with prejudice on March 12, 2009.

Other third parties have from time to time claimed, and others may claim in the future that we have infringed their past, current or future intellectual property rights. We have in the past been forced to litigate such claims. These claims, whether meritorious or not, could be time-consuming, result in costly litigation, require expensive changes in our methods of doing business or could require us to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

The ultimate outcome of any litigation is uncertain, and either unfavorable or favorable outcomes could have a material negative impact on our results of operations, consolidated balance sheets and cash flows due to defense costs, and divert management resources.

ITEM 1A. RISK FACTORS.

Information regarding the Company’s risk factors appears in “Part I. Financial Information — Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Quarterly Report on Form 10-Q and in “Part I. — Item 1A. Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

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

Not applicable.

ITEM 5. OTHER INFORMATION.

The information about the May Amendment to the March Loan Facility under Note 9 of the Notes to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

On May 26, 2009, our common stock began trading on the OTC Bulletin Board (OTCBB) under the symbol "KANAE" instead of "KANA", because we were delinquent in the filing of our annual report on Form 10-K for the year ended December 31, 2008 and this quarterly report on Form 10-Q. After the "E" is added to a company's symbol by the OTCBB, the company is given 30 calendar days to become current in its reports. If KANA fails to correct any remaining deficiency by June 25, 2009, its common stock will be removed from trading on the OTCBB. KANA anticipates that it will file an amendment to its annual report on Form 10-K, to include the information required by part III of that form, before June 25, 2009 and that with this filing, it will no longer have any remaining deficiency in its SEC filings.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference				Provided Herewith
		Form	File No.	Exhibit	Filing Date	
3.05	Amended and Restated Bylaws of Kana Software, Inc. as currently in effect	8-K	000-27163	3.1	1/13/09	
4.03	Amended and Restated Rights Agreement	8-K	000-27163	4.1	1/13/09	
10.41	Loan and Security Modification Agreement, dated May 26, 2009					X
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act and Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act and Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.01	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X
32.02	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X

* These certifications accompany KANA's Quarterly Report on Form 10-Q; they are not deemed "filed" with the Securities and Exchange Commission and are not to be incorporated by reference in any filing of KANA under the Securities Act of 1933, or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

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.

May 28, 2009

Kana Software, Inc.

/s/ MICHAEL S. FIELDS

Michael S. Fields
Chairman of the Board of Directors and Chief Executive Officer
(Principal Executive Officer)

/s/ JAY A. JONES

Jay A. Jones
Interim Chief Financial Officer
(Principal Financial Officer)

Exhibit Index

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4.03	Amended and Restated Rights Agreement	8-K	000-27163	4.1	1/13/09	
10.41	Loan and Security Modification Agreement, dated May 26, 2009					X
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act and Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act and Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.01	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X
32.02	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X

* These certifications accompany KANA's Quarterly Report on Form 10-Q; they are not deemed "filed" with the Securities and Exchange Commission and are not to be incorporated by reference in any filing of KANA under the Securities Act of 1933, or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

LOAN AND SECURITY MODIFICATION AGREEMENT

This Loan and Security Modification Agreement is entered into as of May 26, 2009, by and between Kana Software, Inc. (the "Borrower") and Bridge Bank, National Association ("Lender").

1. DESCRIPTION OF EXISTING INDEBTEDNESS: Among other indebtedness which may be owing by Borrower to Lender, Borrower is indebted to Lender pursuant to, among other documents, a Second Amended and Restated Loan and Security Agreement, dated March 28, 2008 by and between Borrower and Lender, as may be amended from time to time, including without limitation by that certain Loan and Security Modification Agreement dated as of March 17, 2009 (collectively, the "Loan and Security Agreement"). Capitalized terms used without definition herein shall have the meanings assigned to them in the Loan and Security Agreement.

Hereinafter, all indebtedness owing by Borrower to Lender shall be referred to as the "Indebtedness" and the Loan and Security Agreement and any and all other documents executed by Borrower in favor of Lender shall be referred to as the "Existing Documents".

2. ACKNOWLEDGEMENT OF DEFAULTS.

Borrower hereby acknowledges that as of the date hereof, the following Events of Default (the "Existing Defaults") have occurred and remain uncured under the Loan and Security Agreement:

- 1) For the months ended January 31, 2009, February 28, 2009, March 31, 2009 and April 30, 2009, failure to maintain the monthly Asset Coverage Ratio of at least 2.00 to 1.00, as required in Section 6.7, entitled "Asset Coverage Ratio."
- 2) For the quarter ended March 31, 2009, failure to maintain the quarterly Profitability of not less than One Dollar (\$1.00), as required in Section 6.8, entitled "Profitability."
- 3) For the quarter ended March 31, 2009, failure to maintain a Debt Service Coverage ratio of at least 1.50:1.00, as required in Section 6.9, entitled "Debt Service Coverage."

3. WAIVER OF DEFAULT.

Lender hereby agrees to waive the Existing Defaults, provided, and only so long as, Borrower complies in all respects with the Loan and Security Agreement and with the Existing Documents. This waiver shall not constitute a continuing waiver or a course of conduct waiving this or any other provisions of the Loan and Security Agreement.

4. DESCRIPTION OF CHANGE IN TERMS.

A. Modifications to Loan and Security Agreement:

- 1) The following defined terms in Section 1.1 are hereby amended as follows:

"EBITDA" means with respect to any fiscal period an amount equal to the sum of (a) Consolidated Net Income of the Borrower and its Subsidiaries for such fiscal period, plus (b) in each case to the extent deducted in the calculation of the Borrower's Consolidated Net Income and without duplication, (i) depreciation and amortization for such period, plus (ii) income tax expense for such period, plus (iii) Consolidated Total Interest Expense paid or accrued during such period, plus (iv) non-cash expense associated with granting stock options, plus (v) extraordinary and non-recurring restructuring costs, and minus, to the extent added in computing Consolidated Net Income, and without duplication, all extraordinary and non-recurring revenue and gains (including income tax benefits) for such period, all as determined in accordance with GAAP.

“Revolving Line” means a credit extension of up to an aggregate amount of Six Million Dollars (\$6,000,000) less the Existing Equipment Advances and the Equipment Loan B Advances.

“Revolving Maturity Date” means June 30, 2010.

- 2) Sections 6.7, 6.8 and 6.9 of the Loan and Security Agreement are amended in their entirety to read as follows:

6.7 Asset Coverage Ratio. Beginning with the period ending May 31, 2009, Borrower shall maintain, measured monthly, a ratio of Cash plus Eligible Accounts to all Indebtedness to Bank of at least 1.50 to 1.00.

6.8 Minimum EBITDA. Beginning with the period ending June 30, 2009, Borrower shall maintain a minimum EBITDA, measured on a quarterly basis, of not less than Five Hundred Thousand Dollars (\$500,000).

6.9 Term Sheets/New Equity. By no later than June 15, 2009, Borrower shall provide Bank with fully executed term sheets from investors acceptable to Bank that have been approved and accepted by Borrower’s Board of Directors providing cash proceeds for a minimum amount of Two Million Dollars (\$2,000,000) received after May 26, 2009 (the “New Equity”) from the sale or issuance of Borrower’s equity or Subordinated Debt securities. By no later than July 7, 2009, Borrower shall close the New Equity and any related Lien on Borrower’s assets shall be formally subordinated to the Bank’s Lien in the Collateral in form and substance acceptable to Bank.

- 3) Exhibit D to the Loan and Security Agreement is hereby replaced with Exhibit D attached hereto.

5. **PREPAYMENT OF EXISTING EQUIPMENT ADVANCE AND TERM LOAN B ADVANCES.** On May 26, 2009, Borrower shall request an Advance in an amount sufficient to repay in full all outstanding Obligations owing under the Existing Equipment Advance and the Term Loan B Advances.

6. **CONSISTENT CHANGES.** The Existing Documents are each hereby amended wherever necessary to reflect the changes described above.

7. **PAYMENT OF MODIFICATION FEE.** Borrower shall pay Lender a fee in the amount of \$20,000 (“Modification Fee”) plus all out-of-pocket expenses.

8. **NO DEFENSES OF BORROWER/GENERAL RELEASE.** Borrower agrees that, as of this date, it has no defenses against the obligations to pay any amounts under the Indebtedness. Borrower (“Releasing Party”) acknowledges that Lender would not enter into this Loan and Security Modification Agreement without Releasing Party’s assurance that it has no claims against Lender or any of Lender’s officers, directors, employees or agents. Except for the obligations arising hereafter under this Loan and Security Modification Agreement, Releasing Party releases Lender, and each of Lender’s and entity’s officers, directors and employees from any known or unknown claims that Releasing Party now has against Lender of any nature, including any claims that Releasing Party, its successors, counsel, and advisors may in the future discover they would have now had if they had known facts not now known to them, whether founded in contract, in tort or pursuant to any other theory of liability, including but not limited to any claims arising out of or related to the Agreement or the transactions contemplated thereby. Releasing Party waives the provisions of California Civil Code section 1542, which states:

“A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor.”

CERTIFICATION

I, Michael S. Fields, Chief Executive Officer of the registrant, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Kana Software, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 28, 2009

/s/ MICHAEL S. FIELDS

Michael S. Fields
Chief Executive Officer

CERTIFICATION

I, Jay A. Jones, Interim Chief Financial Officer of the registrant, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Kana Software, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 28, 2009

/s/ JAY A. JONES

Jay A. Jones
Interim Chief Financial Officer

**CERTIFICATION PURSUANT TO
RULE 13a-14(b) OF THE SECURITIES EXCHANGE ACT OF 1934
AND 18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Kana Software, Inc. (the "Registrant") on Form 10-Q for the quarterly period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael S. Fields, Chief Executive Officer of the Registrant, certify, in accordance with Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, that to the best of my knowledge:

- (1) The Report, to which this certification is attached as Exhibit 32.01, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: May 28, 2009

/s/ MICHAEL S. FIELDS

Michael S. Fields

Chief Executive Officer

A signed original of this written statement required by Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
RULE 13a-14(b) OF THE SECURITIES EXCHANGE ACT OF 1934
AND 18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Kana Software, Inc. (the "Registrant") on Form 10-Q for the quarterly period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jay A. Jones, Interim Chief Financial Officer of the Registrant, certify, in accordance with Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, that to the best of my knowledge:

- (1) The Report, to which this certification is attached as Exhibit 32.02, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: May 28, 2009

/s/ JAY A. JONES

Jay A. Jones
Interim Chief Financial Officer

A signed original of this written statement required by Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.

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