MOTIVE INC
Form S-1/A
June 09, 2004

As filed with the Securities and Exchange Commission on June 9, 2004

Registration Statement No. 333-111030

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Amendment No. 4

to

FORM S-1

REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

MOTIVE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**7372**	**74-2834515**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification No.)**

12515 Research Boulevard, Building 5

Austin, Texas 78759-2220

(512) 339-8335

(Name, address, including zip code, and telephone number, including area code, or registrant s principal executive offices)

J. Wesley Jones

Vice President and General Counsel

Motive, Inc.

12515 Research Boulevard, Building 5

Austin, Texas 78759-2220

(512) 339-8335

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are being offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box: ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, please check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, or until the registration statement shall become effective on such date as the

Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to completion, dated June 9, 2004

Prospectus

5,000,000 shares

Common stock

This is an initial public offering of shares of common stock by Motive, Inc. Motive is selling 5,000,000 shares of common stock. The estimated initial public offering price is between $11.00 and $13.00 per share.

Our common stock has been approved for quotation on the Nasdaq National Market under the symbol MOTV.

	Per share	Total
Initial public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds to Motive, Inc., before expenses	$	$

Motive and one of our stockholders have granted the underwriters an option for a period of 30 days to purchase up to a total of 750,000 additional shares of common stock. We will not receive any proceeds from the sale of shares by the selling stockholder.

Investing in our common stock involves a high degree of risk. See Risk factors beginning on page 6.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

JPMorgan **Thomas Weisel Partners LLC**

Friedman Billings Ramsey

Needham & Company, Inc.

America s Growth Capital

, 2004

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PROSPECTUS SUMMARY

You should read the following summary together with the entire prospectus, including the more detailed information in our consolidated financial statements and related notes appearing in the back of this prospectus. You should carefully consider, among other things, the matters discussed in Risk Factors.

MOTIVE, INC.

We are a leading provider of service management software that enables companies to build management and service directly into their customer-facing products and services. A large and increasing number of companies are employing digital hardware, software and communications technologies to enhance or, in some cases, completely redefine the products and services they sell. These new technology-enabled products create strategic growth opportunities in industries as diverse as computers, communications, software and financial services, but the costs associated with managing state-of-the-art technology environments can be over five times the cost of the technology itself. These high costs are the result of the many manual and inefficient processes required of both the providers and consumers of technology products processes such as activation, set-up, troubleshooting, updating and repair. Our software optimizes these processes by embedding self-management services directly into our customers technology products.

Our product suite includes three distinct types of service management products. Our Self-Management products optimize management processes for the end users and administrators of technology-enabled products and services. Our Service Operations Management products optimize the processes involved in delivering service and support for these complex technology products and services, simplifying and streamlining the operations of large-scale call centers and advanced remote technical support teams. Our Policy Management products enable product vendors and service providers to manage the usage of their products and services according to business objectives and policy guidelines.

As technology-enabled products and services have proliferated, companies have struggled with the time-consuming, labor-intensive and error-prone management processes that surround them. Service management software is an emerging category of management infrastructure software designed to optimize the effectiveness and efficiency of these management processes. Service management software takes a top-down, business-driven view of the ecosystem of people, processes and technology that work together in support of the most strategic products and services offered by a company. According to International Data Corporation, the market opportunity for service-centric management software is anticipated to grow from an estimated $1.7 billion in 2004 to an estimated $3.5 billion in 2007. We believe that service management software has become a primary driver of growth in the broader $10 billion systems and network management software industry.

Our software is unique in three specific ways, providing significant competitive advantages over typical infrastructure management solutions:

- first, our service management software is built directly into technology products and services enabling *self-configuration* (the ability to adapt real time to changing environments), *self-repair* (the ability to detect problems and automatically resolve them) and *self-regulation* (the ability to enforce policies that govern the acceptable use of products and services);

- second, through our automated modeling and differencing approach, our software defines the optimal set-up and operational parameters of these products and services and automatically detects and corrects differences that develop as the products are used;

and

- third, our software uses a process-driven management approach to automate the end-to-end execution of key management processes that surround these technology products.

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We believe that our solutions provide important advantages over other infrastructure management approaches and allow our customers to:

- rapidly and cost-effectively adjust to change while minimizing time and labor costs that can impede business growth and profit objectives;
- implement new service offerings faster and with less investment and risk;
- optimize management and service processes beyond company boundaries;
- avoid wasting time and labor troubleshooting system, application or network problems and to reduce the number of calls to service centers and information technology, or IT, operations; and
- improve asset utilization by locating under- and over-utilized technology assets and allocating usage in the most profitable manner.

Our products are complemented by a suite of services to assist customers in rapidly implementing their service management initiatives, optimizing their business processes and measuring the financial impact of our solution.

Since our inception, we have developed and successfully deployed our service management software solutions to industry-leading technology vendors, service providers and large enterprises. We estimate that these customers have used our software in connection with more than 30 million technology products and devices. Our customers include Advanced Digital Information Corp., Aliant Inc., AOL (UK) Limited, Bell Canada, BellSouth Corporation, British Telecommunications plc, Centrica Telecommunications Limited, Cognos Incorporated, Cox Communications, Inc., Deutsche Telekom, EMC Corporation, Fannie Mae, Fujitsu Limited, Hewlett-Packard Development Company, L.P., Hyperion Solutions Corporation, Mercury Interactive Corporation, NTL Group Ltd., N.V. Casema, SBC Communications, Inc., Sprint Communications Company, Storage Technology Corporation, Stratus Computer, Inc., Swisscom AG, Telecom Italia Media S.p.a., Telenet, Telewest Broadband, Telus Corporation, Time Warner Cable/RoadRunner, Inc., T-Online France, VERITAS Software Corporation, Verizon Communications and Warranty Corporation of America.

We were formed in 1997. Our principal executive offices are located at 12515 Research Boulevard, Building 5, Austin, Texas 78759-2220, and our telephone number is (512) 339-8335. Our website is *www.motive.com*. The information on our website is not incorporated by reference into this prospectus, and you should not consider information on our website as part of this prospectus.

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THE OFFERING

Common stock offered by us	5,000,000 shares
Common stock to be outstanding after this offering	25,155,448 shares
Over-allotment option:	
Shares saleable by us	680,000 shares
Shares saleable by the selling stockholder	70,000 shares
Total	750,000 shares
Use of proceeds	We estimate that we will receive approximately $54.3 million in net proceeds from this offering. We will use approximately $12.5 million of the net proceeds to repay outstanding indebtedness to related parties, and the remainder will be used for general corporate purposes, including working capital and possible acquisitions of assets and businesses. See Use of Proceeds for additional information on how we intend to use the proceeds from this offering.
Nasdaq National Market symbol	MOTV

The number of shares of common stock to be outstanding after this offering is based on the pro forma number of shares outstanding as of March 31, 2004. This information excludes:

- 3,439,746 shares issuable upon the exercise of outstanding options awarded under our existing stock option plans at exercise prices ranging from $0.24 to $44.00;
- 67,028 shares authorized for future issuance under our existing stock option plan; and
- 711,439 shares issuable upon the exercise of outstanding warrants at exercise prices ranging from $0.004 to $16.00.

Unless otherwise indicated, all information contained in this prospectus:

- assumes an initial public offering price of $12.00 per share;

- gives effect to a one-for-four reverse split of our common stock and preferred stock which will occur immediately prior to the closing of this offering;
- assumes that the underwriters over-allotment option will not be exercised;
- assumes that preemptive rights to purchase shares of common stock sold in this offering will not be exercised; and
- gives effect to the conversion of all outstanding shares of preferred stock into 10,322,056 shares of common stock upon completion of this offering.

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SUMMARY FINANCIAL DATA

The following table presents our summary consolidated financial data. The summary consolidated statement of operations data for the years ended December 31, 2001, 2002 and 2003 are derived from our audited consolidated financial statements, including the notes thereto, included elsewhere in this prospectus. The summary consolidated statement of operations data for the years ended December 31, 1999 and 2000 are derived from our audited consolidated financial statements, including the notes thereto, not included in this prospectus. The summary consolidated statement of operations data for the three months ended March 31, 2003 and 2004 and the summary consolidated balance sheet data as of March 31, 2004 are derived from our unaudited consolidated financial statements included elsewhere in this prospectus which, in management s opinion, include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of our financial position and results of operations for those periods. The historical results are not necessarily indicative of results to be expected in any future period. The pro forma amounts give effect to the conversion of all outstanding shares of preferred stock into common stock upon the closing of this offering. The pro forma as adjusted consolidated balance sheet amounts give further effect to this offering and the use of the net proceeds as described under Use of Proceeds. You should read the data presented below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto included elsewhere in this prospectus.

	Year Ended December 31,					Three Months Ended March 31,	
	1999	2000(1)	2001(2)	2002	2003(3)	2003(3)	2004
				Restated(4)	Restated(5)		Restated(5)
	(in thousands, except per share data)						
Consolidated Statement of Operations Data:							
Revenue:							
License fees	$ 7,031	$ 18,669	$ 39,431	$ 44,659	$ 42,957	$ 6,390	$ 11,495
Services:							
Services	2,130	9,557	12,599	13,397	24,452	6,299	7,755
Acquired in business combination (6)					24,883	8,003	3,426
Total services revenue	2,130	9,557	12,599	13,397	49,335	14,302	11,181
Total revenue	9,161	28,226	52,030	58,056	92,292	20,692	22,676
Cost of revenue:							
License fees	244	522	689	1,212	1,999	43	194
Amortization of acquired technology		138	150	13	448	97	214
Services	1,966	9,945	14,234	12,258	30,818	7,432	7,537
Total cost of revenue	2,210	10,605	15,073	13,483	33,265	7,572	7,945
Gross margin	6,951	17,621	36,957	44,573	59,027	13,120	14,731
Operating expenses:							
Sales and marketing	6,339	20,400	31,470	26,082	33,016	7,149	7,555
Research and development	3,713	7,792	12,852	11,224	16,869	3,610	4,234
General and administrative	1,946	5,919	6,656	6,321	7,951	1,890	2,169
Amortization of goodwill and intangibles		8,315	12,218		2,381	476	773
Amortization of deferred stock compensation (7)	743	6,168	2,344	2,081	1,190	166	851
Costs associated with spin-off	6,683						

Write off of prepaid stock offering costs			1,401				
Business restructuring charge			1,374		1,422	1,422	
Total operating expenses	19,424	48,594	68,315	45,708	62,829	14,713	15,582
Loss from operations	(12,473)	(30,973)	(31,358)	(1,135)	(3,802)	(1,593)	(851)
Interest income (expense), net	685	1,548	232	(1,173)	(1,910)	(490)	(510)
Other income (expense), net			(2)	120	6,207	57	472
Loss on investment, net of recovery				(7,923)			
Income (loss) before income taxes	(11,788)	(29,425)	(31,128)	(10,111)	495	(2,026)	(889)
Provision for income taxes		20	144	403	1,705	257	681
Net loss	$ (11,788)	$ (29,445)	$ (31,272)	$ (10,514)	$ (1,210)	$ (2,283)	$ (1,570)

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	Year Ended December 31,					Three Months Ended March 31,	
	1999	2000(1)	2001(2)	2002	2003(3)	2003(3)	2004
				Restated(4)	Restated(5)		Restated(5)
	(in thousands, except per share data)						
Basic and diluted loss per share	$ (4.79)	$ (7.40)	$ (6.78)	$ (1.95)	$ (0.12)	$ (0.23)	$ (0.16)
Shares used in computing basic and diluted loss per share	2,461	3,977	4,612	5,397	9,832	9,964	9,755
Pro forma basic and diluted loss per share (unaudited)					$ (0.06)		$ (0.08)
Shares used in computing pro forma basic and diluted loss per share (unaudited)					20,154		20,077

	As of March 31, 2004		
	Actual	Pro Forma	Pro Forma As Adjusted
	(in thousands)		
Consolidated Balance Sheet Data:			
Cash and cash equivalents	$ 50,458	$ 50,458	$ 92,258
Working capital	30,655	30,655	72,455
Total assets	153,926	153,926	195,726
Long-term debt, net of current portion	5,500	5,500	5,500
Related party subordinated debt, net of discount	10,873	10,873	
Redeemable convertible preferred stock	119,785		
Total stockholders equity (deficit)	(23,308)	96,477	149,150

(1) Reflects the acquisition of Ventix Systems, Inc. on January 28, 2000.
(2) Reflects the acquisition of certain assets from Question Technologies, Inc. on November 2, 2001.
(3) Reflects the acquisition of BroadJump, Inc. on January 17, 2003.
(4) License fees revenue has been restated to correct the fair value assigned to shares of common stock received from Peregrine Systems as payment pursuant to a software arrangement. See Management s Discussion and Analysis of Financial Condition and Results of Operations-Overview-Peregrine Systems. The effect of such restatement was to increase license fees revenue by $3,520,000 and to increase loss on investment, net of recovery, by approximately $3,520,000.
(5) Cost of license fees revenue has been restated to immediately expense certain license royalties paid for software that was not ultimately utilized. The effect of such restatement in 2003 was to increase cost of license fees revenue by $307,000. The effect of such restatement for the quarter ended March 31, 2004 was to decrease cost of license fees revenue by $307,000.
(6) In January 2003, we assumed liabilities related to existing software arrangements with a fair value of approximately $40.1 million as a result of our acquisition of BroadJump, Inc. The fair value of these assumed liabilities, which was recorded as deferred revenue, relates to the remaining contractual obligations under the BroadJump software arrangements and is being recognized ratably as services revenue acquired in business combination over the remaining life of the individual contractual obligations. This revenue will continue to decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire.
(7) If the amortization of deferred stock compensation were allocated to specific operating statement line items, it would be allocated as follows:

	Year Ended December 31,	Three Months Ended March 31,

	1999	2000(1)	2001(2)	2002	2003(3)	2003(3)	2004
				(in thousands)			
Cost of service revenue	$ 166	$ 895	$ 122	$ 181	$ 38	$ (28)	$ 53
Sales and marketing	181	2,698	824	144	437	102	320
Research and development	70	668	279	364	331	17	288
General and administrative	326	1,907	1,119	1,392	384	75	190
	$ 743	$ 6,168	$ 2,344	$ 2,081	$ 1,190	$ 166	$ 851

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RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors and the other information in this prospectus, including our consolidated financial statements and the related notes thereto, before investing in our common stock. Our business, operating results and financial condition could be seriously harmed by any of the following risks. The trading price of our common stock could decline due to any of these risks, in which case you could lose all or part of your investment.

Risks Related to Our Business

Our total revenue was $24.7 million in the second quarter, $20.0 million in the third quarter and $27.0 million in the fourth quarter of 2003 and $22.7 million in the first quarter of 2004, and we expect that our quarterly financial results will continue to fluctuate and may be difficult to predict. If our future results are below the expectations of public market analysts and investors, the price of our common stock may decline.

Our quarterly revenue and results of operations are difficult to predict. Unlike more established enterprise software vendors, we have experienced, and expect to continue to experience, fluctuations in revenue and operating results from quarter to quarter. As a result, we believe that quarter-to-quarter comparisons of our revenue and operating results are not necessarily meaningful, and that such comparisons may not be accurate indicators of future performance. The reasons for these fluctuations include, but are not limited to:

- the timing of sales of our software, including the relatively long sales cycles of up to nine months or more associated with most of our larger software sales to large enterprises;
- our quarterly revenue is dependent on larger software sales to a relatively small number of large enterprises;
- our dependence on license revenue from new software sales (as opposed to recurring maintenance revenue) to achieve our revenue objectives;
- budget and spending decisions by our customers, who are concentrated in the communications and high technology markets;
- our ability to renew existing licenses, most of which are for a term of three years, or to secure new licenses on beneficial terms;
- demand for our service management software;
- market acceptance of newly released products or delays in new product introductions;

- our utilization and billing rates for our professional services personnel;
- our history of growth through acquisitions which have typically affected our operating results;
- the amount and timing of operating costs related to the expansion of our business, operations and infrastructure; and
- changes in our pricing policies or our competitors pricing policies.

In addition, we experience seasonality in our revenue, with the fourth quarter of the year typically having the highest revenue for the year. We believe that this seasonality results primarily from customer budgeting cycles and our sales compensation model. We expect that this seasonality will continue.

Our operating expenses, which include sales and marketing, research and development and general and administrative expenses, are based on our expectations of future revenue and are, to a large extent, fixed in the short term. If revenue falls below our expectations in a quarter and we are not able to quickly reduce our operating expenses in response, our operating results for that quarter could be adversely affected. It is possible that in some future quarter our operating results may be below the expectations of public market analysts and investors and, as a result, the price of our common stock may fall.

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Our customer base is concentrated. For example, one customer accounted for 11% of our revenue for the year ended December 31, 2003. Accordingly, the loss of a major customer could cause our revenue to decline.

Our quarterly revenue is especially subject to fluctuation because it depends on the completion of large orders for our products and related services primarily from a small number of large customers. For example, sales to Hewlett-Packard represented 19% of our total revenue in 2002. One customer, Mercury Interactive Corporation, accounted for 11% of our total revenue in the year ended December 31, 2003. Although our customer make-up varies from quarter to quarter, a small number of customers are likely to continue to account for a significant portion of our revenue, and our revenue could decline due to the loss or delay of a single customer order or the failure of an existing customer to renew its license. Our ability to mitigate this risk is based almost entirely on our ability to obtain additional customers and to expand our sales to existing customers. Our failure to obtain additional customers, the loss or delay of customer orders or the failure of existing customers to renew their licenses will harm our business and operating results.

We have never been profitable on an annual basis and we have incurred net losses in almost every fiscal period since we began operations. We may incur losses in the future.

To date, we have not been profitable on an annual basis and we have incurred net losses in almost every fiscal period since we began operations. For the year ended December 31, 2003, we had a net loss of $1.2 million and as of March 31, 2004, we had an accumulated deficit of approximately $89.9 million. We will need to generate significant additional revenue and manage expenses appropriately to achieve and maintain profitability. Therefore, we may not be able to achieve or increase profitability on a quarterly or annual basis.

We have a limited history of sales of some of our products which makes it difficult to evaluate our prospects.

Some of the products in our current product suite have been released within the past year, including our Business Class Manager which was released in August 2003, our Usage Policy Manager which was released in September 2003 and our Technical Profile Manager which was released in May 2004. These products target solving customers problems that we have not previously addressed. There can be no assurance that our customers will perceive these products as adequately addressing those problems or that there will be substantial demand for them. It is difficult to evaluate our future prospects because of our limited experience with these products, the rapidly evolving and competitive nature of the markets in which we sell these products and other factors that are beyond our control.

The typical sales cycle for our products and services is long and it may be difficult for us to predict when certain customers will complete the sales cycle. As a result, our quarterly operating results may fluctuate and the price of our common stock could decline.

We believe that a customer s decision to purchase our software and services is highly discretionary, involves a significant commitment of resources and is influenced by customer budgetary cycles. To successfully sell our software and services, we must educate potential customers regarding their use and benefits, which can require significant time and resources from us and our customers. The period between our initial contact with a potential customer and the purchase of our software and services is often long and subject to delays associated with the budgeting, approval and competitive evaluation processes that frequently accompany significant capital expenditures. Our sales cycle varies substantially and may require up to nine months or more depending on the customer and the size of the transaction. A lengthy sales cycle may have an impact on the timing of our revenue, which in turn could cause our quarterly operating results to fluctuate and our stock price to trade at lower levels than would otherwise be the case.

Our failure to adapt to technological change in our industry and to develop and achieve broad adoption and acceptance of our new products could cause the loss of existing and potential customers and therefore adversely affect our revenue and earnings. We are dependent on new product introductions for future revenue growth and such introductions involve significant risks.

If we fail to keep pace with technological change in our industry, such failure would have an adverse effect on our revenue and earnings. During the past several years, many new technological advancements and

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competing products have entered the marketplace to address the same problems that our products and services are intended to address. Our ability to compete effectively and our growth prospects depend upon many factors, including the success of our existing software products, the timely introduction and success of future software products and releases and the ability of our products to interoperate and perform well with existing and future leading databases, applications, operating systems and other platforms. We have made significant investments in research and development and our business model requires us to generate substantial revenue from new product introductions. We released two new products in 2003, one new product in the second quarter of 2004 and anticipate releasing one new product in the third quarter of 2004. New product introductions involve significant risks. For example, delays in new product introductions or less-than-anticipated market acceptance of our new products are possible and would have an adverse effect on our revenue and earnings. We cannot be certain that our new products or future enhancements to existing products will meet customer performance needs or expectations when shipped or that they will be free of significant software defects or bugs. If they do not meet customer needs or expectations, for whatever reason, upgrading or enhancing these products could be costly and time consuming. In addition, the selling price of software products tends to decline significantly over the life of the product. If we are unable to offset any reductions in the selling prices of our products by introducing new products at higher prices or by reducing our costs, our revenue, gross margin and operating results would be adversely affected.

If we do not successfully address the risks inherent in the expansion of our international operations, our business could suffer.

We currently have operations in Canada, the United Kingdom, Germany, Switzerland, France, Spain and Japan, and we intend to expand further into international markets. Unlike more established enterprise software vendors, we have limited experience in international operations and may not be able to compete effectively in international markets or to operate profitably in these markets. At the same time, our dependence on international revenue has steadily increased over time. From our inception through March 31, 2004, we have derived approximately $56.2 million of revenue from our customers outside the U.S., and our international revenue was $29.5 million for the year ended December 31, 2003, an increase of $14.0 million over international revenue of $15.5 million for 2002. Our international revenue was $9.4 million for the three months ended March 31, 2004, an increase of $5.4 million over international revenue of $4.0 million for the three months ended March 31, 2003. Continued expansion of our international operations will require a significant amount of attention from our management and substantial financial resources and may require us to add qualified management in these markets. Our direct sales model requires us to attract, retain and manage qualified sales personnel capable of selling into markets outside the U.S. In our opinion, this is significantly more difficult in markets outside the U.S. Additionally, in some cases, our costs of sales may increase if our customers require us to sell through local distributors.

In 2003, 32% of our revenue was derived from our international operations. If we are unable to continue to grow our international operations in a cost effective and timely manner, our business and operating results could be harmed. Doing business internationally involves additional risks that could harm our operating results, particularly:

- differing technology standards;
- difficulties in collecting accounts receivable and longer collection periods;
- political and economic instability;
- fluctuations in currency exchange rates;
- imposition of currency exchange controls;

- potentially adverse tax consequences;
- reduced protection for intellectual property rights in certain countries;
- dependence on local vendors;
- compliance with multiple conflicting and changing governmental laws and regulations;
- seasonal reductions in business activity specific to certain markets;

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- longer sales cycles;
- restrictions on repatriation of earnings;
- differing labor regulations;
- restrictive privacy regulations in different countries, particularly in the European Union;
- restrictions on the export of sensitive U.S. technologies such as data security and encryption; and
- import and export restrictions and tariffs.

Our business is dependent on the renewal of licenses by our existing customers. If our customers do not renew their licenses for our products or if they do not renew their licenses on terms that are favorable to us, our operating results could be adversely affected and the price of our common stock could decline.

Most of our licenses are for a fixed term of three years. For example, for the year ended December 31, 2003, approximately 78% of the license agreements we entered into were fixed term licenses, as opposed to perpetual licenses. In addition, the revenue from our contracts acquired in the BroadJump acquisition will decline on a quarterly basis through 2006 when the remaining obligations expire. As the end of the term of a fixed term license approaches, we negotiate the renewal of the license with the customer for the same product and/or for new products and services. If our customers choose not to renew their fixed term licenses with us or if we are unable to license additional products to our existing customers on beneficial terms, our business, operating results and financial condition could be harmed.

If we do not expand our sales and distribution capabilities, we may not be able to expand the sales of our software and services and achieve revenue growth.

We need to substantially expand our direct and indirect sales and distribution efforts, both domestically and internationally, in order to increase sales of our software and related services. Competition for qualified sales and marketing personnel is intense, and we might not be able to hire and retain adequate numbers of such personnel to maintain our growth. Our sales and marketing organization grew from 74 employees at December 31, 2002 to 84 at December 31, 2003. New hires require training and take time to achieve full productivity. Our competitors have attempted to hire our employees and we expect that they will continue to do so. We also plan to expand our relationships with system integrators, enterprise software vendors and other third-party resellers to develop our indirect sales channel. As we develop our indirect sales channel, we will need to manage potential conflicts between our direct sales force and third-party reselling efforts.

If we do not expand our professional services organization, our customers may become dissatisfied and our operating results could suffer. Also, our professional services organization may not operate in a profitable manner.

Our software sales, particularly those to large enterprises, are often dependent on our ability to provide a significant level of professional services to our customers. Clients that license our software typically engage our professional services organization to assist with installation, training, consulting and implementation of our software. We believe that growth in our software sales depends to a significant degree on our ability to provide our clients with these services. We cannot be certain that our professional services business will operate in a profitable manner. For example, our cost of services revenue represented 104% and 113% of services revenue in 2000 and 2001, respectively. We plan to further increase the number of services personnel to meet customer needs. New services personnel will require training and education and take time to reach full productivity. We may not be able to recruit the services personnel we need or retain our current services personnel because competition for qualified services personnel is intense. We are in a relatively new market and only a limited number of individuals have the skills needed to provide the services that our clients require. To meet our needs for services personnel, we may also need to use third-party consultants to supplement our own professional services organization.

If we lose the services of any of our senior management or other key personnel, our business may be harmed.

Our success will depend on the skills, experience and performance of our senior management, engineering, sales, marketing and other key personnel, many of whom have worked together for only a short period of time.

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Currently, we do not have long-term employment agreements with any of our executive officers, with the exception of Kenny Van Zant who joined us as a result of our acquisition of BroadJump and received an employment agreement as part of the terms and conditions of that acquisition. The loss of the services of any of our senior management or other key personnel, including our Chief Executive Officer, Scott Harmon, could harm our business. Mr. Harmon, in particular, is one of our co-founders and possesses unique knowledge of our markets, our products and our customers. We possess key man life insurance for Scott Harmon, but not for any of our other officers.

Our failure to expand our strategic alliances would impede our revenue growth.

Unlike more established enterprise software vendors, we must successfully establish and extend relationships that enable us to expand market acceptance of our software solutions. Specifically, we must establish new and extend existing distribution alliances with specialized technology and services firms, such as support outsourcers. We must also establish new and extend existing solutions alliances with leading providers of complementary technologies. Although our business does not depend on any one strategic alliance, our strategic alliances as a whole are a valuable component of our business. Without adequate strategic alliances, we may have to devote substantially more resources than we would otherwise to the sales, marketing and implementation of our products and the development of complementary products in order to deliver comprehensive service management solutions, and our efforts may not be as effective as those who have such alliances. In many cases, the firms with which we wish to form alliances have extensive relationships with our existing and potential customers and may influence the decisions of these customers by recommending products. If we fail to establish, successfully implement or maintain these alliances, our ability to achieve market acceptance of our service management software will suffer and our business and operating results will be harmed.

We have experienced significant growth in our business in the past and we may not be able to manage our future growth efficiently or profitably.

We have expanded the scope of our operations at a rapid rate in the past. For example, in January 2003, we acquired BroadJump, Inc., a provider of broadband Internet activation and support solutions. Primarily as a result of the BroadJump acquisition, the number of people we employ has grown from 240 employees as of December 31, 2002 to 374 employees as of December 31, 2003. Future expansion efforts could be expensive and may strain our managerial and other resources. To manage future growth effectively, we must maintain and enhance our financial and accounting systems and controls, integrate new personnel and manage expanded operations. If we do not manage growth properly, it could harm our business, operating results and financial condition.

We may find it difficult to integrate potential future business combinations, which could disrupt our business, dilute stockholder value and adversely affect our operating results.

From inception to date, we have completed three acquisitions of other companies and businesses. We may acquire other companies and businesses in the future, which could add substantial complexity and additional burdens to the substantial tasks already performed by our management team. We may need to integrate operations that have different and unfamiliar corporate cultures. Likewise, we may need to integrate disparate technologies and product offerings, as well as multiple direct and indirect sales channels. These integration efforts may not succeed or may distract our management s attention from existing business operations. Our failure to successfully manage and integrate future acquisitions could seriously harm our business.

In addition, our existing stockholders ownership would be diluted if we financed our acquisitions by issuing equity securities. Under the purchase method of accounting, now required under generally accepted accounting principles for all acquisitions, we could be required to incur in-process research and development or other charges in connection with future acquisitions, which would adversely affect our operating results.

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The service management software and services industry is highly competitive, the market for our products is subject to rapid change and we may not be able to compete effectively.

The market for our products is intensely competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. Although we do not currently compete against any one entity with respect to all aspects of our software solutions, our solutions compete against various vendors software products designed to accomplish specific elements of functionality. Moreover, these vendors may broaden their product portfolios to more directly compete against our products.

Our current and potential competitors may have longer operating histories, significantly greater financial, technical and other resources or greater name recognition than we do. Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements. Competitive pressures could reduce our market share or require us to reduce the price of our products, either of which could harm our business and operating results. For more information on our competitors, please read Business Competition.

If our products fail to perform properly due to undetected errors or similar problems, our business could suffer because, among other things, we might have to limit or suspend product shipments, we might have to expand resources providing enhancements to correct such errors and we may experience other adverse consequences described below.

Our software products are complex and have been more recently developed than those of more established enterprise software vendors. Software such as ours often contains undetected errors or bugs. Such errors are frequently found during the period immediately following introduction of new software or enhancements to existing software. We continually introduce new products. If we detect any errors before we ship a product, we might have to limit or suspend product shipments for an extended period of time while we address the problem. We may not discover software errors that affect our new or current products or enhancements until after they are deployed and we may need to provide enhancements to correct such errors. Therefore, it is possible that, despite testing by us, errors may occur in our software. These errors could result in:

- damage to our reputation;
- lost sales;
- delays in commercial release;
- product liability claims;
- delays in or loss of market acceptance of our products;
- license terminations or renegotiations; and

- unexpected expenses and diversion of resources to remedy errors.

Furthermore, our customers may use our software together with products from other companies. As a result, when problems occur, it may be difficult to identify the source of the problem. Even when these problems are not caused by our software, they may cause us to incur significant costs, divert the attention of our engineering personnel from our product development efforts, impact our reputation and cause significant customer relations problems.

Our failure to integrate third-party technologies could harm our business because we may incur increased costs and experience delays procuring or building replacement technologies.

We do not own all of the technology that is used in our business and that is incorporated into our products. Accordingly, we intend to continue licensing technologies from third parties, including applications used in our research and development activities and technologies which are integrated into our products. These technologies may not continue to be available to us on commercially reasonable terms or at all. Our inability to obtain any of

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these licenses could delay product development until equivalent technology can be identified, licensed and integrated. This inability in turn would harm our business and operating results. For example, we license security and encryption technology from RSA Security. The RSA agreement continues indefinitely unless terminated in the event of a material default by either party or insolvency, or unless we terminate for convenience on 90-days written notice. Our use of third-party technologies exposes us to increased risks, including, but not limited to, risks associated with the integration of new technology into our products, the diversion of our resources from development of our own proprietary technology and our inability to generate revenue from licensed technology sufficient to offset associated acquisition and maintenance costs.

If the system security of our software is breached, our business and reputation could suffer.

A fundamental and unique requirement for effective use of many of our products is the secure transmission, collection and storage of confidential end user information. Third parties may attempt to breach our security or that of our customers. We may be liable to our customers for any breach in such security and any breach could harm our customers, our business and our reputation. In addition, our software contains features which may allow us or our customers to control, monitor or collect data from computers running the software. Therefore, we may be subject to claims associated with invasion of privacy or inappropriate disclosure, use or loss of this information. Any imposition of liability, particularly liability that is not covered by insurance or is in excess of insurance coverage, could harm our reputation and our business and operating results. Also, computers, including those that utilize our software, are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We may be required to expend significant capital and other resources to further protect against security breaches or to rectify problems caused by any security breach.

We rely upon patents, trademarks, copyrights and trade secrets to protect our proprietary rights, which may provide us with inadequate protection.

Our success and ability to compete depend to a significant degree upon the protection of our software and other proprietary technology rights. We may not be successful in protecting our proprietary technology, and our proprietary rights may not provide us with a meaningful competitive advantage. To protect our proprietary technology, we rely on a combination of patents, trademarks, copyrights, trade secrets and disclosure agreements, each of which affords only limited protection. Any inability to protect our intellectual property rights could seriously harm our business, operating results and financial condition. It is possible that:

- our pending patent applications may not result in the issuance of patents;
- any patents issued to us may not be broad enough to protect our proprietary rights;
- any issued patent 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; and
- current and future competitors may independently develop similar technologies, duplicate our products or design around any of our patents.

In addition, the laws of some foreign countries do not protect our proprietary rights in our products to the same extent as do the laws of the U.S. Despite the measures taken by us, it may be possible for a third party to copy or otherwise obtain and use our proprietary technology and information without authorization. Policing unauthorized use of our products is difficult, and litigation may be necessary in the future to enforce our intellectual property rights. Any litigation could be time consuming and expensive to prosecute or resolve, result in substantial diversion of management attention and resources, and materially harm our business, financial condition and results of operations.

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Claims that we infringe upon third parties intellectual property rights could be costly to defend or settle, thus adversely affecting our operating results.

Litigation regarding intellectual property rights is common in the software industry. We expect that software products and services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. We may from time to time encounter disputes over rights and obligations concerning intellectual property. Although we believe that our intellectual property rights are sufficient to allow us to market our software without incurring liability to third parties, third parties may bring claims of infringement against us. Such claims may be with or without merit. Any litigation to defend against claims of infringement or invalidity could result in substantial costs and diversion of resources. Furthermore, a party making such a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our software. Our business, operating results and financial condition could be harmed if any of these events occurred.

In addition, we have agreed, and will likely agree in the future, to indemnify certain of our customers against certain claims that our software infringes upon the intellectual property rights of others. We could incur substantial costs in defending ourselves and our customers against infringement claims. In the event of a claim of infringement, we and our customers may be required to obtain one or more licenses from third parties. We, or our customers, may be unable to obtain necessary licenses from third parties at a reasonable cost, if at all. Defense of any lawsuit or failure to obtain any such required licenses could harm our business, operating results and financial condition.

If we become subject to product liability claims, they could be time consuming and costly to defend, thus adversely affecting our operating results.

Errors, defects or other performance problems in our software could result in financial or other damages to our customers. They could seek damages from us for losses associated with these errors, defects or other performance problems. If successful, these claims could have a material adverse effect on our business, operating results or financial condition. Although we possess product liability insurance and errors and omissions insurance, there is no guarantee that our insurance would be enough to cover the full amount of any loss we might suffer. Our license agreements typically contain provisions designed to limit our exposure to product liability claims, but existing or future laws or unfavorable judicial decisions could negate these limitation of liability provisions. We have not experienced any product liability claims to date. However, a product liability claim brought against us, even if unsuccessful, could be time consuming and costly to defend and could harm our reputation.

Risks Relating To This Offering

There has been no prior market for our common stock, our stock price may be volatile, and after the offering you may not be able to sell your shares at or above the offering price.

Prior to this offering, our common stock has not been publicly traded, and an active trading market may not develop or be sustained after this offering. You may not be able to sell your shares at or above the offering price, which has been determined by negotiations between representatives of the underwriters and us. The price at which our common stock will trade after this offering is likely to be highly volatile and may fluctuate substantially due to factors such as the following:

- actual or anticipated fluctuations in our operating results;
- changes in or our failure to meet securities analysts expectations;
- announcements of technological innovations;
- entry of new competitors into our markets;
- introduction of new products and services by us or our competitors;

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- significant developments with respect to intellectual property rights;
- additions or departures of key personnel;
- conditions and trends in the communications and high technology markets;
- volatility in stock market prices and volumes, which is particularly common among securities of software and technology companies;
- general stock market conditions; and
- the general state of the U.S. and world economies.

After this offering, our directors, executive officers and principal stockholders will continue to have substantial control over matters requiring stockholder approval and may not vote in the same manner as our other stockholders.

Following this offering, it is anticipated that our executive officers, directors and their affiliates will beneficially own or control approximately 36.7% of our common stock. Together with other persons or entities owning 5% or more of our outstanding shares of common stock, this group will control 12,638,284 shares of common stock, or approximately 50.2% of the outstanding shares of our stock. As a result, if such persons act together, they will have the ability to control all matters submitted to our stockholders for approval, including the election and removal of directors and the approval of any merger, consolidation or sales of all or substantially all of our assets. These stockholders may make decisions that are adverse to your interests. See our discussion under the caption Principal Stockholders for more information about ownership of our outstanding shares.

A substantial portion of our outstanding shares, other than the shares sold in this offering, will be restricted from immediate resale but may be sold into the market beginning 180 days after this offering. Any future sales of our common stock may depress our stock price.

Sales of a substantial number of shares of our common stock into the public market after the offering, or the perception that these sales could occur, could adversely affect our stock price or could impair our ability to obtain capital through an offering of equity securities. After the offering, we will have outstanding 25,155,448 shares of common stock, assuming no options are exercised after March 31, 2004. The 5,000,000 shares sold in this offering will be freely tradable without restriction or further registration under the Securities Act of 1933, except for any shares purchased by our affiliates as that term is defined by Rule 144. Based upon the number of shares outstanding as of March 31, 2004, an aggregate of approximately 16,254,799 shares of our common stock will be eligible to be sold pursuant to Rule 144 or Rule 701 beginning 90 days after the date of this prospectus and an aggregate of approximately 3,830,473 shares of our common stock will be freely tradable without restriction or further registration under the Securities Act of 1933 upon completion of this offering. However, all but 279,070 of such shares are subject to lock-up agreements and will only become eligible for sale upon the expiration or termination of such agreements, generally 180 days after the date of this prospectus. You should read Shares Eligible For Future Sale for a more complete discussion of these matters.

As a new investor, you will experience immediate and substantial dilution in the value of the common stock.

The initial public offering price of our common stock will be substantially higher than the book value per share of the outstanding common stock. As a result, investors purchasing common stock in this offering will incur immediate dilution of $9.20 per share, assuming that we sell 5,000,000 shares at an initial public offering price of $12.00 per share.

We may need additional capital, and raising additional capital may dilute existing stockholders.

We believe that our existing capital resources, including the anticipated proceeds of this offering, will enable us to maintain our current and planned operations for at least the next 12 months. However, we may

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choose to, or be required to, raise additional funds due to unforeseen circumstances. If our capital requirements vary materially from those currently planned, we may require additional financing sooner than anticipated. This financing may not be available in sufficient amounts or on terms acceptable to us and may be dilutive to existing stockholders. If adequate funds are not available or are not available on acceptable terms, our ability to fund our future growth, take advantage of unanticipated opportunities, develop or enhance services or products, or otherwise respond to competitive pressures would be significantly limited.

Our certificate of incorporation, bylaws and Delaware corporate law contain provisions which could delay or prevent a change in control even if the change in control would be beneficial to our stockholders.

Delaware law as well as our certificate of incorporation and bylaws contain provisions that could delay or prevent a change in control of our company, even if it were beneficial to our stockholders to do so. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. These provisions:

- authorize the issuance of preferred stock that can be created and issued by the board of directors without prior stockholder approval to increase the number of outstanding shares and deter or prevent a takeover attempt;
- prohibit stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of our stockholders;
- prohibit cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;
- provide that our board of directors is divided into three classes, each serving three-year terms;
- preclude the ability of stockholders to call special meetings of stockholders; and
- establish advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law imposes restrictions on business combinations such as mergers between us and a holder of 15% or more or our voting stock. See Description of Capital Stock Anti-Takeover Effects of Delaware Law and Provisions of Our Certificate of Incorporation and Bylaws.

Our term loans and our line of credit are secured by substantially all of our assets, and in the event of our bankruptcy or liquidation, our assets will first be used to satisfy our secured indebtedness.

Our term loans and our $15 million line of credit are secured by substantially all of our assets, including our intellectual property. In the event of our bankruptcy, liquidation, dissolution, reorganization or other winding up, our assets that collateralize this secured indebtedness would first be used to satisfy amounts outstanding under our term loans and our line of credit before they would be available to satisfy our other obligations or to be distributed to holders of our capital stock following satisfaction of all of our outstanding indebtedness.

We have substantial discretion as to how to use the offering proceeds, and the investment of these proceeds may not yield a favorable return.

Our management will have flexibility in deploying the net proceeds of this offering. The net proceeds could be used in ways that do not increase our operating results or market share. You will not have the opportunity, as part of your investment decision, to assess whether proceeds are being used appropriately. The proceeds may be invested in ways that do not yield favorable returns.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements under Prospectus Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business, and elsewhere in this prospectus constitute forward-looking statements. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among other things, those listed under Risk Factors and elsewhere in this prospectus. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential, or continue or the negative of such terms or other comparable ter These statements are only predictions. Actual events or results may differ materially.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of such statements. We are under no duty to update any of the forward-looking statements after the date of this prospectus to conform such statements to actual results.

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USE OF PROCEEDS

Our net proceeds from the sale of the 5,000,000 shares of common stock in this offering are estimated to be $54.3 million, assuming an initial public offering price of $12.00 per share and after deducting estimated offering expenses and underwriting discounts and commissions. We intend to use approximately $12.5 million of the net proceeds of the offering to repay senior secured promissory notes issued in October 2002 to certain of our stockholders, which bear interest at the rate of 11% per annum and would otherwise be payable in full on October 11, 2007. These stockholders include Austin Ventures VII, L.P. who, together with its affiliated funds, owned approximately 19.2% of our outstanding shares as of March 31, 2004, and Eric L. Jones, one of our directors.

We intend to use the remainder of the net proceeds for working capital and other general corporate purposes, including capital expenditures and research and development with respect to developing new and improving our existing product and service offerings. In addition, if the appropriate opportunities arise for the acquisition of assets and businesses that are complementary to ours, for example, complementary product lines, products or technologies, we may use a portion of the net proceeds for such an acquisition. However, we have no current plans, agreements or commitments and are not currently engaged in any negotiations with respect to any such transaction. Pending such uses, we will invest the net proceeds of this offering in investment grade, interest-bearing securities.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our capital stock, and we currently do not intend to pay cash dividends on our common stock. We currently expect to retain any future earnings to fund the operation and expansion of our business. Our line of credit with Comerica Bank prohibits us from declaring or paying dividends without Comerica s consent.

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CAPITALIZATION

The following table sets forth our cash and cash equivalents and capitalization as of March 31, 2004 on:

- an actual basis;
- a pro forma basis to reflect the conversion of all of shares of outstanding preferred stock into 10,322,056 shares of common stock and the filing of an amended and restated certificate of incorporation to provide for, among other things, authorized capital of 150,000,000 shares of common stock and 15,000,000 shares of undesignated preferred stock upon the closing of this offering; and
- a pro forma as adjusted basis to give further effect to our sale of 5,000,000 shares of common stock in this offering and the application of the net proceeds from this offering as described under Use of Proceeds.

This table should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and accompanying notes included elsewhere in this prospectus.

	As of March 31, 2004		
	Actual	Pro Forma	Pro Forma As Adjusted
	(in thousands, except share data)		
Cash and cash equivalents	$ 50,458	$ 50,458	$ 92,258
Long-term debt, net of current portion	$ 5,500	$ 5,500	$ 5,500
Related party subordinated debt, net of discount	10,873	10,873	
Redeemable convertible preferred stock:			
Preferred stock, $0.001 par value, 47,000,000 shares authorized, 10,322,056 issued and outstanding, actual; no shares authorized, issued and outstanding, pro forma and pro forma as adjusted	119,785		
Stockholders equity (deficit):			
Preferred stock, $0.001 par value, no shares authorized, issued and outstanding, actual; 15,000,000 shares authorized, none issued and outstanding, pro forma and pro forma as adjusted			
Common stock, $0.001 par value, 25,000,000 shares authorized, 9,833,392 issued and outstanding, actual; 150,000,000 shares authorized, 20,155,448 issued and outstanding, pro forma; 150,000,000 shares authorized, 25,155,448 issued and outstanding, pro forma as adjusted	10	20	25
Additional paid-in capital	70,352	190,127	244,422
Deferred stock compensation	(3,482)	(3,482)	(3,482)
Accumulated comprehensive loss	(252)	(252)	(252)
Accumulated deficit	(89,936)	(89,936)	(91,563)

Total stockholders equity (deficit)	(23,308)	96,477	149,150
Total capitalization	$ 112,850	$ 112,850	$ 154,650

The number of shares of common stock to be outstanding after this offering:

- excludes 3,439,746 shares issuable upon the exercise of outstanding options awarded under our existing stock option plans at exercise prices ranging from $0.24 to $44.00;
- excludes 67,028 shares authorized for future issuance under our existing stock option plan; and
- excludes 711,439 shares issuable upon the exercise of outstanding warrants at exercise prices ranging from $0.004 to $16.00.

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DILUTION

The pro forma net tangible book value of our common stock as of March 31, 2004, giving effect to the conversion of all shares of preferred stock outstanding as of March 31, 2004 into common stock on the closing of this offering, was $17.8 million, or approximately $0.88 per share. Pro forma net tangible book value per share represents the amount of our stockholders equity less intangible assets, divided by 20,155,448 shares of common stock outstanding after giving effect to the conversion of our preferred stock into common stock.

Net tangible book value dilution per share to new investors represents the difference between the amount per share paid by purchasers of common stock in this offering and the pro forma net tangible book value per share of common stock immediately after completion of this offering. After giving effect to the sale by us of 5,000,000 shares of common stock in this offering at an assumed initial offering price of $12.00 per share and after deducting the estimated underwriting discounts and commissions and estimated offering expenses and the application of the estimated net proceeds from this offering, our pro forma net tangible book value as of March 31, 2004 would have been $70.5 million, or $2.80 per share. This represents an immediate increase in net tangible book value of $1.92 per share to existing stockholders and an immediate dilution in net tangible book value of $9.20 per share to purchasers of common stock in this offering. The following table illustrates the per share dilution:

Assumed initial public offering price per share		$ 12.00
Pro forma net tangible book value per share as of March 31, 2004	$ 0.88	
Increase per share attributable to new investors	1.92	
Pro forma net tangible book value per share after this offering		2.80
Dilution per share to new investors		$ 9.20

The following table sets forth on a pro forma basis as of March 31, 2004, after giving effect to the difference between the number of shares of common stock purchased from us, the total consideration paid to us and the average price paid by existing stockholders and by new investors, before deduction of estimated discounts and commissions and estimated offering expenses payable by us:

	Shares Purchased		Total Consideration		Average Price
	Number	Percent	Amount	Percent	Per Share
Existing stockholders	20,155,448	80.1%	$ 139,764,000	70.0%	$ 6.93
New investors	5,000,000	19.9	60,000,000	30.0	12.00
Total	25,155,448	100.0%	$ 199,764,000	100%	$ 7.94

Assuming the underwriters over-allotment is exercised in full, the percentage of shares held by existing stockholders will decrease to 77.8% of the total number of shares of common stock outstanding after this offering and the number of shares held by new investors will increase to 22.2%.

As of March 31, 2004, there were options outstanding to purchase a total of 3,439,746 shares of common stock at a weighted average exercise price of $5.53 per share and warrants outstanding to purchase a total of 711,439 shares of capital stock at a weighted average exercise price of $4.28 per share. If all of these options and warrants are exercised, the percentage of shares sold by us in this offering compared to the total number of shares outstanding would decrease from 19.9% to 17.1% and the percentage of consideration paid by investors to us in this offering compared to the total consideration paid by all investors would decrease from 30.0% to 27.0%.

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SELECTED FINANCIAL DATA

The following table presents our selected consolidated financial data. The selected consolidated statement of operations data for the years ended December 31, 2001, 2002 and 2003 and the selected consolidated balance sheet data as of December 31, 2002 and 2003 are derived from the audited consolidated financial statements, including the notes thereto, included elsewhere in this prospectus. The selected consolidated statement of operations data for the years ended December 31, 1999 and 2000 and the selected consolidated balance sheet data as of December 31, 1999, 2000 and 2001 are derived from audited consolidated financial statements, including the notes thereto, not included in this prospectus. The summary consolidated statement of operations data for the three months ended March 31, 2003 and 2004 and the summary consolidated balance sheet data as of March 31, 2004 are derived from our unaudited consolidated financial statements included elsewhere in this prospectus which, in management s opinion, include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of our financial position and results of operations for those periods. The historical results are not necessarily indicative of results to be expected in any future period. The pro forma amounts give effect to the conversion of all outstanding shares of preferred stock into common stock upon the closing of this offering. You should read the data presented below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto included elsewhere in this prospectus.

	Year Ended December 31,					Three Months Ended March 31,	
	1999	2000(1)	2001(2)	2002	2003(3)	2003(3)	2004
				Restated(4)	Restated(5)		Restated(5)
	(in thousands, except per share data)						
Consolidated Statement of Operations Data:							
Revenue:							
License fees	$ 7,031	$ 18,669	$ 39,431	$ 44,659	$ 42,957	$ 6,390	$ 11,495
Services:							
Services	2,130	9,557	12,599	13,397	24,452	6,299	7,755
Acquired in business combination (6)					24,883	8,003	3,426
Total services revenue	2,130	9,557	12,599	13,397	49,335	14,302	11,181
Total revenue	9,161	28,226	52,030	58,056	92,292	20,692	22,676
Cost of revenue:							
License fees	244	522	689	1,212	1,999	43	194
Amortization of acquired technology		138	150	13	448	97	214
Services	1,966	9,945	14,234	12,258	30,818	7,432	7,537
Total cost of revenue	2,210	10,605	15,073	13,483	33,265	7,572	7,945
Gross margin	6,951	17,621	36,957	44,573	59,027	13,120	14,731
Operating expenses:							
Sales and marketing	6,339	20,400	31,470	26,082	33,016	7,149	7,555
Research and development	3,713	7,792	12,852	11,224	16,869	3,610	4,234
General and administrative	1,946	5,919	6,656	6,321	7,951	1,890	2,169
Amortization of goodwill and intangibles		8,315	12,218		2,381	476	773
Amortization of deferred stock compensation (7)	743	6,168	2,344	2,081	1,190	166	851
Costs associated with spin-off	6,683						
Write off of prepaid stock offering costs			1,401				

Business restructuring charge			1,374		1,422	1,422	
Total operating expenses	19,424	48,594	68,315	45,708	62,829	14,713	15,582
Loss from operations	(12,473)	(30,973)	(31,358)	(1,135)	(3,802)	(1,593)	(851)
Interest income (expense), net	685	1,548	232	(1,173)	(1,910)	(490)	(510)
Other income (expense), net			(2)	120	6,207	57	472
Loss on investment, net of recovery				(7,923)			
Income (loss) before income taxes	(11,788)	(29,425)	(31,128)	(10,111)	495	(2,026)	(889)
Provision for income taxes		20	144	403	1,705	257	681
Net loss	$ (11,788)	$ (29,445)	$ (31,272)	$ (10,514)	$ (1,210)	$ (2,283)	$ (1,570)
Basic and diluted loss per share	$ (4.79)	$ (7.40)	$ (6.78)	$ (1.95)	$ (0.12)	$ (0.23)	$ (0.16)
Shares used in computing basic and diluted loss per share	2,461	3,977	4,612	5,397	9,832	9,964	9,755
Pro forma basic and diluted loss per share (unaudited)					$ (0.06)		$ (0.08)
Shares used in computing pro forma basic and diluted loss per share (unaudited)					20,154		20,077

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	As of December 31,					As of March 31,
	1999	2000(1)	2001(2)	2002	2003(3)	2004
		(in thousands)			Restated(5)	
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$ 6,409	$ 6,469	$ 17,708	$ 32,728	$ 28,433	$ 50,458
Working capital	22,321	20,910	14,562	23,501	14,647	30,655
Restricted cash					15,000	
Total assets	28,822	61,420	47,682	63,817	158,443	153,926
Long-term debt, net of current portion	713	2,759	1,529	5,291	6,026	5,500
Related party subordinated debt, net of discount				10,280	10,757	10,873
Redeemable convertible preferred stock	31,155	53,521	69,047	68,915	119,785	119,785
Total stockholders equity (deficit)	(7,847)	(10,461)	(39,631)	(45,362)	(22,971)	(23,308)

(1) Reflects the acquisition of Ventix Systems, Inc. on January 28, 2000.
(2) Reflects the acquisition of certain assets from Question Technologies, Inc. on November 2, 2001.
(3) Reflects the acquisition of BroadJump, Inc. on January 17, 2003.
(4) License fees revenue has been restated to correct the fair value assigned to shares of common stock received from Peregrine Systems as payment pursuant to a software arrangement. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview Peregrine Systems. The effect of such restatement was to increase license fees revenue by $3,520,000 and to increase loss on investment, net of recovery, by approximately $3,520,000.
(5) Cost of license fees revenue has been restated to immediately expense certain license royalties paid for software that was not ultimately utilized. The effect of such restatement in 2003 was to increase cost of license fees revenue by $307,000. The effect of such restatement for the quarter ended March 31, 2004 was to decrease cost of license fees revenue by $307,000.
(6) In January 2003, we assumed liabilities related to existing software arrangements with a fair value of approximately $40.1 million as a result of the BroadJump acquisition. The fair value of these assumed liabilities, which was recorded as deferred revenue, relates to the remaining contractual obligations under the BroadJump software arrangements and is being recognized ratably as services revenue acquired in business combination over the remaining life of the individual contractual obligations. This revenue will continue to decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire.
(7) If the amortization of deferred stock compensation were allocated to specific operating statement line items, it would be allocated as follows:

	Year Ended December 31,					Three Months Ended March 31,	
	1999	2000(1)	2001(2)	2002	2003(3)	2003(3)	2004
				(in thousands)			
Cost of services revenue	$ 166	$ 895	$ 122	$ 181	$ 38	$ (28)	$ 53
Sales and marketing	181	2,698	824	144	437	102	320
Research and development	70	668	279	364	331	17	288
General and administrative	326	1,907	1,119	1,392	384	75	190
	$ 743	$ 6,168	$ 2,344	$ 2,081	$ 1,190	$ 166	$ 851

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MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Selected Financial Data and our consolidated financial statements and related notes thereto appearing elsewhere in this prospectus. This discussion contains forward-looking statements. These statements reflect our current views with respect to future events and financial performance and are subject to risks, uncertainties and assumptions, including those discussed in Risk Factors. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated in the forward-looking statements.

Overview

We are a leading provider of service management software that enables companies to build management and service directly into their customer-facing products and services, optimizing time and reducing waste from labor-intensive management processes. Our revenue has increased from $1.4 million in 1998 to $92.3 million in 2003.

From our incorporation in April 1997, we have developed and successfully deployed our service management software solutions to industry-leading technology vendors, service providers and large enterprises. We estimate that these customers have used our software in connection with more than 30 million technology products and devices. We have continued to enhance the functionality of our products, and our current service management product suite includes products in the service operations management, self management and policy management categories.

Our future success will depend on many factors, including but not limited to:

- the measurable benefits that our products provide to our customers, such as allowing them to execute rapid and profitable change, optimizing management processes across company boundaries, increasing productivity, optimizing asset utilization, and creating new sources of revenue;
- our service management software being built directly into the technology products and services of our customers; and
- our flexible term or usage-based licensing model.

In evaluating our financial condition and operating performance, our management team and our board of directors focus on a wide variety of information and performance metrics, including, among others, the following:

- the level of revenue generated from sales of our software products to existing and new customers;
- the mix of revenue generated from license fees and services fees;
- the mix of revenue generated within the U.S. and outside the U.S.;
- the extent to which customers license our products under term as opposed to perpetual licenses;
- our ability to manage our cost structure such that it supports our revenue generation efforts while optimizing profitability; and
- our employee headcount numbers, both in terms of function within the company and in terms of geographic dispersal, which numbers are directly reflective of our cost structure.

The principal operational challenge that we face is the fact that our quarterly revenue and results of operations are difficult to predict. Unlike more established software vendors, we have experienced, and expect to continue to experience, fluctuations in revenue and operating results from quarter to quarter. Weak capital

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spending and competitive pressures may challenge our future financial performance. Additionally, we typically derive a significant portion of our revenue each quarter from a number of license agreements closed in the last month of a quarter. If we fail to close certain agreements that are expected to be completed toward the end of a quarter, our quarterly results would suffer.

To address these challenges, we intend to continue to invest to enhance our current products and services and to develop new products and services. We also intend to increase our services, sales and development resources, and to invest in the expansion of our international operations, which represented 32% of our revenue in 2003. We may seek to accomplish these expansions by acquiring businesses that possess products, technology, or operations that are complementary to ours.

Another operational challenge that we face is the fact that our operating expenses are, to a large extent, fixed in the short term. If our revenue falls below our expectation in a quarter and we are not able to greatly reduce our operating expenses in response, our operating results for that quarter could be adversely affected. To address this challenge, we attempt to closely monitor our cost structure and operating expense trends, as well as to closely monitor our sales pipeline and related sales activities.

In addition, our ability to compete effectively will depend on the timely introduction and success of future software products and releases and the ability of our products to interoperate and perform well with existing and future leading databases, applications, operating systems and other platforms. To address this challenge, we have made and will continue to make significant investments in research and development to keep pace with technological change in our industry.

We intend that the discussion of our financial condition and results of operations that follows to provide information that will assist in understanding our financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our financial statements.

Sources of Revenue

Through March 31, 2004, substantially all of our revenue was derived from licensing our product suite and providing related services. Customers pay us license fees for the right to use our products for a fixed or perpetual term. For the years ended December 31, 2002 and 2003, 70% and 78%, respectively, of the license agreements we entered into were fixed-term and 30% and 22%, respectively, were perpetual. The term of our licenses is typically three years. We price our license fees based on an expected volume of usage during the license term.

Our licensing arrangements may also include the provision of certain services. Services revenue is comprised of revenue from professional services, such as consulting services, maintenance and support services and hosting and managed services. Consulting services include a range of services such as installation, implementation and non-complex interface development for the customer s specific applications. Maintenance and support services represent technical support of our software products and include the right to unspecified product upgrades on an if-and-when available basis. Hosting and managed services involve remote management of our solutions.

We experience seasonality in our revenue, with the fourth quarter of the year typically having the highest revenue for the year. We believe that this seasonality results primarily from customer budgeting cycles and our sales compensation model. We expect that this seasonality will continue.

In January 2003, we assumed liabilities related to existing software arrangements with a fair value of approximately $40.1 million as a result of the BroadJump acquisition. The fair value of these assumed liabilities, which was recorded as deferred revenue, relates to the remaining contractual obligations under the BroadJump software arrangements and is being recognized ratably as services revenue acquired in business combination over the remaining life of the individual software arrangements. This revenue will continue to decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software

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arrangements expire. We expect this declining services revenue stream to be partially offset by new contracts with these former BroadJump customers for use of a broader range of our products. We expect these new contracts to contain a ratio of license fees revenue to services revenue commensurate with our historical experience.

Excluding services revenue acquired in business combination, license fees revenue has typically represented 64% to 77% of total revenue in recent years and services revenue has typically represented 23% to 36% of total revenue in recent years.

Recent Acquisitions

In January 2000, we acquired Ventix in exchange for 1,541,333 shares of our capital stock. We acquired Ventix, a provider of Internet-based service solutions for e-business applications, to accelerate our entry into the e-business market. We accounted for the Ventix acquisition using the purchase method of accounting and Ventix has been included in our results of operations from the date of the acquisition. We recorded approximately $26.9 million in goodwill and intangibles in connection with the acquisition. Approximately $270,000 of the purchase price was allocated to acquired in-process research and development and was expensed in the first quarter of 2000 because technological feasibility had not been established and no future alternative uses existed.

In November 2001, we acquired certain assets of Question Technologies in exchange for 1,293,860 shares of our capital stock. We accounted for the acquisition of assets at fair market value on the date of closing. Approximately $3 million of the purchase price was allocated to acquired in-process research and development and was expensed in the fourth quarter of 2001 because technological feasibility had not been established and no future alternative uses existed.

In January 2003, we acquired BroadJump in exchange for 9,557,977 shares of our capital stock. We acquired BroadJump, a provider of Internet-based service solutions for broadband companies, to solidify our position as a leader in providing service management software for broadband technology ecosystems. We accounted for the BroadJump acquisition using the purchase method of accounting and BroadJump has been included in our results of operations from the date of acquisition. We recorded approximately $73.6 million in goodwill and intangibles in connection with the acquisition.

Peregrine Systems

We entered into a software license arrangement with Peregrine Systems in April 2000, as amended in October 2000, pursuant to which we granted to Peregrine the right to sublicense and distribute certain of our software in exchange for minimum license fees of $30 million. In March 2002, we amended the agreement to allow Peregrine to satisfy its payment obligations to us with either cash or Peregrine common stock.

We did not recognize revenue from the Peregrine license arrangement in 2000, as no amounts were due during that year. In 2001, we recognized license revenue of $10.5 million based upon nonrefundable fixed minimum license fees due during the 2001 calendar year. As of December 31, 2001 we had an accounts receivable balance of $6.0 million which was considered collectible based on Peregrine s past payment history and general creditworthiness.

Pursuant to the amended license arrangement, we received 1,000,000 shares of unregistered Peregrine common stock in the first quarter of 2002. Upon receipt of the shares, we recorded a short-term investment in marketable equity securities of $9.5 million. The fair value of the shares received was determined based on the then-current trading price of the stock. Additionally, in the first quarter of 2002 we credited accounts receivable for $6.0 million and license fees revenue for $3.5 million. We recorded revenue at the time the shares were received because such amount was nonrefundable and we had performed all of our obligations under the amended agreement.

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The trading price of Peregrine stock fell from $9.52 on March 31, 2002 to $0.30 on June 30, 2002. Due to the decline in market value of the Peregrine stock, in the second quarter of 2002 we deemed the Peregrine shares to be other than temporarily impaired and recorded an impairment charge of $9.5 million pursuant to Staff Accounting Bulletin (SAB) Topic 5M. In August 2002, we received $1.6 million in cash from CIBC pursuant to the termination and settlement of an agreement in connection with our attempted sale of a portion of the Peregrine shares. We recorded the receipt of such cash as a recovery of impairment on investment during the quarter ended September 30, 2002.

Peregrine filed for bankruptcy in September 2002. Peregrine s plan of reorganization provided for satisfaction of Peregrine s obligations by payments to us of cash totaling $9.0 million, and Peregrine s return to us of 416,667 shares of our common stock that had been previously issued by us to Peregrine for a cash purchase price of $11.0 million. The cash payments totaling $9.0 million are comprised of a $4.0 million payment that was paid in August 2003 and four annual payments of $1.25 million to be made over the following four years. We recognize other income from this arrangement when cash or shares are actually received. During 2003, we recognized approximately $6.1 million in other income from this arrangement, based upon our receipt of $4.0 million in cash and the return of 416,667 shares of our common stock. The 416,667 shares of common stock were recorded at $5.00 per share or approximately $2.1 million, which was the then current fair value of our common stock as determined by our board of directors.

Critical Accounting Policies

Revenue Recognition

License fees revenue is comprised of fees for term and, to a lesser extent, perpetual licenses of our software. To date, we have not entered into any software arrangement solely for the license of products and, therefore, we have not demonstrated vendor specific objective evidence (VSOE) of fair value for the license element. We (1) recognize revenue for the fees associated with a perpetual license or a term license with VSOE for maintenance using the residual method in accordance with Statement of Position (SOP) 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*, regardless of any separate prices stated within the contract for each element, or (2) recognize revenue for the fees associated with a term license without VSOE for maintenance ratably over the term of the agreement, generally one to three years. Prior to the fourth quarter of 2001, we did not have VSOE to determine the fair value of maintenance for term licenses. As a result, license fees revenue also includes maintenance for term licenses entered into prior to the establishment of VSOE of maintenance for term licenses. License fees revenue is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no unfulfilled vendor obligations remain, the fee is fixed or determinable and collectibility is probable.

If the fee for the license has any payment terms that are in excess of our normal payment terms, the fee is considered not to be fixed or determinable. In this scenario, the amount of revenue recognized for perpetual license arrangements and term license arrangements *with* VSOE for maintenance is limited to the amount currently due from the customer. In such arrangements, license fees are recognized as license fees revenue as the related amounts become due. Because each such arrangement is individually negotiated, the payment schedule and resulting revenue recognition associated with each agreement can vary. The amount of revenue recognized for term license arrangements *without* VSOE for maintenance is limited to the lesser of the amount due from the customer during each reporting period and a ratable portion of the total unallocated arrangement fee. In most cases, this means that both license fees and maintenance associated with the underlying arrangement are recognized as license fees revenue ratably over the term of the contract, which generally tends to defer revenue recognition over longer periods of time. To the extent that sufficient amounts are not due from the customer to cover the ratable revenue recognition for an applicable period, the amount of revenue recognized is limited to the amount currently due.

If an arrangement includes a right of acceptance or a right to cancel, revenue is recognized when acceptance is received or the right to cancel has expired.

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License fees revenue from arrangements with resellers involving nonrefundable fixed minimum license fees are recognized when payment becomes due from the customer and delivery of the product has occurred, assuming no significant unfulfilled vendor obligations remain. Royalties related to such reseller arrangements in excess of the fixed minimum amounts are recognized as revenue when such amounts are reported to us.

Services revenue is comprised of revenue from professional services, such as consulting services, maintenance and support services and hosting and managed services. Consulting services include a range of services such as installation, implementation and non-complex interface development for the customer s specific applications. Maintenance and support services represent technical support of our software products and include the right to unspecified product upgrades on an if-and-when available basis. Hosting and managed services involve remote management of our solutions for which we receive fees. We have determined that the service elements of our software arrangements are not essential to the functionality of the software. We have also determined that our professional services: (1) are available from other vendors; (2) do not involve a significant degree of risk or unique acceptance criteria; and (3) qualify for separate accounting as we have sufficient experience in providing such services.

VSOE of fair value of services in multiple element arrangements is based upon rates for consulting and training services and fees for pre-packaged technical support and hosting and managed services which we have charged in stand-alone contracts for these services. For perpetual licensing arrangements and term licensing arrangements with VSOE for maintenance and hosting and managed services, in accordance with paragraph 57 of SOP 97-2, VSOE of fair value for maintenance and hosting and managed services is determined by reference to the price the customer has paid or will be required to pay when it is sold separately. VSOE of fair value for maintenance and hosting and managed services contracts under perpetual license arrangements and term license arrangements with VSOE for maintenance and hosting and managed services is based upon our pricing practice that maintenance and hosting and managed services renewal rates are based upon a percentage of the quoted license fees in the related contract. Each contract typically offers additional renewal periods at a stated price or rate. Maintenance revenue is deferred and recognized on a straight-line basis as services revenue over the life of the related agreement, which is typically one year. Hosting and managed services revenue is deferred and recognized on a straight-line basis as services revenue over the life of the related agreement, which typically ranges from one month to one year.

In January 2003, we assumed liabilities related to existing software arrangements with a fair value of approximately $40.1 million as a result of the BroadJump acquisition. The fair value of these assumed liabilities, which was recorded as deferred revenue, relates to the remaining contractual obligations under the BroadJump software arrangements and is being recognized ratably as services revenue acquired in business combination over the remaining life of each software arrangement. This revenue will continue to decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire. The following table summarizes how this revenue will be recognized in each calendar quarter of 2004 through 2006 (in millions):

	Quarter Ended			
	Mar. 31	**June 30**	**Sept. 30**	**Dec. 31**
2004	$ 3.4	$ 2.1	$ 1.5	$ 1.4
2005	1.3	1.0	0.9	0.9
2006	0.9	0.9	0.6	0.3

Accounts receivable include amounts due from customers for which revenue has been recognized. Deferred revenue includes amounts received from customers for which revenue has not been recognized.

Allowance for Doubtful Accounts

We continuously assess the collectibility of outstanding customer invoices and in doing so, we maintain an allowance for estimated losses resulting from the non-collection of customer receivables. In estimating this allowance, we consider factors such as: historical collection experience; a customer s current credit worthiness;

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customer concentration; age of the receivable balance, both individually and in the aggregate; and general economic conditions that may affect a customer s ability to pay. Actual customer collections could differ from our estimates and accordingly could exceed our related loss allowance.

Goodwill and Other Intangible Assets

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations,* and SFAS No. 142, *Goodwill and Other Intangible Assets,* in June 2001. Pursuant to SFAS No. 141, assembled workforce no longer meets the criteria to be recognized and reported apart from goodwill. As a result, we have reclassified assembled workforces of $212,093, net of amortization and impairment charges, to goodwill. Effective January 1, 2002, we adopted SFAS No. 142 and no longer amortize goodwill. In accordance with SFAS No. 142, we periodically assess our intangible assets, including goodwill, for indicators of impairment.

Prior to January 1, 2002, intangible assets related to the Ventix acquisition were being amortized using the straight-line method over a two-year period for acquired technology and a three-year period for workforce and goodwill. The acquired technology from the Ventix acquisition was fully amortized as of March 31, 2002. In January 2003, we acquired BroadJump and recorded certain intangibles, including acquired technology, customer contractual relationships, order backlog and non-competition agreements. Amounts allocated to acquired technology, customer contractual relationships and order backlog are being amortized over the respective assets estimated useful lives of four to five years using a method of amortization that reflects the pattern in which their economic benefits are consumed based upon estimated contributions to discounted cash flows during the applicable period. Amounts allocated to non-compete agreements are being amortized over their estimated useful lives of three years using the straight line method. We periodically review the estimated useful lives of our identifiable intangible assets, taking into consideration any events or circumstances which might result in a diminished fair value or revised useful life.

We assess whether goodwill and indefinite-lived intangibles are impaired on an annual basis. Upon determining the existence of goodwill and/or indefinite-lived intangibles impairment, we measure that impairment based on the amount by which the book value of goodwill and/or indefinite-lived intangibles exceeds its fair value. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit s identifiable assets and liabilities from the fair value of the reporting unit as a whole, as if that reporting unit had just been acquired and the purchase price were being initially allocated. Additional impairment assessments may be performed on an interim basis if we encounter events or changes in circumstances that would indicate that, more likely than not, the book value of goodwill and/or indefinite-lived intangibles has been impaired.

Stock-Based Compensation

We account for our employee stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees.* We make disclosures regarding employee stock-based compensation using the fair value method in accordance with SFAS No. 123, *Accounting for Stock Based Compensation*. We have calculated the fair value of options granted and have determined the pro forma impact on net income (loss). We account for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services.*

Results of Operations

In view of our limited operating history and changes in the general economic climate, we believe that period-to-period comparisons of revenue and operating results are not necessarily meaningful and should not be relied upon as indications of future performance. Our prospects must be considered in light of the risks, expenses

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and difficulties encountered by companies in new and rapidly evolving markets. Additionally, despite our revenue growth during prior periods, we do not believe that historical growth rates are necessarily sustainable or indicative of future growth.

The following discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. We base our 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 value of assets and liabilities that are not readily apparent from other sources. Estimates and assumptions are reviewed periodically, and actual results may differ from these estimates under different assumptions or conditions.

The following table sets forth, for the periods indicated, our consolidated statements of operations as a percentage of total revenue.

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
Revenue:					
License fees	76%	77%	47%	31%	51%
Services:					
Services	24	23	26	30	34
Acquired in business combination			27	39	15
Total services revenue	24	23	53	69	49
Total revenue	100	100	100	100	100
Cost of revenue:					
License fees	2	2	2		1
Amortization of acquired technology					1
Services	27	21	34	36	33
Total cost of revenue	29	23	36	36	35
Gross margin	71	77	64	64	65
Operating expenses:					
Sales and marketing	60	45	36	35	33
Research and development	25	19	18	18	19
General and administrative	13	11	9	9	10
Amortization of goodwill and intangibles	24		3	2	3
Amortization of deferred stock compensation	5	4	1	1	4
Write off of prepaid stock-offering costs	2				
Business restructuring charge	2		1	7	

Total operating expenses	131	79	68	72	69
Income (loss) from operations	(60)	(2)	(4)	(8)	(4)
Interest income (expense), net		(2)	(2)	(2)	(2)
Other income			7		2
Loss on investment, net of recovery		(13)			
Income (loss) before income taxes	(60)	(17)	1	(10)	(4)
Provision for income taxes		1	2	1	3
Net loss	(60)%	(18)%	(1)%	(11)%	(7)%

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Comparison of the Three Months Ended March 31, 2003 and 2004

Revenue

Total revenue increased by $2.0 million from $20.7 million for the three months ended March 31, 2003 to $22.7 million for the three months ended March 31, 2004. The increase was due to a $5.1 million increase in license fees revenue and an increase in services revenue of $1.5 million, partially offset by a $4.6 million decrease in services revenue acquired as a result of the BroadJump acquisition.

Domestic revenue decreased by $3.4 million from $16.7 million for the three months ended March 31, 2003 to $13.3 million for the three months ended March 31, 2004. International revenue increased by $5.4 million from $4.0 million for the three months ended March 31, 2003 to $9.4 million for the three months ended March 31, 2004. International revenue represented 19% and 41% of our total revenue for the three months ended March 31, 2003 and 2004, respectively. For more information about our international revenue and expansion plans, please see Quantitative and Qualitative Disclosures About Market Risk.

Our revenue recognition policy requires that we only recognize revenue when persuasive evidence of an agreement exists, delivery of the product has occurred, no unfulfilled vendor obligations remain, the fee is fixed and determinable and collectibility is probable. If the fee for a license has payment terms that exceed our normal payment terms, the fee is not considered to be fixed or determinable and we only recognize license revenue when amounts actually become due. Therefore, the revenue contribution by a customer in any given period is dictated by the payment terms associated with such customer s agreement. As a result, the revenue both in absolute dollars and as a percentage of total revenue attributable to any particular customer in any given period can vary significantly. See Critical Accounting Policies Revenue Recognition above. Cox Communications, Inc. accounted for 15% of our total revenue for the three months ended March 31, 2003, and no customers accounted for 10% or more of our total revenue for the three months ended March 31, 2004.

License Fees. Revenue from license fees increased by $5.1 million from $6.4 million for the three months ended March 31, 2003 to $11.5 million for the three months ended March 31, 2004, representing 31% and 51%, respectively, of our total revenue. The increase in license fees as a percentage of total revenue for the three months ended March 31, 2004 was a result of license fees growing by 80% from the first quarter in 2003 to the first quarter in 2004 as well as a decrease in services revenue for this period as a result of the declining revenue from the contracts acquired in the BroadJump acquisition in January 2003.

The increase in license fees in absolute dollars was due to a $6.0 million increase in license fees revenue from existing customers from $1.6 million to $7.6 million, partially offset by a $0.9 million decrease in license fees revenue from new license customers. The increase in revenue from existing customers was due to revenue recognized on contracts entered into in previous periods based on their negotiated payment terms and the application of our revenue recognition policy described above, as well as new product sales into existing customers.

Services. Our revenue from services decreased by $3.1 million from $14.3 million for the three months ended March 31, 2003 to $11.2 million for the three months ended March 31, 2004, representing 69% and 49%, respectively, of our total revenue. Approximately $4.6 million of the decrease was due to services revenue from contracts acquired in the BroadJump acquisition. This decrease was offset by a $0.9 million increase in consulting and training services and approximately $0.6 million due to the growth in the number and size of maintenance contracts. Revenue from acquired contracts was $8.0 million and $3.4 million or 39% and 15% of our total revenue for the three months ended March 31, 2003 and 2004, respectively. This revenue will decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the

BroadJump software arrangements expire (see Critical Accounting Policies Revenue Recognition). We expect this declining services revenue stream to be partially offset by new contracts with these former BroadJump customers for use of a broader range of our products. We expect these new contracts to contain a ratio of license fees revenue to services revenue commensurate with our historical experience.

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Cost of Revenue

Cost of License Fees Revenue. Cost of license fees revenue includes third-party software royalties, product packaging, documentation production and shipping costs related to software used by our customers. Cost of license fees revenue increased by $151,000 from $43,000 for the three months ended March 31, 2003 to $194,000 for the three months ended March 31, 2004, representing 1% and 2%, respectively, of our license fees revenue. The increase in cost of license fees revenue in absolute dollars was due to the amortization of $53,000 of license fees under an agreement we entered into in June 2003 whereby we had the right to integrate certain third-party software with certain of our software for distribution through March 31, 2004. These fees were being amortized on a straight-line basis over the life of the agreement. Additionally, the increase in cost of license fees revenue was due to an increase of approximately $100,000 in third-party software royalties as a result of increased license fees revenue. We have expensed all costs incurred in the research and development of our software products as incurred, and, as a result, cost of license fees revenue includes no amortization of capitalized software development costs.

Amortization of Acquired Technology. As a result of our January 2003 purchase of BroadJump, we acquired certain intangible technology assets having an estimated fair value of $9.4 million and an estimated useful life of five years. Amortization of these intangible assets in the amounts of $97,000 and $214,000 was recorded as a cost of revenue for the three months ended March 31, 2003 and 2004, respectively. These amounts represented less than 1% of revenue in these periods.

Cost of Services Revenue. Costs of services revenue includes salaries and related expenses for our customer support, consulting, training and hosting and managed services organizations, other costs of providing services to customers, third-party contractor expenses and an allocation of our facilities, communications and depreciation expenses. Services costs increased by $0.1 million from $7.4 million for the three months ended March 31, 2003 to $7.5 million for the three months ended March 31, 2004, representing 52% and 67%, respectively, of our services revenue. The increase in services costs in absolute dollars was due to an increase of $500,000 in costs as a result of servicing our growing international customer base. Also contributing to the increase was $460,000 of increased salary costs and an increase of $120,000 in third-party consulting costs. These increases were offset by a decrease of $980,000 in costs incurred in connection with servicing the remaining contractual obligations under the acquired BroadJump software arrangements. We expect cost of services revenue to increase as a percentage of our services revenue as services revenue from contracts acquired in the BroadJump acquisition continues to decline. Excluding the costs and revenue associated with the acquired BroadJump software arrangements, costs of services represented 59% and 62% of services revenue for the three months ended March 31, 2003 and 2004, respectively.

Operating Expenses

Sales and Marketing. Sales and marketing expenses consist of salaries and related costs of our sales and marketing organizations, sales commissions, travel and entertainment expenses, costs of our marketing programs, including public relations, and collateral materials, and rent and facilities costs associated with our regional sales offices. Sales and marketing expenses increased by $0.5 million from $7.1 million for the three months ended March 31, 2003 to $7.6 million for the three months ended March 31, 2004, representing 35% and 33%, respectively, of our total revenue. The increase in absolute dollars was due to an increase of $70,000 in sales commissions due to the growth in revenue, an increase of $220,000 as a result of an increase in the number of regional offices and the expansion of existing international sales offices, and an increase of $230,000 in salary costs.

Research and Development. Research and development expenses consist of employee salaries, benefits, consulting costs and the cost of software development tools and expenses associated with the development of new products, enhancements of existing products and quality assurance activities. Research and development expenses increased by $0.6 million from $3.6 million for the three months ended March 31, 2003 to $4.2 million for the three months ended March 31, 2004, representing 18% and 19%, respectively, of our total revenue. The increase in absolute dollars was primarily attributable to an increase of $260,000 in third-party consulting costs and approximately $280,000 in increased salary costs.

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General and Administrative. General and administrative expenses consist of salaries and related costs of our administrative, finance, business operations and information technology personnel as well as legal and accounting services and costs associated with our recruiting programs. General and administrative expenses increased by $0.3 million from $1.9 million for the three months ended March 31, 2003 to $2.2 million for the three months ended March 31, 2004, representing 9% and 10%, respectively, of our total revenue. The increase in absolute dollars was due to an increase of $400,000 in legal and professional costs, partially offset by a decrease in salary expenses resulting from a reduction of two personnel in the general and administrative organizations.

Amortization of Goodwill and Intangibles. Total amortization expense, including the write-off of acquired in-process research and development, was $476,000 and $773,000 for the three months ended March 31, 2003 and 2004, respectively, representing 2% and 3%, respectively, of our total revenue. In January 2003, we recorded $13.0 million of definite-lived intangibles in connection with the BroadJump acquisition, which resulted in increased amortization expense for the three months ended March 31, 2004.

Amortization of Deferred Stock Compensation. Deferred stock compensation represents the difference between the exercise price of certain stock option grants and the deemed fair value of our common stock at the time of such grants. We are amortizing these amounts over the vesting periods of the applicable options, resulting in amortization expense of $166,000 and $851,000 for the three months ended March 31, 2003 and 2004, respectively. The increase in amortization was related to the grant of in-the-money options in the fourth quarter of 2003 and first quarter of 2004, which is being amortized over the vesting term of the options.

Business Restructuring Charge. During the first quarter of 2003, we initiated a restructuring program as a result of our integration of BroadJump. We incurred a non-recurring charge of approximately $1.4 million related to severance and other employee termination benefits related to a reduction in workforce of approximately 25 employees in January 2003 as well as costs associated with the closing of duplicative facilities and the elimination of other overlapping efforts. As of March 31, 2004, all termination benefits related to the restructuring had been paid.

Interest Income (Expense), Net

Interest income (expense), net decreased from $(490,000) for the three months ended March 31, 2003 to $(510,000) for the three months ended March 31, 2004. The decrease in interest income (expense), net during these periods was due to decreased interest rates on cash, cash equivalents and short-term investment balances.

Other Income

Other income increased from $57,000 for the three months ended March 31, 2003 to $472,000 for the three months ended March 31, 2004 due to gains on foreign currency related to fluctuations in the exchange rates.

Provision for Income Taxes and Net Operating Losses

We have incurred operating losses for all fiscal years from inception through December 31, 2003, and therefore have not recorded a material provision for income taxes. Our provision for income taxes consists primarily of foreign income tax withholdings related to international sales. We have recorded a valuation allowance for the full amount of our net deferred tax assets, which include net operating loss and research and development credit carryforwards, because of the uncertainty regarding their realization.

Comparison of the Fiscal Years Ended December 31, 2001, 2002 and 2003

Revenue

Total revenue increased by $6.1 million from $52.0 million in 2001 to $58.1 million in 2002 and by $34.2 million in 2003 to $92.3 million. The increase in 2002 was due to an increase in license fees revenue of

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$5.3 million and an increase in services revenue of $0.8 million. The increase in 2003 was due to $24.9 million of services revenue acquired as a result of the BroadJump acquisition and an increase of $11.0 million of other services revenue, partially offset by a $1.7 million decrease in license fees revenue.

Domestic revenue decreased by $8.0 million from $50.5 million in 2001 to $42.5 million in 2002 and increased by $20.3 million in 2003 to $62.8 million. International revenue increased by $14.1 million from $1.5 million in 2001 to $15.6 million in 2002 and by $13.9 million in 2003 to $29.5 million. International revenue represented 3%, 27% and 32% of our total revenue for 2001, 2002 and 2003, respectively. For more information about our international revenue and expansion plans, please see Quantitative and Qualitative Disclosures About Market Risk.

As noted in our discussion of our revenue recognition accounting policy, we did not have VSOE of fair value for maintenance for term licenses prior to the fourth quarter of 2001. Prior to establishing such VSOE, the entire license and maintenance value of term licenses was classified as license fees revenue and was recognized ratably over the term of the agreement. For all agreements executed after the establishment of VSOE of maintenance, we allocate VSOE of fair value for maintenance to services revenue and recognize it ratably over the term of the agreement. We then utilize the residual value method to calculate the license fees revenue, which is recognized as license fees revenue as payments become due. The establishment of VSOE of fair value for maintenance for term licenses resulted in an increase in total revenue recognized in 2001 and 2002 of $3.6 million and $9.9 million, respectively. This increase in revenue is attributable to the requirement that, once VSOE was established, we recognize license fees revenue as the amounts become due as opposed to ratably over the term of the underlying agreement. For term licenses entered into after the establishment of VSOE for maintenance, license revenue is typically greater at the beginning of a contractual term because most amounts typically come due in the earlier periods of the contractual term. See Critical Accounting Policies Revenue Recognition above.

Our revenue recognition policy requires that we only recognize revenue when persuasive evidence of an agreement exists, delivery of the product has occurred, no unfulfilled vendor obligations remain, the fee is fixed and determinable and collectibility is probable. If the fee for a license has payment terms that exceed our normal payment terms, the fee is not considered to be fixed or determinable and we only recognize license revenue when amounts actually become due. Therefore, the revenue contribution by a customer in any given period is dictated by the payment terms associated with such customer s agreement. As a result, the revenue both in absolute dollars and as a percentage of total revenue attributable to any particular customer in any given period can vary significantly. Revenue from individual customers constituting 10% or more of total revenue for each period were as follows:

	2001	2002	2003
Hewlett-Packard	18%	19%	2%
Mercury Interactive	0%	0%	11%
Peregrine Systems	21%	6%	0%

Although we had no revenue contribution in 2003 from Peregrine Systems, we received proceeds from Peregrine of $6.1 million in settlement of license fee obligations in the third quarter of 2003, which we recorded as other income see Overview Peregrine Systems.

License Fees. Revenue from license fees increased by approximately $5.3 million from $39.4 million in 2001 to $44.7 million in 2002, and decreased by $1.7 million in 2003 to $43.0 million. Had we not established VSOE of fair value for maintenance for term licenses during the fourth quarter of 2001, revenue from license fees would have been $35.9 million and $35.8 million in 2001 and 2002, respectively. As noted above, our establishment of VSOE for maintenance had the effect of increasing our license fees revenue in 2001 and 2002 as we were required to recognize such revenue as amounts came due under our term licenses rather than ratably over the term of such licenses. License fees revenue represented 76%, 77% and 47% of our total revenue for

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2001, 2002 and 2003, respectively. License fees declined as a percentage of total revenue in 2003 primarily because of the significant increase in services revenue as a result of the BroadJump acquisition.

The increase in license fees revenue from 2001 to 2002 was due to an $8.9 million increase in license fees revenue from new license customers from $12.5 million to $21.4 million, partially offset by a $3.6 million decrease in license fees revenue from existing customers from $26.9 million to $23.3 million. The increase in license fees revenue from new license customers was due to increased acceptance of our products in international markets. Approximately $11.5 million of license fees revenue from new license customers in 2002 was attributable to international sales. The decrease in license fees revenue from existing customers was attributable to the fact that we ceased recognizing revenue from our agreements with Peregrine Systems after the first quarter of 2002 due to collectibility concerns. See Overview Peregrine Systems.

The decrease in license fees from 2002 to 2003 was due to a $8.0 million decrease in license fees revenue from existing customers from $23.3 million to $15.3 million, partially offset by a $6.3 million increase in license fees revenue from new license customers from $21.4 million to $27.7 million. Approximately $6.0 million of the decrease in license fees revenue from existing customers in 2003 was attributable to the reduction in revenue recognized from a license agreement previously entered into with Hewlett-Packard due to the fact that the payment terms under that license agreement provided for substantial payments in 2002 and relatively minor payments in 2003. Under our revenue recognition policy described above for payment terms that exceed our normal payment terms, license revenue attributable to this agreement is recognized when amounts actually become due. License fees revenue from new license customers was primarily generated from increased acceptance of our products, as evidenced by the 19 new customers that executed license agreements during 2003. Approximately $9.9 million of license fees revenue from new license customers in 2003 was attributable to international sales.

Services. Our revenue from services increased by $0.8 million from $12.6 million in 2001 to $13.4 million in 2002 and by $35.9 million in 2003 to $49.3 million. Services revenue represented 24%, 23% and 53% of our total revenue in 2001, 2002 and 2003, respectively.

As noted above, we established VSOE of fair value for maintenance on term licenses during the fourth quarter of 2001, which required maintenance associated with term licenses to be classified as services revenue as opposed to license fees revenue. The result was a $1.0 million increase in services revenue from 2001 to 2002. Services revenue increased an additional $0.3 million over this period due to growth in the number and size of maintenance contracts. These increases were partially offset by a decrease of approximately $0.5 million in revenue from consulting and training services.

Approximately $24.9 million of the increase in services revenue in 2003 was due to services revenue from contracts acquired in the BroadJump acquisition. The remainder of the increase was due to an increase of approximately $4.5 million in consulting and training services, approximately $3.7 million due to the growth in the number and size of maintenance contracts, and approximately $2.8 million due to revenue from our hosting and managed service business which was introduced during 2003.

Service revenue acquired in business combinations was 27% of our total revenue for the year ended December 31, 2003. This revenue will decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire (see Critical Accounting Policies Revenue Recognition). We expect this declining services revenue stream will be partially offset by new contracts with these former BroadJump customers for use of a broader range of our products. We expect these new contracts to contain a ratio of license fees revenue and services revenue commensurate with our historical experience.

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Cost of Revenue

Cost of License Fees Revenue. Cost of license fees revenue increased by $523,000 from $689,000 in 2001 to $1.2 million in 2002 and by $787,000 in 2003 to $2.0 million, representing 2%, 3% and 5% of license fees revenue for 2001, 2002 and 2003, respectively. The increase in cost of license fees revenue in 2003 was primarily due to royalties paid for our right to integrate and distribute certain third-party software to several of our customers. We expect that cost of license fees will decrease as a percentage of license fees revenue for 2004. We have expensed all costs as they have been incurred in the research and development of our software products and, as a result, cost of license fees revenue includes no amortization of capitalized software development costs.

Amortization of Acquired Technology. As a part of our January 2000 purchase of Ventix, we acquired certain intangible technology assets having an estimated fair value of $300,000 and an estimated useful life of two years. The amortization of these intangible assets is recorded as a cost of revenue of $150,000 and $13,000 in 2001 and 2002, respectively. Each of these amounts represented less than 1% of revenue in their respective years. The intangible asset was fully amortized by March 31, 2002. As a result of our January 2003 purchase of BroadJump, we acquired certain intangible technology assets having an estimated fair value of $9.4 million and an estimated useful life of five years. Amortization of these intangible assets in the amount of $448,000 is recorded as a cost of revenue in 2003. This amount represented less than 1% of revenue in 2003.

Cost of Services Revenue. Services costs decreased by $1.9 million from $14.2 million in 2001 to $12.3 million in 2002 and increased by $18.5 million in 2003 to $30.8 million, representing 113%, 91% and 62% of services revenue in 2001, 2002 and 2003, respectively. The decrease in 2002 was due to a decrease of $1.0 million in third-party consulting expense as well as a decrease in average services personnel from 75 in 2001 to 65 in 2002 due to the business restructuring that took place in October 2001. See further discussion in Business Restructuring Charge below. The majority of the increase in services costs in absolute dollars in 2003 was due to approximately $14.1 million of costs incurred in connection with servicing the remaining contractual obligations under the acquired BroadJump software arrangements. These costs consist of employee salaries and the related benefits and overhead for those individuals servicing the BroadJump software arrangements as well as the amortization of prepaid commissions and royalties associated with the services revenue acquired in the BroadJump acquisition. Expansion of our professional services organization to support the increase in our services revenue and the addition of the BroadJump hosting and managed services organization contributed an additional $3.7 million to this increase as did $700,000 in increased third party consulting costs. Excluding the costs and revenue associated with the acquired BroadJump software arrangements, costs of services represented 68% of services revenue in 2003. We expect cost of services revenue to increase as a percentage of our services revenue as services revenue from contracts acquired in the BroadJump acquisition continues to decline.

Operating Expenses

Sales and Marketing. Sales and marketing expenses decreased by $5.4 million from $31.5 million in 2001 to $26.1 million in 2002 and increased by $6.9 million in 2003 to $33.0 million, representing 60%, 45% and 36% of total revenue for 2001, 2002 and 2003, respectively. The decrease in 2002 was due to a $1.5 million decrease in marketing programs, a decrease in average sales and marketing personnel from 105 in 2001 to 80 in 2002 due to the business restructuring that took place in October 2001, as well as a $1.0 million decrease in sales commissions due to a change in our incentive plan structure. The increase in absolute dollars in 2003 was due to growth in our sales and marketing organization from 74 at December 31, 2002 to 84 at December 31, 2003, a $3.1 million increase in sales commissions due to the growth in revenue, and to a lesser extent by an increase of approximately $200,000 in marketing program expenses during the year ended December 31, 2003. The decrease in sales and marketing as a percentage of total revenue was due primarily to our revenue growth and efficiencies gained as a result of the BroadJump acquisition, such as the elimination of duplication in sales management and marketing functions.

Research and Development. Research and development expenses decreased by $1.7 million from $12.9 million in 2001 to $11.2 million in 2002 and increased by $5.7 million in 2003 to $16.9 million, representing 25%, 19% and 18% of total revenue for 2001, 2002 and 2003, respectively. The decrease in 2002

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was due to a decrease in average research and development personnel from 84 in 2001 to 69 in 2002 due to the business restructuring that took place in October 2001. The increase in absolute dollars in 2003 was attributable to costs of additional personnel in the research and development organization as headcount increased significantly from 66 at December 31, 2002 to 105 at December 31, 2003 driven mainly by the BroadJump acquisition.

General and Administrative. General and administrative expenses decreased by $0.4 million from $6.7 million in 2001 to $6.3 million in 2002 and increased by $1.7 million in 2003 to $8.0 million, representing 13%, 11% and 9% of total revenue in each of the respective periods. The decrease in 2002 was due to a decrease in average personnel in the administrative organization from 45 in 2001 to 31 in 2002, which was partially offset by an increase of $800,000 in legal and professional fees. The increase in absolute dollars in 2003 was due to an increase of 9 employees in the general and administrative organizations necessary to support the expansion in our operations.

Amortization of Goodwill and Intangibles. In January 2000, we acquired Ventix in exchange for 1,541,333 shares of our capital stock. We accounted for the Ventix acquisition using the purchase method of accounting and Ventix has been included in our results of operations from the date of acquisition. We recorded approximately $26.3 million in goodwill and intangibles in connection with the acquisition. In October 2001, in connection with a corporate restructuring and employee terminations as discussed below, the long-lived asset related to the workforce acquired in the Ventix acquisition was deemed to be impaired. Therefore, this asset was written down to its fair value. As a result, an impairment loss of approximately $452,000 was included in amortization of goodwill and other intangibles for the year ended December 31, 2001. Additionally, in November 2001, we acquired certain assets of Question Technologies in exchange for 1,293,860 shares of our capital stock. We accounted for the acquisition of assets at fair market value on the date of closing. Approximately $3 million of the purchase price was allocated to acquired in-process research and development and was expensed in the fourth quarter of 2001 because technological feasibility had not been established and no future alternative uses existed. Therefore, total amortization expense, including the write-off of acquired in-process research and development and impairment charges, for the year ended December 31, 2001 was $12.2 million, representing 24% of our total revenue for the respective period. In January 2003, we recorded $13.0 million of definite-lived intangibles in connection with the BroadJump acquisition, which resulted in amortization expense of $2.4 million for 2003, representing 3% of our total revenue for the respective period.

Amortization of Deferred Stock Compensation. We recorded deferred stock compensation in connection with stock options granted to employees and consultants. These amounts represent the difference between the exercise price of certain stock option grants and the deemed fair value of our common stock at the time of such grants. We are amortizing these amounts over the vesting periods of the applicable options, resulting in amortization expense of $2.3 million in 2001, $2.1 million in 2002 and $1.2 million in 2003.

Write-Off of Prepaid Stock Offering Costs. In March 2001, we withdrew our Form S-1 Registration Statement on file with the Securities and Exchange Commission due to weak equity market conditions. As a result, $1.4 million of prepaid stock offering costs were written off in March 2001. These costs consisted of legal, accounting and printing fees incurred in connection with the drafting, review and filing of the Form S-1.

Business Restructuring Charge. During the fourth quarter of 2001, we initiated a restructuring program to conform our expense and revenue levels to better position us for growth and profitability in the marketplace. We incurred a non-recurring charge of approximately $1.4 million related to severance and other employee termination benefits related to a reduction in workforce in October 2001 as a result of this restructuring. The reduction in workforce consisted of approximately 85 employees at all levels within the organization. During the first quarter of 2003, we initiated a restructuring program as a result of our integration of BroadJump. We incurred a non-recurring charge of approximately $1.4 million related to severance and other employee termination benefits related to a reduction in workforce of approximately 25 employees in January 2003 as well as costs associated with the closing of duplicative facilities and the elimination of other overlapping efforts. As of December 31, 2003, all termination benefits related to the restructuring had been paid.

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Interest Income (Expense), Net

Interest income (expense), net decreased from $230,000 in 2001 to $(1.2) million in 2002 and by $700,000 to $(1.9) million in 2003. The decrease in interest income (expense), net from 2001 to 2002 was primarily due to the increased interest expense incurred on our outstanding bank debt, which rose from $6.7 million at December 31, 2001 to $15.2 million at December 31, 2002, and interest expense on related party subordinated debt of $12.5 million at December 31, 2002. The decrease in interest income (expense), net from 2002 to 2003 was due to the increased interest expense incurred on the outstanding subordinated debt as it was outstanding for a full year in 2003 compared to only a quarter in 2002.

Other Income

In connection with Peregrine s plan of reorganization in the third quarter of 2003, we recognized approximately $6.1 million in other income based upon our receipt of $4.0 million in cash and the return of 416,667 shares of our common stock. The 416,667 shares of common stock were recorded at $5.00 per share or approximately $2.1 million, which was the then current fair value of our common stock as determined by our board of directors.

Loss on Investment

In connection with a software license arrangement between us and Peregrine Systems, we received 1,000,000 shares of unregistered Peregrine common stock in the first quarter of 2002 in satisfaction of certain accounts receivable. Upon receipt of the shares, they were classified as a short-term investment in marketable equity securities. The trading price of Peregrine stock fell from $9.52 on March 31, 2002 to $0.30 on June 30, 2002. Due to the decline in value of the Peregrine stock, in the second quarter of 2002 we deemed the Peregrine shares to be other than temporarily impaired and recorded an impairment charge of $9.5 million. In August 2002, we received $1.6 million in cash from CIBC pursuant to the termination and settlement of an agreement in connection with the attempted sale of a portion of the Peregrine shares. We recorded the receipt of such cash as a recovery of impairment on investment.

Provision for Income Taxes and Net Operating Losses

We have incurred operating losses for all fiscal years from inception through December 31, 2003, and therefore have not recorded a material provision for income taxes. Our provision for income taxes consists primarily of foreign income tax withholdings related to international sales. We have recorded a valuation allowance for the full amount of our net deferred tax assets, which include net operating loss and research and development credit carryforwards, because of the uncertainty regarding their realization. Our accounting for deferred taxes under SFAS No. 109, *Accounting for Income Taxes*, involves the evaluation of a number of factors concerning the realizability of our deferred tax assets. In concluding that a full valuation allowance was required, management primarily considered such factors as our history of operating losses and expected future losses and the nature of our deferred tax assets.

As of December 31, 2003, we had net operating loss, research and development credit and foreign tax credit carryforwards of approximately $88.5 million, $2.6 million and $1.7 million, respectively. The net operating loss and research and development credit carryforwards will expire at various dates, beginning in 2012, if not utilized. The foreign tax credit carryforward will begin to expire in varying amounts between 2007 and 2008, if not utilized. Under the provisions of the Internal Revenue Code, certain substantial changes in our ownership may limit the amount of net operating loss and tax credit carryforwards that could be utilized annually in the future to offset taxable income.

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Quarterly Results of Operations

The following tables set forth our consolidated statement of operations data for the eight quarters ended March 31, 2004, as well as these data expressed as a percentage of our total revenue represented by each item. We believe this information has been prepared on the same basis as the audited consolidated financial statements appearing elsewhere in this prospectus and believe that all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below and present fairly the results of such periods when read in conjunction with the audited consolidated financial statements and notes thereto.

	Quarter Ended							
	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003	Mar. 31, 2004
	Restated(1)	Restated(1)		Restated(2)	Restated(3)(4)	Restated(3)(4)(5)	Restated(3)(4)	Restated(3)
					(in thousands) (unaudited)			
Revenue:								
License fees	$ 10,007	$ 11,182	$ 13,093	$ 6,390	$ 11,228	$ 8,995	$ 16,344	$ 11,495
Services								
Services	3,482	3,408	4,006	6,299	5,615	6,231	6,307	7,755
Acquired in business combination				8,003	7,827	4,732	4,321	3,426
Total services revenue	3,482	3,408	4,006	14,302	13,442	10,963	10,628	11,181
Total revenue	13,489	14,590	17,099	20,692	24,670	19,958	26,972	22,676
Cost of revenue:								
License fees	339	107	384	43	1,026	682	248	194
Amortization of acquired technology				97	117	117	117	214
Services	2,874	3,195	3,192	7,432	8,146	7,638	7,602	7,537
Total cost of revenue	3,213	3,302	3,576	7,572	9,289	8,437	7,967	7,945
Gross margin	10,276	11,288	13,523	13,120	15,381	11,521	19,005	14,731
Operating expenses:								
Sales and marketing	5,470	6,084	7,661	7,149	8,735	8,041	9,091	7,555
Research and development	2,932	2,701	2,630	3,610	3,913	4,518	4,828	4,234
General and administrative	1,556	1,858	1,497	1,890	2,081	2,067	1,913	2,169
Amortization of goodwill and intangibles				476	571	571	763	773
Amortization of deferred stock compensation (4)	288	335	169	166	115	77	832	851
Business restructuring charge				1,422				
Total operating expenses	10,246	10,978	11,957	14,713	15,415	15,274	17,427	15,582
Income (loss) from operations	30	310	1,566	(1,593)	(34)	(3,753)	1,578	(851)
Interest income (expense), net	(210)	(238)	(640)	(490)	(458)	(470)	(492)	(510)
Other income (expense), net	41	58	24	57	85	5,939	126	472
Gain (loss) on investment	(9,520)	1,597						

Income (loss) before income taxes	(9,659)	1,727	950	(2,026)	(407)	1,716	1,212	(889)
Provision for income taxes	69	67	218	257	1,130	130	188	681
Net income (loss)	$ (9,728)	$ 1,660	$ 732	$ (2,283)	$ (1,537)	$ 1,586	$ 1,024	$ (1,570)

(1) Gain (loss) on investment has been restated to correct the fair value assigned to shares of common stock received from Peregrine Systems as payment pursuant to a software arrangement. The effect of such restatement was to increase gain (loss) on investment during the quarter ended June 30, 2002 by $5,117,000, and to decrease gain (loss) on investment, due to recovery, by $1,597,000 during the quarter ended September 30, 2002.

(2) For the quarter ended March 31, 2003, amounts previously allocated to acquired in-process research and development ($11,182,000) in connection with the BroadJump acquisition have been reclassified to goodwill. Such reclassification resulted from our determination that the in-process research and development at the time of acquisition would not be utilized.

(3) Cost of license fees revenue has been restated to immediately expense certain license royalties paid for software that was not ultimately utilized. The effect of such restatement was to increase cost of license fees revenue by approximately $921,000 during the quarter ended June 30, 2003 and to decrease cost of license fees revenue by $307,000 for each of the quarters ended September 30, 2003, December 31, 2003 and March 31, 2004.

(4) Provision for income taxes has been restated to record foreign withholding tax in the quarter in which the related revenue was recognized. The effect of such restatement was to increase provision for income taxes by $1,045,000 during the quarter ended June 30, 2003, to decrease provision for income taxes by $1,158,000 during the quarter ended September 30, 2003, and to increase provision for income taxes by $113,000 during the quarter ended December 31, 2003.

(5) For the quarter ended September 30, 2003, consideration received from Peregrine Systems in the amount of $6,083,000 has been reclassified from license fees revenue to other income.

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(6) If the amortization of deferred stock compensation were allocated to specific operating statement line items, it would be allocated as follows:

	Quarter Ended							
	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003	Mar. 31, 2004
	(in thousands) (unaudited)							
Cost of services revenue	$ 53	$ 39	$ 45	$ (28)	$ 11	$ 8	$ 47	$ 53
Sales and marketing	62	14	(2)	102	19	7	309	320
Research and development	56	182	62	17	14	10	290	288
General and administrative	117	100	64	75	71	52	186	190
	$ 288	$ 335	$ 169	$ 166	$ 115	$ 77	$ 832	$ 851

	Quarter Ended							
	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003	Mar. 31, 2004
As a Percentage of Revenue:								
Revenue:								
License fees	74%	77%	77%	31%	45%	45%	61%	51%
Services								
Services	26	23	23	30	23	31	23	34
Acquired in business combination				39	32	24	16	15
Total services revenue	26	23	23	69	55	55	39	49
Total revenue	100	100	100	100	100	100	100	100
Cost of revenue:								
License fees	3	1	2		4	3	1	1
Amortization of acquired technology					1	1		1
Services	21	22	19	36	33	38	29	33
Total cost of revenue	24	23	21	36	38	42	30	35
Gross margin	76	77	79	64	62	58	70	65
Operating expenses:								
Sales and marketing	41	42	45	35	35	40	34	33
Research and development	22	18	15	18	16	23	18	19
General and administrative	11	13	9	9	8	10	7	10
Amortization of goodwill and intangibles				2	3	3	3	3

Amortization of deferred stock compensation	2	2	1	1			3	4
Business restructuring charge				7				
Total operating expenses	76	75	70	72	62	76	65	69
Income (loss) from operations		2	9	(8)		(18)	5	(4)
Interest income (expense), net	(1)	(1)	(4)	(2)	(2)	(3)	(1)	(2)
Other income (expense), net						30		2
Gain (loss) on investment	(70)	11						
Income (loss) before income taxes	(71)	12	5	(10)	(2)	9	4	(4)
Provision for income taxes	1	1	1	1	4	1		3
Net income (loss)	(72)%	11	4%	(11)%	(6)%	8%	4%	(7)%

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Revenue

Except for the quarter ended September 30, 2003, revenue increased sequentially in each of the quarters of 2002 and 2003. During the quarter ended September 30, 2003, our total revenue decreased primarily due to a decrease in license fees revenue. License fees revenue decreased from the quarter ended December 31, 2002 to the quarter ended March 31, 2003 and from the quarter ended December 31, 2003 to the quarter ended March 31, 2004. This is typical as we experience seasonality in our revenue, with the fourth quarter of the year typically having the highest revenue for the year, and thus we typically experience a decrease in license fees revenue from the fourth quarter to the first quarter of the following year. We believe that this seasonality results primarily from customer budgeting cycles and our sales compensation model. We expect this seasonality will continue.

Services revenue growth during 2003 accelerated as a result of the BroadJump acquisition. As a part of this acquisition, we assumed liabilities related to existing contractual obligations of the BroadJump software arrangements. The fair value of these assumed liabilities was recorded as deferred revenue and this revenue is being recognized ratably over the remaining life of the individual software arrangements. This revenue will continue to decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire as further described in our Critical Accounting Policies. We expect this declining services revenue stream to be partially offset by new contracts with these former BroadJump customers for use of a broader range of our products. We expect these new contracts to contain a ratio of license fees revenue to services revenue commensurate with our historical experience.

Cost of Revenue

Cost of revenue generally increased on a quarterly basis in absolute dollars through the quarter ended June 30, 2003 in conjunction with our increase in revenue and the growth in our professional services organization. A component of the cost of services growth includes the costs associated with hiring and training service personnel in advance of anticipated services revenue growth as well as the costs associated with servicing the acquired BroadJump software arrangements during each of the quarters of 2003 and the first quarter of 2004. The only notable increase in cost of license fees revenue occurred during the three months ended June 30, 2003 and was due to approximately $920,000 of costs related to an agreement we entered into in June 2003 whereby we had the right to integrate and distribute certain third-party software to several of our customers. Also included in cost of revenue is the amortization of intangible technology assets acquired in the BroadJump acquisition. The intangible technology assets related to the BroadJump acquisition are being amortized over a five-year estimated useful life.

Operating Expenses

Operating expenses increased sequentially in each of the quarters of 2002 as a result of increases in expenses that are directly correlated to increased revenue. Operating expenses increased during the three months ended March 31, 2003 due to the acquisition of BroadJump in mid-January 2003. This acquisition resulted in increased personnel across all organizations. Operating expenses remained relatively constant in absolute dollars for the remaining quarters through March 31, 2004 with the exception of the quarter ended December 31, 2003 in which operating expenses increased as a result of increased commission expense due to revenue growth, higher marketing expenses due to our annual customer event being held in the fourth quarter, and additional deferred stock compensation recorded in connection with stock options granted to employees and directors.

Other Income (Expense), Net

In connection with a software license arrangement between us and Peregrine Systems, we received 1,000,000 shares of unregistered Peregrine common stock in the first quarter of 2002 in satisfaction of certain accounts receivable. Upon receipt of the shares, they were classified as a short-term investment in marketable equity securities. The trading price of Peregrine stock fell from $9.52 on March 31, 2002 to $0.30 on June 30, 2002. Due to the decline in value of the Peregrine stock, in the second quarter of 2002, we deemed the Peregrine

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shares to be other than temporarily impaired and recorded an impairment charge of $9.5 million. In August 2002, we received $1.6 million in cash from CIBC pursuant to the termination and settlement of an agreement in connection with our attempted sale of a portion of the Peregrine shares. We recorded the receipt of such cash as a recovery of impairment on investment during the quarter ended September 30, 2002.

In connection with Peregrine s plan of reorganization in the third quarter of 2003, we recognized approximately $6.1 million in other income based upon our receipt of $4.0 million in cash and the return of 416,667 shares of our common stock. The 416,667 shares of common stock were recorded at $5.00 per share or approximately $2.1 million, which was the then current fair value of our common stock as determined by our board of directors.

Liquidity and Capital Resources

Since inception, we have funded our operations and met our capital expenditure requirements through the private sale of equity securities and acquisitions. The net proceeds from our private securities issuances plus cash received from acquisitions was approximately $107 million through March 31, 2004. Cash used in operating activities was $18.2 million, $7.7 million and $23.8 million in 2001, 2002 and 2003, respectively. Cash provided by operating activities was $7.1 million for the three months ended March 31, 2004.

To date, cash used in investing activities has consisted primarily of capital expenditures totaling $2.6 million, $1.4 million and $4.1 million in 2001, 2002 and 2003, respectively, and $397,000 for the three months ended March 31, 2004, to acquire property and equipment, mainly computer hardware and software, for our employee base and our hosting and managed services operations. Cash provided by other investing activities includes $12.6 million in cash acquired in connection with the purchase of certain assets of Question Technologies in 2001 and $51.7 million in cash acquired in connection with the acquisition of BroadJump in January 2003. Additionally, $5.7 million of cash was used in connection with the acquisition of BroadJump, of which $4.8 million was related to payments for non-competition agreements with certain executive officers of BroadJump. Net cash provided by short-term investing activities totaled $17.4 million, $3.3 million and $1.7 million in 2001, 2002, and 2003, respectively. There were no short-term investing activities for the three months ended March 31, 2004. We also had an increase in restricted cash in 2003 in the amount of $15.0 million due to covenants existing on our term loans and line of credit. This amount was no longer restricted as of March 31, 2004 because this covenant was removed in the first quarter of 2004.

At March 31, 2004, we had cash and cash equivalents on hand of $50.5 million and working capital of $30.7 million. Our accounts receivable increased $2.6 million and $10.4 million during the years ended December 31, 2002 and 2003, respectively and decreased $10.5 million during the three months ended March 31, 2004. These changes are due to the fluctuations in revenue, timing of shipments and the timing of payments received from our customers. Our payment terms generally require payment within 30 to 90 days of shipment.

In October 2002, we issued senior subordinated promissory notes totaling $12.5 million, bearing interest at 11% annually, to certain of our stockholders. Additionally, we have term loans with Comerica Bank which bear interest at rates ranging from the bank s prime rate (4.25% at March 31, 2004) plus 2.0% to prime plus 2.5%. At March 31, 2004, $6.2 million was outstanding under the term loans. In addition, we had a bank line of credit totaling $15.0 million which bears interest at the bank s prime rate plus 1%. At March 31, 2004, no amount was outstanding under the bank line of credit. We have incurred $2.5 million in interest expense for the year ended December 31, 2003 and $0.6 million in interest expense for the three months ended March 31, 2004. These loans are secured by substantially all of our assets, including intellectual property. These term loans and the line of credit include financial covenants requiring us to maintain (a) a ratio of (i) cash, cash equivalents and eligible accounts receivable to (ii) current liabilities plus all indebtedness owed to the bank less deferred revenue, of at least 1.30 to 1.00 and (b) tangible net worth of not less than one dollar at the end of each fiscal quarter. The term loans and the line of credit define tangible net worth to include redeemable convertible preferred stock. In addition, the term loans and the line of credit restrict our ability to pay dividends, effect mergers or acquisitions,

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or have an account of greater than $2.0 million at another institution without the bank s prior approval. At December 31, 2003 and March 31, 2004, we were in compliance with such covenants and restrictions.

We expect to use a portion of the proceeds of this offering to retire the senior subordinated notes in their entirety. See Use of Proceeds.

We lease our facilities and sales offices under various operating lease agreements which expire at various times through 2012. In connection with the lease of our headquarters in Austin, Texas, we issued a stand-by letter of credit to the lessor in the amount of $1.8 million. The lessor may draw on this letter of credit should we fail to remit our monthly rent payment or should we fail to provide a renewal letter of credit prior to the expiration of the lease. The letter of credit amount is reduced to $900,000 upon the closing of an initial public offering with proceeds of at least $40 million; $450,000 upon the closing of an initial public offering with proceeds of at least $60 million; and is released in full upon the closing of an initial public offering with proceeds of at least $80 million.

The following table describes our commitments to settle contractual obligations in cash as of December 31, 2003:

	Payments Due by Period				
	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
	(in thousands)				
Operating leases	$ 4,555	$ 8,232	$ 4,441	$ 8,446	$ 25,674
Bank loans	278	4,026	2,000		6,304
Related party subordinated debt			12,500		12,500
Total contractual obligations	$ 4,833	$ 12,258	$ 18,941	$ 8,446	$ 44,478

We believe that cash on hand, cash equivalents, short-term investments and commercial credit facilities will be sufficient to meet our working capital requirements for at least the next 12 months. Thereafter, we may require additional funds to support our working capital requirements or for other purposes and may seek to raise such additional funds through public or private equity financings or from other sources. There can be no assurance that additional financing will be available at all or that, if available, such financing will be obtainable on terms favorable to us or our stockholders. The sale of additional equity or convertible debt securities could dilute the per share value of our common stock. Additionally, we could be forced to engage in debt financing on terms that could restrict our ability to make capital expenditures or incur additional indebtedness, which could impede our ability to achieve our business objectives.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of December 31, 2002 and 2003 or as of March 31, 2004.

Recently Issued Accounting Standards

In November 2002, the FASB reached a consensus on EITF No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables.* EITF 00-21 sets out criteria for whether revenue can be recognized separately from other deliverables in a multiple deliverable arrangement. The criteria considers whether the delivered item has stand-alone value to the customer, whether the fair value of the delivered item can be reliably determined and the rights of returns for the delivered item. EITF 00-21 was required to be adopted by us beginning June 15, 2003. The adoption of EITF 00-21 did not have a material impact on our financial position, results of operations or cash flows.

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In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after December 15, 2003. We do not expect adoption of FIN 46 to have a material impact on our financial position, results of operations or cash flows.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 requires that certain financial instruments that are settled in cash, including certain types of mandatorily redeemable securities, be classified as liabilities rather than as equity or temporary equity. SFAS No. 150 becomes effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period after June 15, 2003. We do not expect the adoption of SFAS No. 150 to have a material effect on our financial position, results of operations or cash flows.

Quantitative and Qualitative Disclosures About Market Risk

We develop our products in the United States and market them in North America, South America, Europe and the Asia/Pacific markets. As a result, our future financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As the majority of our sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets.

From our inception through March 31, 2004, we have derived approximately $56.2 million of revenue from customers outside the United States, and our international revenue was $29.5 million for the year ended December 31, 2003, an increase of $14.0 million over international revenue of $15.5 million for 2002. Our international revenue was $9.4 million for the three months ended March 31, 2004, an increase of $5.4 million over international revenue of $4.0 million for the three months ended March 31, 2003. We intend to continue to further expand our European and Asia/Pacific operations in the near term. To the extent our foreign operations expenses increase or to the extent we begin to denominate more foreign sales in local currencies, we will become subject to foreign currency fluctuations. We do not currently anticipate using hedging activities to offset these fluctuations.

Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in short-term instruments. Due to the short-term nature of our investments, we believe that there is no material interest rate risk exposure.

As of March 31, 2004, our outstanding long-term debt, excluding our subordinated debt, was $5.5 million. Our interest expense related to long-term debt, excluding our subordinated debt, is sensitive to changes in the prime interest rate. However, we do not believe that a 10% change in the prime rate would have a significant impact on our interest expense.

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BUSINESS

The following description of our business contains forward-looking statements that involve risks and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements. Some of the factors that may cause such results to differ include, but are not limited to, those discussed in Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

We are a leading provider of service management software that enables companies to build management and service directly into their customer-facing products and services. A large and increasing number of companies are employing digital hardware, software and communications technologies to enhance or, in some cases, completely redefine the products and services they sell. These new technology-enabled products create strategic growth opportunities in industries as diverse as computers, communications, software and financial services, but the costs associated with managing state-of-the-art technology environments can be over five times the cost of the technology itself. These high costs are the result of the many manual and inefficient processes required of both the providers and consumers of technology products processes such as activation, set-up, troubleshooting, updating and repair. Our software optimizes these processes by embedding self-management services directly into our customers technology products.

Our product suite includes three distinct types of service management products. Our Self-Management products optimize management processes for the end users and administrators of technology-enabled products and services. Our Service Operations Management products optimize the processes involved in delivering service and support for these complex technology products and services, simplifying and streamlining the operations of large-scale call centers and advanced remote technical support teams. Our Policy Management products enable product vendors and service providers to manage the usage of their products and services according to business objectives and policy guidelines. Our customers license and use these products individually and in combination to address their specific business requirements.

Our service management software is unique in three specific ways, providing significant competitive advantages over typical infrastructure management solutions. First, our software is built directly into technology-enabled product and service offerings. This approach enables *self-configuration* the ability to adapt real time to changing environments, *self-repair* the ability to detect problems and automatically resolve them, and *self-regulation* the ability to enforce policies that govern the acceptable use of products and services. Second, through our automated modeling and differencing approach, our software defines the optimal set-up and operational parameters of these technology products and services and automatically detects and corrects differences that develop as the products are used by customers. Finally, our software uses a process-driven management approach to automate the end-to-end execution of key management processes that surround the use of these technology products. By employing these unique approaches, our software addresses the entire ecosystem of people, processes and technology that must work together to bring management costs back in line with technology costs.

Since our inception in 1997, we have developed and successfully deployed our service management software solutions for industry-leading technology vendors, service providers and large enterprises. We estimate that these customers have used our software in connection with more than 30 million technology products and devices. We typically license our products for use during a fixed period of time, and have licensed our software to over 100 global customers. Our product offerings are complemented by a suite of services to assist customers in rapidly implementing their service management initiatives, optimizing their business processes and measuring the financial impact of our solution. Our customers include Advanced Digital Information Corp., Aliant Inc., AOL (UK) Limited, Bell Canada, BellSouth Corporation, British Telecommunications plc, Centrica

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Telecommunications Limited, Cognos Incorporated, Cox Communications, Inc., Deutsche Telekom, EMC Corporation, Fannie Mae, Fujitsu Limited, Hewlett-Packard Development Company, L.P., Hyperion Solutions Corporation, Mercury Interactive Corporation, NTL Group Ltd., N.V. Casema, SBC Communications, Inc., Sprint Communications Company, Storage Technology Corporation, Stratus Computer, Inc., Swisscom AG, Telecom Italia Media S.p.a., Telenet, Telewest Broadband, Telus Corporation, Time Warner Cable/RoadRunner, Inc., T-Online France, VERITAS Software Corporation, Verizon Communications and Warranty Corporation of America. In addition, we have established relationships with leading technology providers to further the distribution of our technology. For example, October 2002, we formed the *Meteor Alliance* with Hewlett-Packard, VERITAS and EMC to establish a program to deliver proactive services into multi-vendor IT datacenters utilizing a common technology infrastructure that we have supplied. We have also established a strategic relationship with Mercury Interactive through which Mercury Interactive licenses and incorporates various elements of our technology to create a problem resolution product in future releases of their application management suite.

Industry Background

The past decade has been characterized by a proliferation of technology assets. Currently, technology represents over 50% of capital expenses and accounts for hundreds of billions of dollars in spending annually. Faced with increased pressure to drive growth and profitability, today s business executives are changing their expectations about the role of these technology investments. Rather than the traditional focus on improving employee productivity and automating internal functions, companies are now focused on leveraging their technology to deliver new products and services that drive revenue generation as well as cost savings.

As technology-enabled products and services have proliferated, companies have struggled with the time-consuming, labor-intensive and error-prone management processes that surround them. For example, product and service problems waste the customer s time, require technical support calls and drive escalating labor costs for companies who are forced to staff large call centers to keep up with service demand. Changes, such as activating or updating new products and services, result in manual and expensive truck rolls to consumer households and labor-intensive and error-prone upgrades of complex distributed applications and data center environments. In addition, the wasted labor and time of these management processes impedes a company s ability to rapidly and cost-effectively launch new product and service offerings, impacting revenue, expense and time to market. The problem of widespread and increasing inefficiency is driving demand for solutions that optimize these time-intensive and labor-intensive management processes.

Companies have spent billions of dollars implementing systems management solutions to monitor and control internally owned technology assets, which has helped them ensure increased performance and uptime of their internal systems. However, these solutions were designed to control the reliability and availability of technology assets, rather than to optimize the time and labor-intensive management processes involved with customer-facing technology products and services.

Service management is an emerging category of infrastructure management software designed to optimize the effectiveness and efficiency of these management processes. Service management takes a top-down, business driven view of the ecosystem of people, processes and technology that work together in support of the most profitable and strategic products and services offered by a company. By focusing on optimizing management processes rather than increasing the performance and uptime of internally owned technology assets, service management software improves customer productivity and satisfaction, enables new revenue opportunities, decreases cost-of-change and reduces capital and labor expense.

According to International Data Corporation (IDC), the market opportunity for service-centric management software is anticipated to grow from an estimated $1.7 billion in 2004 to an estimated $3.5 billion in 2007. We believe that service management software has become a primary driver of growth in the broader $10 billion systems and network management software industry.

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The Motive Solution

We provide service management software and services to remove management waste incurred by both providers and customers in association with leading-edge technology products. For example, product teams use our software to accelerate time to market with products that are more manageable and serviceable than competitive offerings. Call centers are able to support increased service burdens without increased cost, and can expand their capabilities to deliver remote services and value-added services. End users, whether consumers or administrators, are able to self-manage products and services, thereby increasing the value they receive and reducing cost of ownership.

Our service management software complements and extends traditional systems management software as well as systems management capabilities offered by other technology vendors in their products. Over the past several years, systems management vendors have widely propagated agents that collect management information from a variety of technology assets, including networks, systems, databases and applications. At the same time, the industry has also advanced through the development of open instrumentation standards and interfaces. Our service management solution exploits management data from these open interfaces and systems management products, eliminating the need to deploy proprietary agents or replace existing systems management capabilities in order to use our software.

Our service management software has three key characteristics built-in management, modeling and differencing and process driven management that differentiate it from traditional systems management software and provides competitive advantages to our customers.

Built-in management. Unlike traditional systems management solutions that use external frameworks and distributed agents to monitor and control internally-owned technology assets, our service management software makes manageability and serviceability a built-in attribute of a technology-enabled product or service. Building manageability and serviceability into these products and services makes them easier for service teams, end users and administrators to activate, configure, change, diagnose, repair, upgrade and use. In addition, the technology-enabled products and services are able to automatically perform tasks to manage themselves, including *self-configuration* the ability to adapt real time to changing environments, *self-repair* the ability to detect problems and automatically resolve them and *self-regulation* the ability to enforce policies that govern the acceptable use of products and services. These and other self-management capabilities are particularly important because of the constant change inherent in complex technology environments. Our built-in management capabilities work automatically with and on behalf of end users, reducing the need for external IT involvement and decreasing the occurrence of service labor spikes, product and service failure rates, customer attrition and upgrade resistance.

Modeling and differencing. Data about the availability and performance status of individual technology elements is ineffective in helping a business understand how well the broader ecosystem of people, processes and technology is meeting business objectives. Our software uses a modeling and differencing approach to manage the desired behavior of technology products and services according to defined business objectives. Our model-based approach starts with a set of visual tools that enable business people to specify the optimal set-up and operational parameters of a product or service. Our analysis and differencing engine then automatically detects and corrects differences that develop as the product is used by customers, ensuring the entire ecosystem remains within optimal business guidelines.

Process-driven management. Our service management software takes a process-driven approach focused on optimizing the execution and completion of management processes that operate across multiple technology assets and constituents, both inside and outside the company. Its objective is to ensure that critical business processes are being completed according to expected levels. For example, ensuring that the company is activating the expected number of new subscribers in order to meet revenue objectives, or ensuring that the company is resolving customer problems within expected timeframes in order to meet operating cost guidelines and service level agreements. Our approach enables product and service providers to deliver a set of automated,

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process-driven services that eliminate manual management steps for customers and service operations personnel. These services are transactional, which means that our software automates the end-to-end sequence of steps in the process and manages it as a transaction between the product vendor or service provider and the customer. They are also permission-based, ensuring that external customers are able to control the management information a product vendor or service provider is allowed to access from their systems at every point in the end-to-end process.

Advantages of Our Solution

We believe that our solution provides important advantages over other infrastructure management approaches and allows our customers to:

Execute rapid and profitable change. Our customers must constantly adjust their technology-enabled products and services in response to rapidly changing market and competitive scenarios. The combination of our software s built-in management capabilities, our model-based differencing and our process management enables our customers to rapidly and cost-effectively adjust to change while minimizing time and labor costs that can impede business growth and profit objectives.

Optimize management processes across company boundaries. Management of state-of-the-art technology environments typically involves products, people and processes functioning together as a unit, often extending into partner and end user premises. For example, outsourcers are being asked to manage third-party assets in remote data centers and communications service providers face the escalating challenge of activating and supporting subscriber connections in networked homes that involve personal computers, or PCs, and other digital products that are not owned by the service provider. Our service management solution permits our customers to gather management data according to permission-based guidelines established with their end users. As a result, our customers can use our service management solution to address the extended technology ecosystem, including technology in the end user premises, not just the internal technology assets owned by the company delivering products or services.

Increase productivity. Our products enable businesses to automatically prevent, discover, diagnose and react to disruptions in technologies that directly impact, and are used by, their customers. Our software detects and resolves many problems before they impact our customers end users. In addition, should a problem occur, our automated approach gathers system data and contextual information specific to the end user s application, and then guides the end user and the service expert to the correct solution, reducing the burden on the end user to be a technology expert. Because our customers can process and respond to service requests and service events based upon the specific context of the situation, our service management products allow organizations to satisfy a wider range of service requests through self-service transactions, self-management and self-correction. As a result, we believe our software enables end users to minimize time wasted troubleshooting system, application or network problems and reduces the number of calls to service centers and IT operations, resulting in operational savings and improved labor productivity.

Optimize utilization. Our software improves asset utilization by locating under- and over-utilized technology assets and allocating usage in their most profitable manner. For example, broadband service providers can use our technology to determine which subscribers are consuming more network resources than can be profitably delivered for the price of a typical monthly subscription fee.

Create new sources of revenue. Companies can use our service management software to implement new service offerings faster and with less investment and risk. For example, enterprise IT service providers use our solutions to create on-demand, fee-based service offerings for managing data center, application and desktop services for Global 2000 companies and small/medium businesses. Broadband service providers use our software solutions to more rapidly and cost-effectively deploy new value-added services to their existing subscribers, such as home networking and premium content. Our infrastructure technologies for modeling complex technology ecosystems, managing service automation and enabling integration of existing systems, combined with our

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packaged and extensible service management applications, provide a way for businesses to accelerate their efforts to profit from these new opportunities.

Growth Strategy

We intend to achieve our growth objectives by building leading positions in strategic segments of the service management software market and are pursuing the following strategies:

Develop new and innovative products. We have consistently added new products and entire product lines to our service management suite of products. We intend to continue to do so in the future as a means of increasing our strategic value to both existing and prospective customers. For example, in August 2003, we introduced Usage Policy Manager as the first product in a new policy management product line. We believe this product is the first to allow communications providers to automate service policies in response to growing business issues, such as subscriber attrition and excessive use or misuse of bandwidth. We believe that continued substantial investments in research and development for both new product development and enhancements to our current offerings will help us maintain a leading position in the service management software sector. In addition to developing new products internally, we have acquired complementary businesses that have expanded our product offerings and intend to continue to opportunistically pursue this strategy in the future.

Penetrate new market segments. Our platform is extensible and allows us to focus on entering new markets with reduced development time by building applications with additional relevant functionality to meet the specific needs of these new markets. For example, our Desktop Management solution was initially targeted at the consumer PC market. We subsequently targeted that solution at the commercial PC market by adding unique functionality required for corporate administration. We are also combining our development efforts with initiatives to address new markets, including assembling new sales teams and packaging our existing products in new ways.

Maintain our flexible licensing model that allows us to grow with our customers. Our licensing model enables us to generate additional revenue from existing customers in three ways. First, the majority of our license agreements are fixed-term as opposed to perpetual. Accordingly, customers renewing these licenses typically pay additional license fees to renew them upon the expiration of the initial term. Second, we price our licenses based on an expected volume of usage during the license term. Therefore, to the extent that the number of a customer s end users increases during the initial license term, the license fees to be charged upon a renewal may increase. Finally, our licenses permit customers to use our software only in a particular manner. To the extent a customer desires to expand the scope of use of our software, we renegotiate to expand the license, creating new revenue opportunities. We intend to continue to focus on entering into term-based licenses with defined volume and usage limits in order to maintain our flexibility to grow revenue with our customers.

Continue to enhance customer value. We measure the success of our products in our customers environments and are committed to providing recommendations for improving the effectiveness of our solutions. We do this by working closely with our customers to develop an understanding of their businesses. As a result, we are able to align our solutions to dramatically improve the effectiveness of their organizations and to optimize their investment in our solutions. We install, customize and deploy our service management solutions and deliver a comprehensive series of consulting and training programs covering all aspects of our service management solutions.

Expand our international operations. We believe that international markets represent a significant opportunity for sales of our service management products and services. We intend to accelerate our growth by expanding our existing direct sales model in international markets, focusing primarily on Europe and Asia-Pacific. Today we have international operations in Canada, the United Kingdom, Germany, Switzerland, France, Spain and Japan. Our solutions are available in native languages in their key foreign markets.

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Products

Our Service Management product suite is divided into three categories according to the primary constituent served, as summarized below:

Self Management products optimize the management processes for the end users and administrators of technology-enabled products and services. Products in this category utilize our problem remediation and configuration management capabilities to enable end users and administrators to self-activate, self-repair and self-update their products to minimize downtime, management overhead and expense. For example, over 50 large consumer and enterprise technology providers have used our software to deliver enhanced remote product support to over 15 million end users and over 5,000 datacenter products. For the years ended December 31, 2001, 2002 and 2003, revenue from Self-Management products represented 45%, 50% and 45%, respectively, of total revenues.

Service Operations Management products optimize the processes involved in delivering service and support for complex technology products and services. They simplify and streamline the operations of large-scale call centers and advanced technical support departments. Products in this category use our problem remediation and configuration management capabilities to deliver troubleshooting, monitoring and change services to customers. For example, over 35 of the world s leading broadband service call centers and computer and software support departments have used our software to optimize the work processes of their technical support representatives. For the years ended December 31, 2001, 2002 and 2003, revenue from Service Operations Management products represented 53%, 48% and 26%, respectively, of total revenues.

Policy Management products enable product and service owners to monitor and manage the consumption or usage of technology products, according to business objectives or operational requirements. For example, broadband service providers have experienced high variable costs due to a small number of subscribers consuming exorbitant amounts of bandwidth. Customers could use our policy management products to automatically identify the excessive users and enable a policy-based response, such as upgrading them to a more lucrative service plan, or declining their unprofitable business. To date, we have not recognized any revenue associated with the recently launched Policy Management products.

Our products are described in the following table:

Product Name (Date Generally Available)	**Key Features/Capabilities**	**Key Benefits**
Self-Management Products		
Broadband Manager (September 2001)	Automates pre-qualification, activation, provisioning and value-added services delivery	Reduces the costs of acquiring new broadband subscribers
	Provides automated self-management of residential broadband service	Increases revenue for service providers delivering enhanced services
	Performs automated troubleshooting and resolution of problems	Reduces the volume of technical support requests from subscribers

	Proactively detects service problems and guides subscribers through the resolution process	Reduces subscriber attrition by increasing customer satisfaction
Desktop Manager (June 2002)	Provides automated self-management of desktop environments Provides protection and restoration of network and browser settings and Windows applications Provides self-service diagnostics, troubleshooting and health checks Provides fast answers to common user questions	Improves customer productivity and satisfaction Increases revenue for service providers by enabling fee-based remote desktop service offerings Reduces technical support requests volume from desktop computer users Reduces mean time to resolution of problems for call centers

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Product Name (Date Generally Available)	Key Features/Capabilities	Key Benefits
Enterprise Service Manager (June 2002)	Provides IT administrators with a central point of control over their relationships with service providers Provides automated self-management of mission-critical data center hardware or software Enables IT administrators to diagnose and resolve problems locally in their data center environments Provides scheduled data collection for proactive remote services	Increases revenue for enterprise service providers by enabling fee-based remote service offerings Reduces the volume of data center support requests for enterprise service providers from IT administrators in enterprises Reduces mean time to resolution of problems
Home Network Manager (August 2002)	Provides automated self-management of consumer home networks Automates common home networking configuration tasks Enables simple management of services such as online gaming and file and print sharing Simplifies troubleshooting of home networking services, including wired and wireless connections, file and print sharing and firewall	Enables service providers to increase revenue by cost effectively delivering home networking services Simplifies the customer experience and improves customer satisfaction around home networking services Reduces the cost of supporting home networks for providers by reducing call volumes and average handle time for support requests
Business Class Manager (August 2003)	Provides automated self-management of small business IT networks Standardizes activation of all computers, including configuration of complex network devices Provides integrated management of business services, simplifying subscriber experience Provides self-service tools and enables subscribers to request assisted service	Increases revenue for service providers by enabling high-value services for small business customers Reduces customer acquisition costs for new value-added services Increases average revenue per user Reduces mean time to resolution for call centers delivering support for small business
Technical Profile Manager (May 2004)	Provides self-management of complex enterprise application environments Provides software vendors (ISVs) with permission-based visibility into customer deployment environments Automatically identifies changes by comparing current profiles to a baseline model or last known good state Integrates with existing support portals	Increases application availability and performance Eliminates repetitive questions about customer deployments and configurations Improves analyst productivity and efficiency On-demand hosted deployment model lowers costs and mitigates risk while rapidly delivering return on investment
Motive Triage and Resolution (Estimated the third quarter of 2004)	Provides automated self-management of complex enterprise IT environments	Improves mean time to resolution for mission critical applications

	Enables application teams to capture and automate key application information for downstream operations personnel Provides snapshot and comparison capabilities against a gold standard image Provides a guided triage and diagnostics experience for level one technicians Integrates with other service management applications to create a seamless problem management process	Reduces management overhead for applications Reduces manual effort and errors in the triage and diagnostic processes Extends existing investments in service management systems

Service Operations Management Products

Customer Service Manager (April 2001)	Digitally connects users with support personnel, providing context on support issues Provides remote service tools to automate the resolution of problems Provides management tools to drive work processes and report on performance metrics Integrates with existing systems and infrastructure including call tracking, network diagnostics, call handling and voice response	Streamlines and reduces cost of call center operations Improves customer satisfaction and reduces customer attrition by resolving problems faster and more easily Enables service operations to scale with new products and subscriber growth

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Product Name (Date Generally Available)	Key Features/Capabilities	Key Benefits
Remote Service Manager (June 2002)	Automates problem resolution and delivers proactive, value-add services Provides two-way, permission-based connection between service providers and technology assets of an end customer Automates collection of ecosystem information as context to aid problem resolution and proactive services Integrates with existing business systems and infrastructure such as call tracking and help desk systems	Streamlines and reduces cost of service operations Increases revenue for the service provider by enabling fee-based remote service offerings Enables service operations to scale with new product and service offerings Improves customer productivity and satisfaction
Policy Management Products		
Usage Policy Manager (September 2003)	Enables service providers to establish and enforce business policy on optimal usage of network assets Gathers and processes event notifications from network and back office systems Automates subscriber enforcement and operations notification	Optimizes provider profits by enabling service tiers and consumption based business models Reduces bandwidth over-use from subscribers violating terms of service Provides a proactive prediction of customer attrition by modeling subscribers who are under-using broadband services

Licensing

We license our products in one of four ways. First, we license our products on an individual basis where each product is designed to optimize the management of a specific scenario or user community. For example, our Desktop Manager product enables PC manufacturers to provide a solution for their consumers that automates the self-management of their PC environment, including self-diagnosis, self-repair and, where necessary, automates the escalation of service problems to the vendor service desk.

Second, we license combinations of our products under a branded solution to address a technology optimization area. For example, our Total Broadband Care solution combines the Broadband Manager and Customer Service Manager products with a defined set of professional services to enable broadband service providers to address the full lifecycle of subscriber management, from subscriber acquisition and activation to on-going customer care including electronic and phone support. In both of these scenarios, our product is deployed at our customer s site, and managed either by our customers or by our remote management service.

Third, some of our customers use our hosting and operations infrastructure rather than deploying their own IT infrastructure to deploy and support our products. For these customers, we provide a fully hosted service in which our software is deployed in our data center environment and all administration is managed by us. Our hosting operations perform in excess of 20 million daily transactions for our customers, utilizing a secure hosting facility comprising over five terabytes of storage, 175 servers and redundant high-speed OC3 connections from independent providers.

Finally, there are a small number of instances where large technology companies or service providers want to utilize our platform technology to build highly customized management services that they embed in their product or service. In these situations, we license our platform and tools on a stand-alone basis.

Services

Our products are complemented by a suite of services to assist customers in rapidly implementing their service management initiatives, optimizing their business processes and measuring the financial impact of our solution. We have considerable expertise in large service management deployments and focus on incorporating our solutions into our customer s overall business strategy.

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As of December 31, 2003, we had 106 employees in our services organizations. These employees are based primarily in Austin, Texas, but also reside in other locations throughout the United States, Europe and Asia/ Pacific. We have also established relationships with several consulting partners across our various service offerings. Among these partners are industry leaders, such as Accenture, Bizmatica, Sapphire Technologies, Syntel Inc. and VASS. These partners provide us with a network of expertise and enhanced geographic coverage. We intend to further expand our service partners in the future.

Professional Services

Motive Deployment Services. Our deployment services are utilized to install, customize and deploy our service management solutions, addressing our customers business needs on a global, regional and industry-specific level. Our proven methodology includes pre-project preparation, planning and managing requirements definition and design, installation and configuration, testing and transitioning into the production environment. Deployment services are typically provided on our customers premises. With most engagements, two to four consultants complete the entire process from initiation to full production within three to four months. However, some larger implementations can take four to six months and may involve additional consultants.

Motive Business Optimization Services. Our business optimization services are designed to align our customers business processes with our technology solutions and to dramatically improve the effectiveness of introducing our technology into an organization. Leveraging the experience gained through hundreds of deployments of our technology solutions worldwide, these packaged services provide our customers with industry best practices that optimize their ability to achieve business goals, while lowering the overall cost of utilizing our technology. Specifically, our business optimization services include packages focused on usability of customer user interfaces, optimization of contact center processes, service data analytics and internal marketing of our technology solutions.

Motive Education Services. Our education services are designed to enable customer independence in ongoing maintenance and administration of our solutions. Drawing on industry-standard instructional principles and real-world experience, our training organization delivers a comprehensive series of training programs spanning all aspects of our service management solutions. These programs can be delivered at the customer s business, via the Internet or at our state-of-the-art training facilities in Austin, Texas**.**

Hosting and Managed Services

Motive Outsourcing Services. Our outsourcing services provide maximum deployment and production flexibility for customers by offering either complete solution hosting or remote management of our solutions. Our outsourcing services provide a competitive advantage by enabling customers to realize the benefits of our solution with reduced project risk, complexity and time to market, while simultaneously achieving increased operational efficiency, service and maintenance levels. Featuring dedicated staff and advanced technology infrastructure, our outsourcing services deliver the high system availability, proactive monitoring and disaster recovery capabilities necessary to operate a mission-critical service management solution.

Motive Technical Services. Our technical services deliver a wide range of production support for our service management solutions, including 24x7 technical assistance and problem resolution and customer-specific services with named technicians and on-site support. In addition, we have created platform monitoring services to relieve many of the common tasks associated with managing a mission-critical installation of our solutions, including availability monitoring, performance monitoring and transaction monitoring. Using our platform monitoring services, our customers are able to free-up resources normally associated with the day-to-day management of our solution. All platform monitoring services work in connection with our service management platform and use RSA encryption.

Account Services

Motive Customer Care. We believe that we are unique in the enterprise software industry in establishing complimentary post-deployment services to ensure that our customers derive maximum financial value from our

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solution. These services utilize a proven methodology and include establishing solution success criteria, developing deployment and marketing plans, monitoring and measuring results through regularly scheduled meetings and diagnostic checks as well as our performance impact analysis plan. Customer care is responsible for managing all aspects of our business and technical relationship with our customers post-deployment.

Customers

Since our inception, we have licensed our products to over 100 leading companies in a variety of industries. The following is a list of our largest customers who, as of March 31, 2004, have renewed or purchased licenses over the last two years.

Advanced Digital Information Corp.	NTL Group Ltd.
Aliant Inc.	N.V. Casema
AOL (UK) Limited	SBC Communications, Inc.
Bell Canada	Sprint Communications Company
BellSouth Corporation	Storage Technology Corporation
British Telecommunications plc	Stratus Computer, Inc.
Centrica Telecommunications Limited	Swisscom AG
Cognos Incorporated	Telecom Italia Media S.p.a.
Cox Communications, Inc.	Telenet
Deutsche Telekom	Telewest Broadband
EMC Corporation	Telus Corporation
Fannie Mae	Time Warner Cable / RoadRunner, Inc.
Fujitsu Limited	T-Online France
Hewlett-Packard Development Company, L.P.	VERITAS Software Corporation
Hyperion Solutions Corporation	Verizon Communications
Mercury Interactive Corporation	Warranty Corporation of America

In 2001, Hewlett-Packard and Peregrine Systems collectively accounted for 39% of our total revenue, each of which individually accounted for 10% or more of our total revenue. In 2002, Hewlett-Packard accounted for 19% of our total revenue. Mercury Interactive accounted for 11% of our total revenue for the year ended December 31, 2003. No customers accounted for 10% or more of our total revenue for the three months ended March 31, 2004.

Technology and Architecture

We utilize a distributed Internet systems architecture and deliver a broad set of component-based management services that can be accessed across network boundaries. As described in the following diagram, these services are organized to deliver key capabilities of our product suite and to meet the management requirements of complex technology products and services.

Our product capabilities include:

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Instrumentation Infrastructure

- *Standards-based, Vendor and Motive Instrumentation:* Capabilities that make heterogeneous system and device telemetry available to our platform in a structured XML telemetry format. Our instrumentation infrastructure normalizes data from standards-based instrumentation (such as JMX, WMI, WBEM and SNMP), vendor-specific instrumentation and our instrumentation using a lightweight agent-less approach.

Foundation Capabilities

- *Ecosystem Repository*: Capabilities that provide secure data storage for critical service management parameters in our solution, including information about user roles and privileges, policies for service interactions, managed resource information and other configuration data. This set of capabilities is key to our ecosystem modeling and blueprinting abilities.

- *Secure Transaction Services*: Capabilities that provide secure message encoding, packaging, transmission and decoding for all service management transactions. These secure transactions services utilize industry standard authentication and encryption technologies such as RSA public key encryption, X.509v3 / PKS#7 digital certificates and SSL communication protocols to perform remote service management operations. These transactions can be short- or long-lived, in that they are completed in mere seconds, or persist for days, weeks or even months.

Core Capabilities

- *ServiceFlow Creation and Automation:* Tools and technologies that codify, automate and execute end-to-end service management processes. Our service management system automates service processes by capturing them in a script or model that presents employees, customers and business partners with data-driven management information specific to their system and any particular service issues they are having. By tying this data-driven context to service delivery processes, we connect people to answers, experts and management data directly relevant to solving their problem. This enables customers to analyze the impact of a configuration change or determine whether service usage is within specified business policy.

- *Programmable Data Collection:* Capabilities that enable data to be flexibly harvested from all parts of a technology environment and leveraged to drive automated service flows. This enables a service management system to flexibly change service processes and adapt to new business requirements as the needs of an enterprise or its customers and partners change over time.

- *External Systems Integration:* Capabilities that enable robust bi-directional communication between our platform and other mission critical systems in our customers environments. The architecture provides a rich set of integration services that permit events, functions, data and transactions to be captured and exported to third-party systems such as trouble-ticket, billing and provisioning systems.

- *Incident Management:* Capabilities that enable external customers and business partners to digitally request service, check the status of open requests and update or close these requests using a set of interaction interfaces. These capabilities track service requests throughout their life cycle and organize and display management data for use by relevant parties, including enterprise IT organizations, customers and business partners. Our incident management capabilities include business intelligence attributes that enable companies to gain detailed business information about the impact of their service management efforts on customer satisfaction, responsiveness to change and cost reduction. This enables companies to analyze service transaction data, consolidated historical data and detailed business statistics involving customer profitability, customer adoption, employee efficiency and system performance.

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- *Service Collaboration:* Capabilities that enable multiple people within a company or across companies to digitally collaborate on service management endeavors. These capabilities create dramatic efficiency gains because they enable groups of people to simultaneously work on a service request in a service management network rather than requiring serial escalations in which a service management request is passed from one person to another. These capabilities also enable secure, permission-based access to service collaboration capabilities by outside trusted parties, such as vendors or outsourcers.

Management Services

- *Problem Management:* Capabilities that enable the prevention, discovery, diagnosis and reaction of disruptions in technology products and services.
- *Configuration Management:* Capabilities that provide visibility and control over the configuration of technology products and services.
- *Policy Management:* Capabilities that monitor and manage the consumption or usage of technology assets according to business objectives or operational requirements.

Our architecture also ensures the scalability, reliability, flexibility and security required of an enterprise/carrier class ecosystem:

- *High scalability.* We combine a scalable service architecture with the performance, capacity, load balancing and management facilities of industry-standard web servers and databases familiar to our customers to support the highest degrees of scalability and redundancy.
- *High flexibility.* Our component-based architecture is programmable and easily customized, ensuring that the technology can be leveraged and extended to accommodate changing demands by adding new service management components and functionality as needed.
- *Open architecture to integrate with existing systems.* Our architecture makes use of Java and XML-based technologies for its integration services and provides a set of interfaces that permit access to events, functions and data within the service management system. This general-purpose interface allows integration with all types of systems as well as opportunities to customize interactions.
- *Certified security.* Our architecture ensures that all service requests come from authorized sources and provides encryption of data for transport across the Internet. In addition, our technology is designed to permit service requests to pass through corporate firewalls without requiring changes that compromise firewall integrity. Our security implementation is regularly audited and certified by an independent firm of national standing.
- *Broad range of computing platforms.* Our browser plug-ins are designed to run on Microsoft Windows platforms as well as Solaris, HP/UX, Linux and AIX. Our architecture is also designed to be extendible to Internet appliance devices. Our servers currently run on the UNIX, HP/UX, AIX, Solaris, Linux and Microsoft NT operating system platforms.

Strategic Relationships

We are committed to working with application and system-level partners that can enhance our solutions or increase the value our customers receive from our technology. We focus on establishing and maintaining relationships with leading hardware and software providers across the entire IT infrastructure, as well as with the systems integrators who deploy the technology. These relationships range from strategic software licensing agreements, where our technology is embedded into a partner s products and deployed as part of their solution, to strategic platform agreements, where third parties can deploy and sell their own set of applications on top of our software.

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In October 2002, we formed the *Meteor Alliance* with Hewlett-Packard, VERITAS and EMC to establish a program to deliver proactive services into multi-vendor IT datacenters utilizing a common technology infrastructure supplied by us. The *Meteor Alliance* was publicly launched in October 2003.

We have also established a strategic relationship with Mercury Interactive through which Mercury has executed a three-year license agreement permitting it to incorporate various elements of our technology to create a problem resolution product in future releases of their application management suite. Mercury has paid the $15 million minimum license fees owed to us pursuant to this agreement.

We also have relationships with complementary product companies to deliver a more comprehensive management solution to our customers. For example, we have a dedicated program to ensure effective technology integrations necessary for provisioning and management of customer premise equipment. We also have relationships with major CRM software providers, as well as major systems and network platform providers.

We have established relationships with leading systems integrators whose work is the design and implementation of technology ecosystems. These partners include firms offering strategy, change management, process design, usability and integration and outsourcing services.

Sales and Marketing

Our strategy has been to develop a direct sales model and target leading companies in selected industries to build our service management solutions into their technology-enabled products and services. As of December 31, 2003, our sales and marketing organizations consisted of 84 employees located in a variety of domestic locations, as well as Canada, the United Kingdom, Germany, Switzerland, France, Spain and Japan. We generate leads from a variety of sources, including marketing programs and inside sales activities. Initial sales activities typically include a demonstration of our product capabilities, a customer-specific technical and financial analysis and information regarding deployment capabilities.

We develop and execute a variety of marketing programs to build market awareness about us, our service management solutions and their value to potential customers. A broad mix of programs is used to accomplish these goals, including market research, product and strategy updates with industry analysts, public relations activities, direct mail and relationship marketing programs, Internet marketing, seminars, industry-specific trade shows, speaking engagements and co-operative marketing with customers and partners. Our marketing organization also produces materials in support of sales to prospective customers that include Internet web sites, programs and materials, brochures, data sheets, white papers, presentations, demonstrations and other marketing tools.

Research and Development

We have made substantial investments in research and development through both internal development and technology acquisition. The majority of our research and development activity has been directed towards the expansion of our service management solutions. This development consists primarily of adding new competitive features to established products, as well as the creation of additional products, content and tools as we expand into new markets. In addition, we leverage our strategic partner and customer relationships to identify and develop new innovative solutions. As of March 31, 2004, we have received eight issued patents for our technology innovations over the course of five generations of product development and have an additional 10 patent applications currently being reviewed by the United States Patent and Trademark Office.

As of December 31, 2003, we had 105 employees in our research and development organization. Our research and development expenditures for fiscal 2001, 2002 and 2003 were approximately $12.9 million, $11.2 million and $16.9 million, respectively. Our research and development expenditures for the three-month period ended March 31, 2004 were approximately $4.2 million. We expect that we will continue to commit

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significant resources to research and development in the future. All research and development expenses have been expensed as incurred. See Management s Discussion and Analysis of Financial Condition and Results of Operations.

Competition

The service management market is new, rapidly evolving and increasingly competitive. Our current and potential competitors in the market vary in size and in the scope of the products and services that they offer or may offer in the future. Many of our current and potential competitors have greater financial, marketing and infrastructure resources than we have. As a result, they may be able to respond more quickly to changes in customer requirements. They may also be able to devote greater resources than we can to sales and marketing and research and development. Competition may also result in changes in pricing policies by us or our competitors, which could adversely affect our business, prospects, future quarterly and annual operating results and financial condition. We may not be able to compete successfully against current and future competitors.

Companies that individually, or collectively, offer competitive products, may develop competitive products or may adopt a similar business model to ours include the following:

- providers of broad service management product lines, such as Mercury Interactive. Mercury Interactive currently licenses certain components of our technology and provides its customers with categories of service management software different from those we provide our customers. Specifically, Mercury Interactive provides products for application testing, tuning and performance and IT governance, while we provide products that principally address problem management, configuration management and policy management. Mercury Interactive may broaden its product portfolio to enter our current markets;
- providers of point service management products focused on problem management and technical support automation for PCs and devices, such as SupportSoft, Inc., Control-F1 and Axeda;
- providers of point service management products focused on configuration management such as Relicore Inc., Troux, Cendura and OpsWare Inc., along with broadband-specific companies such as Fine Point Technologies, Inc. and Alopa;
- providers of service management products focused on automated policies governing technology usage, such as Euclid and Oblicore Inc. in the enterprise IT market, along with Stargus and Ellacoya Networks in the broadband market;
- providers of point products for application performance management, including Dirig Software, Inc., Tonic Software, Inc. and Wily Technology;
- providers of traditional enterprise systems management platforms and point products such as IBM/Tivoli Systems, BMC Software, Inc., Hewlett-Packard, Computer Associates, Micromuse, Managed Objects and Smarts. While none of these companies currently offer service management products that are designated to optimize profits from technology assets, they are beginning to incorporate aspects of service management concepts in their marketing messages and may in the future deliver service management products;
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Internet infrastructure and platform companies that may add service management functionality to their products, such as BEA Systems, IBM, Microsoft Corp., SAP and Oracle Corp.;

- providers of hardware devices for broadband networks attempting to differentiate their products with proprietary built-in management software such as 2Wire and Efficient Networks.
- providers of call center automation products and solutions such as Amdocs Limited (Clarify), Onyx Software and Siebel Systems; and
- internal development groups of our current and prospective customers who may choose to develop their own service management software.

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We believe the principal competitive factors in our industry are:

- product features and functionality;
- time to market with new products that respond to changing customer requirements;
- availability of professional services to rapidly develop and deploy a complete solution;
- flexible deployment options including remote-managed and hosted environments;
- ability to handle large volumes of end users and transactions; and
- price.

Intellectual Property and Other Proprietary Rights

Our success heavily depends on our proprietary technology. We rely on a combination of copyright, trade secret, trademark and patent laws, confidentiality procedures, contractual provisions and other similar measures to protect our proprietary information and intellectual property rights. As part of our confidentiality procedures, we enter into proprietary information and invention agreements with our employees and non-disclosure agreements with certain of our consultants, customers, prospective customers and service providers. We also enter into license agreements with respect to our technology, documentation and other proprietary information.

The unauthorized reproduction or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it. In addition, the steps we have taken to protect our proprietary rights and intellectual property may not be adequate to deter misappropriation. We may not be able to detect unauthorized use of our proprietary information or take appropriate steps to enforce our intellectual property rights. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our software or technology that we consider proprietary and third parties may attempt to develop similar technology independently.

We currently hold a trademark registration in the United States for the Motive name, our logo and certain marks associated with our product suite. We also hold a trademark registration of, or have pending applications for the trademark registration of, the Motive name, our logo and for certain marks associated with our product suite in certain countries in North America, South America, Europe, Asia and Australia. In addition, as of March 31, 2004, we have eight patents issued and 10 pending patent applications for technology related to our product suite. Our patents have expiration dates ranging from 2018 to 2020. It is possible that our patents, copyrights or registered trademarks could be challenged and invalidated. In addition, existing patent, copyright and trademark laws afford only limited protections. Effective protection of intellectual property rights may be unavailable or limited in certain countries, because the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Monitoring unauthorized use of our patents and trademarks is difficult and expensive, particularly given the global nature and reach of the Internet. Furthermore, it is possible that our competitors will adopt product or service names similar to ours, impeding our ability to protect our intellectual property and possibly leading to customer confusion. Although we are not aware that our products, patents, trademarks, copyrights or other proprietary rights infringe the proprietary rights of third parties, any infringement claims, with or without merit, brought by such third parties could be time-consuming and expensive to defend.

Employees

As of December 31, 2003, we had 374 total employees. Our future success will depend on our continuing ability to attract, train and retain highly qualified technical, sales and managerial personnel. Our employees are not represented by a collective bargaining agreement and we have never experienced a strike or similar work stoppage. We consider our relations with our employees to be good.

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Facilities

Our principal administrative, sales and marketing and research and development facility is located in Austin, Texas and consists of approximately 117,300 square feet of office space under a lease that expires December 2012. We also maintain offices for sales and support personnel in San Ramon, California; Denver, Colorado; Atlanta, Georgia; Boston, Massachusetts; Minneapolis, Minnesota; Houston, Texas; Toronto, Canada; Paris, France; Zurich, Switzerland; Munich, Germany; London, England; and Tokyo, Japan. We believe that our facilities are adequate for our current needs and that suitable additional or substitute space will be available as needed to accommodate foreseeable expansion of our operations.

Legal Proceedings

From time to time, we may be involved in litigation relating to claims arising out of our ordinary course of business. We are not currently a party to any material legal proceedings.

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MANAGEMENT

Officers and Directors

The following table sets forth certain information concerning our executive officers and directors:

Name	Age	Position
Scott L. Harmon	45	Chairman of the Board of Directors and Chief Executive Officer
R. Logan Wray	44	Chief Operating Officer
Paul M. Baker	43	Chief Financial Officer
Scott R. Abel	45	Executive Vice President of Enterprise Business Unit
Douglas F. McNary	44	Executive Vice President of Corporate Development
Kenny Van Zant	34	Executive Vice President of Consumer Business Unit
Jeffrey S. Bolke	42	Vice President of Worldwide Sales
Eric L. Jones	69	Director
Michael LaVigna	64	Director
Michael J. Maples, Sr	61	Director
Tom Meredith	53	Director
David Sikora	42	Director
John D. Thornton	39	Director

Scott L. Harmon co-founded our company in April 1997 and has served as Chief Executive Officer since June 1997, as Chairman of the Board since November 2003 and as a director since April 1997. He served as President from our inception in April 1997 to January 2003. From November 1996 to May 1997, Mr. Harmon was a Venture Partner of Austin Ventures, a venture capital firm. From March 1992 to November 1996, Mr. Harmon was employed by Tivoli Systems Inc., a systems management software company, where he held several marketing positions including Vice President and General Manager of the Applications Management Business Unit and Vice President of Marketing and Strategy. Mr. Harmon received a Bachelor of Science degree in Computer Science from Iowa State University.

R. Logan Wray has served as our Chief Operating Officer since November 2001. Prior to that time, he served as our Chief Financial Officer and Executive Vice President of Customer Operations from August 2000 to November 2001. From May 1997 to April 2000, Mr. Wray served as Senior Vice President and Chief Financial Officer of Sterling Software, Inc., a systems management software and services company, which was purchased by Computer Associates in April 2000. From September 1981 until April 1997, Mr. Wray held various positions with Ernst & Young LLP, most recently as a partner in the technology group focused on software. Mr. Wray received a Bachelor of Science degree in Commerce from the University of Virginia.

Paul M. Baker has served as our Chief Financial Officer since November 2001. From July 1997 to October 2001, Mr. Baker held various positions, most recently Controller, with Sterling Software, Inc. From October 1985 until June 1997, Mr. Baker worked with Ernst & Young in London, specializing in multi-national companies and technology. Mr. Baker received a Bachelor of Arts degree in Finance and Accounting from the University of East London, and is a Chartered Accountant.

Scott R. Abel co-founded our company and has served as Executive Vice President of our Enterprise Business Unit since January 2003. From February 2001 to January 2003, Mr. Abel served as our Vice President of Solution Services. From October 1999 to January 2001, Mr. Abel served as Chief Operating Officer of All.com, Inc., a company that provided live one-on-one technical support over the internet directly to small and medium businesses. From April 1997 to October 1999, Mr. Abel held various positions with our company, most notably in the online services arena. Prior to joining us, Mr. Abel held the title of Vice President of Worldwide Professional Services for NeXT Software as well as various business and software development positions at Apollo Computer, a work station computer company, Motorola and PSW Technologies, a software services company. Mr. Abel holds a Bachelor of Science degree in Physics from the University of Texas.

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Douglas F. McNary has served as our Executive Vice President of Corporate Development since February 2000. From April 1998 to January 2000, Mr. McNary served as Vice President of Sales. From January 1997 to April 1998, he served as Vice President of Sales of Trellix Corporation, a web authoring tool software company. From August 1991 to January 1997, he was employed by Tivoli Systems where he held several sales management positions including Vice President of Sales and Director of European Sales. Mr. McNary received a Bachelor of Science degree in Mechanical Engineering from Worcester Polytechnic Institute.

Kenny Van Zant has served as Executive Vice President of our Consumer Business Unit since January 2003. From November 1998 to January 2003, Mr. Van Zant, a co-founder of BroadJump, Inc. was Chief Operating Officer of BroadJump, Inc. Prior to BroadJump, Mr. Van Zant held positions at Cisco Systems, NetSpeed, Cypress Semiconductor, Andrew Corporation and Thomas-Conrad Corporation. Mr. Van Zant received a Bachelor of Science degree in Electrical Engineering from the University of Texas.

Jeffrey S. Bolke has served as our Vice President of Worldwide Sales since November 2002. From November 2001 to November 2002, Mr. Bolke was Regional Vice President of Sales, Southern US and Latin America of Tibco, a business integration software company. From August 1996 to November 2001, he was Vice President of Sales at Trilogy. Prior to that time he held various positions at Landmark Graphics, an oil and gas software company, and IBM. Mr. Bolke received a Bachelor of Science degree in Petroleum Engineering from The Colorado School of Mines.

Eric L. Jones has served as a director of our company since June 1997. Mr. Jones has been a General Partner of CenterPoint Ventures, a Texas-based venture capital firm, since April 2002. He has also been a partner in two funds managed by SSM Ventures, a Tennessee-based venture capital firm, from May 1994 to the present. Mr. Jones served as interim Chief Executive Officer of Tivoli Systems from January 1991 to April 1991 and as a director and Chairman of the Board of Tivoli Systems from January 1991 through its public offering and the company s acquisition by IBM in March 1996. Mr. Jones was a director of Active Power, Inc., a manufacturer of battery-free power products, and VTEL Corporation (now Forgent Networks, Inc.), a video conferencing company. He has also served as a director of several privately held companies, including Dazel Corporation, which was purchased by Hewlett-Packard in 1999. Mr. Jones also served as Corporate Vice President and Group President during a 25 year career at Texas Instruments. Mr. Jones received a Ph.D. in Mechanical Engineering from the University of Texas at Austin.

Michael LaVigna has served as a director of our company since May 2003. Mr. LaVigna is a Co-Founding General Partner of Techxas Ventures, an Austin-based venture capital firm, where he has been employed since 1998. Mr. LaVigna was President, COO and director of the technology company Bolt, Beranek & Newman from 1983 to 1993, which, under his direction, successfully completed the first packet switching network called the ARPANet, which along with other components, has evolved into what is commonly known today as the Internet. Prior to Bolt, Beranek & Newman, Mr. LaVigna was a founder and Vice-President of Sales and Marketing of On-Line Systems, Inc., a computer timesharing company, that was acquired by United Telecommunications Inc. in 1977. Mr. LaVigna also serves as a director for several other privately held companies. He received a Bachelor of Arts degree in Mathematics from SUNY Buffalo and a Master of Science degree in Math Education from Siena College. He has also completed extensive post-graduate studies in math and physics under an NSF grant at Union College.

Michael J. Maples, Sr. has served as a director of our company since June 1997. Mr. Maples currently manages private investments and ranches. From April 1988 to July 1995, Mr. Maples held various management positions at Microsoft Corporation, the most recent of which was Executive Vice President of the Worldwide Products Group and a member of the Office of the President. He also serves as a director of NetIQ Corporation, a provider of software for managing e-business enterprise infrastructures, PeopleSoft, an enterprise software applications company, and Lexmark International, Inc., a laser and inkjet printer company. Mr. Maples received a Bachelor of Science degree in Electrical Engineering from the University of Oklahoma and a Masters in Business Administration from Oklahoma City University.

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Tom Meredith has served as a director of our company since May 2003. Mr. Meredith is a General Partner of Meritage Capital, LLC, a fund of hedge funds, which commenced operations in April 2003 as well as Chairman and CEO of MFI Capital, the Meredith family s private investment firm since 2001. Mr. Meredith also serves as a director for FreeMarkets, Inc., a supply management software company, as well as for several privately held companies. From November 1992 until September 2001, Mr. Meredith served as Chief Financial Officer and in various other capacities at Dell, Inc. He received a Bachelor of Arts degree in Political Science from St. Francis University, a Juris Doctor degree from Duquesne University and a Master of Law degree from Georgetown University.

David Sikora has served as a director of our company since January 2000. In July 2002, Mr. Sikora was named President and Chief Executive Officer of Pervasive Software Inc., a data infrastructure software company, where he has been a member of the board since January 2002. In January 2000, Mr. Sikora co-founded Question Technologies, Inc., an Internet relationship management software company, where he served as Chairman and Chief Executive Officer until its acquisition by us in November 2001. From January 2000 to April 2000, he served as our co-president. From July 1998 to January 2000, he served as President and Chief Executive Officer of Ventix Systems, Inc., an enterprise software company which we acquired in January 2000. Mr. Sikora received a Bachelor of Science degree in Electrical Engineering Technology from the University of Houston and a Masters in Business Administration from Harvard Graduate School of Business Administration.

John D. Thornton has served as a director of our company since March 2000. Mr. Thornton is a General Partner of Austin Ventures where he has been employed since 1991. Mr. Thornton also serves as a director for several other privately held companies. He joined Austin Ventures from McKinsey & Co., where he served clients in the United States and Europe. He received a Bachelor of Arts degree with honors from Trinity University and a Masters of Business Administration from the Stanford Graduate School of Business.

Board Composition

Upon completion of this offering, our board of directors will be divided into three separate classes, as follows:

- Class I consisting of Mr. Harmon, Mr. Jones and Mr. Thornton, whose terms will expire at our annual meeting of stockholders to be held in 2005;
- Class II consisting of Mr. LaVigna and Mr. Sikora, whose terms will expire at our annual meeting of stockholders to be held in 2006; and
- Class III consisting of Mr. Maples and Mr. Meredith, whose terms will expire at our annual meeting of stockholders to be held in 2007.

Upon expiration of the term of a class of directors, directors for that class will be elected for three-year terms at the annual meeting of stockholders in the year in which such term expires. Each director s term is subject to the election and qualification of his successor, or his earlier death, resignation or removal. The authorized number of directors may be changed by resolution duly adopted by at least a majority of our entire board of directors. Any increase or decrease in the number of directors will be distributed among the three classes so that, as nearly as possible, each class will consist of one-third of the directors. Because no more than one-third of our board may be elected at each annual meeting, this classification of our board of directors may have the effect of delaying or preventing changes in control of management.

Board Committees

The board of directors has an audit committee, a compensation committee and a nominating committee.

Audit Committee. The audit committee selects our independent accountants, reviews the results and scope of audit and other services provided by our independent accountants, reviews and evaluates the audit and control functions and pre-approves any non-audit related services performed by our independent auditors. The members of our audit committee are Mr. LaVigna, Mr. Meredith and Mr. Sikora.

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Compensation Committee. The compensation committee reviews, administers and makes recommendations to our board of directors regarding our stock plans and makes decisions concerning salaries and incentive compensation for our management. The members of our compensation committee are Mr. Meredith and Mr. Thornton.

Nominating Committee. The nominating committee identifies individuals qualified to become board members, recommends a slate of director nominees to be elected or appointed to the board and recommends membership on standing board committees. The members of our nominating committee are Mr. LaVigna and Mr. Sikora.

Compensation Committee Interlocks and Insider Participation

During 2002, Mr. Maples and Mr. Sikora were members of our compensation committee. From January 2000 to April 2000, Mr. Sikora served as our co-president. At the time of our acquisition of certain assets of Question Technologies, Mr. Sikora was an officer, director and stockholder of Question Technologies. For additional discussion of this transaction see Certain Relationships and Related Party Transactions Transactions with Directors and Officers. None of our executive officers serves as a member of the board of directors of, or compensation committee of, any entity that has one or more executive officers serving as a member of our board of directors or compensation committee.

Director Compensation

Prior to 2003, except for grants of stock options, our directors generally did not receive compensation for services provided as a director. We also did not pay compensation for committee participation or special assignments of the board of directors. In January 2003, our board of directors adopted a director remuneration plan with respect to its members. The plan provides that each new non-employee director that joins our board is granted an option to purchase 12,500 shares of our common stock (25,000 shares in the case of a new director who serves as the chairman of the audit committee of our board) at an exercise price equal to the fair market value of such stock on the date of the option grant. Thereafter, each non-employee director will be granted an option to purchase 3,125 shares of our common stock (6,250 shares in the case of a director who serves as the chairman of the audit committee of our board of directors) on each anniversary of his service at an exercise price equal to the fair market value of such stock on the date of the option grant. Each option under the director remuneration plan is granted under our 1997 Stock Option/Stock Issuance Plan and is subject to the same restrictions as options typically granted to employees of the company, but vests in equal successive quarterly amounts over a 48-month period. Following the offering contemplated by this prospectus, no additional options will be granted under the 2003 director remuneration plan. Instead, options will be granted to non-employee directors under our Equity Incentive Plan, as described below.

Non-employee board members are eligible for option grants under the automatic option grant program for non-employee board members under our Equity Incentive Plan. Under our Equity Incentive Plan, each non-employee director who first becomes a non-employee board member after the date of this offering will be granted an option to purchase 12,500 shares of our common stock on the date such individual joins the board (25,000 shares in the case of a new director who is appointed chairman of the audit committee of our board). These options will become vested as follows: 25% of the option shares become vested upon the completion of 12 months of service and an additional 6.25% of the option shares become vested upon the completion of each quarter of service thereafter. In addition, at each annual meeting of stockholders, each individual who will continue to be a director after such annual meeting will receive an additional option to purchase 3,125 shares of common stock (6,250 shares in the case of a non-employee director who serves as chairman of the audit committee of our board). These options will vest at a rate of 6.25% upon the completion of each quarter of service after the grant date. Each director who received an initial option grant under the automatic option grant program will first be eligible to receive an annual option grant under the automatic option grant program in the calendar year following the year in which he or she received the initial option grant. The exercise price for each option grant will be equal to the fair market value per share of our common stock on the option grant date. Upon a change in control of our company or a termination of the director s service as a result of death, disability or retirement at or after age 65, the options granted under this automatic option grant program become fully vested.

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The following option grants have been made to our non-employee board members as of March 31, 2004: Mr. Jones has received options for 101,787 shares of our common stock at an exercise price of $0.24 per share, options for 2,500 shares of our common stock at an exercise price of $5.00 per share and options for 626 shares of our common stock at an exercise price of $8.00 per share; Mr. LaVigna has received options for 14,500 shares of our common stock at an exercise price of $5.00 per share, and options for 313 shares of our common stock at an exercise price of $8.00 per share; Mr. Maples, Sr. has received options for 33,929 shares of our common stock at an exercise price of $0.24 per share, options for 2,500 shares of our common stock at an exercise price of $5.00 per share, and options for 313 shares of our common stock at an exercise price of $8.00 per share; Mr. Meredith has received options for 26,000 shares of our common stock at an exercise price of $5.00 per share, and options for 626 shares of our common stock at an exercise price of $8.00 per share; and Mr. Sikora has received options for 13,750 shares of our common stock at an exercise price of $26.44 per share, options for 500 shares of our common stock at an exercise price of $5.00 per share, and options for 626 shares of our common stock at an exercise price of $8.00 per share.

Non-employee directors are also eligible to receive options and be issued shares of common stock under our Equity Incentive Plan outside of the automatic option grant program. Directors who are also our employees are eligible to receive options and be issued shares of common stock directly under our Equity Incentive Plan and are also eligible to participate in our Employee Stock Purchase Plan.

Non-employee directors also receive a meeting fee equal to $1,500 for each meeting of either the entire board of directors or a committee thereof that the director attends in person, as opposed to by teleconference. Under the Equity Incentive Plan, each of our non-employee directors has the option at the beginning of each calendar year to choose to waive the meeting fees and instead to be granted an option to purchase 1,500 shares of our common stock for each meeting that the director attends.

We have an arrangement with Mr. Eric Jones pursuant to which we pay him $6,250 each month for executive management consulting services. Mr. Jones consults with our CEO and other executives on matters of strategic importance to our company as well as on other current business issues, all as we may request from time to time. Examples of such consultation include providing input on organizational structure and responsibility, interviewing and screening potential executive hires, and participating in quarterly executive strategy sessions with respect to our product and market direction. Mr. Jones monthly consulting fee is fixed regardless of the amount of services rendered. The agreement will continue until terminated by either party upon 30 days prior notice.

Indemnification and Limitation of Director and Officer Liability

Our certificate of incorporation limits the liability of our directors for monetary damages arising from a breach of their fiduciary duty as directors, except to the extent otherwise required by the Delaware General Corporation Law. This limitation of liability may not apply to liabilities arising under the federal securities laws and does not affect the availability of equitable remedies such as injunctive relief or rescission.

Our certificate of incorporation also provides that we shall indemnify our directors and officers to the fullest extent permitted by Delaware law. We have also entered into indemnification agreements with certain of our directors and executive officers containing provisions that may require us to, among other things:

- indemnify our directors and officers against liabilities that may arise by reason of their status or service as directors or officers to the fullest extent permitted under Delaware law;

- advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified; and

- obtain directors and officers insurance, if available on reasonable terms.

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Executive Compensation

The following table sets forth information with respect to compensation earned during 2003 and 2002 by our chief executive officer and our four other highest-paid executive officers. These individuals are referred to as the named executive officers in this prospectus.

		Annual Compensation		Long-Term Compensation	
Name and Principal Position at December 31, 2003	Year	Salary	Bonus	Number of Securities Underlying Options (#)	All Other Compensation
Scott L. Harmon Chief Executive Officer	2003 2002	$ 269,583 244,973	$	50,000	
R. Logan Wray Chief Operating Officer	2003 2002	240,000 231,250	520,713	162,500(1) 243,750(1)	
Douglas F. McNary Executive Vice President of Corporate Development	2003 2002	250,000 500,000(2)	500,000	200,000	
Kenny Van Zant (3) Executive Vice President of Consumer Business Unit	2003	225,000	1,200,000(4)		
Jeffrey S. Bolke (5) Vice President of Worldwide Sales	2003 2002	225,000 21,346	218,201 18,750	150,000	

(1) Options to purchase 75,000 shares of our common stock were cancelled on September 27, 2002 in connection with a stock option exchange program. On March 31, 2003, Mr. Wray received options to purchase 12,500 shares of our common stock.

(2) Mr. McNary s salary also consisted of $250,000 of sales commissions earned in 2002. For 2002, Mr. McNary was paid the commissions when we determined that he had satisfied his target commission objectives, which were based on a combination of bookings, revenue and management objectives.

(3) Mr. Van Zant became our Executive Vice President of Consumer Business Unit in January 2003 in connection with the BroadJump acquisition.

(4) In connection with the BroadJump acquisition, Mr. Van Zant entered into a Non-Competition and Non-Solicitation Agreement for which he received $1.2 million.

(5) Mr. Bolke became an employee and our Vice President of Worldwide Sales in November 2002.

Stock Options

The following table sets forth each grant of stock options in 2003 to our named executive officers. No stock appreciation rights were granted during such period.

The figures representing percentages of total options granted to employees in the last fiscal year are based on a total of 2,553,624 options granted to our employees during fiscal year 2003. Each of the options listed in the table is immediately exercisable. The shares purchased under the options may be repurchased by us at the original exercise price per share if the optionee ceases service with us before vesting in the shares.

The amounts listed in the following table under the heading Exercise or Base Price were valued by our board of directors on the date of grant. In determining this fair market value, the board of directors took into account the purchase price paid by the investors for shares of our preferred stock (taking into account the liquidation preferences and other rights, privileges and preferences associated with such preferred stock) and an evaluation by the board of directors of our revenue, operating history and prospects. The exercise price may be paid in cash, in shares of our common stock valued at fair market value on the exercise date or through a cashless exercise procedure involving a same-day sale of the purchased shares.

The amounts shown in the table as potential realizable value are calculated by:

- multiplying the number of shares of our common stock subject to a given option by the assumed initial public offering price of $12.00 per share;

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- assuming that the aggregate stock value derived from that calculation compounds at the annual 0%, 5% or 10% rates shown in the table for the entire ten-year term of the option; and

- subtracting from that result the total option exercise price.

The 5% and 10% assumed compounded annual rates of stock price appreciation are mandated by rules of the Securities and Exchange Commission and do not represent our estimate or projection of the future price of our common stock. Actual gains, if any, on stock option exercises depend on the future performance of our common stock.

Option/SAR Grants in Last Fiscal Year

	Individual Grants				Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation for Option Term		
Name	Number of Securities Underlying Options/SARs Granted (#)	Percent of Total Options/SARs Granted to Employees in Fiscal Year (%)	Exercise or Base Price ($/share)	Expiration Date	0%	5%	10%
Scott L. Harmon	50,000(1)	2.0%	$ 5.00	3/21/2010	$ 350,000	$ 594,260	$ 919,230
R. Logan Wray	12,500(1)(2)	0.5	5.00	3/31/2010	87,500	148,565	229,808
	150,000(3)	5.9	5.00	11/10/2010	1,050,000	1,782,781	2,757,691
Douglas F. McNary	50,000(1)	2.0	5.00	3/21/2010	350,000	594,260	919,230
	150,000(3)	5.9	5.00	11/10/2010	1,050,000	1,782,781	2,757,691
Kenny Van Zant							
Jeffrey S. Bolke	100,000(1)	3.9	5.00	1/23/2010	700,000	1,188,521	1,838,461
	50,000(3)	2.0	5.00	11/10/2010	350,000	594,260	919,230

(1) These stock options are immediately exercisable. We have the right to repurchase all unvested option shares at the original exercise price if the optionee s service terminates. Vested option shares are those no longer subject to our repurchase right. 20% of these stock options will become vested on the one-year anniversary of the date of grant with the remaining option shares becoming vested in equal quarterly installments over the next subsequent 16 calendar quarters.

(2) On March 31, 2003, Mr. Wray received these options in connection with a stock option exchange program.

(3) These stock options are immediately exercisable. We have the right to repurchase all unvested option shares at the original exercise price if the optionee s service terminates. Vested option shares are those no longer subject to our repurchase right. 25% of these stock options will become vested on the one-year anniversary of the date of grant with the remaining option shares becoming vested in equal quarterly installments over the next subsequent 12 calendar quarters.

Aggregate Option Exercises in 2003 and Option Values at December 31, 2003

The following table sets forth for our named executive officers the number and value of securities underlying unexercised options that are held by such executive officers as of December 31, 2003. No options or stock appreciation rights were exercised by such executive officers in 2003, and no stock appreciation rights were outstanding at the end of that year.

These stock options are immediately exercisable. We have the right to repurchase all unvested option shares at the original exercise price if the optionee s service terminates. The heading Vested refers to shares no longer subject to our right of repurchase; the heading Unvested refers to shares subject to our right of repurchase as of December 31, 2003.

Fiscal Year-End Option Values

	Number of Securities Underlying Unexercised Options at Fiscal Year End (#)		**Value of Unexercised In-the-Money Options at Fiscal Year End ($) (1)**	
Name	**Vested**	**Unvested**	**Vested**	**Unvested**
Scott L. Harmon		50,000	$	$ 350,000
R. Logan Wray	113,591	217,659	1,014,511	1,641,739
Douglas F. McNary	37,500	200,000	204,127	1,400,000
Kenny Van Zant				
Jeffrey S. Bolke	20,000	130,000	140,000	910,000

(1) Based on the assumed offering price of $12.00 per share, less the exercise price payable for such shares.

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Change of Control Arrangements and Employment Agreements

If we experience a change in control, an option or other award granted under our Equity Incentive Plan will become fully exercisable and fully vested if the option or award is not assumed by the surviving corporation or its parent or if the surviving corporation or its parent does not substitute comparable awards for the awards granted under such plans. In addition, under the Equity Incentive Plan, if an award recipient is involuntarily terminated within 12 months following a change in control, then such recipient will receive an additional 12 months of vesting in his or her award.

In January 2003, we entered into a bonus agreement with R. Logan Wray, our Chief Operating Officer. This agreement provides for 12 quarterly cash payments to Mr. Wray (in addition to his salary) each in the amount of $125,000. The agreement will terminate upon the last quarterly payment due to Mr. Wray, or earlier if (1) Mr. Wray voluntarily terminates his employment with us (except as a result of a material reduction by us in his responsibilities or in his compensation and benefits not also imposed on other senior executives) or (2) his employment is terminated due to death or disability.

In November 2001, we entered into a written agreement with Paul M. Baker, our Chief Financial Officer. This agreement provided for an initial annual base salary of $175,000, participation in our stock option program and all eligible employee benefit plans and reimbursement for certain travel expenses. In addition, we will reimburse Mr. Baker for any U.S. income taxes that he may incur on certain expense reimbursements. If we terminate Mr. Baker s employment for any reason, Mr. Baker is entitled to receive a severance package consisting of 12 months salary plus any bonus that he would have received and continued vesting of any stock options issued to Mr. Baker for 12 months and we will repatriate Mr. Baker to the United Kingdom and reimburse his relocation expenses up to $50,000.

In January 2003, we entered into a written employment agreement with Kenny Van Zant, Executive Vice President of our Consumer Business Unit. This employment agreement is for a three-year term expiring January 2006 and provides for an initial annual base salary of $235,000. In addition, he is entitled to participate in employee benefit plans for which other senior executives are generally eligible. Mr. Van Zant is entitled to receive bonuses and such other compensation as we may determine that is commensurate with bonuses and other compensation that we may pay to other senior executives. Under the terms of the employment agreement, Mr. Van Zant may not terminate his employment prior to January 17, 2006 except for reasons described in the agreement, including a material breach of the agreement by us, which would include a material reduction in his duties, job title or responsibilities. Additionally, we may terminate Mr. Van Zant s employment upon death, disability or for cause (as defined in the agreement). If we terminate Mr. Van Zant s employment for any other reason, or if Mr. Van Zant terminates his employment due to a material breach of the agreement by us, then Mr. Van Zant will be entitled to a severance package consisting of 12 months of salary, a pro rata share of any bonus to which he would have otherwise been entitled and 12 months of benefits. Additionally, in connection with the BroadJump acquisition, Mr. Van Zant entered into a Non-Competition and Non-Solicitation Agreement that expires in January 2006, for which he received $1.2 million.

In October 2002, we entered into a written agreement with Jeffrey S. Bolke, our Vice President of Worldwide Sales. This agreement provides for an annual base salary of $225,000, and target annual variable compensation of $225,000 in accordance with our sales commission plan and participation in our stock option program and all eligible employee benefit plans. If, prior to January 31, 2005, we terminate Mr. Bolke s employment in connection with a corporate transaction or for any reason other than for misconduct, then Mr. Bolke is entitled to 12 months of severance and benefits at his then-current base salary.

Employee Stock Plans

Equity Incentive Plan

Our Equity Incentive Plan was adopted by our board of directors on November 21, 2003. We have also obtained stockholder approval of this plan. We have reserved 1.25 million shares of our common stock for issuance under the

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Equity Incentive Plan. Any shares not yet issued under our 1997 Stock Option/Stock Issuance Plan on the date of this offering will also be available to be issued under the Equity Incentive Plan. On January 1 of each year, starting with the year 2005, the number of shares in the reserve will automatically increase by the lesser of: (1) 4% of the total number of shares of common stock that are then outstanding; (2) 1.25 million shares; or (3) a lesser number determined by our board. In general, if options or shares awarded under the Equity Incentive Plan or options awarded under the 1997 Stock Option/Stock Issuance Plan are forfeited, then those options or shares will again become available for awards under the Equity Incentive Plan. No options have yet been granted under the Equity Incentive Plan.

Under the Equity Incentive Plan, the eligible individuals are:

- employees;
- non-employee members of our board of directors; and
- consultants.

The types of awards that may be made under the Equity Incentive Plan are:

- options to purchase shares of common stock;
- stock appreciation rights;
- restricted shares; and
- stock units.

Options may be incentive stock options that qualify for favorable tax treatment for the optionee under Section 422 of the Internal Revenue Code of 1986, as amended, or nonstatutory stock options not designed to qualify for such favorable tax treatment. The exercise price for incentive stock options granted under the Equity Incentive Plan may not be less than 100% of the fair market value of our common stock on the option grant date.

The compensation committee of our board of directors administers the Equity Incentive Plan. Except with respect to the automatic option grant program for non-employee board members discussed below, the committee has the complete discretion to make all decisions relating to the interpretation and operation of our Equity Incentive Plan. The committee has the discretion to determine which eligible individuals are to receive any award, and to determine the type, number, vesting requirements and other features and conditions of each award.

The exercise price for options granted under the Equity Incentive Plan may be paid by using:

- cash;
- outstanding shares of our common stock; or
- an approved cashless exercise method with a designated broker.

The purchase price for newly issued restricted shares awarded under the Equity Incentive Plan will be stated in each individual restricted share agreement. However, in all cases, the par value for the newly issued restricted shares will be payable in cash.

The purchase price for a stock appreciation right may be paid by using cash or outstanding shares of common stock.

The committee may reprice options and may modify, extend or assume outstanding options and stock appreciation rights. The committee may accept the cancellation of outstanding options or stock appreciation rights in return for the grant of new options or stock appreciation rights. The new option or right may have the same or a different number of shares and the same or a different exercise price.

The maximum number of option shares that a person may receive in a fiscal year is five million.

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If we experience a change in control, an option or other award under the Equity Incentive Plan will become fully exercisable and fully vested if the option or award is not assumed by the surviving corporation or its parent or if the surviving corporation or its parent does not substitute comparable awards for the awards granted under the Equity Incentive Plan.

A change in control includes:

- a merger or consolidation involving our company after which our then current stockholders own less than 50% of the surviving corporation;
- sale of all or substantially all of our assets;
- a proxy contest that results in replacement of more than one-half of our directors over a 24-month period; or
- an acquisition of 50% or more of our outstanding stock by a person other than a person related to us, such as a corporation owned by our stockholders.

Non-employee board members are eligible for option grants under the automatic option grant program for non-employee board members under our Equity Incentive Plan. Under our Equity Incentive Plan, each non-employee director who first becomes a non-employee board member after the date of this offering will be granted an option to purchase 12,500 shares of our common stock on the date such individual joins the board (25,000 shares in the case of a new director who is appointed chairman of the audit committee of our board). These options will become vested as follows: 25% of the option shares become vested upon the completion of 12 months of service and an additional 6.25% of the option shares become vested upon the completion of each quarter of service thereafter. In addition, at each annual meeting of stockholders, each individual who will continue to be a director after such annual meeting will receive an additional option to purchase 3,125 shares of common stock (6,250 shares in the case of a director who serves as chairman of the audit committee of our board). These options will vest at a rate of 6.25% upon the completion of each quarter of service after the grant date. Each director who received an initial option grant under the automatic option grant program will first be eligible to receive an annual option grant under the automatic option grant program in the calendar year following the year in which he or she received the initial option grant. The exercise price for each option grant will be equal to the fair market value per share of our common stock on the option grant date. Upon a change in control of our company or a termination of the director s service as a result of death, disability or retirement at or after age 65, the options granted under this automatic option grant program become fully vested.

Our board may amend or terminate the Equity Incentive Plan at any time. If our board amends the plan, stockholder approval of the amendment will be sought only if required by applicable law. The Equity Incentive Plan will continue in effect for a 10-year term unless the board decides to terminate the plan earlier.

Employee Stock Purchase Plan

Our board of directors adopted our Employee Stock Purchase Plan on November 21, 2003. We have also obtained stockholder approval of this plan. We have reserved 750,000 shares of our common stock for issuance under our Employee Stock Purchase Plan. As of January 1 each year, starting in 2005, the number of shares reserved for issuance under our Employee Stock Purchase Plan will be increased automatically by the lesser of: (1) 2% of the total number of shares of common stock then outstanding; (2) 500,000 shares; or (3) a lesser amount determined by our board. Our Employee Stock Purchase Plan is intended to qualify under Section 423 of the Internal Revenue Code.

Eligible employees may begin participating in the Employee Stock Purchase Plan at the start of an offering period. Each offering period will last six months. Offering periods will start on February 1 and August 1 of each calendar year. However, the first offering period will start on the effective date of this offering and end on July 31, 2004. Purchases of our common stock will occur on the last day of each offering period, approximately every January 31 and July 31.

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Our Employee Stock Purchase Plan will be administered by the compensation committee of our board of directors. Each of our employees is eligible to participate if he or she is employed by us for more than 20 hours per week for more than five months per year.

Our Employee Stock Purchase Plan permits each eligible employee to purchase common stock through payroll deductions. Each employee s payroll deductions may not exceed 15% of the employee s cash compensation. The initial period during which payroll deductions may be contributed will begin on the effective date of this offering and end on July 31, 2004.

The price of each share of common stock purchased under our Employee Stock Purchase Plan will be 85% of the lower of:

(A) the fair market value per share of common stock on the first day of the applicable offering period or

(B) the fair market value per share of common stock on the last day of the applicable offering period.

In the case of the first offering period, the price per share under the plan will be 85% of the lower of:

(A) the price offered to the public in this offering or

(B) the fair market value per share of common stock on July 31, 2004.