

SABA SOFTWARE INC
Form 10-K
August 12, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED MAY 31, 2009

or

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

For the Transition Period from _____ to _____.

Commission file number: 001-34372

SABA SOFTWARE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of

Incorporation or Organization)

2400 Bridge Parkway

Redwood Shores, California

(Address of Principal Executive Offices)

94-3267638

(I.R.S. Employer Identification Number)

94065-1166

(Zip Code)

(650) 581-2500

(Registrant's Telephone Number, including area code)

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Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.001 per share

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-Accelerated filer

Smaller reporting company

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of November 28, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$28,502,000 (based on a closing sale price of \$1.20 per share as reported for the Nasdaq Global Market). Shares of common stock beneficially held by each executive officer and director and by each person who beneficially owns 5% or more of the outstanding common stock have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the registrant's common stock, \$0.001 par value per share, outstanding as of July 31, 2009 was 29,232,000.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on November 18, 2009 are incorporated by reference in Part III of this Form 10-K to the extent stated herein. Except as expressly incorporated by reference, the registrant's Proxy Statement shall not be deemed to be a part of this Form 10-K.

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SABA SOFTWARE, INC.

FISCAL YEAR 2009

FORM 10-K

ANNUAL REPORT

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PART I

FORWARD-LOOKING INFORMATION

For purposes of this Annual Report, the terms Saba , the Company , we , us and our refer to Saba Software, Inc. and its consolidated subsidiaries (unless the context indicates otherwise). This Annual Report on Form 10-K and certain information incorporated herein by reference contain forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements contained in this Annual Report on Form 10-K other than statements of historical fact are forward-looking statements for purposes of these provisions, including any statements of plans and objectives for future operations and any statement of assumptions underlying any of the foregoing. Statements that include the use of terminology such as may, will, expects, believes, plans, estimates, potential, or continue, or the use thereof or other comparable terminology are forward-looking statements. Forward-looking statements include:

(i) in Item 1, statements regarding competition, our belief that we offer the most comprehensive and flexible Human Capital Management platform, our belief that we are the leader in our market space, and registration of trademarks;

(ii) in Item 1A, statements regarding our expectation that we will derive substantially all of our revenues for the foreseeable future from the Saba Enterprise suite and the Saba Centra product suite, the incurrence of non-cash expenses relating to the amortization of purchased intangible assets, our expectations to incur losses in the future, our belief that quarter-to-quarter comparisons of our revenues and operating results are not necessarily meaningful and should not be relied upon as indicators of future performance, expanding our international presence, periodically acquiring complementary businesses or technologies, regularly releasing new products, and issuance of a reexamination certificate canceling certain patent claims;

(iii) in Item 2, statements regarding the adequacy of our existing facilities to meet anticipated needs for the foreseeable future;

(iv) in Item 3, statements regarding the financial impact of any proposed settlements, our intention to dispute claims against us, and the merits of claims against us;

(v) in Item 5, statements regarding our intention to retain our future earnings;

(vi) in Item 7, statements regarding the benefits of the acquisition of Centra, our expectation that the Saba Enterprise Suite and Saba Centra product suite will generate substantially all of our revenues in the foreseeable future, our belief that the revenue generated from OnDemand will continue to grow, our anticipation that a substantial majority of our customers will renew their contracts on expiration and that we will continue to add new OnDemand customers, our expectation that license updates and product support revenue will continue to grow, our belief that we will not use certain technology in future offerings, the effects of our restructuring efforts, our anticipation that we will continue to experience long sales cycles, the table summarizing our contractual obligations at May 31, 2009, the sufficiency of our available cash resources, credit facility and cash flows generated from revenues over the next twelve months, the adequacy of tax provisions related to the examination of certain of our tax returns, our estimate of future forfeiture rates in stock-based compensation and our anticipation to not pay dividends in the foreseeable future;

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(vii) in Item 7A, statements regarding the effects of future changes in interest rates and foreign currency rates; and

(viii) in Item 8, statements regarding our anticipation that revenues from Saba Enterprise Suite and Saba Centra product suite will constitute substantially all of our revenues for the foreseeable future, our management's belief that financial risks associated with cash, cash equivalents and accounts receivable are minimal, the financial impact of a proposed settlement, the merits of our litigation, statements regarding total expected future amortization related to intangible assets, our estimate of future forfeiture rates in our

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stock-based compensation plans, the anticipated adjustments to total unrecognized stock-based compensation, and the adequacy of tax provisions related to the examination of certain of our tax returns.

These forward-looking statements involve known and unknown risks and uncertainties. Our actual results may differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are incorrect estimates or assumptions, unanticipated adverse results for pending litigation, contraction of the economy and world markets, lack of demand for information technologies from our customers, unanticipated need for capital for operations, lack of demand for our products, inability to introduce new products, unanticipated difficulties relating to the Human Capital Management software suite, unanticipated decrease in demand for our OnDemand product, unanticipated changes in domestic and foreign tax regulations and the factors detailed under the heading Risk Factors in Item 1A of this Annual Report on Form 10-K. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement or risk factor.

ITEM 1: BUSINESS

Overview

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

By using our solutions to manage their extended workforce, which can include employees, customers and partners, our customers achieve demonstrably higher levels of performance through:

Increased productivity, sales and service effectiveness;

Reduced personnel development and training costs; and

Improved organizational agility and execution.

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

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We were incorporated in Delaware in April 1997. Our headquarters are located at 2400 Bridge Parkway, Redwood Shores, California 94065, and our telephone number is +1 (650) 581-2500. Our Internet address is www.saba.com. On the Investor Relations page of our web site we post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission: our Annual Report on Form 10-K; our Quarterly Reports on Form 10-Q; our Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act). The filings on our Investor Relations web page are available to be viewed free of charge. Information contained on our web site is not part of this Annual Report on Form 10-K or our other filings with the Securities and Exchange Commission. We assume no obligation to update or revise any forward-looking statements in this Annual Report on Form 10-K, whether as a

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result of new information, future events or otherwise, unless we are required to do so by law. A copy of this Annual Report on Form 10-K is available without charge upon written request to: Investor Relations, Saba Software, Inc., 2400 Bridge Parkway, Redwood Shores, California 94065.

Products and Services

We offer the Saba® Enterprise Suite, the Saba® Centra product suite and a range of professional, education and customer support services. Our solutions are available to customers through our OnDemand service offering or through our on-premise software product license.

Saba Enterprise Suite

The Saba Enterprise Suite consists of:

Saba Learning Suite. A comprehensive enterprise learning and learning content management solution that gives organizations and their people the tools they need to develop skills and competencies and improve productivity;

Saba Performance Suite. Enables organizations to continuously align people's daily activities with key organizational goals and establish a relevant performance review process that clarifies expectations and improves accountability;

Saba Talent Suite. Enables organizations to proactively plan for successions as well as identifying, developing, tracking and managing future leaders;

Saba Foundation. Delivers a unified profile that offers a common view of employee skills, interests, and experience, providing greater visibility into the impact of Human Capital Management (HCM) initiatives and business results, as well as how well people are aligned to the goals of the organization;

Saba Collaboration. Facilitates enabled learning and knowledge transfer between individuals and subject matter experts in informal settings or in conjunction with learning events and allows the organization to build and manage communities of practice, create repositories of institutional knowledge and leverage the collective intelligence of the workforce to make people management more effective. Saba Collaboration includes tools such as chat rooms, threaded discussions, wikis and document sharing, and is integrated with Saba Centra to allow creation of knowledge assets based on web conference sessions that build the organization's knowledge base over time.

Languages. The Saba Enterprise Suite is available in the following languages: American English, Brazilian Portuguese, British/International English, Canadian French, Continental French, Continental Spanish, Danish, Dutch, Estonian, German, Greek, Hungarian, Indonesian (Bahasan), Italian, Japanese, Korean, Latvian, Lithuanian, Mexican Spanish, Norwegian, Polish, Russian, Simplified Chinese, Swedish, Turkish

and Traditional Chinese.

Saba Learning Suite

The Saba Learning Suite is a family of products designed to deliver configurable, targeted functionality in a single solution that addresses five key enterprise learning areas:

Regulatory Compliance. Allows a regulated organization to track required certifications and qualification programs and effectively respond to compliance audits;

Sales and Channel Readiness. Enables sales organizations to rapidly gain the skills and knowledge required to build a sales pipeline and win business for new offerings;

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Channel Certification. Manages certification of channel partners to drive consistent representation of an organization's products and brands and deliver a higher quality customer experience;

Customer Education. Supports an organization's ability to generate revenue and increase customer loyalty through the sale and distribution of training; and

Corporate Universities. Provides the ability to develop employees' skills and competencies to effectively execute organizational objectives and gain competitive advantage.

By implementing multiple enterprise learning solutions in a single system, organizations can lower the overall cost of supporting enterprise-wide learning processes, leverage internally-created content and subject-matter experts in multiple areas and create a common pool of knowledge for and about people. This unified solution also offers the flexibility to change processes and develop new opportunities from a common foundation, while creating the visibility needed to operate as an integrated virtual enterprise.

The Saba Learning Suite combines enterprise learning with collaboration for formal and informal learning, synchronous learning, analytics and content creation and management. It also provides support for blended learning and is available in 26 languages for global deployment. The Saba Learning Suite is also integrated with Saba Centra for virtual classroom and informal learning. The Saba Learning Suite includes the following applications:

Saba Learning. Enables global organizations to deliver and manage critical knowledge and skills to improve productivity and achieve business results; supports certifications with multiple learning pathways, and provides flexible audit trails and supports e-signatures to meet a wide variety of stringent regulatory requirements;

Saba Learning Commerce. Provides support for optimized pricing, discounting schemes, marketing campaigns, branded certification programs, bundled training units and a variety of convenient payment methods for education businesses;

Saba Content Management. Helps global organizations capture, consolidate, organize, manage, share and reuse all types of learning content through a learning object repository and automated content and project-management processes;

Saba Publisher. Allows users to create new courses, or repurpose courses, and publish them in HTML or standard learning formats, such as AICC or SCORM, quickly and efficiently; and

Saba Knowledge Center. Delivers Web 2.0 collaboration, recommendation and power search features that take informal learning to the next level by enabling organizations to broadly capture and access institutional knowledge.

Saba Performance Suite

Saba Performance Suite helps improve organizational performance by aligning the workforce around the organization's most important business objectives. Saba Performance Suite provides real-time visibility into an organization's progress against goals, allowing leaders to make ongoing adjustments and respond to changing requirements. With Saba Performance Suite, companies and government agencies of all sizes can automate all the processes associated with managing performance across the extended enterprise of employees, customers, partners and suppliers. These processes include:

Goal and objective management. Enables creation, distribution and management of goals and objectives throughout the extended enterprise;

Goal alignment. Provides line-of-sight visibility to ensure that individual and team goals are aligned to the organization's goals and that the organization is executing against its most important objectives;

Initiative management. Enables management and tracking of goals in support of a cross-functional initiative;

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Performance reviews. Provides highly flexible, multi-level review and assessment functionality; and

Performance planning. Enables creation of performance plans that combine performance goals, career development goals and recommended learning.

Saba Talent Suite

Saba Talent Suite is a solution that provides the ability to track and manage processes that relate to the development of talent across the organization. The Saba Talent Suite enables organizations to create succession plans for key positions, as well as develop key talent for the demands of future positions. Candidates identified as potential successors to key roles are not just assessed and ranked, but are provided with guidance to prepare them for the position, enabling organizations to develop the skilled individuals they need to be successful. In addition, Saba Talent Suite provides organizations with the following capabilities:

Talent Profiles. Creates and manages detailed talent profiles of people in the organization. These profiles are based on data in HR Information Systems, can be supplemented by employees and managers, and are enhanced automatically as employees complete learning and performance plans;

Talent Pools. Assesses bench strength for key positions and/or targeted career development opportunities. Fit to pool criteria is automatically assessed, allowing dynamic tracking of readiness of pool candidates;

Extensible 9-Box Analysis. Graphically views key metrics on selected talent in order to devise the most appropriate development strategies;

Career Development. Develops top performers for future responsibilities and assign goals and competencies to pool candidates, as well as allow employees to self-manage careers by designating career goals and understanding required competencies to be eligible for the desired positions and determine learning plans to fill competency gaps;

Organization Chart View. Views competency, performance and potential metrics from an organization chart viewpoint to understand key strengths and weaknesses across the enterprise; and

Workforce Planning. Moves beyond general headcount-based planning and model the future based on unique employee attributes and position requirements to understand future gaps and plan talent development and acquisition strategies; and

Internal Recruiting. Enhances talent pipelines and employee engagement by enabling active participation in talent development opportunities. Managers can also search for external candidates and include them as part of a succession pool to advance talent development.

Saba Centra

Saba Centra enables online virtual learning, training and meetings. Organizations can share knowledge and exchange information with customers, partners, prospects and employees around the world in real-time. Centra helps organizations increase productivity and efficiency by

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helping to incorporate learning and knowledge transfer into business processes. Saba Centra works with the Windows, Apple Macintosh and Linux platforms and accelerates mission-critical initiatives that involve learning, training and general web conferencing.

Saba Centra for Virtual Classes. Enables employees to engage with groups in live, interactive education sessions across many locations;

Saba Centra Virtual Classes for Universities and Schools. Brings instructors and students together online in interactive, online classes and degree programs to help provide the interaction of a typical classroom;

Saba Centra for Web Seminars. Equips the organization with an efficient and cost-effective way to reach and engage large audiences quickly; and

Saba Centra for eMeetings. Helps eliminate the difficulties of complex meeting coordination and the time and expense of business travel

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Saba Centra is integrated with Saba Learning to provide seamless, on-demand access to blended learning programs, knowledge assets and important documents. Tight integration of the Saba Knowledge Base makes it easy for organizations to capture knowledge from subject matter experts and share that information with a single click. Powerful, unified search enables users to search across all formal and informal learning content.

Saba Services

We offer comprehensive services to assist in the successful implementation of our products. As of May 31, 2009, we employed approximately 159 people worldwide in services-related activities.

Our global services organization supports multiple offerings, including:

Professional Services.

Strategic Services. Saba Strategic Services are designed to enable organizations to effectively link human capital management to business strategies. Offerings include developing new human capital management strategies, change management and governance, developing and deploying competency models, measurement and evaluation strategies, as well as content integration and deployment;

Consulting services. Our consulting services include definition of business objectives, design of phased plans for achieving these objectives, technical solution specifications, establishment of implementation timelines and resource requirements, installation of Saba solutions, systems configuration, data loading, custom report and notification design, website development, enterprise system integration and post-implementation assessment; and

Education services. We provide a broad range of education offerings in a variety of formats, including instructor-led training and web and technology-based training. Course curricula, designed to enable customers to fully exploit the value of Saba solutions, include product training, project team training and technology training.

Saba Hosting services, which include security administration and backup and recovery services.

License Updates and Product Support Services. Our License Updates and Product Support services are designed to ensure that our customers have the latest technology available to them and to assist them in ensuring on-going success with our products. We provide a range of product support options, allowing customers to utilize their own resources to the degree desired and leverage their existing investments in customer support or to count on Saba to provide the support services needed. Options include enterprise support, an end-user help desk and on-site support.

Our Customers

Our customers include a wide spectrum of large, global enterprises and small- to mid-size organizations in the automotive, communications, computer software and hardware, electronics, consumer package goods, energy, financial services, health care, manufacturing, medical

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equipment, pharmaceutical, professional services, retail and transportation industries, as well as government and other public sector organizations. Based on total revenues, our customers are also leaders in their regions, representing two of the largest five companies in Europe, three of the largest companies in Germany and the largest company in Brazil. In the public sector, our customers include several branches of the U.S. Government, and state and local government agencies. In fiscal years 2009, 2008 and 2007, no customer accounted for more than 10 percent of total revenues.

Alliances

As of May 31, 2009, we had strategic alliance agreements with a number of global and regional software resellers as well as consulting firms who act as systems integrators and implementation partners for our solutions.

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These alliances and the associated training of qualified personnel in these organizations greatly increase the number of sales representatives and consulting professionals trained to implement our solutions.

We have also entered into several alliance agreements with packaged content providers, custom content developers and content authoring and learning delivery tool providers in order to increase the range of content offerings available to our customers. The Saba Content Alliance Program helps our content partners create and deliver learning content for use in conjunction with Saba solutions through support of industry standards applicable to a broad variety of media formats, including web-based training, computer-based training, video and asynchronous and synchronous delivery, as well as through support of traditional forms of learning such as instructor-led classes, seminars and workshops. In support of this program, we also operate a content developers resource center and testing lab that provides our content partners with direct access to our systems for standards compliance testing.

Sales and Marketing

We license our products and sell our OnDemand services to organizations through a worldwide direct sales force and global network of alliance partners. Our direct sales efforts target large enterprises, including Global 2000 businesses, mid-size organizations and government entities. As of May 31, 2009, we had 81 sales and marketing professionals. Our channel sales efforts involve value-added resellers around the globe, as well as systems-integrator relationships.

We focus our marketing efforts on extending our market leadership, establishing market positioning, generating sales leads, supporting sales efforts, creating awareness of our solutions in the market and establishing strong brand awareness. Our marketing activities include public relations, analyst relations, direct marketing, industry trade shows, online marketing, seminar programs, and customer community building.

Technology

Product Architecture

Our proven product architecture coupled with our development processes facilitates the rapid development, deployment and configuration of enterprise scale solutions for People Management. Our platforms use the latest industry standards and technologies including AJAX, XML, SOAP, Java, Enterprise Java Beans, web services and learning industry standards to deliver innovative, configurable features for our on-premise and SaaS customers.

We continue to provide a fully J2EE-compliant application platform. This helps accelerate application development by leveraging the transaction management, persistence management and resource pooling capabilities of standard J2EE-compliant application servers so application developers can focus on building business logic and user interfaces. Key features of the Saba platform include:

Open and Standards Based. The core Saba architecture is based on a current reference J2EE implementation. We leverage third-party, industry-leading and standards-based platforms wherever possible. We typically support more than one deployment platform to offer

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our customers the maximum choice for their deployments. For example we currently support a number of J2EE application servers including JBoss, Websphere and Weblogic and a variety of database platforms including Oracle, IBM DB2 and Microsoft SQL Server. Our architecture supports both on-premise and OnDemand deployments allowing us to provide the broadest possible choice to our customers.

Security. Saba solutions offer highly secure environments through which organizations manage their people management processes. A granular security model supports the highly complex business structures and processes used by our customers and can be easily configured to meet their needs. Our security implementation has been subject to rigorous validation by a number of customers and third parties.

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Scalability. Saba offers a highly scalable solution able to meet the needs of many thousands of concurrent users both on-premise and OnDemand. Scalability is accomplished through a variety of techniques including clustering, distributed caching, session failover management and off-line processing for asynchronous processes. We maintain a dedicated performance lab which works with our internal development teams and with our customers to ensure that our solutions meet the complex and varying usage demands that are placed on them.

Configurability and Extensibility. The Saba platform offers a highly configurable application environment. Business processes, system features and user experiences can be easily configured to meet the needs of our diverse customer base. Where more complex requirements exist, the Saba solution also provides a complete set of development tools and Application Programming Interface (API) which can be used to extend system functionality.

Integration Ready. Saba solutions are deployed in complex IT ecosystems where integrations with other systems are commonly required. We provide for such integrations by delivering open and standards based solutions, based on common technologies such as J2EE, XML, SOAP and JAAS. In addition we provide a series of documented Web Services and APIs to facilitate tight data and application integration.

Compelling User Experiences. The Saba solution provides a variety of user experiences through standard web browsers via embedded portlets, online and offline clients and through integrations with other business applications such as Microsoft Outlook, Lotus Notes and SAP Enterprise Portal. This allows users to use Saba where they work. We make extensive use of rich internet application technologies (such as AJAX) to deliver more engaging and intuitive user experiences.

Learning Standards. We continue to be active participants in the main learning standards bodies including ADL, IMS and AICC. We also continue to ensure our solutions are compliant with the most current versions of the standards delivered by these organizations.

Multiple language support. Saba's platform is fully internationalized and is, therefore, independent of any particular language, script, culture, and coded character set. We currently provide a number of localized versions of our solutions and support over 26 languages.

Research and Development

Our research and development operations are organized around software platform and applications development initiatives. These two development activities share resources and collaborate on design and development. Core teams are responsible for platform and infrastructure development, application development, user interface and application design, enterprise connectivity, internet applications and design, quality assurance, documentation and release management. As of May 31, 2009, we had 164 research and development employees in the United States and India. We incurred \$17.4 million, \$16.5 million and \$17.1 million in research and development expenses during the years ended May 31, 2009, 2008 and 2007, respectively.

We adhere to a well defined and managed Software Development Lifecycle Model. This model, which makes increasing use of agile development practices, defines how we envision, plan, develop and test our products. It further defines the detailed phases of the project, the specific milestones to be achieved and the policies to be followed and documented. We continue to make extensive investments in the development tools and processes to support our development model.

We conduct our development efforts at multiple sites in the United States and India, which enables continuous development 24 hours per day.

Competition

The market for our products and services is intensely competitive, dynamic and subject to rapid change. The intensity of competition and the pace of change are expected to increase in the future. Competitors vary in size

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and in the scope and breadth of the products and services they offer. Although we believe that we offer the most comprehensive and flexible Human Capital Management suite, we encounter competition with respect to different aspects of our solutions from a variety of sources including:

Companies that offer human capital management solutions that provide one or more applications within the HCM market, such as learning management, performance management, talent management, competition and recruiting, including SumTotal and Success Factors;

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

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

Potential customers' internal development efforts; and

Companies that operate internet-based marketplaces for the sale of online learning.

We expect additional competition from other established and emerging companies as the market for human capital management solutions continues to evolve. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business.

We believe the principal competitive features affecting our market include:

Breadth and depth of the solution;

A significant installed base of Global 2000 and government customers;

The ability to support all forms of content offerings;

The ability to meet the requirements of the world's largest organizations, including support for global deployments;

The ability to support a broad range of extended-enterprise users, including employees, partners, customers and suppliers;

The ability to offer a choice of deployment options;

Product quality and performance;

Product features and functions;

Customer service and support;

Ease of implementation;

Core technology;

Price to performance ratio; and

Partner ecosystem.

Although we believe that we are a leader in our market space and that our solutions currently compete favorably with respect to these factors, our market is relatively new and is changing rapidly. We may not be able to maintain our competitive position against current and potential competitors, especially those with significantly greater financial, technical, service, support, marketing and other resources.

Proprietary Rights

Proprietary rights are important to our success and our competitive position. To protect our proprietary rights, we rely on copyright, trademark, patent and trade secret laws, confidentiality procedures and contractual provisions.

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We license and provide OnDemand services rather than sell our software license products and require our customers to enter into written agreements, which impose restrictions on the use, copying and disclosure of our software. In addition, we seek to avoid disclosure of our trade secrets through a number of means, including but not limited to, requiring those persons with access to our proprietary information to execute confidentiality agreements with us. These contractual provisions, however, may be unenforceable under the laws of some jurisdictions and foreign countries.

We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection. In addition, we have seven patents issued in the United States and seven patent applications pending in the United States. We cannot be assured that any patents will be issued for any of the pending patent applications. Even for the issued patents, or any patent issued to us in the future, there can be no assurance that such patents (i) will protect our intellectual property, or (ii) will not be challenged by third parties. Furthermore, other parties may independently develop similar or competing technologies or design around any patents that may be issued to us. It is possible that any patent issued to us may not provide any competitive advantages, that we may not develop future proprietary products or technologies that are patentable, and that the patents of others may seriously limit our ability to do business. In this regard, we have not performed any comprehensive analysis of patents of others that may limit our ability to conduct our business.

We have obtained registration of various trademarks, including Saba and the Saba S-design logo, in the United States and in certain other countries. In addition, we have registration applications pending in various countries. We will continue to register additional trademarks as appropriate. There can be no assurance that we will be successful in obtaining registration of the trademarks for which we have applied. Even for any registered trademarks that we have obtained, or will obtain, the trademarks may be successfully challenged by others or invalidated. If the applications are not approved because third parties own the trademarks, or if our registered trademarks are successfully challenged or invalidated, the use of the trademarks will be restricted unless we enter into arrangements with third parties that may be unavailable on commercially reasonable terms.

We cannot assure you that any of our proprietary rights with respect to our products or services will be viable or of value in the future since the validity, enforceability and type of protection of proprietary rights in Internet-related industries are uncertain and still evolving.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult, and while we are unable to determine the extent to which piracy of our software products exists, software piracy can be expected to be a persistent problem. In addition, the laws of some foreign countries do not protect proprietary rights to as great an extent as do the laws of the United States, and effective copyright, trademark and trade secret protection may not be available in those jurisdictions. Our means of protecting our proprietary rights may not be adequate to protect us from the infringement or misappropriation of such rights by others.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights, particularly in the software and Internet-related industries. On August 19, 2003, EdiSync Systems, LLC filed a complaint against Centra in federal court in Denver, Colorado, alleging infringement of two patents for a remote multiple user editing system and method and seeking to enjoin us from continuing to sell our products, as well as unspecified compensatory damages. Centra filed an answer to the complaint denying all of the allegations, and instituted reexamination proceedings for the patents at issue with the U.S. Patent and Trademark Office (the Patent Office). The case was stayed by the Colorado district court pending the outcome of the reexamination proceedings. A reexamination certificate was issued for one of the patents that cancelled all of the patent's claims, thus rendering it of no further force or effect. The Patent Office has issued a Notice of Intent to Issue a Reexamination Certificate for the other patent which indicated that all of the patent's original claims will be cancelled and specified that a set of newly-added claims has been determined to be patentable. In view of that development, the Colorado district court lifted the stay of the case on February 13, 2009. On March 16, 2009, EdiSync's patent attorney submitted a petition to the Patent Office requesting that the

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reexamination proceeding be reopened to allow the examiner to assess the patentability of the claims over a newly-submitted prior art reference. If the petition is granted, the Patent Office could issue another office action rejecting the newly-presented claims over the reference. If the petition is denied, we expect that a reexamination certificate will issue that will cancel all of the patent's original claims and indicate that only the newly-added claims are patentable. If that happens, we expect we will be free from liability for past actions, as the newly-added claims would be enforceable only prospectively as of the issue date of the anticipated reexamination certificate. We believe that we have meritorious defenses and intend to vigorously defend this action. However, due to the inherent uncertainties of litigation, we can give no assurance that we will be able to achieve a satisfactory outcome. We could become subject to additional intellectual property infringement claims as the number of our competitors grows and our products and services overlap with competitive offerings. Any of these claims, even if not meritorious, could be expensive to defend and could divert management's attention from operating our company. If we become liable to third parties for infringing their intellectual property rights, we could be required to pay a substantial award of damages and to develop non-infringing technology, obtain a license or cease selling the products that contain the infringing intellectual property. We may be unable to develop non-infringing technology or obtain a license on commercially reasonable terms, if at all.

Employees

As of May 31, 2009, we had a total of 554 employees, including 164 in research and development, 81 in sales and marketing, 159 in services-related activities, 79 in operations and 71 in administration and finance. Of these employees, 287 were located in North America and 267 were located outside of North America. None of our employees is represented by a collective bargaining agreement, and we have not experienced any work stoppages. We consider our relations with our employees to be good. Our future success depends on our continuing ability to attract and retain highly qualified technical, sales and senior management personnel.

Executive Officers of the Registrant

Our executive officers are listed below.

Name	Office(s)
Bobby Yazdani	Chairman and Chief Executive Officer
William Slater	Chief Financial Officer
Peter E. Williams III	Executive Vice President, Corporate Development and Secretary
Jeff Carr	President, Global Fields Operations

Bobby Yazdani, 46, founded Saba, has been a Director of Saba since our inception in April 1997 and has served as Saba's Chairman of the Board and Chief Executive Officer since September 2003. From February 2003 through September 2003, Mr. Yazdani served as Saba's President and Chief Operating Officer. From April 1997 until February 2003, Mr. Yazdani served as Saba's Chairman of the Board and from April 1997 until March 2002, Mr. Yazdani served as Chief Executive Officer. From 1988 until founding Saba, Mr. Yazdani served in various positions at Oracle, most recently as Senior Director. Mr. Yazdani holds a B.A. from the University of California, Berkeley.

William Slater, 57, has served as our Chief Financial Officer since December 2008. From August 2000 to September 2008, Mr. Slater served as Executive Vice President and Chief Financial Officer at Symmetricom, a provider of precise time and frequency technology. From August 1991 to November 1999, Mr. Slater served as Executive Vice President and Chief Financial Officer at Computer Curriculum Corporation, an educational publisher and division of Viacom. Mr. Slater has also served as Vice President, Financial Planning, at Simon & Schuster and Vice President and Controller, Professional Products Group, for Revlon. Mr. Slater holds a BA from Queens College, City University of New York.

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Peter E. Williams III, 48, has served as our Executive Vice President, Corporate Development since July 2007 and has served as our Secretary since our inception in April 1997. Mr. Williams served as our Chief Financial Officer from March 2004 to July 2007, and our Vice President, Corporate Development and General Counsel from October 1999 through March 2004. Mr. Williams was a partner at Morrison & Forester LLP, an international law firm, from January 1995 until March 2000. Mr. Williams holds B.A. degrees from the University of California, Los Angeles and a J.D. from Santa Clara University.

Jeff Carr, 50, has served as our President, Global Field Operations since April 2009. From 2004 to 2008, Mr. Carr served as an Executive Vice President and Corporate Officer at Taleo Corporation, a provider of on-demand talent management solutions. From 2001 to 2003, Mr. Carr served as Chief Executive Officer of Motiva Inc., a leader in the enterprise incentive management and compensation software industry. From 2000 to 2001, Mr. Carr served as President and COO of RightWorks Corporation, a leading provider of eProcurement and B2B enterprise business applications. From 1991 to 2000, Mr. Carr worked at PeopleSoft, Inc., a global enterprise software company, in a number of sales and general management roles, including Division President and Executive Vice President. From 1984 to 1990, Mr. Carr worked at Integral Systems, a leading provider of Human Resource Management and Financial enterprise application software, in sales and account management positions. Mr. Carr holds a BA from Miami University (Ohio) and studied in the MBA program at Xavier University (Ohio).

ITEM 1A: RISK FACTORS

The effects of the recent global economic crisis may impact our business, operating results or financial condition.

The recent global economic crisis has caused a tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, public sector deficits and extreme volatility in credit, equity and fixed income markets, which have contributed to diminished expectations for the global economy. In addition, the U.S. economy and other economies around the world have entered into a recessionary environment characterized by slow or negative economic growth. We believe that these macroeconomic factors may influence our customers purchasing decisions, particularly in some customer segments. We believe that we have experienced some slowing of demand for our products and services as a result of these economic factors, and that this economic climate may continue to adversely affect demand for our products and services for future periods.

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

Our operating results have varied significantly in the past and will likely fluctuate significantly in the future. For instance, in fiscal years 2009, 2008 and 2007, our quarterly revenues have fluctuated between approximately \$28.2 million and \$23.2 million and our quarterly results have fluctuated between net income of approximately \$1.3 million and a net loss of approximately \$3.1 million. Our quarterly operating results are particularly affected by the number of customers licensing our products during any quarter and the size of such licensing transactions. We have limited visibility into our future revenue, especially license revenue, which often has been heavily concentrated in the third month of each quarter. As a result, if we were to fail to close a sufficient number of transactions by the end of our quarter, particularly large license transactions, we would miss our revenue projections. In addition, our operating expenses are based in part on future revenue projections and are relatively fixed in the short-term. If we cannot meet our revenue projections, our business will be seriously harmed and net losses in a given quarter will be even larger than expected.

Other factors that could affect our quarterly operating results include:

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

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

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

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

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

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

Fluctuations in foreign currency exchange rates.

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

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

We expect to continue to derive substantially all of our revenues for the foreseeable future from sales of licenses and OnDemand services for the Saba Enterprise Suite and the Saba Centra product suite and providing related services, including license updates and product support, implementation, training and consulting services. Except for two previous quarters, we have not been profitable on a quarterly or annual basis in the past. We cannot be certain that we will realize sufficient revenues to achieve or sustain profitability on a quarterly or annual basis, especially if our recurring OnDemand business grows faster than expected relative to license sales. In addition, in the future, we expect to continue to incur non-cash expenses relating to the amortization of purchased intangible assets that will contribute to our net losses, along with any potential goodwill impairment. As of May 31, 2009, we had \$8.7 million of purchased intangible assets to be amortized as a result of our January 2006 acquisition of Centra Software, Inc. (Centra) and May 2005 acquisition of THINQ Learning Solutions, Inc. (THINQ) and our goodwill balance was \$36.1 million. Further, starting with the first quarter of fiscal 2007, we were required to record as an expense charges related to all current outstanding and future grants of stock options in our reported results from operations in accordance with Statement of Financial Accounting Standards No.123 (revised 2004) (SFAS No. 123R), which was issued by Financial Accounting Standards Board (FASB) in December 2004. These non-cash expenses have made it and will continue to make it significantly more difficult for us to achieve profitability. If we achieve GAAP profitability, we may not be able to sustain it on a consistent basis.

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

In order for us to improve our operating results, it is important that our OnDemand customers renew their agreements with us when the initial contract term expires and also purchase additional products or additional users. Our OnDemand customers have no obligation to renew their subscriptions after the initial subscription period, and we cannot assure you that customers will renew subscriptions at the same or higher level of service, if at all. During fiscal year 2009, 13 % of our OnDemand customers elected not to renew their agreements with us. Our customers renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our product offerings, pricing, the prices of competing products or services, completion of customer initiatives, mergers and acquisitions affecting our customer base, or reductions in our customers spending levels. If our OnDemand customers do not renew their subscriptions, renew on less favorable terms or fail to purchase additional products or users, our revenue may decline, and we may not realize significantly improved operating results from our customer base.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Pursuant to Sarbanes-Oxley Section 404, our management is required to report on and our independent registered public accounting firm to attest to, the effectiveness of our internal controls over financial reporting, at least annually. The rules governing the standards that must be met for management to assess our internal controls over financial reporting are complex. Currently, the rules require significant documentation, testing and possible remediation of our internal controls over financial reporting. The process of reviewing, documenting and testing our internal controls over financial reporting will likely continue to result in increased expenses and the devotion of significant management and other

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internal resources. During this process, if our management identifies one or more material weaknesses in our internal control over financial reporting, we will be unable to assert such

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internal control is effective and the price of our stock may suffer. In addition, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute assurance that the objectives of the control system are met. Our management does not expect that our internal controls and procedures will prevent all errors and all fraud, if any, because, in addition to resource constraints, there are inherent limitations in all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. If our management is unable to assert that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to attest that our management report is fairly stated or they are unable to express an opinion on the effectiveness of our internal controls) we may not be able to timely file, or file at all, our periodic financial reports and thus we will be subject to delisting. Even if we are able to file such reports, investor confidence in the accuracy and completeness of our financial reports may be lost, leading to an adverse effect on the price of our stock.

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

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

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

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

Companies that offer human capital management solutions that provide one or more applications within the HCM market, such as learning management, performance management, talent management, competition and recruiting, including SumTotal and Success Factors;

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

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

Potential customers' internal development efforts; and

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

We expect competition from a variety of companies.

Many of our competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do, enabling them to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Such resources also enable our competitors to withstand prolonged periods of negative cash flows and unfavorable economic, political and market conditions. Competition could seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products and services obsolete, unmarketable or less competitive. Our current and

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potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other partners, thereby increasing the availability of their services to address the needs of our current and prospective customers. We may not be able to compete successfully against our current and future competitors, and competitive pressures that we encounter may seriously harm our business.

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

International revenues accounted for 29%, 28% and 29% of our revenues for our fiscal years ended May 31, 2009, 2008 and 2007, respectively. Although we intend to continue to expand our international presence, in the future we may not be able to successfully market, sell or distribute our products and services in foreign markets. Factors that could materially adversely affect our international operations, and our business and future growth include:

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

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

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

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

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

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

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

Tariffs, export controls and other trade barriers; and

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

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

The enactment of legislation implementing changes in U.S. taxation of international business activities or the adoption of other tax reform policies could materially impact our financial position and results of operations.

Recently several tax bills have been introduced to reform U.S. taxation of international business activities. The current Administration has made public statements indicating that it has made the issue a priority and key members of the U.S. Congress have conducted hearings and proposed legislation. Accordingly, depending on the final form of legislation enacted, if any, these consequences may be significant for us due to the large scale of our international business activities. If any of these proposals are enacted into legislation, they could have material adverse consequences on the amount of tax we pay and thereby on our financial position and results of operations.

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Currency exchange rate fluctuations could lower our revenue and net income.

During the fiscal year 2009, we recognized approximately 29% percent of our revenue in markets outside the United States in each market's respective local currency. We provide our products and services to customers in the United States, Europe and elsewhere through the world. Sales are primarily made in U.S. dollars, and to an increasing extent, British pounds and Euros. As we continue to expand our operations, more of our contracts may be denominated in Australian dollars, Canadian dollars, Japanese yen and other foreign currencies. In preparing our financial statements, we translate revenues and expenses in foreign countries from their local currencies into U.S. dollars using average exchange rates. Because an increasing portion of our sales is in foreign countries, exchange rate fluctuations may have a significant effect on our sales and earnings. Our reported net earnings may be significantly affected by fluctuations in currency exchange rates, with earnings generally increasing with a weaker U.S. dollar and decreasing with a strengthening U.S. dollar. As sales expand in countries where foreign currency transactions may be made, our operating results will increasingly be subject to the risks of exchange rate fluctuations and we may not be able to accurately estimate the impact that these changes may have on our future results of operations or financial condition.

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

As part of our overall business strategy, we expect to continue periodically to acquire complementary businesses or technologies that will provide additional products or services offerings, additional industry expertise or an expanded geographic presence. We acquired Centra Software, Inc. in January 2006 and THINQ Learning Solutions, Inc. in May 2005. The consideration and negotiation of potential acquisitions, regardless of whether they are completed, could require us to incur substantial expense and divert management's attention from other business concerns.

The pursuit of acquisitions involves a number of uncertainties, including selecting the appropriate products, technologies or companies to acquire and successfully complete the targeted transaction. Completed acquisitions could further result in the use of significant amounts of cash, the incurrence of debt or potentially dilutive issuances of equity securities which may reduce earnings per share. Further, acquisitions that we complete expose us to numerous risks, including:

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

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

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

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

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

We may incur impairments to goodwill or long-lived assets.

We are required to test goodwill for impairment annually or if a triggering event occurs in accordance with the provisions of SFAS No. 142 Goodwill and Other Intangible Assets. We are also required to test long-lived assets for impairment if a triggering event occurs in accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Such impairment could be caused by internal factors as well as external factors beyond our control.

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Significant negative industry or economic trends, reduced estimates of future cash flows, disruptions to our business, slower growth rates or lack of growth in the areas in which we generate revenues could lead to an impairment charge for any of our intangible assets or goodwill. If, in any period, our stock price decreases to the point where the fair value of the Company, as determined by our market capitalization, is less than our book value, this too could indicate a potential impairment and we may be required to record an impairment charge in our statement of operations in that period which would cause our profits to decline.

Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. We operate in highly competitive environments and projections of future operating results and cash flows may vary significantly from actual results. Additionally, if a significant decline in our stock price and/or market capitalization result in impairment to our goodwill, we may be required to record a charge to earnings in our financial statements during a period in which such impairment is determined to exist, which may negatively impact our results of operations.

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

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

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

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

As a result of such errors, we may be subject to warranty and product liability claims that are costly or difficult to settle. Our products and services enable customers to manage critical business information. If product

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errors are alleged to cause or contribute to security and privacy breaches or misappropriation of confidential information, we may also be subject to significant liability. Although our license agreements contain provisions intended to limit our exposure to liability, we cannot assure you that these limits will be adequate, that they will be enforceable or, if enforceable, that they will be interpreted favorably by a court.

We face risks related to claims third parties that we infringe their intellectual property rights and other litigation.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights, particularly in the software and Internet-related industries. We have in the past been and are presently subject to intellectual property actions. For example, on August 19, 2003, EdiSync Systems, LLC filed a complaint against Centra in federal court in Denver, Colorado, alleging infringement of two patents for a remote multiple user editing system and method and seeking to enjoin us from continuing to sell our products, as well as unspecified compensatory damages. Centra filed an answer to the complaint denying all of the allegations, and instituted reexamination proceedings for the patents at issue with the Patent Office. The case was stayed by the Colorado district court pending the outcome of the reexamination proceedings. A reexamination certificate was issued for one of the patents that cancelled all of the patent's claims, thus rendering it of no further force or effect. The Patent Office has issued a Notice of Intent to Issue a Reexamination Certificate for the other patent which indicated that all of the patent's original claims will be cancelled and specified that a set of newly-added claims has been determined to be patentable. In view of that development, the Colorado district court lifted the stay of the case on February 13, 2009. On March 16, 2009, EdiSync's patent attorney submitted a petition to the Patent Office requesting that the reexamination proceeding be reopened to allow the examiner to assess the patentability of the claims over a newly-submitted prior art reference. If the petition is granted, the Patent Office could issue another office action rejecting the newly-presented claims over the reference. If the petition is denied, we expect that a reexamination certificate will issue that will cancel all of the patent's original claims and indicate that only the newly-added claims are patentable. If that happens, we expect we will be free from liability for past actions, as the newly-added claims would be enforceable only prospectively as of the issue date of the anticipated reexamination certificate. Although we believe that we have meritorious defenses and intend to vigorously defend this action, we can give no assurance that we will be able to achieve a satisfactory outcome. We could become subject to additional intellectual property infringement claims as the number of our competitors grows and our products and services overlap with competitive offerings. Any of these claims, even if not meritorious, could be expensive to defend and could divert management's attention from operating our company. If we become liable to third parties for infringing their intellectual property rights, we could be required to pay a substantial award of damages and to develop non-infringing technology, obtain a license or cease selling the products that contain the infringing intellectual property. We may be unable to develop non-infringing technology or obtain a license on commercially reasonable terms, if at all. We also may face other forms of litigation or claims as part of our business, which may expose us to additional costs and risks.

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

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

Our use of open source technology could impose limitations on our ability to commercialize our products.

We use open source software in our application suite. Although we monitor our use of open source software closely, the terms of many open source licenses have not been interpreted by United States courts, and there is risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to re-engineer our technology or to

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discontinue offering all or a portion of our products in the event re-engineering cannot be accomplished on a timely basis, any of which could adversely affect our business, operating results and financial condition.

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

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

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

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

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

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

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

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Our OnDemand solutions involve the storage and transmission of confidential information of clients and their existing and potential employees, and security breaches could expose us to a risk of loss of, or unauthorized

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

We depend in part on the success of our relationships with third-party resellers and integrators.

Our success depends on various third-party relationships. The relationships include third party resellers as well as system integrators that assist with implementations of our products. Identifying partners, negotiating and documenting relationships with them and maintaining their relationships require significant time and resources from us. In addition, our agreements with our resellers and integrators are typically non-exclusive and do not prohibit them from working with our competitors or from offering competing products or services. Our competitors may be effective in providing incentives to third parties to favor their products or services. If we are unsuccessful in establishing or maintaining our relationships with these third parties, our ability to compete in the marketplace or to maintain or grow our revenue could be impaired and our operating results would suffer.

Our stock price may fluctuate substantially.

For example, from the beginning of fiscal 2007 through the end of fiscal 2009, the market price for our common stock has fluctuated between \$7.75 per share and \$0.91 per share. The market price for our common stock may be affected by a number of factors, including those described above and the following:

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

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

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

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

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

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

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

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

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

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

In addition, on June 2, 2009, our board of directors authorized and declared a dividend of one right for each outstanding share of our common stock to stockholders of record at the close of business on June 15, 2009. Each right entitles the registered holder, subject to the terms of the rights agreement between us and the rights agent, to purchase from us one one-thousandth of a share (a unit) of Series A Preferred Stock, par value \$0.001 per share, at a purchase price of \$12.50 per unit, under circumstances described in the rights agreement. The purchase price, the number of units of preferred stock and the type of securities issuable upon exercise of the rights are subject to adjustment. The rights will expire at the close of business June 2, 2012 unless earlier redeemed or exchanged. Until a right is exercised, the holder thereof, as such, will have no rights as one of our stockholders, including the right to vote or to receive dividends. The rights are not immediately exercisable. Subject to the terms and conditions of the rights agreement, they will become exercisable ten business days after a person or group acquires, or commences a tender or exchange offer which would lead to the acquisition of, beneficial ownership of 15% or more of our outstanding common stock. Once a person or group acquires beneficial ownership of 15% or more of our outstanding common stock, subject to the terms of the rights agreement, each right not owned by that person or group or certain related parties will entitle its holder to purchase, at the right's then-current purchase price, units of Series A Preferred Stock or, at our option, shares of common stock or cash, property or other securities of our company having a market value equal to twice the then-current purchase price.

Our anti-takeover provisions as well as our rights agreement could have the effect of discouraging a third party from making a tender offer or otherwise attempting to gain control of us, even though the transactions could be profitable for our stockholders. If the acquirer was discouraged from offering to acquire us or prevented from successfully completing a hostile acquisition by our anti-takeover measures, our stockholders could lose the opportunity to sell their shares at a favorable price.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None.

ITEM 2: PROPERTIES

Facilities

Our principal executive offices occupy approximately 36,000 square feet in Redwood Shores, California under a lease that expires in April 2014. Our Research and Development offices occupy approximately 12,500 square feet in Pune, India under a lease that expires in August 2012. We

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have additional leased facilities in Baltimore, Maryland, Lexington, Massachusetts and Duluth, Georgia, in Australia, Brazil, Canada, France, Germany, India, Japan, Mexico, New Zealand, Singapore and the United Kingdom. We believe that our facilities are adequate to meet our needs for the foreseeable future.

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ITEM 3: LEGAL PROCEEDINGS

Litigation Relating to Our Initial Public Offering

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

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

In June 2003, a proposed collective partial settlement of this litigation was structured between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. In June 2004, an agreement of partial settlement was submitted to the District Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. Our case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a

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price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing has been scheduled for September 10, 2009. Following the hearing, if the Court determines that the settlement is fair to the class members, the settlement will be approved and the case against us and the individual defendants will be dismissed with prejudice. There can be no assurance that this proposed settlement will be approved and implemented in its current form, or at all.

Due to the inherent uncertainties of litigation and because the settlement approval process is at a preliminary stage, the ultimate outcome of the matter is uncertain.

We intend to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, the ultimate outcome of the litigation is uncertain. An unfavorable outcome in litigation could materially and adversely affect our business, financial condition and results of operations.

Litigation Relating to Centra's Initial Public Offering

Centra, certain of its former officers and directors and the managing underwriters of Centra's initial public offering were named as defendants in an action filed in the District Court. The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve the Centra defendants on or about March 18, 2002. The original complaint has been superseded by an amended complaint filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, is purportedly brought on behalf of the class of persons who purchased Centra's common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act and Sections 10(b) and 20(a) of the Exchange Act. The complaint alleges that, in connection with Centra's initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the aftermarket at pre-determined prices. The complaint asserts that Centra's registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92.

On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all the actions, including the action involving Centra. On July 15, 2002, Centra, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On October 9, 2002, the plaintiffs dismissed, without prejudice, the claims against the named Centra officers and directors in the above-referenced action. On February 19, 2003, the District Court issued an order denying the motion to dismiss the claims against Centra under Rule 10b-5. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including Centra.

In June 2003, a proposed collective partial settlement of this litigation was structured between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. In June 2004, an agreement of settlement was submitted to the District Court for preliminary approval. The District Court granted the preliminary approval motion on

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February 15, 2005, subject to certain modifications. On August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice

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administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of focus cases rather than in all of the 310 cases that have been consolidated. Our case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing has been scheduled for September 10, 2009. Following the hearing, if the Court determines that the settlement is fair to the class members, the settlement will be approved and the case against Centra and the individual defendants will be dismissed with prejudice. There can be no assurance that this proposed settlement will be approved and implemented in its current form, or at all.

Due to the inherent uncertainties of litigation and because the settlement approval process is at a preliminary stage, the ultimate outcome of the matter is uncertain.

On December 28, 2007, the underwriter defendants moved to strike class allegations in 26 cases, including Centra's, in which the plaintiffs failed to identify proposed class representatives, and the issuer defendants joined in the motion. On May 13, 2008, the District Court granted the motion in part and struck the class allegations in eight cases in which the proposed class representative was not a member of the class. The District Court denied the motion with respect to the remaining 18 cases, including Centra's case. For those 18 cases, the District Court ordered the plaintiffs to notify the defendants and the District Court of the identity of the putative class representatives and the basis of each putative representative's claim, and indicate whether the putative representatives are members of the proposed class. On April 2, 2009, the plaintiffs submitted a list of proposed class representatives for each action in conjunction with the motion for preliminary approval of the settlement.

We, on behalf of Centra, intend to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, the ultimate outcome of the litigation is uncertain. An unfavorable outcome in litigation could materially and adversely affect our business, financial condition and results of operations.

Litigation Relating to Claim of Patent Infringement by Centra

On August 19, 2003, a complaint was filed against Centra and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)) (the Colorado District Court). The complaint alleges infringement of two patents for a

remote multiple user editing system and

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method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. Centra has filed an answer to the complaint denying all of the allegations. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred. Centra filed a request for reexamination of the patents at issue with the U.S. Patent and Trademark Office (the Patent Office). Our patent counsel is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the Colorado District Court had approved the parties' motion to stay the court proceedings during the re-examination proceedings. A reexamination certificate has issued for one of the patents that canceled all of the patent's claims, thus rendering that patent of no further force or effect. The Patent Office issued a reexamination certificate for the other patent confirming the rejection of all of the patent's original claims and allowing certain newly-added claims. We believe we are free from liability for past actions, as we believe the newly-added claims would be enforceable only prospectively as of the issue date of the reexamination certificate. We believe that we have meritorious defenses with respect to any future claims and intend to vigorously defend this action. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome of the litigation could materially and adversely affect our business, financial condition and results of operations.

Litigation Relating to Claim of Patent Infringement by Saba

On November 19, 2007, a complaint was filed against us and ten other defendants by Gemini IP, LLC, in the United States District Court for the Eastern District of Texas (No. 07-CV-521) (the Texas District Court). The complaint alleges infringement of a patent directed to a method for processing client help requests using a computer network and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. We filed an answer to the complaint denying all of the allegations. At our request, the United States Patent and Trademark Office (the Patent Office) has instituted reexamination proceedings against the asserted patent and the Texas District Court has stayed the action pending the outcome of those proceedings. We believe that we have meritorious defenses with respect to the asserted patent and intend to vigorously defend this action. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome of the litigation could materially and adversely affect our business, financial condition and results of operations.

Other Litigation

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

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

Table of Contents**PART II****ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Since our initial public offering on April 7, 2000, our common stock has traded on the Nasdaq Global Market under the symbol SABA. The following table sets forth the range of the quarterly high and low sales prices of our common stock for the periods indicated.

Year ended May 31, 2009	High	Low
First Quarter	\$ 3.86	\$ 2.70
Second Quarter	\$ 3.70	\$ 0.91
Third Quarter	\$ 1.98	\$ 0.93
Fourth Quarter	\$ 3.57	\$ 1.37
Year ended May 31, 2008	High	Low
First Quarter	\$ 6.15	\$ 4.09
Second Quarter	\$ 5.31	\$ 4.21
Third Quarter	\$ 5.35	\$ 3.36
Fourth Quarter	\$ 4.40	\$ 3.22

We had approximately 216 stockholders of record as of May 31, 2009. We have not declared or paid any cash dividends on our common stock, and presently we intend to retain our future earnings, if any, to fund the development and growth of our business. Our credit facility restricts our ability to pay cash dividends. For a description of this credit facility and these restrictions, see Item 7: *Management's Discussion and Analysis of Financial Condition and Results of Operation*, Liquidity and Capital Resource Contractual Obligations and Commitments.

Table of Contents**Stock Performance Graph**

The following line graph compares the yearly percentage change in the cumulative total stockholder return on our common stock from May 31, 2004 through the end of our fiscal year ended May 31, 2009 with the percentage change in cumulative total stockholder return for (i) the NASDAQ Stock Market U.S. Index and (ii) the Research Data Group RDG Technology Composite Index. The comparison assumes an investment of \$100 on May 31, 2004 in stock or index, including reinvestment of dividends, if any. The stock price performance shown on the graph below is not necessarily indicative of future price performance.

Index	5/04	5/05	5/06	5/07	5/08	5/09
SABA SOFTWARE, INC	100.00	115.34	176.14	170.74	108.52	101.42
NASDAQ STOCK MARKET -U.S. INDEX	100.00	104.91	113.08	136.66	132.60	92.61
RDG TECHNOLOGY COMPOSITE	100.00	100.73	105.17	128.63	129.52	91.98

For equity compensation plan information, please refer to Item 12 in Part III of this Annual Report.

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The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and *Management's Discussion and Analysis of Financial Condition and Results of Operation* included elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data for each of the three years ended May 31, 2009, 2008 and 2007 and the consolidated balance sheet data as of May 31, 2009 and 2008 are derived from our audited financial statements included elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data for the years ended May 31, 2006 and 2005 and the balance sheet data as of May 31, 2007, 2006 and 2005 are derived from our audited financial statements previously filed with the Securities and Exchange Commission (SEC).

Selected Consolidated Financial Data

	2009	2008	Years ended May 31,		2005 (1)
			2007	2006 (2)	
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Total revenues	\$ 102,821	\$ 107,777	\$ 99,867	\$ 71,147	\$ 42,210
Gross profit	61,539	67,553	62,928	45,936	29,335
Total operating expenses	62,062	70,216	70,244	52,315	32,411
Loss from operations	(523)	(2,663)	(7,316)	(6,379)	(3,076)
Net loss	(2,355)	(3,542)	(7,974)	(6,931)	(3,416)
Basic and diluted net loss per share	(0.08)	(0.12)	(0.28)	(0.33)	(0.22)
Shares used in computing basic and diluted net loss per share	29,174	29,016	28,541	20,898	15,687
	2009	2008 (3)	May 31, 2007	2006 (2)	2005 (1)
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 25,978	\$ 16,624	\$ 18,088	\$ 23,029	\$ 15,408
Total assets	99,723	98,931	101,613	106,375	54,299
Long-term obligations, less current portion	6,293	6,031	6,695	7,321	6,286
Total stockholders' equity	48,565	48,488	47,901	51,847	20,834

- (1) Saba completed its acquisition of THINQ Learning Solutions, Inc. as of May 5, 2005.
- (2) Saba completed its acquisition of Centra Software, Inc. as of January 31, 2006.
- (3) Certain reclassifications have been made to prior period amounts to conform to the current period presentation, as follows: (i) part of the restricted cash has been classified as long-term restricted cash; and (ii) part of deferred revenue related to OnDemand has been reclassified as long term deferred revenue. Such reclassifications did not have a significant impact on the Company's gross profit, net loss of net cash (used in) provided by operating activities.

**ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

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The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes contained herein and the information included in our other filings with the Securities and Exchange Commission. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the Securities Act) and Section 21E of the Securities and Exchange Act of 1934 (the Exchange Act). All statements in this Annual

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Report on Form 10-K other than statements of historical fact are forward-looking statements. These forward-looking statements involve known and unknown risks and uncertainties. Our actual results may differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under Item 1A: Risk Factors. All forward-looking statements and risk factors included in this document are made as of the date of this report, based on information available to us as of such date. We assume no obligation to update any forward-looking statement or risk factor.

INTRODUCTION

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

Overview;

Critical Accounting Policies;

Results of Operations; and

Liquidity and Capital Resources.

OVERVIEW

General

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

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

Increased productivity, sales and service effectiveness

Reduced personnel development and training costs

Improved organizational agility and execution

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

Background

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

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

On January 31, 2006, we completed the acquisition of Centra Software, Inc. (Centra), a provider of online learning and training software and services. We believe our acquisition of Centra strengthened our competitive position in the human capital management market and provided us with a broader and deeper product offering. In addition, as a result of the acquisition our customer base substantially increased. The Centra acquisition included total purchase consideration of \$62.3 million. We have included the results of operations of Centra in our consolidated financial statements beginning February 1, 2006.

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

Sources of Revenue

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

Software Licenses

We license our software solutions in multiple element arrangements that include a combination of our software, license updates and product support and/or professional services. A significant amount of our license sales are for perpetual licenses. To date, a substantial majority of our software license revenue has been derived from the Saba Learning product suite. For the foreseeable future, we expect the Saba Enterprise Suite and Saba Centra product suite to generate substantially all of our software license revenues. Our license revenue is affected by the strength of general economic and business conditions, as well as customers' budgetary cycles and the competitive position of our software products. In addition, the sales cycle for our products is long, typically six to 12 months. The timing of a few large software license transactions can substantially affect our quarterly license revenue.

OnDemand

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

Licenses Updates and Product Support

License updates and product support includes the right to receive future unspecified updates for the applicable software product and technical support. We typically sell license updates and product support for an initial period of one year concurrently with the sale of the related software license. After the initial period, license updates and product support are renewable on an annual basis at the option of the customer. Our license updates

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and product support revenue depends upon both our sales of additional software licenses and annual renewals of existing license updates and product support agreements. We believe that license updates and product support revenue will grow steadily for the foreseeable future as we anticipate that a substantial majority of our customers will renew their annual contracts and the sale of new software licenses will increase the number of customers that purchase license updates and product support.

Professional Services

Our professional services business consists of consulting, education and strategic services. Consulting and education services are typically provided to customers that license software directly from us. These consulting and education services are generally provided over a period of three to nine months after licensing the software. Generally, consulting services related to software implementations are not considered essential to the functionality of the software. Our consulting and education services revenue varies directly with the levels of license revenue and new OnDemand service bookings generated from our direct sales organization in the preceding three to nine month period. In addition, our consulting and education services revenue varies following our commercial release of significant software updates as our customers generally engage our services to assist with the implementation of their software update. We provide consulting services on a time and materials basis and on a fixed fee basis. Strategic services are less dependent than consulting and education services on the sale of our licenses. Strategic services present additional opportunities that arise at different times throughout a customer life cycle. In arrangements that include professional services and OnDemand offerings, but not a license of our software, we recognize revenue for professional services as the services are performed if these professional services qualify as a separate element of the arrangement. If the professional services do not qualify as a separate element of the arrangement, the related revenue is combined with the OnDemand revenue and recognized ratably over the OnDemand service period.

Cost of Revenue

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

Additionally, when our professional services revenue is combined with our OnDemand subscription revenue, we defer the direct costs related to the professional services and recognize them ratably over the applicable OnDemand service period. We categorize deferred revenue and deferred costs on our consolidated balance sheet as current if we expect to recognize such revenue or cost within the following 12 months. As of May 31, 2009, the deferred balance of the professional services revenue related to such OnDemand offerings and the related deferred costs was \$1.7 million and \$1.0 million, respectively. When the revenue from professional services is recognized ratably over the OnDemand subscription service period, we allocate the revenue to professional services revenue and to OnDemand revenue based on the vendor specific objective evidence (VSOE) of fair value for similar professional services that qualify as a separate element of the arrangement. Our judgment as to whether the consulting services qualify as a separate unit of accounting may materially affect the timing of our revenue recognition and our results of operations.

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Operating Expenses

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

CRITICAL ACCOUNTING POLICIES

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

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

persuasive evidence of an arrangement exists;

delivery has occurred;

the fee is fixed or determinable; and

collection is probable.

SOP 97-2, as amended, requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. We have analyzed each element in our multiple element arrangements and determined that we have sufficient vendor-specific objective evidence (VSOE) to allocate revenues to certain OnDemand offerings, license updates and product support and professional services. Accordingly, assuming all other revenue recognition criteria are met, revenues from perpetual licenses are recognized

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upon delivery using the residual method in accordance with SOP 98-9. We limit our assessment of VSOE for each element to the price charged when the same element is sold separately, price charged upon renewal or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

License revenues from licenses with a term of three years or more are generally recognized on delivery if the other conditions of SOP 97-2 are satisfied. We do not grant our resellers the right of return and we do not

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recognize revenue from resellers until an end-user has been identified and the other conditions of SOP 97-2 are satisfied. License revenues from licenses with a term of less than three years are generally recognized ratably over the term of the arrangement. License updates and product support revenue is also recognized ratably over the term of the arrangement, typically 12 months. In arrangements where term licenses are bundled with license updates and product support and such revenue is recognized ratably over the term of the arrangement, we allocate the revenue to license revenue and to license updates and product support revenue based on the VSOE of fair value for license updates and product support revenue on perpetual license of similar products.

Revenue related to professional services is generally recognized as the services are performed. Although we provide professional services on a time and materials basis, a portion of these services is provided on a fixed-fee basis. For services performed on a fixed fee basis, revenues are generally recognized on the proportional performance of the project, with performance measured based on hours of work performed. For contracts that involve significant customization and implementation or consulting services that are essential to the functionality of the software, the license and services revenues are recognized over the service delivery period using the percentage-of-completion method or, if we are unable to reliably estimate the costs to complete the services, we use the completed contract method of accounting in accordance with SOP 97-2 and relevant guidance of SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production Type Contracts*. A contract is considered complete when all significant costs have been incurred and the item has been accepted by the customer.

Revenue from our OnDemand offerings is recognized as a service arrangement whereby the revenue is recognized ratably over the term of the arrangement or on an as-used basis if defined in the contract. Certain of our OnDemand offerings are integrated offerings pursuant to which the customers' ability to access our software is not separable from the services necessary to operate the software and customers are not allowed to take possession of our software, in which case revenue is recognized under the SEC's Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*. Our OnDemand offerings also include arrangements with customers that have separately licensed and taken possession of our software. When these OnDemand offerings are part of a multiple element arrangement involving licenses, we recognize revenue in accordance with SOP 97-2, when the Emerging Issues Task Force (EITF) Issue No. 00-3 *Application of AICPA Statement of Position 97-2, Software Revenue Recognition, to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware* criteria is met.

In arrangements that include professional services and OnDemand offerings, but not a license of our software, we recognize revenue for professional services as the services are performed if these professional services qualify as a separate element of the arrangement. If the professional services do not qualify as a separate element of the arrangement, the professional services revenue is combined with the OnDemand subscription revenue and recognized ratably over the OnDemand subscription service period. Additionally, we defer the direct costs related to the professional services and recognize them ratably over the applicable OnDemand service period. We categorize deferred revenue and deferred costs on our consolidated balance sheet as current if we expect to recognize such revenue or cost within the following twelve months. When the revenue from professional services is recognized ratably over the subscription service period, we allocate the revenue to professional services revenue and to OnDemand revenue based on the VSOE of fair value for similar professional services that qualify as a separate element of the arrangement. Our judgment as to whether the consulting services qualify as a separate unit of accounting may materially affect the timing of our revenue recognition and our results of operations.

Allowance for doubtful accounts. Accounts receivable are recorded net of allowance for doubtful accounts and totaled \$20.0 million as of May 31, 2009. The allowance for doubtful accounts, which totaled \$0.1 million as of May 31, 2009, is based on our assessment of the amount of probable credit losses in the existing accounts receivable. We determine the allowance based on the aging of the accounts receivable, the financial condition of our customers and their payment history, our historical write-off experience and other assumptions. Past due balances based on purchase order terms and other specific accounts as necessary are reviewed monthly. Account

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balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than our historical experience, we may be required to increase the allowance for doubtful accounts.

Recoverability of goodwill and purchased intangible assets. We account for goodwill under Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. Our goodwill balance at May 31, 2009 was \$36.1 million, including \$21.3 million and \$9.5 million recorded as a result of our acquisitions of Centra and THINQ, respectively. We account for purchased intangible assets under SFAS No. 144, *Accounting for the Impaired or Disposal of Long-Lived Assets*. Amortization of purchased intangible assets, including acquired developed technology, was \$4.0 million for fiscal 2009, \$4.0 million for fiscal 2008 and \$4.0 million for fiscal 2007. As of May 31, 2009, our purchased intangible assets balance was \$8.7 million, net of accumulated amortization. The total expected future amortization related to purchased intangible assets will be approximately \$3.7 million, \$3.3 million and \$1.8 million in fiscal years 2010 through 2012, respectively.

SFAS No. 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment; while the second phase, if necessary, measures the impairment. We consider Saba to be a single reporting unit. Accordingly, all of our goodwill is associated with the entire company. We perform the required impairment analysis of goodwill annually or on a more frequent basis if indicators or impairment arise or circumstances otherwise dictate. A significant and extended reduction in our enterprise fair value to below the recorded amount of our stockholders' equity could indicate a change in our business climate and under SFAS 142, we could be required to write down the carrying value of our goodwill and record an expense for an impairment loss.

In accordance with SFAS No. 144, we review our long-lived asset groups, including property and equipment and other intangibles, for impairment whenever events indicate that their carrying amount may not be recoverable.

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value:

Level 1: quoted prices in active markets for identical assets and liabilities;

Level 2: inputs other than Level 1 that are observable, either directly and indirectly, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or

Level 3: unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis. Financial assets and liabilities measured at fair value on a recurring basis, excluding accrued interest components consisted of the following types of instruments as of May 31, 2009 (Level 1 input is defined above):

	Fair Value Measurements Using Input Type Level 1 (in thousands)
Assets:	
Money market funds (included in cash equivalents)	\$ 11,329
Total financial assets	\$ 11,329

Our valuation techniques used to measure the fair values of our money market funds were derived from quoted market prices.

Restructuring costs. The total accrued restructuring balance as of May 31, 2009 was \$146,000, which across all functions consisted primarily of severance and fringe benefits associated with the elimination of 34 positions during the third and fourth quarter of fiscal 2009. Any changes to the estimates will be reflected in future results of operations, and it could materially affect our accrual. If, in future periods, it is determined that we have over-accrued for restructuring charges, the reversal of such over-accrual would have a favorable impact on our results of operations in the period this was determined and may be recorded as a credit to restructuring costs. Conversely, if it is determined that our accrual is insufficient, an additional charge would have an unfavorable impact on our results of operations in the period this was determined.

Share-based compensation. On June 1, 2006, we adopted SFAS 123R, *Share-Based Payment*, under the modified prospective method. SFAS 123R generally requires share-based payments to employees to be recognized in our consolidated statements of operations based on their fair values. Prior to June 1, 2006, we accounted for our share-based compensation plans under the intrinsic value method of accounting as defined by Accounting Principles Board (APB) Opinion No. 25, (APB 25), *Accounting for Stock Issued to Employees and applied the disclosure provisions of SFAS 123, Accounting for Stock-Based Compensation*, as amended. Under APB 25, we generally did not recognize any compensation expense for stock options granted to employees or outside directors as the exercise price of our options was equivalent to the market price of our common stock on the date of grant. For pro forma disclosures of share-based compensation prior to June 1, 2006, the estimated fair values for options granted and options assumed were amortized using the accelerated expense attribution method. In addition, we reduced pro forma share-based compensation expense for actual forfeitures in the periods they occurred. In March 2005, the SEC issued SAB 107, which provides supplemental implementation guidance for SFAS 123R. We applied the provisions of SAB 107 in our adoption of SFAS 123R.

Upon our adoption of SFAS 123R, we were required to estimate the awards that we ultimately expect to vest and to reduce share-based compensation expense for the effects of estimated forfeitures of awards over the expense recognition period. Although we estimate forfeitures based on historical experience, forfeitures in the future may differ. Under SFAS 123R, the forfeiture rate must be revised if actual forfeitures differ from our original estimates. Also in connection with our adoption of SFAS 123R, we elected to recognize awards granted after our adoption date under the straight-line amortization method.

We estimate the fair value of employee stock options using the Black-Scholes-Merton (BSM) pricing model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their stock options. For restricted stock units (or RSUs), which provide for shares to be issued upon the lapse of vesting conditions, stock compensation is calculated based on the fair

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market value of the stock on the award date. The risk-free interest rate assumption is based upon United States treasury interest rates appropriate for the expected life of the awards. We estimate the volatility of our common stock based upon our historical stock price volatility over the length of the expected term of the stock option. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. Our expected dividend rate is zero since we do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future.

Beginning in our fiscal year 2007, SFAS 123R required the benefits of tax deductions in excess of the tax-effected compensation that would have been recognized as if we had always accounted for our stock-based award activity under SFAS 123R to be reported as a cash flow from financing activities, rather than as a cash flow from operating activities, as was prescribed under accounting rules applicable to our fiscal year 2006 and prior. As we do not expect to realize any of these benefits, due to operating losses, no such amounts have been recorded through May 31, 2009.

To the extent we change the terms of our employee stock-based compensation programs and refine different assumptions in future periods such as forfeiture rates that differ from our estimates, the stock-based compensation expense that we record in future periods may differ significantly from what we have recorded during our fiscal 2009 reporting periods.

Income Taxes. Significant judgment is required in determining our worldwide income tax provision. In the ordinary course of a global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of the process of identifying items of revenues and expenses that qualify for preferential tax treatment, and segregating foreign and domestic earnings and expenses to avoid double taxation, and determining required intercompany revenue sharing, cost reimbursement and other transfer pricing arrangements among related entities. Although we believe that our estimates are reasonable, the final tax outcome of these matters could be different from that which is reflected in our historical income tax provisions and accruals. Such differences could have a material effect on our income tax provision and net income in the period in which such determination is made.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Our deferred tax assets consist primarily of net operating loss carry forwards and stock based compensation deductions. In order for us to realize our deferred tax assets, we must be able to generate sufficient taxable income in those jurisdictions where the deferred tax assets are located. We consider future growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies in determining the need for a valuation allowance. We maintain a full valuation allowance on our U.S. deferred tax assets. A portion of the valuation allowance pertains to deferred tax assets established in connection with prior acquisitions, and to the extent that this portion of the valuation allowance is reversed in fiscal 2009, goodwill will likely be adjusted. Although we believe that our tax estimates are reasonable, the ultimate tax determination involves significant judgment that could become subject to audit by tax authorities in the ordinary course of business.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are generally recorded in the period when the tax returns are filed and the global tax implications are known. The amount of income tax we pay is subject to ongoing audits by federal, state and foreign tax authorities, which often result in proposed assessments. Our estimate of the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, audits are closed or when statutes of limitation on potential assessments expire. Additionally, the jurisdictions in which our earnings or deductions are realized may differ from our current estimates. As a result, our effective tax rate may fluctuate significantly on a quarterly basis.

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On June 1, 2007, we adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48), which contains a two-step approach to recognizing and measuring uncertain tax positions taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained on audit assuming that all issues are audited and resolution of any related appeals or litigation processes are considered. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The adoption of FIN 48 did not have a material impact on the Company's consolidated financial position. Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given with respect to the final outcome of these matters. We adjust reserves for our uncertain tax positions due to changing facts and circumstances, such as the closing of a tax audit, expiration of statutes of limitation on potential assessments or the refinement of an estimate. To the extent that the final outcome of these matters is different than the amounts recorded, such differences will impact our provision for income taxes in the period in which such a determination is made. Our provisions for income taxes include the impact of reserve provisions and changes to reserves that are considered appropriate and also include the related interest and penalties.

Business Combinations. As part of our accounting for business combinations, some of the purchase price is allocated to goodwill and intangible assets. Impairment charges associated with goodwill are generally not tax deductible and will result in an increased effective income tax rate in the quarter any impairment is recorded. Amortization expenses associated with acquired intangible assets are generally not tax deductible pursuant to our existing tax structure; however, deferred taxes have been recorded for non-deductible amortization expenses as a part of the purchase price allocation process. We have taken into account the allocation of these identified intangibles among different taxing jurisdictions, including those with nominal or zero percent tax rates, in establishing the related deferred tax liabilities. Income tax contingencies existing as of the acquisition dates of the acquired companies are evaluated quarterly and any adjustments are recorded as adjustments to goodwill. Under Financial Accounting Standards Board (FASB) Statement No. 141R, Business Combinations, any future adjustments will be recorded as tax expense or benefit beginning with the Company's three month period ending August 31, 2009.

RESULTS OF OPERATIONS**YEARS ENDED MAY 31, 2009, 2008 AND 2007****Revenues**

	Years ended		Years ended		Years ended	
	May 31, 2009	Percent of Total Revenues	May 31, 2008	Percent of Total Revenues	May 31, 2007	Percent of Total Revenues
(in thousands)						
Revenues:						
License	\$ 15,139	15%	\$ 22,041	20%	\$ 22,621	23%
License updates and product support	34,468	33%	35,092	33%	31,344	31%
OnDemand	20,809	20%	18,191	17%	15,924	16%
Professional services	32,405	32%	32,453	30%	29,978	30%
Total revenues	\$ 102,821	100%	\$ 107,777	100%	\$ 99,867	100%

Total revenues decreased 5% during fiscal 2009 compared to fiscal 2008 and increased 8% during fiscal 2008 compared to fiscal 2007. In fiscal 2009, 2008 and 2007, no customer represented more than 10% of total revenues. As a percentage of total revenues, revenues from customers outside the United States represented approximately 29% for fiscal 2009, 28% for fiscal 2008 and 29% for fiscal 2007. The only country outside

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the United States that consisted of more than 10% of total revenue was the United Kingdom, which represented 14% for fiscal 2009 and 12% for both fiscal 2008 and fiscal 2007.

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License Revenue. License revenue decreased \$6.9 million, or 31%, during fiscal 2009 compared to fiscal 2008. License revenue decreased \$0.6 million, or 3%, during fiscal 2008 compared to fiscal 2007. These decreases were caused by a shift from sales of licenses to OnDemand services and, in addition with respect to fiscal 2009, a decrease in new licenses and renewed licenses as a result of the recessionary economic environment.

License Updates and Product Support Revenue. License updates and product support revenue decreased \$0.6 million, or 2%, during fiscal 2009 compared to fiscal 2008. This decrease was attributable in part to a stronger dollar during 2009 over 2008, in addition to product support revenue recognized during fiscal 2008 which included a favorable impact of approximately \$0.3 million due to renewals for major customers that were renewed after the contracts expired. We recognize the portion of revenue associated with the period that has lapsed upon renewal. License updates and product support revenue increased \$3.7 million, or 12%, during fiscal 2008 compared to fiscal 2007. This increase was primarily due to the ratable recognition of the full contract value of license updates and product support renewals from former Centra customers and to the sale of new and renewal license updates and product support contracts to our growing customer base.

OnDemand Revenue. OnDemand revenue increased \$2.6 million, or 14%, during fiscal 2009 compared to fiscal 2008. This increase in OnDemand revenue was primarily attributable to a high rate of OnDemand renewals, increased demand for Saba Enterprise OnDemand offerings including a shift from license revenue. OnDemand revenue increased \$2.3 million, or 14%, during fiscal 2008 compared to fiscal 2007. The increase in OnDemand revenue was primarily attributable to an increase in customer demand for these offerings from both existing and new customers as well as the ratable recognition of the full contract value of OnDemand renewals from former Centra customers.

Professional Services Revenue. Professional services revenue decreased \$48,000, or less than 1%, during fiscal 2009 compared to fiscal 2008. The decrease was slight, despite the negative impact of the recessionary environment, since it was offset by higher demand for our consulting services for upgrades and expansions from our existing customer base. Professional services revenue increased \$2.5 million, or 8%, during fiscal 2008 compared to fiscal 2007. This increase was primarily due to increased demand for our consulting services for our expanded customer base.

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

Geographic Information

The following tables represent revenue and long-lived assets information by geographic area as of and for the fiscal years ended May 31, 2009, 2008 and 2007. Long-lived assets consist of property and equipment, goodwill and purchased intangible assets:

	Total Revenue			Long-Lived Assets	
	2009	2008	2007	2009	2008
	(in thousands)				
United States	\$ 72,602	\$ 77,767	\$ 66,384	\$ 48,836	\$ 54,657
United Kingdom	14,090	12,789	11,842	429	643
Rest of the World	16,129	17,221	21,641	328	310
Total	\$ 102,821	\$ 107,777	\$ 99,867	\$ 49,593	\$ 55,610

Long-lived assets located in the United Kingdom have been classified with the Rest of the World.

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	Years ended					
	May 31, 2009	Percent of Total Revenues	May 31, 2008	Percent of Total Revenues	May 31, 2007	Percent of Total Revenues
(in thousands)						
Cost of revenues:						
Cost of license	\$ 909	1%	\$ 839	1%	\$ 1,196	1%
Cost of license updates and product support	8,191	8%	8,900	8%	8,558	9%
Cost of OnDemand	9,157	9%	7,232	7%	5,025	5%
Cost of professional services	21,847	21%	22,075	20%	20,982	21%
Amortization of acquired developed technology	1,178	1%	1,178	1%	1,178	1%
Total cost of revenues	\$ 41,282	40%	\$ 40,224	37%	\$ 36,939	37%

The following table is the summary of gross margin:

	Years ended May 31,		
	2009	2008	2007
(in thousands, except percentages)			
Gross margin:			
License (including amortization of acquired developed technology)	\$ 13,052	\$ 20,024	\$ 20,247
<i>Percentage of license revenue</i>	86%	91%	90%
License updates and product support	26,277	26,192	22,786
<i>Percentage of license updates and product support revenue</i>	76%	75%	73%
OnDemand	11,652	10,959	10,899
<i>Percentage of OnDemand revenue</i>	56%	60%	68%
Professional services	10,558	10,378	8,996
<i>Percentage of professional services revenue</i>	33%	32%	30%
Total	\$ 61,539	\$ 67,553	\$ 62,928
<i>Percentage of total revenues</i>	60%	63%	63%

Total cost of revenues increased \$1.0 million, or 3%, in fiscal 2009 when compared to fiscal 2008 and increased \$3.3 million, or 9%, in fiscal 2008 when compared to fiscal 2007.

Cost of License Revenue. Cost of license revenue increased \$0.1 million, or 8%, in fiscal 2009 compared to fiscal 2008. This increase was primarily due to an increase in third-party royalty costs. License revenue gross margins decreased to 94% in fiscal 2009 from 96% in fiscal 2008 due to the decrease of product volume relative to fixed expenses. Cost of license revenue decreased \$0.4 million, or 30%, in fiscal 2008 compared to fiscal 2007. License revenue gross margins increased slightly from 95% in fiscal 2007 to 96% in fiscal 2008. This decrease was primarily due to a reduction in third-party royalty costs and higher costs of license revenue during fiscal 2007 due to the \$0.2 million write-off of a prepaid royalty related to technology that we will not use in future offerings.

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Cost of License Updates and Product Support Revenue. Cost of license updates and product support revenue decreased \$0.7 million, or 8%, in fiscal 2009 compared to fiscal 2008. This decrease was primarily due to salaries and related expenses of \$0.5 million through reduced headcount as result of attrition and restructuring and a decrease in travel related expenses of \$0.1 million. License updates and product support gross margin increased to 76% in fiscal 2009 from 75% in fiscal 2008. The increase in gross margins was primarily due to cost reductions when compared to the prior period. Cost of license updates and product support revenue increased

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\$0.3 million, or 4%, in fiscal 2008 compared to fiscal 2007. This increase was primarily due to salaries and related expenses attributable to additional headcount needed to support the infrastructure of the growing installed customer base. License updates and product support gross margin increased to 75% in fiscal 2008 from 73% in fiscal 2007. This increase was primarily due to the ratable recognition of the full contract value of license updates and product support renewals from former Centra customers.

Cost of OnDemand Revenue. Cost of OnDemand revenue increased \$1.9 million, or 27%, in fiscal 2009 compared to fiscal 2008. This increase was primarily due to increases in third party co-location and connectivity fees of \$0.6 million, salaries and related expenses of \$0.7 million and infrastructure fees of \$0.6 million including depreciation and amortization of computer hardware and software, associated with supporting our growing OnDemand business. OnDemand gross margin decreased to 56% in fiscal 2009 from 60% in fiscal 2008. This decrease was primarily due to the continued additions to support anticipated growth in our OnDemand business. In fiscal 2009, we completed building infrastructure for our OnDemand business for the foreseeable future and expect that OnDemand gross margin will improve with revenue increases. Cost of OnDemand revenue increased \$2.2 million, or 44%, in fiscal 2008 compared to fiscal 2007. This increase was primarily due to additional headcount and increases in third party co-location and connectivity fees of \$0.7 million, third party contractor fees of \$0.5 million and infrastructure fees, including depreciation and amortization of computer hardware and software associated with supporting our growing OnDemand business, of \$1.0 million. OnDemand gross margin decreased to 60% in fiscal 2008 from 68% in fiscal 2007. This decrease was primarily due to the continued investment to support anticipated growth in our OnDemand business offset, in part, by the ratable recognition of the full contract value of OnDemand renewals from former Centra customers.

Cost of Professional Services Revenue. Cost of professional services revenue decreased \$0.2 million, or 1%, in fiscal 2009 compared to fiscal 2008. This decrease is primarily due to reduction in travel related expenses. Cost of professional services revenue increased \$1.1 million, or 5%, in fiscal 2008 compared to fiscal 2007. This increase is primarily due to additional headcount costs (including the direct costs of research and development personnel expensed at the completion of a consulting arrangement accounted for as a completed contract under SOP 81-1) incurred in connection with generating additional professional services revenue.

Amortization of acquired developed technology. The amortization of acquired developed technology is comprised of the ratable amortization of technological assets acquired in the acquisition of Centra Software, Inc. in 2006. We amortize the cost of these assets over a period of five years. Amortization expense was \$1.2 million in fiscal 2009, 2008 and 2007.

Operating Expenses

	Years ended		Years ended		Years ended	
	May 31, 2009	Percent of Total Revenues	May 31, 2008 (in thousands)	Percent of Total Revenues	May 31, 2007	Percent of Total Revenues
Operating expenses:						
Research and development	\$ 17,380	17%	\$ 16,498	15%	\$ 17,052	17%
Sales and marketing	26,405	26%	36,571	34%	38,317	38%
General and administrative	15,200	15%	14,609	14%	12,337	12%
Restructurings	539	1%				
Amortization of purchased intangible assets	2,538	2%	2,538	2%	2,538	3%
Total operating expenses	\$ 62,062	61%	\$ 70,216	65%	\$ 70,244	70%

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Research and development. Research and development expenses increased \$0.9 million, or 5%, during fiscal 2009 compared to fiscal 2008. This increase is primarily due to increases in salaries and related expenses of \$0.8

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million, consulting services of \$0.2 million and software and equipment maintenance of \$0.1 million, partially offset by a decrease in facilities and internal information technology related costs of \$0.2 million. Research and development expenses decreased \$0.6 million, or 3%, during fiscal 2008 compared to fiscal 2007. This decrease is primarily due to a \$0.8 million decrease in salaries and related expenses and a decrease of \$0.2 million in employee recruiting expenses, partially offset by increases in facilities and internal information technology related costs of \$0.3 million and in third-party consulting services of \$0.1 million.

Sales and marketing. Sales and marketing expenses decreased by \$10.2 million, or 28%, during fiscal 2009 compared to fiscal 2008. The decrease in sales and marketing expenses in fiscal 2009 was primarily attributable to decreases of \$6.9 million in salaries and related expenses (including commissions) through reduced headcount as result of attrition and restructuring and marketing expenses of \$0.7 million, decreases in facilities and internal information technology related costs of \$1.3 million, and decreases in travel and related expenses of \$0.7 million. We anticipate an increase in sales and marketing expenses in fiscal 2010 due to headcount additions for the build-out of our sales and marketing functions to take advantage of developing market opportunities. Sales and marketing expenses decreased by \$1.7 million, or 5%, during fiscal 2008 compared to fiscal 2007. The decrease in sales and marketing expenses in fiscal 2008 was primarily attributable to decreases of \$2.1 million in salaries and related expenses and \$0.3 million in employee recruiting expenses, partially offset by an increase of \$0.5 million in facilities and internal information technology related costs.

General and administrative. General and administrative expenses increased \$0.6 million, or 4%, during fiscal 2009 compared to fiscal 2008. This increase is primarily due to increases in legal and accounting fees of \$0.7 million and facilities and internal information technology related costs of \$0.7 million, partially offset by decreases in bad debt of \$0.2 million, travel of \$0.2 million, compensation related expense of \$0.2 million, consulting services of \$0.1 million and \$0.1 million in software maintenance. General and administrative expenses increased \$2.3 million, or 18%, during fiscal 2008 compared to fiscal 2007. This increase is primarily due to an increase in salaries and related expenses of \$1.5 million and an increase in stock based compensation expense of \$0.6 million.

Amortization of purchased intangible assets. Amortization of purchased intangible assets totaled \$2.5 million in fiscal 2009, 2008 and fiscal 2007. Future amortization expense over each of the next five years is currently expected to range from \$3.7 million in fiscal 2010 through \$1.8 million in fiscal 2012 and zero thereafter. We review our intangible assets at least annually and the estimated remaining useful lives of our intangible assets for impairment. Any impairment or reduction in our estimate of remaining useful lives could result in increased amortization expense in future periods.

Restructuring charges

During fiscal 2009, we approved and initiated a plan to restructure and eliminate approximately 5% of the workforce across all functions (the 2009 Plan). This restructuring program was implemented under the provisions of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The total restructuring costs associated with the 2009 Plan were \$0.5 million. The restructuring eliminated 23 positions during the third quarter, 19 positions in the fourth quarter and charges for the workforce reduction consisted primarily of severance and fringe benefits. The restructuring charges are classified as Restructuring in the statement of operations and totaled approximately \$0.5 million during the six months ended May 31, 2009 of which approximately \$0.4 million had been paid as of May 31, 2009.

During fiscal 2007, the estimated restructuring charge from the fiscal 2006 restructuring plan associated with the consolidation of excess facilities related to the acquisitions of THINQ and Centra was reduced by \$0.2 million as the result of a building lease renegotiation.

Table of Contents**Interest income and other, net**

Interest income and other, net consists of interest income and other non-operating expenses, including foreign currency exchange gains or losses. Interest income and other, net decreased by \$0.6 million to \$55,000 in fiscal 2009 from \$0.6 million in fiscal 2008. The decrease was primarily due to losses from realized and unrealized foreign currency transactions with large fluctuations specifically in India and between the British pound and European Union euro. Interest income and other, net consists of interest income and other non-operating expenses, including foreign currency exchange gains or losses. Interest income and other, net increased by \$0.5 million to \$0.6 million in fiscal 2008 from \$0.2 million in fiscal 2007. The increase was primarily due to gains from realized and unrealized foreign currency transactions with large fluctuations specifically in India and between the British pounds and European Union euros.

Interest expense

Interest expense was \$31,000 in fiscal 2009, \$0.2 million in fiscal 2008 and \$0.5 million in fiscal 2007. These decreases in interest expense were primarily due to the interest resulting from a lower average debt balance and lower average interest rates for the debt.

DEFERRED REVENUES

Deferred revenues consisted of the following:

	May 31, 2009	May 31, 2008
	(in thousands)	
License updates and product support	\$ 20,011	\$ 18,219
OnDemand	10,925	9,004
Professional services	2,998	3,321
Licenses	1,405	741
Total deferred revenues	\$ 35,339	\$ 31,285
Deferred revenues, current	\$ 32,611	\$ 28,748
Deferred revenues, non-current	2,728	2,537
Total deferred revenues	\$ 35,339	\$ 31,285

Deferred software license updates and product support revenues represent customer billings made in advance for annual support contracts. Software license updates and product support contracts are typically billed on a per annum basis in advance and revenues are recognized ratably over the support periods. Deferred OnDemand revenue represents customer billings made in advance and recognized ratably over the OnDemand service term. Deferred professional services revenue includes prepayments for consulting, education, strategic services and professional services, not separable from the OnDemand subscription business. Revenue for these services is recognized as the services are performed. Deferred revenues from new software license typically result from undelivered products or specified enhancements, term license agreements that are recognized over the related term, customer specific acceptance provisions, and software license transactions that cannot be

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segmented from consulting services or certain extended payment term arrangements. Our deferred revenue is generally at its lowest annual level at the end of the second quarter. We have a disproportionately higher level of renewal billings for software license updates and product support in our third fiscal quarter.

COMMISSIONS

Commissions are generally expensed as they are earned per the terms of the sales compensation plans.

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KEY OPERATING METRICS

Billing and Renewal Rates

We track operating metrics for invoicing, which represents our total billings, and renewal rates for enterprise software maintenance and OnDemand services. For the fiscal year ended May, 2009, we invoiced \$111.0 million compared to \$115.0 million for fiscal year 2008. Our renewal rate on a dollar basis on enterprise software maintenance was 93% during the fiscal 2009 compared to 91% for the fiscal 2008. Our renewal rate on a dollar basis for our OnDemand business for the fiscal years ended May 31, 2009 was 87% compared to 86% for the fiscal year ended May 31, 2008.

Provision for income taxes

From inception to May 31, 2007, we incurred net losses for federal and state tax purposes. Income tax expense from inception to May 31, 2009, was comprised primarily of U. S. deferred and foreign income taxes and also included a provision for federal alternative minimum tax, state income taxes and usage of net operating losses in acquisitions. We recorded income tax expense of approximately \$1.9 million in fiscal 2009, \$1.3 million in fiscal 2008 and \$0.3 million in fiscal 2007.

We have recorded a valuation allowance for the full amount of the net deferred tax assets, as we believe it is more likely than not that the deferred tax assets will not be realized.

Table of Contents**QUARTERLY RESULTS OF OPERATIONS**

The following table sets forth condensed consolidated statement of operations data for each of the eight quarters in the period ended May 31, 2009. This information has been derived from our unaudited condensed consolidated financial statements that, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of this information. You should read this information in conjunction with our audited consolidated financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. We have experienced and expect to continue to experience fluctuations in operating results from quarter to quarter. Except for one quarter, we have incurred net losses on a GAAP basis in each quarter since inception. You should not draw any conclusions about our future results from the results of operations for any quarter, as quarterly results are not necessarily indicative of results for a full fiscal year or any other period.

	May 31, 2009	Feb 28, 2009	Nov 30, 2008	Three months ended			Nov 30, 2007	Aug 31, 2007
				Aug 31, 2008	May 31, 2008	Feb 29, 2008		
	(in thousands, except per share data)							
Revenues:								
License	\$ 4,486	\$ 4,725	\$ 2,971	\$ 2,958	\$ 5,607	\$ 6,000	\$ 5,704	\$ 4,730
License updates and product support	8,553	8,500	8,773	8,641	8,842	8,483	8,950	8,817
OnDemand	5,239	5,327	5,323	4,918	4,678	4,583	4,503	4,427
Professional services	7,272	7,594	8,756	8,782	9,052	8,348	7,575	7,478
Total revenues	25,550	26,146	25,825	25,299	28,179	27,414	26,732	25,452
Cost of revenues	9,743	10,042	10,440	11,057	10,807	10,237	9,425	9,755
Gross profit	15,807	16,104	15,385	14,242	17,372	17,177	17,307	15,697
Operating expenses:								
Research and development	4,142	4,346	4,606	4,286	4,215	4,060	4,015	4,208
Sales and marketing	6,805	5,673	6,821	7,107	8,379	8,489	10,436	9,267
General and administrative	3,575	3,389	3,871	4,341	3,910	3,608	3,284	3,807
Restructurings	287	277						
Amortization of purchased intangible assets	634	634	634	634	636	634	634	634
Total operating expenses	15,443	14,319	15,932	16,368	17,140	16,791	18,369	17,916
(Loss) income from operations	364	1,785	(547)	(2,126)	232	386	(1,062)	(2,219)
Interest income (expense) and other, net	330	(35)	319	71	242	(83)	160	(19)
Income (loss) before provision for income taxes	34	1,750	(228)	(2,055)	474	469	(902)	(2,238)
Provision for income taxes	(1,155)	(415)	(127)	(159)	(784)	(311)	(132)	(118)
Net (loss) income	\$ (1,121)	\$ 1,335	\$ (355)	\$ (2,214)	\$ (310)	\$ 158	\$ (1,034)	\$ (2,356)
Basic and diluted net (loss) income per share	\$ (0.04)	\$ 0.05	\$ (0.01)	\$ (0.08)	\$ (0.01)	\$ 0.01	\$ (0.04)	\$ (0.08)
Shares used in computing basic net (loss) income per share	29,197	29,186	29,164	29,151	29,123	29,102	29,003	28,859

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Shares used in computing diluted net (loss) income per share	29,197	29,247	29,164	29,151	29,123	29,373	29,003	28,859
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Our results of operations could vary significantly from quarter to quarter. If revenues fall below our expectations, we may not be able to reduce our spending rapidly in response to the shortfall and operating losses will increase. We anticipate that we will continue to experience long sales cycles. Therefore, the timing of future customer contracts could be difficult to predict, making it difficult to estimate revenues between quarters.

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

LIQUIDITY AND CAPITAL RESOURCES

	Years ended May 31,		
	2009	2008	2007
	(in thousands)		
Cash provided by (used in) operating activities	\$ 12,690	\$ 5,052	\$ (2,453)
Cash used in investing activities	(2,071)	(3,327)	(2,949)
Cash (used in) provided by financing activities	(299)	(3,069)	189
Effect of exchange rate changes on cash and cash equivalents	(967)	(120)	272

We have funded our operations through operating activities and our most significant source of operating cash flows stems from customer purchases of our license, license updates and product support, OnDemand and professional services. Our primary uses of cash from operating activities are for personnel and facilities related expenditures. As of May 31, 2009, we had \$26.0 million in available cash and cash equivalents. On July 29, 2009, we entered into a new credit facility with a bank. The terms of the credit facility are described further below under the heading Contractual Obligations and Commitments. We may use some of our cash balance or draw amounts under the credit facility to fund acquisitions of technology, products or businesses.

Cash Provided By (Used In) Operating Activities

Cash provided by operating activities was \$12.7 million in fiscal 2009 compared to cash provided by operating activities of \$5.1 million in fiscal 2008. The increase in fiscal 2009 is primarily a result of adjusting our net loss of \$2.4 million for non-cash expenses related to stock-based compensation of \$2.3 million, depreciation and amortization of \$6.1 million, as well as an increase in deferred revenue of \$4.9 million, adjustment of goodwill of \$1.6 million, and decrease in prepaid expenses and other assets of \$0.5 million, and accounts receivable of \$1.3 million. These increases and decreases to our cash provided by operating activities were partially offset by a decrease in accounts payable of \$1.3 million and a decrease in accrued expenses of \$0.6 million.

Cash provided by operating activities was \$5.1 million in fiscal 2008 compared to cash used in operating activities of \$2.5 million in fiscal 2007. The increase in fiscal 2008 is primarily a result of adjusting our net loss of \$3.5 million for non-cash expenses related to stock-based compensation of \$3.0 million and depreciation and amortization of \$5.9 million, as well as an increase in deferred revenue of \$1.8 million. These increases to our cash provided by operating activities were partially offset by a decrease in accounts payable of \$0.8 million and an increase in accounts receivable of \$0.9 million.

Total accounts receivable days sales outstanding (DSO), based on a rolling four quarter calculation, was 77 days at May 31, 2009 compared to 79 days at May 31, 2008 and 75 days at May 31, 2007. Changes in accounts receivable have a significant impact on our cash flow. Items that can affect our accounts receivable DSO include: timing of license revenue and the proportion of that license revenue relative to our other types

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of revenue, timing of billing of our professional services revenue, contractual payment terms, client payment patterns (including approval or processing delays and cash management) and the effectiveness of our collection efforts. As a result of these different factors, our DSO decreased from fiscal 2008 to fiscal 2009, after increasing from fiscal 2007 to fiscal 2008.

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Cash Used In Investing Activities

Cash used in investing activities of \$2.1 million in fiscal 2009, \$3.3 million in fiscal 2008 and \$2.9 million in fiscal 2007 was to purchase additional equipment for use in our operations.

Cash (Used In) Provided By Financing Activities

Cash used in financing activities decreased in fiscal 2009 to \$0.3 million compared to cash used in financing activities of \$3.1 million in fiscal 2008. The decrease in cash used included a reduction from \$4.2 million in fiscal 2008 to \$0.4 million in fiscal 2009 of cash used for the repayments of borrowings under our credit facilities and equipment term loans offset by a reduction in cash proceeds from the issuance of our stock under our stock-based compensation plans from \$1.2 million in fiscal 2008 to \$0.2 million in fiscal 2009. Cash used in financing activities decreased in fiscal 2008 to \$3.1 million compared to cash provided by financing activities of \$0.2 million in fiscal 2007. The decrease included \$4.2 million in repayments of borrowings under our credit facilities and equipment term loans in fiscal 2008 and proceeds from the issuance of our stock under our stock-based compensation plans of \$1.2 million. The cash provided during fiscal 2007 included proceeds from the issuance of our stock under our stock-based compensation plans of \$1.5 million, partially offset by the net repayment of \$1.1 million on our term credit and equipment facility.

Contractual Obligations and Commitments

On January 31, 2006, we entered into a credit facility with a bank that provided for a term loan, in a principal amount of \$6.5 million and a receivables borrowing base revolving credit line in an aggregate principal amount of up to \$7.5 million. All amounts borrowed under the term loan and the credit line were repaid in full on or prior to January 31, 2009, in accordance with the terms of the credit facility. In addition, we amended this credit facility in November 2006 to add an equipment facility up to a principal amount of \$3.0 million.

We obtained advances on November 30, 2006 and February 28, 2007 with respect to the equipment facility, and those advances mature on November 30, 2009 and February 28, 2010, respectively. We are not entitled under the terms of the facility to obtain any additional advances. As of May 31, 2009, the outstanding amount of our obligations under the equipment facility was \$0.2 million, and we were in compliance with our liquidity and EBITDA covenants under the equipment facility. The interest rate applicable to loans under the equipment facility is the bank's prime rate plus 0.25%. As of May 31, 2009, there were no material changes in capital leases, operating lease obligations, purchase obligations or any other long-term liabilities reflected on our consolidated balance sheets as compared to such obligations and liabilities as of May 31, 2008.

On July 29, 2009, we entered into a new credit facility with a bank. The new facility provides for a new revolving line of credit with a maturity date of July 28, 2010. An aggregate principal amount of up to \$9.0 million may be outstanding at any time under the revolving line. With respect to borrowings in excess of \$4.0 million, the revolving line is a receivables borrowing base credit facility. The revolving line also includes a sublimit of up to \$4.0 million for letters of credit, cash management and foreign exchange services. The interest rate applicable to the revolving line is, at our option, equal to either (i) the sum of the Prime Rate (as defined in the facility) plus 0.25%, or (ii) the sum of the LIBOR Rate (as defined in the facility) plus 3.25%. The new credit facility also incorporates under its terms the outstanding \$0.2 million owed under the prior equipment facility, but the repayment terms of the prior equipment facility otherwise remain unchanged.

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The equipment facility and new credit facility are secured by all of our personal property other than our intellectual property. The facilities also include certain negative covenants restricting or limiting the ability of us and our subsidiaries to, among other things: incur additional indebtedness; create liens on our property; make certain investments and acquisitions; merge or consolidate with any other entity; convey, sell, lease, transfer or otherwise dispose of assets; change our business; experience a change of control; pay dividends, distributions or make other specified restricted payments or repurchases; and enter into certain transactions with affiliates. Such

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restrictions and limitations are subject to usual and customary exceptions contained in credit agreements of this nature. In addition, the facilities require that we satisfy (a) a minimum quarterly EBITDA covenant and (b) a minimum monthly adjusted quick ratio covenant (which also includes a requirement that we maintain certain levels of cash and cash equivalents in accounts with the bank or in accounts at other financial institutions with which the bank has an account control agreement). If the new facility had been in place on May 31, 2009, we would have been in compliance with these covenants as of such date.

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

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

During the fiscal quarter ended February 28, 2009, we entered into a non-cancelable three year contract for software services of which \$1.0 million remained payable as of May 31, 2009. As of May 31, 2009, except for this three year contract for software services, we did not have any additional significant purchase obligations for goods or services that are enforceable and legally binding.

The following table summarizes our contractual obligations at May 31, 2009 and the effect these obligations are expected to have on our liquidity and cash flows in future periods.

	Total	Payments due by fiscal year					Thereafter
		FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	
(in thousands)							
Contractual obligations:							
Long-term debt obligations	\$ 254	\$ 254	\$	\$	\$	\$	\$
Long-term contract commitment	965	386	386	193			
Operating lease obligations	17,836	3,722	3,842	3,814	3,509	2,949	
Other long-term liabilities	210	105	105				
Total	\$ 19,265	\$ 4,467	\$ 4,333	\$ 4,007	\$ 3,509	\$ 2,949	\$

Off-Balance Sheet Arrangements

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

Table of Contents**ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our borrowings and investments. As described above, we previously entered into a credit facility with a bank that provided for a term loan in a principal amount of \$6.5 million and a receivables borrowing base revolving credit line in an aggregate principal amount of up to \$7.5 million, but all amounts borrowed under the term loan and the credit line were repaid in full on or prior to January 31, 2009, in accordance with the terms of the credit facility. In addition, we amended this credit facility in November 2006 to add an equipment facility up to a principal amount of \$3.0 million. We obtained advances on November 30, 2006 and February 28, 2007 with respect to the equipment facility and those advances mature on November 30, 2009 and February 28, 2010, respectively. We are not entitled under the terms of the facility to obtain any additional advances. As of May 31, 2009, the outstanding amount of our obligations under the equipment facility was \$0.2 million. The interest rate applicable to loans under the equipment facility is the bank's prime rate plus 0.25%. On July 29, 2009, we entered into a new credit facility with a bank. The new facility provides for a new revolving line of credit with a maturity date of July 28, 2010. An aggregate principal amount of up to \$9.0 million may be outstanding at any time under the revolving line. The interest rate applicable to the revolving line is, at our option, equal to either (i) the sum of the Prime Rate (as defined in the facility) plus 0.25%, or (ii) the sum of the LIBOR Rate (as defined in the facility) plus 3.25%. The new credit facility also incorporates under its terms the outstanding \$0.2 million owed under the prior equipment facility, but the repayment terms of the prior equipment facility otherwise remain unchanged.

At May 31, 2009, we had available cash and cash equivalents totaling \$26.0 million. Of this amount, approximately \$11.3 million was invested in money market accounts bearing variable interest rates of between 0.04% and 9.5%. The remainder of our cash and cash equivalents is held in non-interest bearing accounts at several banks. Variable interest rate securities may produce less income than expected if interest rates fall. A 0.5% change in interest rates would not have a material impact on our financial statements.

Foreign Currency Risk

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

Our exposure to foreign exchange rate fluctuations also arises in part from parent Company's inter-company accounts which are typically denominated in the functional currency of the foreign subsidiaries. These inter-company accounts are translated into U.S. dollars; they have an impact on our operating results depending upon the movement in foreign currency rates. During the fiscal year ended May 31, 2009, our total realized and unrealized losses due to movements in foreign currencies, primarily British pound, European Union euro, Japanese yen and Australian dollar, were \$27,000. As exchange rates vary, these foreign exchange results may vary and adversely or favorably impact operating results. An unfavorable change of 10% in foreign currency rates would not have a material impact on our financial statements.

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ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SABA SOFTWARE, INC.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Saba Software, Inc.

We have audited the accompanying consolidated balance sheets of Saba Software, Inc. as of May 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended May 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Saba Software, Inc. at May 31, 2009 and 2008, and the consolidated results of its operations and its cash flows for each of the three years in the period ended May 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, in fiscal 2008, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No.109*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Saba Software, Inc.'s internal control over financial reporting as of May 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 11, 2009, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California

August 11, 2009

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Saba Software, Inc.

We have audited Saba Software's Internal Control over Financial Reporting as of May 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Saba Software, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Saba Software, Inc. maintained, in all material respects, effective internal control over financial reporting as of May 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Saba Software, Inc. as of May 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended May 31, 2009 of Saba Software, Inc. and our report dated August 11, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California

August 11, 2009

Table of Contents**SABA SOFTWARE, INC.****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share data)**

	2009	May 31,	2008
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 25,978		\$ 16,624
Restricted cash	100		100
Accounts receivable (net of allowance for doubtful accounts of \$101 at May 31, 2009 and \$309 at May 31, 2008)	20,010		22,095
Prepaid expenses and other current assets	2,245		2,893
Total current assets	48,333		41,712
Property and equipment, net	4,755		5,239
Goodwill	36,095		37,708
Purchased intangible assets, net	8,743		12,459
Restricted cash	260		260
Other assets	1,537		1,553
Total assets	\$ 99,723		\$ 98,931
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	\$ 2,620		\$ 4,017
Accrued compensation and related expenses	5,867		5,912
Accrued expenses	3,137		4,568
Deferred revenue	32,611		28,748
Current portion of debt and lease obligations	630		658
Total current liabilities	44,865		43,903
Deferred revenue	2,728		2,537
Other long-term liabilities	1,354		1,386
Accrued rent	2,211		2,363
Debt and lease obligations, less current portion			254
Total liabilities	51,158		50,443
Commitments and contingencies			
Stockholders' equity:			
Preferred stock, issuable in series: \$0.001 par value: 5,000,000 authorized shares at May 31, 2009 and 2008 none issued or outstanding			
Common stock, \$0.001 par value: 50,000,000 authorized; 29,300,148 and 29,227,656 shares issued at May 31, 2009 and 2008	30		30
Additional paid-in capital	258,128		255,637
Treasury stock: 102,997 shares at May 31, 2009 and 2008, at cost	(232)		(232)
Accumulated deficit	(209,230)		(206,875)
Accumulated other comprehensive loss	(131)		(72)
Total stockholders' equity	48,565		48,488

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Total liabilities and stockholders' equity	\$ 99,723	\$ 98,931
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See accompanying Notes to Consolidated Financial Statements.

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

	Years ended May 31,		
	2009	2008	2007
Revenues:			
License	\$ 15,139	\$ 22,041	\$ 22,621
License updates and product support	34,468	35,092	31,344
OnDemand	20,809	18,191	15,924
Professional services	32,405	32,453	29,978
Total revenues	102,821	107,777	99,867
Cost of revenues:			
Cost of license	909	839	1,196
Cost of license updates and product support	8,191	8,900	8,558
Cost of OnDemand	9,157	7,232	5,025
Cost of professional services	21,847	22,075	20,982
Amortization of acquired developed technology	1,178	1,178	1,178
Total cost of revenues	41,282	40,224	36,939
Gross profit	61,539	67,553	62,928
Operating expenses:			
Research and development	17,380	16,498	17,052
Sales and marketing	26,405	36,571	38,317
General and administrative	15,200	14,609	12,337
Restructurings	539		
Amortization of purchased intangible assets	2,538	2,538	2,538
Total operating expenses	62,062	70,216	70,244
Loss from operations	(523)	(2,663)	(7,316)
Interest income and other, net	55	626	153
Interest expense	(31)	(161)	(470)
Loss before provision for income taxes	(499)	(2,198)	(7,633)
Provision for income taxes	(1,856)	(1,344)	(341)
Net loss	\$ (2,355)	\$ (3,542)	\$ (7,974)
Basic and diluted net loss per share	\$ (0.08)	\$ (0.12)	\$ (0.28)
Shares used in computing basic and diluted net loss per share	29,174	29,016	28,541

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**SABA SOFTWARE, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(in thousands, except share data)

	Preferred Stock		Common Stock			Treasury Stock		Accumulated Other Comprehensive Income (loss)		Total Stockholders Equity
	Shares	Amount	Shares	Amount	Additional Paid in Capital	Shares	Amount	Accumulated Deficit	Income (loss)	
Balance at May 31, 2006		\$	28,509,483	\$ 29	\$ 247,716	(102,997)	\$ (232)	\$ (195,359)	\$ (307)	\$ 51,847
Issuance of common stock under employee stock purchase plan			72,890		265					265
Issuance of common stock in connection with exercise of stock options			326,273		1,225					1,225
Stock-based compensation					2,202					2,202
Cancellation of escrow shares from the acquisition of THINQ			(34)							
Net loss								(7,974)		(7,974)
Foreign currency translation adjustments									336	336
Comprehensive loss										(7,458)
Balance at May 31, 2007			28,908,612	29	251,408	(102,997)	(232)	(203,333)	29	47,901
Issuance of common stock under employee stock purchase plan			88,955	1	362					363
Issuance of common stock in connection with exercise of stock options			230,089		857					857
Stock-based compensation					3,010					3,010
Net loss								(3,542)		(3,542)
Foreign currency translation adjustments									(101)	(101)
Comprehensive loss										(3,643)
Balance at May 31, 2008			29,227,656	30	255,637	(102,997)	(232)	(206,875)	(72)	48,488
Issuance of common stock under employee stock purchase plan			72,492		150					150
Stock-based compensation					2,341					2,341
Net loss								(2,355)		(2,355)
Foreign currency translation adjustments									(59)	(59)
Comprehensive loss										(2,414)
Balance at May 31, 2009		\$	29,300,148	\$ 30	\$ 258,128	(102,997)	\$ (232)	\$ (209,230)	\$ (131)	\$ 48,565

See accompanying Notes to Consolidated Financial Statements

Table of Contents**SABA SOFTWARE, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Years ended May 31,		
	2009	2008	2007
Operating activities:			
Net loss	\$ (2,355)	\$ (3,542)	\$ (7,974)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation and amortization	2,422	1,908	1,478
Amortization of purchased intangible assets	3,716	3,955	4,036
Non-cash adjustment to goodwill	1,613	585	
Stock-based compensation	2,341	3,010	2,202
Loss on disposal of property and equipment			23
Write-off of prepaid royalties			170
Changes in operating assets and liabilities:			
Accounts receivable	1,294	(870)	(2,275)
Prepaid expenses and other current assets	569	(93)	(133)
Other assets	(46)	(576)	72
Accounts payable	(1,283)	(805)	(4,023)
Accrued compensation and related expenses	290	(82)	(419)
Accrued expenses	(623)	(40)	(792)
Deferred revenue	4,919	1,798	5,247
Accrued rent	(167)	(196)	(65)
Net cash provided by (used in) operating activities	12,690	5,052	(2,453)
Investing activities:			
Purchases of property and equipment	(2,071)	(3,467)	(2,949)
Proceeds from restricted cash		140	
Net cash used in investing activities	(2,071)	(3,327)	(2,949)
Financing activities:			
Proceeds from issuance of common stock under employee stock plans	150	1,220	1,490
Borrowings under credit facility, net of issuance costs			4,000
Repayments on borrowings under the credit facility	(331)	(4,189)	(6,167)
Borrowings under the equipment credit facility			1,192
Repayments on the equipment credit facility			(165)
Repayments under equipment term loans	(72)	(68)	(63)
Repayments of notes payable	(46)	(32)	(98)
Net cash (used in) provided by financing activities	(299)	(3,069)	189
Effect of exchange rate changes on cash and cash equivalents	(967)	(120)	272
Increase (decrease) in cash and cash equivalents	9,354	(1,464)	(4,941)
Cash and cash equivalents, beginning of period	16,624	18,088	23,029
Cash and cash equivalents, end of period	\$ 25,978	\$ 16,624	\$ 18,088
Supplemental disclosure of other cash flow information:			
Cash paid for income taxes, net of refunds	\$ 696	\$ 523	\$ 155

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Cash paid for interest	\$	31	\$	158	\$	453
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See accompanying Notes to Consolidated Financial Statements.

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company

Saba Software, Inc. (Saba or the Company) provides a software platform for enterprise learning, collaboration, performance, and talent management, as well as license updates and product support, OnDemand, implementation, training, and consulting services. Saba's solutions help its customers through the implementation of a management system for aligning goals, developing and motivating people and measuring results. By implementing Saba's solutions, organizations are better equipped to: align their workforce around the organization's business objectives; effectively manage growing regulatory requirements; increase sales and channel readiness; accelerate the productivity of new people joining the extended enterprise of employees, customers, partners and suppliers; increase both the speed of customer acquisition and long-term customer loyalty; shorten time-to-market of new products; and improve visibility into organizational performance.

To date, Saba Enterprise Learning and related services have accounted for a substantial majority of Saba's revenues. Saba anticipates that revenues from the Saba Enterprise Suite and the Saba Centra product suite, as well as related services will constitute substantially all of its revenues for the foreseeable future.

Saba sells its products and related services worldwide primarily through a direct sales force and alliance partners. The Company's corporate headquarters are located in Redwood Shores, California. In addition, the Company has international subsidiaries in India, France, Japan, Germany, the United Kingdom, Canada and Australia through which it conducts various operating activities related to its business. In each of the non-U.S. jurisdictions in which it has subsidiaries, other than India, Saba has employees or consultants engaged in sales and services activities. In the case of its India subsidiary, Saba's employees primarily engage in software development and quality assurance testing activities.

Saba was incorporated in the State of Delaware in April 1997.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Saba and its wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. Certain previously reported amounts have been reclassified to conform to the current presentation. Certain reclassifications have been made to prior period amounts to conform to the current period presentation, as follows: (i) part of the restricted cash has been classified as long-term restricted cash; and (ii) part of deferred revenue related to OnDemand has been reclassified as long term deferred revenue. Such reclassifications did not have a significant impact on the Company's gross profit, net loss of net cash (used in) provided by operating activities.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ materially from those estimates. On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable, fair values of intangible assets and goodwill, useful lives of intangible assets, property and equipment, fair values of options to purchase the Company's common stock, and valuation of deferred tax assets, among others. The Company bases its estimates for the carrying values of assets and liabilities using historical experience and other assumptions that are believed to be reasonable.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Cash and Cash Equivalents***

Cash and cash equivalents consist of highly liquid short-term investments with insignificant interest rate risk and original maturities from the date of purchase of three months or less. Cash and cash equivalents are stated at fair value based on quoted market prices.

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value:

Level 1: quoted prices in active markets for identical assets and liabilities;

Level 2: inputs other than Level 1 that are observable, either directly and indirectly, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or

Level 3: unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Saba financial assets and liabilities measured at fair value on a recurring basis, excluding accrued interest components consisted of the following types of instruments as of May 31, 2009 (Level 1 input is defined above):

	Fair Value Measurements Using Input Type
	Level 1 (in thousands)
Assets	
Money market funds (included in cash equivalents)	\$ 11,329
Total financial assets	\$ 11,329

The valuation techniques used to measure the fair values of our money market funds were derived from quoted market prices.

Fair Value of Financial Instruments

Carrying amounts of certain of Saba's financial instruments including cash, cash equivalents, trade accounts receivable, trade accounts payable and accrued liabilities approximate fair value due to their short maturities. The carrying amount of Saba's note payable, debt and capital lease obligations approximate fair value based on the terms of similar borrowing arrangements available to Saba.

The restricted cash is comprised of cash deposits of \$0.3 million and \$0.1 million related to a building lease and certain facilities leases, respectively. These funds are represented by cash or cash equivalents.

Trade Accounts Receivable and Concentrations of Credit Risk

Financial instruments that potentially subject Saba to concentrations of credit risk include cash, cash equivalents and trade accounts receivable. Management believes the financial risks associated with cash and cash equivalents are minimal because these amounts are held in banks.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Saba conducts business with companies in various industries throughout the world. Trade accounts receivable are recorded at the invoiced amount, do not bear interest, and generally do not require collateral. Saba Enterprise Learning and related services have accounted for a substantial majority of Saba's revenues since inception. An allowance is maintained for potential credit losses, and to date, such losses have been within management's expectations. The allowance for doubtful accounts is based on Saba's assessment of the amount of probable credit losses in the existing accounts receivable. Saba determines the allowance based on the aging of the accounts receivable, the financial condition of its customers and their payment history, its historical write-off experience and other assumptions. Past due balances based on purchase order terms and other specific accounts as necessary are reviewed monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The changes in the allowance for doubtful accounts are as follows:

Year Ended:	Beginning Balance	Additions or Adjustments charged to Operations	Write-Offs	Ending Balance
		(in thousands)		
May 31, 2007	\$ 114	455	167	\$ 402
May 31, 2008	\$ 402	166	259	\$ 309
May 31, 2009	\$ 309	(25)	183	\$ 101

Accounts receivable includes amounts earned but unbilled of \$2.3 million and \$2.6 million at May 31, 2009 and 2008. At May 31, 2009 and 2008, there were no customers representing more than 10% of Saba's accounts receivable balance.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets, which are generally three to five years. Assets acquired under capital lease obligations are amortized over the shorter of the estimated useful life of the asset or the life of the lease. Amortization expense for assets acquired under capital lease obligations is included with depreciation expense. Leasehold improvements are amortized over the shorter of the estimated useful lives of the assets or the life of the lease.

Purchased Intangible Assets and Goodwill

Purchased intangible assets consist of acquired developed technology, customer relationships, tradenames and customer backlog acquired as part of a purchase business combination. The intangible assets are stated at cost less accumulated amortization and are being amortized on a straight-line basis over their estimated useful lives of two to seven years.

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Goodwill represents the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired. Goodwill amounts are not amortized, but rather are tested for impairment at least annually. In the event that Saba determines that the value of goodwill has become impaired, the Company will incur an impairment charge for the fiscal quarter in which such determination is made. Goodwill is not deductible for income tax purposes.

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Software Development Costs

Saba accounts for software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, whereby costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs are capitalized. Technological feasibility is established upon completion of a working model. Through May 31, 2009, software development costs incurred subsequent to the establishment of technological feasibility have not been significant, and all software development costs have been charged to research and development expense in the accompanying consolidated statements of operations.

Income Taxes

Saba accounts for income taxes in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. Deferred income taxes are recorded for the expected tax consequences of temporary differences between the tax bases of assets and liabilities for financial reporting purposes and amounts recognized for income tax purposes. A valuation allowance is recorded to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized.

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

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

Stock Options and Equity Instruments Exchanged for Services

The Company has share-based payment award plans for its employees and directors that are described fully in Notes 7 and 8. The share-based compensation expenses associated with awards under these plans are recorded in accordance with SFAS No. 123 Revised 2004 (SFAS 123R), *Share-Based Payment*, as discussed in Note 7.

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SFAS 123R requires the use of a valuation model to calculate the fair value of share-based awards. The Company elected to use the Black-Scholes-Merton (BSM) pricing model to determine the fair value of share options on the dates of grant, consistent with that used for pro forma disclosures under SFAS 123, *Accounting for Stock-Based Compensation*.

The Company recognizes share-based compensation using the straight-line method for all stock awards issued after June 1, 2006.

Prior to June 1, 2006, the Company accounted for its share-based compensation plans under the intrinsic value method of accounting as defined by Accounting Principles Board (APB) Opinion No. 25, (APB 25), *Accounting for Stock Issued to Employees* and applied the disclosure provisions of SFAS 123, *Accounting for Stock-Based Compensation*, as amended. Under APB 25, the Company generally did not recognize any compensation expense for stock options granted to employees or outside directors as the exercise price of its

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

options was equivalent to the market price of the Company's common stock on the date of grant. However, the Company recorded share-based compensation for the intrinsic value associated with unvested options assumed in connection with acquisitions. For pro forma disclosures of share-based compensation prior to June 1, 2006, the estimated fair values for options granted and options assumed were amortized using the accelerated expense attribution method. In addition, the Company reduced pro forma share-based compensation expense for actual forfeitures in the periods they occurred. In March 2005, the United States Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 107 (SAB 107), which provides supplemental implementation guidance for SFAS 123R. The Company has applied the provisions of SAB 107 in its adoption SFAS 123R. See Note 6 for information on the impact of the Company's adoption of SFAS 123R and the assumptions the Company used to calculate the fair value of share-based employee compensation.

Basic and Diluted Net Loss Per Share

Basic and diluted net loss per share information for all periods is presented under the requirements of SFAS No. 128, *Earnings per Share*. Basic earnings per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares that may be repurchased, and excludes any dilutive effects of options, warrants and convertible securities.

The calculations of basic and diluted net loss per share are as follows:

	Years ended May 31,		
	2009	2008	2007
	(in thousands, except per share amounts)		
Net loss	\$ (2,355)	\$ (3,542)	\$ (7,974)
Weighted-average shares of common stock outstanding	29,174	29,016	28,541
Weighted-average shares of common stock used in computing basic and diluted net loss per share	29,174	29,016	28,541
Basic and diluted net loss per share	\$ (0.08)	\$ (0.12)	\$ (0.28)

If Saba had reported net income, diluted net income per share would have included common equivalent shares related to outstanding options to purchase common stock not included above of 23,340, 242,296 and 948,093 at May 31, 2009, 2008 and 2007, respectively. The common equivalent shares from options would be determined using the treasury stock method. In addition, potentially dilutive stock options representing 4.7 million, 3.5 million and 2.0 million shares of common stock for the years ended May 31, 2009, 2008 and 2007, respectively, have been excluded from the computation of diluted net loss per share because they have exercise prices, higher than the average stock price during the respective periods and their inclusion would be anti-dilutive under the treasury stock method.

Revenue Recognition

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

persuasive evidence of an agreement exists;

delivery has occurred;

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the fee is fixed or determinable; and

collection is probable.

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

License revenues from licenses with a term of three years or more are generally recognized on delivery if the other conditions of SOP 97-2 are satisfied. Saba does not grant its resellers the right of return and does not recognize revenue from resellers until an end-user has been identified and the other conditions of SOP 97-2 are satisfied. License revenues from licenses with a term of less than three years are generally recognized ratably over the term of the arrangement. License updates and product support revenue is recognized ratably over the term of the arrangement, typically 12 months. In arrangements where term licenses are bundled with license updates and product support and such revenue is recognized ratably over the term of the arrangement, we allocate the revenue to license revenue and to license updates and product support revenue based on the VSOE of fair value for license updates and product support revenue on perpetual license of similar products.

Revenue related to professional services is generally recognized as the services are performed. Although Saba provides professional services on a time and materials basis, a portion of these services is provided on a fixed-fee basis. For services performed on a fixed fee basis, revenues are generally recognized on the proportional performance of the project, with performance measured based on hours of work performed. For contracts that involve significant customization and implementation or consulting services that are essential to the functionality of the software, the license and services revenues are recognized using the percentage-of-completion method or, if we are unable to reliably estimate the costs to complete the services, we use the completed contract method of accounting in accordance with SOP 97-2 and relevant guidance of SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production Type Contracts. A contract is considered complete when all significant costs have been incurred or the item has been accepted by the customer.*

Revenue from Saba's OnDemand offerings is recognized as a service arrangement whereby the revenue is recognized ratably over the term of the arrangement or on an as-used basis if defined in the contract. Certain of its OnDemand offerings are integrated offerings pursuant to which the customers' ability to access the Company's software is not separable from the services necessary to operate the software and customers are not allowed to take possession of the Company's software, in which case revenue is recognized under the SEC's SAB No. 104, *Revenue Recognition*. Saba's OnDemand offerings also include arrangements with customers that have separately licensed and taken possession of the Company's software. When these OnDemand offerings are part of a multiple element arrangement involving licenses, Saba recognizes revenue in accordance with SOP 97-2, when the Emerging Issues Task Force (EITF) Issue No. 00-3 *Application of AICPA Statement of Position 97-2, Software Revenue Recognition to Arrangement That Include the Right to Use Software Stored on Another Entity's Hardware* criteria is met.

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If the requirements of SOP 97-2 are not met when Saba bills a customer or a customer pays Saba, the billed or paid amount is recorded as deferred revenue, a liability account. As the revenue recognition principals of SOP 97-2 are satisfied, the requisite amounts are recognized as revenue.

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In arrangements that include professional services and OnDemand offerings, but not a license of our software, we recognize revenue for professional services as the services are performed if these professional services qualify as a separate element of the arrangement. If the professional services do not qualify as a separate element of the arrangement, the related revenue are combined with the subscription revenue and recognized ratably over the subscription service period. Additionally, we defer the direct costs related to the professional services and recognize them ratably over the applicable service period. We categorize deferred revenue and deferred costs on our consolidated balance sheet as current if we expect to recognize such revenue or cost within the following twelve months. When the revenue from professional services is recognized ratably over the subscription service period, we allocate the revenue to professional services revenue and to OnDemand revenue based on the VSOE of fair value for similar professional services that qualify as a separate element of the arrangement. Our judgment as to whether the consulting services qualify as a separate unit of accounting may materially affect the timing of our revenue recognition and our results of operations.

Advertising Expense

Advertising costs are expensed as incurred and recorded in sales and marketing. Saba incurred advertising costs of \$0.2 million, \$0.1 million and \$0.1 million in fiscal 2009, 2008 and 2007, respectively.

Foreign Currency Translation

In general, the functional currency of the Company's foreign subsidiaries is the local currency. Foreign currency balance sheets are translated using end of period currency rates, while foreign currency statements of operations are translated using average rates for the period. Gains and losses resulting from translation of this foreign currency financial statements into U.S. dollars are recorded within stockholders' equity as part of accumulated other comprehensive loss.

Accumulated Other Comprehensive Income (Loss)

Comprehensive loss is comprised of net loss and other comprehensive income (loss) and is reported in the accompanying statement of stockholders' equity. Accumulated other comprehensive income (loss) is comprised of foreign currency translation activity as follows:

	May 31,	
	2009	2008
	(in thousands)	
Foreign currency translation loss	\$ (131)	\$ (72)

Accumulated other comprehensive loss

\$ (131) \$ (72)

Recent Accounting Pronouncements

In May 2009, the FASB issued SFAS 165, *Subsequent Events*. SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The Company will adopt SFAS 165 in the first quarter of fiscal 2010 and does not believe it will result in significant changes to reporting of subsequent events either through recognition or disclosure.

In April 2009, the FASB issued FASB Staff Position No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This FASB Staff Position (FSP) amends the other-than-

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

temporary impairment accounting guidance for debt securities. This Staff Position requires that other-than-temporary impairment be separated into the amount of the total impairment related to credit losses and the amount of the total impairment related to all other factors. The amount of the total other-than-temporary impairment related to credit losses is recognized in earnings and the amount related to all other factors is recognized in other comprehensive income. This Staff Position is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company will adopt FSP No. FAS 115-2 and FAS 124-2 in its first quarter of fiscal 2010 and does not believe it will have a material impact on its consolidated financial statements.

In November 2008, the FASB ratified Emerging Issues Task Force Issue No. 08-7, *Accounting for Defensive Intangible Assets*. EITF 08-7 clarifies the accounting for certain separately identifiable intangible assets which an acquirer does not intend to actively use but intends to hold to prevent its competitors from obtaining access to them. EITF 08-7 requires an acquirer in a business combination to account for a defensive intangible asset as a separate unit of accounting which should be amortized to expense over the period the asset diminishes in value. EITF 08-7 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company will adopt of EITF 08-7 effective for fiscal 2010, which could materially affect how the Company accounts for certain identifiable intangible assets that may be acquired in connection with any future acquisitions

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. In February 2008, the FASB issued FASB Staff Position No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 and FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157*. Collectively, the Staff Positions defer the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of SFAS No. 157. The Company adopted SFAS No. 157 in the first quarter of fiscal year 2009, except for those items specifically deferred under FSP No. FAS 157-2. The adoption of SFAS No. 157 did not have a material impact on the Company's consolidated financial statements and the Company is currently evaluating the impact of the full adoption of SFAS No. 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 allows entities to voluntarily choose, at specified election dates, to measure certain financial assets and financial liabilities (as well as certain non-financial instruments that are similar to financial instruments) at fair value (the fair value option). The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, SFAS No. 159 specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. The adoption of SFAS No. 159 by the Company did not have a material impact on the Company's consolidated financial statements.

In June 2007, the FASB ratified EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*. EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007. The adoption of EITF 07-3 by the Company did not have a material impact on the Company's consolidated financial statements.

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In April 2008, the FASB issued FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets*. This guidance is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets, and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) when the underlying arrangement includes renewal or extension of terms that would require substantial costs or result in a material modification to the asset upon renewal or extension. Companies estimating the useful life of a recognized intangible asset must now consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension as adjusted for SFAS 142's entity-specific factors. FSP No. FAS 142-3 is effective for the Company's beginning June 1, 2009. The Company will adopt SFAS 142-3 in fiscal 2010 and does not believe it will have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised) (SFAS No. 141(R)), *Business Combinations*. SFAS No. 141(R) changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer's income tax valuation allowance. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company will be required to adopt SFAS No. 141(R) in the first quarter of fiscal year 2010. The Company has not completed the assessment of adopting SFAS 141(R) and has not determined the impact on the Company's consolidated financial statements.

3. Property and Equipment

Property and equipment consists of the following:

	May 31,		Estimated
	2009	2008	Useful Lives
	(in thousands)		
Computer equipment	\$ 16,729	\$ 15,058	1 to 3 Years
Office furniture and fixtures	1,919	1,923	5 Years
Leasehold improvements	1,687	1,401	1 to 5 Years
Construction in process		307	
	20,335	18,689	
Less accumulated depreciation and amortization	(15,580)	(13,450)	
	\$ 4,755	\$ 5,239	

4. Purchased Intangible Assets and Goodwill

Centra Software, Inc.

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

The Centra acquisition has been accounted for as a business combination. Assets acquired and liabilities assumed were recorded at their fair values as of January 31, 2006

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The total purchase price was \$62.3 million, including acquisition related transaction costs, and is comprised of \$37.8 million of Saba common stock, \$19.4 million in cash and \$5.1 million of cash to pay various transaction costs. The purchase price was allocated to Centra's assets based on fair values at the time of the transaction. Saba allocated \$23.3 million to goodwill, \$18.1 to identifiable intangible assets and assumed \$14.0 million of Centra's liabilities. Through the acquisition of Centra, Saba also acquired \$27.7 million in cash, \$6.1 million in prepaid and other assets and \$0.9 million of property and equipment.

THINQ Learning Solutions, Inc.

On May 5, 2005, Saba acquired THINQ Learning Solutions, Inc. to support its long-term strategic direction, strengthen its competitive position in the Human Capital Management market, expand its customer base and provide greater scale to increase its investment in research and development to accelerate innovation and increase stockholder value.

The total purchase price was \$8.7 million, which consisted of \$8.0 million of Saba common stock, \$0.6 million in cash for transaction costs and \$0.1 million in cash paid to THINQ stockholders. In allocating the purchase price based on estimated fair values, Saba recorded approximately \$9.9 million of goodwill, \$5.1 million of identifiable intangible assets and \$5.9 million of net liabilities. The allocation of goodwill decreased by \$0.3 million in fiscal 2006 as a result of the return of approximately \$0.7 million in shares of common stock held in escrow, partially offset by an increase in pre-merger liabilities resulting from the acquisition. In fiscal 2007 goodwill was further reduced by \$0.1 million, primarily as a result of the reexamination and settlement of certain pre-merger assets and liabilities.

The following tables provide a summary of the carrying amounts of purchased intangible assets that continue to be amortized:

	Gross Carrying Amount	May 31, 2009 Accumulated Amortization (in thousands)	Net Carrying Amount	Weighted Average Useful Life
Customer backlog	\$ 740	\$ (740)	\$	2.4 Years
Customer relationships	14,920	(8,413)	6,507	6.3 Years
Tradenames	820	(547)	273	5 Years
Acquired developed technology	5,890	(3,927)	1,963	5 Years
Total	\$ 22,370	\$ (13,627)	\$ 8,743	

	Gross Carrying Amount	May 31, 2008 Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
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	(in thousands)			
Customer backlog	\$ 740	\$ (740)	\$	2.4 Years
Customer relationships	14,920	(6,040)	8,880	6.3 Years
Tradenames	820	(383)	437	5 Years
Acquired developed technology	5,890	(2,749)	3141	5 Years
Total	\$ 22,370	\$ (9,911)	\$ 12,459	

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Amortization expense related to purchased intangible assets was \$3.7 million, \$4.0 million and \$4.0 million in fiscal years 2009, 2008 and 2007, respectively. The total expected future amortization related to purchased intangible assets will be approximately \$3.7 million, \$3.3 million and \$1.8 million in fiscal years 2010 through 2012, respectively.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company does not amortize the cost of goodwill; rather, it examines goodwill each year for impairment and adjusts the carrying value downward if impairment is discovered. SFAS No. 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment; while the second phase, if necessary, measures the impairment. Saba operates as a single operating segment as discussed in Note 11. Accordingly, all of Saba's goodwill is associated with the entire company. During the fourth quarter of fiscal 2009, Saba performed the required annual impairment analysis and determined that there was no indication of impairment of goodwill. Any future reduction of the enterprise fair value below the amount of stockholders' equity could require Saba to write down the value of goodwill to its fair value and record an expense for the impairment loss.

The changes in the carrying amount of goodwill as of May 31, 2009, 2008 and 2007 are as follows and described in Note 3:

	Net Carrying Amount (in thousands)
Goodwill, as of May 31, 2007	\$ 38,293
Adjustments to goodwill related to the Centra acquisition	(585)
Goodwill, as of May 31, 2008	37,708
Adjustments to goodwill related to the Centra acquisition	(1,613)
Goodwill, as of May 31, 2009	\$ 36,095

During the year the Company reported net income which was offset by the utilization of acquired net operating losses. The acquired net operating losses were subject to a full valuation allowance. The tax benefits applicable to the net operating losses of the acquired entities amounted to \$1.3 million and were credited directly to goodwill with the offsetting entry being to income tax expense.

5. Debt and Lease Obligations*Credit Facility*

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On January 31, 2006, the Company entered into a credit facility with a bank that provided for (i) a term loan in a principal amount of \$6.5 million, (ii) a receivables borrowing base revolving credit line in an aggregate principal amount of up to \$7.5 million at any time outstanding, which included a sub-limit of up to \$5.0 million for letters of credit, cash management and foreign exchange services and (iii) an equipment facility up to a principal amount of \$3.0 million. All amounts borrowed under the term loan and the credit line were repaid in full on or prior to January 31, 2009, in accordance with the terms of the credit facility. The Company obtained advances on November 30, 2006 and February 28, 2007 with respect to the equipment facility, and those advances mature on November 30, 2009 and February 28, 2010, respectively. The Company is not entitled to obtain any additional advances under the equipment facility. As of May 31, 2009, the outstanding amount of the Company's obligations under the equipment facility was \$0.2 million, and the Company was in compliance with the liquidity and EBITDA covenants under the equipment facility. The equipment facility is required to be repaid in 36 equal monthly installments of principal, plus interest. The interest rate applicable to the loans under the equipment facility is the bank's prime rate plus 0.25%.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On July 29, 2009, the Company entered into a new credit facility with a bank. The new facility provides for a new revolving line of credit with a maturity date of July 28, 2010. An aggregate principal amount of up to \$9.0 million may be outstanding at any time under the revolving line. With respect to borrowings in excess of \$4.0 million, the revolving line is a receivables borrowing base credit facility. The revolving line also includes a sublimit of up to \$4.0 million for letters of credit, cash management and foreign exchange services. The interest rate applicable to the revolving line is, at the Company's option, equal to either (i) the sum of the Prime Rate (as defined in the facility) plus 0.25%, or (ii) the sum of the LIBOR Rate (as defined in the facility) plus 3.25%. The new credit facility also incorporates under its terms the outstanding \$0.2 million owed under the prior equipment facility, but the repayment terms of the prior equipment facility otherwise remain unchanged.

The equipment facility and the new credit facility are secured by all of the Company's personal property other than its intellectual property. The facilities includes certain negative covenants restricting or limiting the ability of the Company and its subsidiaries to, among other things: encumber its intellectual property; incur additional indebtedness; create liens on its property; make certain investments and acquisitions; merge or consolidate with any other entity; convey, sell, lease, transfer or otherwise dispose of assets; change its business; experience a change of control; pay dividends, distributions or make other specified restricted payments or repurchases; and enter into certain transactions with affiliates. Such restrictions and limitations are subject to usual and customary exceptions contained in credit agreements of this nature. In addition, the facilities require the Company to satisfy a minimum consolidated EBITDA covenant on a quarterly basis and a minimum liquidity covenant on a monthly basis. If the Company violates any of these restrictive covenants or otherwise breaches the credit facility agreement, the Company may be required to repay the obligations under the facilities prior to their stated maturity date, and the bank may be able to foreclose on any collateral provided by the Company. If the new facility had been in place on May 31, 2009, the Company would have been in compliance with these covenants as of such date

Leases

Saba leases its office facilities under various non-cancelable operating leases that expire at various dates through 2014. Rent expense was \$4.4 million, \$4.6 million, and \$4.4 million in fiscal years 2009, 2008 and 2007, respectively. Rent expense of Saba's facility leases is recognized on a straight-line basis over the term of the lease. The difference between the amounts paid and the amounts expensed is classified as accrued rent in the consolidated balance sheets.

During the quarter ended February 28, 2009, the Company entered into a non-cancelable three year contract for software services of which \$1.0 million remained as of May 31, 2009.

The following table summarizes Saba's future minimum lease payments, contract obligations and principal payments under debt obligations as of May 31, 2009.

Total	FY 2010	Payments due by fiscal year			FY 2014	Thereafter
		FY 2011	FY 2012	FY 2013		

(in thousands)

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Contractual obligations:							
Long-term debt obligations	\$ 254	\$ 254	\$	\$	\$	\$	\$
Long-term contract commitment	965	386	386	193			
Operating lease obligations	17,836	3,722	3,842	3,814	3,509	2,949	
Other long-term liabilities	210	105	105				
Total	\$ 19,265	\$ 4,467	\$ 4,333	\$ 4,007	\$ 3,509	\$ 2,949	\$

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Share-Based Compensation

On June 1, 2006, the Company adopted SFAS 123R, *Share-Based Payment*, using the modified prospective method allowed by that statement. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding prior to the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the SFAS 123 pro forma disclosures.

The adoption of SFAS 123R had and will have a material impact on the Company's consolidated results of operations.

Summary of Assumptions

Prior to June 1, 2006, the Company applied the intrinsic value recognition and measurement principles of APB 25, in accounting for share-based incentives. Accordingly, the Company was not required to record compensation expense when stock options were granted to eligible participants as long as the exercise price was not less than the fair market value of the stock when the option was granted. The Company was also not required to record compensation expense in connection with its 2000 Employee Stock Purchase Plan (ESPP) as long as the purchase price of the stock was not less than 85% of the lower of the fair market value of the stock at the beginning of each offering period or at the end of each purchase period. Effective June 1, 2006, the Company's adoption of the fair value recognition provisions of SFAS 123R, as interpreted by SAB 107 using the modified prospective transition method resulted in the recognition of share-based compensation expense for the fiscal year ended May 31, 2007 which included: (a) compensation expense for all share-based instruments granted prior to, but not yet vested as of June 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, *Accounting for Stock-Based Compensation*, and (b) compensation expense for all share-based instruments granted on or after June 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R.

The Company currently uses the BSM option pricing model to determine the fair value of stock options and ESPP shares. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the expected term of the awards; the Company's expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. Through December 2007, the Company estimated the expected term of share-based awards granted by applying the simplified method in accordance with SAB 107, which provides supplemental implementation guidance for SFAS 123R. Beginning January 2008, the Company estimates the expected term of the share-based awards based on its historical option activities including option exercises and holding patterns in accordance with SFAS 123R. The Company estimates the volatility of its common share-based upon its historical stock price volatility over the length of the expected term of the options. The Company bases the risk-free interest rate that it uses in the option valuation model on U.S. Treasury zero-coupon issues with remaining maturities similar to the expected term of the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation

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expense only for those awards that are expected to vest. The expected term of employee stock purchase plan shares is the average of the remaining purchase periods under each offering period.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following assumptions have been used to value the awards granted under the Company's stock option plans and stock purchased under the ESPP:

	2009	Years ended May 31, 2008	2007
<i>Stock Option Plans:</i>			
Expected life (years)	4.1	3.8	4.1
Risk-free interest rate	1.6%	3.5%	4.7%
Dividend yield	0%	0%	0%
Expected volatility	59%	49%	66%
Weighted-average fair value of grants	\$ 0.73	\$ 2.00	\$ 3.16
<i>Employee Stock Purchase Plan:</i>			
Expected life (years)	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0
Risk-free interest rate	0.5%	4.6%	4.9%
Dividend yield	0%	0%	0%
Expected volatility	77%	46%	45%

The following table summarizes the stock-based compensation expense for stock options and ESPP shares that was recorded in the Company's results of operations in accordance with SFAS 123R for the fiscal year ended May 31, 2009.

	2009	Years Ended May 31, 2008	2007
	(in thousands, except per share data)		
Cost of revenues	\$ 384	\$ 399	\$ 286
Research and development	426	467	414
Sales and marketing	729	939	868
General and administrative	802	1,204	634
Share-based compensation expense included in net loss	\$ 2,341	\$ 3,009	\$ 2,202

The share-based compensation expense categorized by various equity components is summarized in the table below:

	2009	Years Ended May 31, 2008	2007
	(in thousands)		
Stock options	\$ 2,202	\$ 2,799	\$ 2,055
Employee stock purchase plan	139	210	147
Total share-based compensation	\$ 2,341	\$ 3,009	\$ 2,202

In order to provide an incentive to its employees, the board of directors (Board) of the Company approved a modification of the contractual term of certain vested and unvested options outstanding as of March 10, 2009 to extend their contractual term from six years to ten years. As a result of this modification, incremental share-based compensation expense for vested awards totaling \$0.4 million was recorded on March 10, 2009. In addition, incremental share-based compensation expense for unvested awards totaling \$0.3 million will be recognized over the remaining vesting periods of the unvested awards that were modified. The incremental share-based compensation expense for vested and unvested awards was determined using the BSM valuation model as the excess of the fair values of the modified replacement awards over the fair value of the existing unmodified awards determined as of March 10, 2009.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Share based compensation expenses for fiscal 2008 include a one-time non-cash charge of \$0.6 million related to an employment agreement amendment which modified the events that trigger accelerated vesting of options and allowed for an extension of the standard exercise terms during fiscal 2008. The incremental share-based compensation expense for vested and unvested awards was determined using the BSM valuation model as the excess of the fair values of the modified replacement awards over the fair value of the existing unmodified awards determined as of July 6, 2007. The current assumptions ranged as follows: expected volatility of 42% to 49%; risk free interest rates of 4.9% to 5.0%; and expected term (years) of 0.75 to 3.5.

7. Stockholders Equity***Shares of Common Stock Reserved for Future Issuance***

As of May 31, 2009 Saba had reserved the following shares of common stock for issuance:

Stock options outstanding	4,933,143
Restricted Stock Units	352,200
Stock options available for future grant	761,345
Employees stock purchase plan	770,832
	6,632,334

Employee Stock Purchase Plan

Under the Company's 2000 Employee Stock Purchase Plan (ESPP), eligible employees may purchase common stock at 85% of the lesser of the fair market value of Saba's common stock on the first day of the applicable two-year offering period or the last day of the applicable six-month purchase period. Beginning June 1, 2001, shares reserved for issuance under the ESPP increase annually in increments equal to the lesser of (i) 500,000 shares, (ii) two percent of the outstanding shares at June 1 of each year, or (iii) a lesser number of shares determined by the Board of Directors. Shares issued under the ESPP were 72,492 during fiscal year 2009 and 88,955 during fiscal year 2008. As of May 31, 2009, 770,832 shares were available for issuance under the ESPP.

Stock Option Plans

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Under the 1997 Stock Option Plan, as amended, (the 1997 Plan), Saba may grant options to purchase up to 2,703,807 shares of common stock to employees, directors and consultants at prices not less than the fair market value at the date of grant for incentive stock options (110% in certain circumstances) and not less than 85% of fair market value for non-statutory stock options. Options generally expire ten years from the date of grant and generally vest over four years. As of May 31, 2009, shares are no longer available for issuance under the 1997 Plan.

In January 2000, the Board of Directors adopted the 2000 Stock Incentive Plan (the 2000 Plan) and reserved 1,500,000 shares for grant under the 2000 Plan. The terms of the 2000 Plan are substantially similar to the 1997 Plan, except that options generally expire six years from the date of grant. Beginning June 1, 2001, stock options reserved for issuance under the 2000 Plan increase annually in increments equal to the lesser of (i) 750,000 shares, (ii) five percent of the outstanding shares on June 1, or (iii) a lesser number of shares determined by the Board of Directors. On January 16, 2009, the Board of Directors implemented and issued from the 2000 Plan, restricted stock units as an incentive to the employees. In addition, on March 10, 2009 the Board of Directors approved a modification of the contractual term of certain options outstanding by extending their contractual term from six to ten years. As of May 31, 2009, 761,345 shares were available for issuance under the 2000 Plan.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Details of activity under the 1997 Plan and 2000 Plan are as follows:

	Number of Shares	Weighted- Average Exercise Price per Share
Balance, May 31, 2006	3,932,104	\$ 5.28
Granted	2,485,782	\$ 6.17
Exercised	(326,273)	\$ 3.66
Canceled	(1,376,986)	\$ 7.44
Balance, May 31, 2007	4,714,627	\$ 5.23
Granted	2,004,725	\$ 4.84
Exercised	(230,089)	\$ 3.73
Canceled	(1,620,007)	\$ 5.58
Balance, May 31, 2008	4,869,256	\$ 5.03
Granted	1,286,150	\$ 1.63
Restricted stock units	352,200	
Exercised		
Canceled	(1,222,263)	\$ 5.40
Balance, May 31, 2009	5,285,343	\$ 4.06

Additional information regarding options outstanding as of May 31, 2009 is as follows:

Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price	
\$ 0.00 - \$ 1.20	303,685	5.5	\$ 1.02	3,685	\$ 1.20	
\$ 1.21 - \$ 2.90	1,005,520	6.9	\$ 1.72	226,416	\$ 2.43	
\$ 2.91 - \$ 3.69	582,934	6.8	\$ 3.47	320,630	\$ 3.62	
\$ 3.70 - \$ 3.85	329,913	4.6	\$ 3.78	329,913	\$ 3.78	
\$ 3.86 - \$ 4.19	207,231	6.0	\$ 4.14	200,212	\$ 4.14	
\$ 4.20 - \$ 5.00	885,288	7.8	\$ 4.67	479,542	\$ 4.71	
\$ 5.01 - \$ 5.59	438,127	7.5	\$ 5.15	242,196	\$ 5.13	
\$ 5.60 - \$ 6.30	700,471	7.4	\$ 6.16	412,607	\$ 6.14	
\$ 6.31 - \$ 6.60	479,974	7.0	\$ 6.40	331,624	\$ 6.40	

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4,933,143	6.9	\$	4.06	2,546,825	\$	4.69
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The Company defines in-the-money stock options outstanding or vested at May 31, 2009 as options that had exercise prices that were lower than the \$3.57 market price of its common stock at that date. The intrinsic value of exercised options is the difference between the market price and the exercise price multiplied by the total number of shares issued on the date of the exercise. There were no exercised options during fiscal 2009. The aggregate intrinsic value of in-the-money options outstanding at May 31, 2009 is calculated as the difference between the exercise price of the underlying options and the market price of the Company's common stock. At May 31, 2009, there were options to purchase 1,519,000 shares that were in-the-money, of which 267,000 options were exercisable at that date. The total intrinsic value of in-the-money options outstanding at May 31, 2009 was \$2.7 million of which \$0.3 million was related to exercisable options.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company recorded \$2.3 million in stock-based compensation expense before income tax benefits during the fiscal year ended May 31, 2009 for stock options granted and shares purchased under the ESPP in its consolidated statement of operations. As of May 31, 2009, the Company had a total of \$2.3 million of unrecognized compensation expense before income tax benefits related to non-vested stock-based compensation arrangements granted under all of its equity compensation plans. Unrecognized compensation cost will be adjusted for future changes in estimated forfeitures and other factors. The Company expects to recognize this cost over a weighted average period of 1.5 years.

8. Income Taxes

The provision for income taxes is comprised of the following:

	Years ended May 31,		
	2009	2008	2007
	(in thousands):		
Current:			
Federal	\$ 37	\$ 34	\$
Foreign	522	676	302
State	56	46	39
	615	756	341
Deferred:			
Foreign	(142)		
Federal	1,383	588	
	1,241	\$ 588	\$
Total provision	\$ 1,856	\$ 1,344	\$

The components of loss before provision for income taxes for the years ended May 31, 2009, 2008 and 2007 are as follows:

	Years ended May 31,		
	2009	2008	2007
	(in thousands):		
United States	\$ (2,242)	\$ (3,901)	\$ (8,476)
Foreign	1,743	1,703	843
	\$ (499)	\$ (2,198)	\$ (7,633)

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has not provided U.S. income taxes on certain non-U.S. subsidiaries for which the earnings are permanently reinvested. Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities are as follows:

	May 31,	
	2009	2008
	(in thousands)	
Deferred tax assets:		
Net operating loss carryforwards	\$ 78,694	\$ 78,758
Deferred revenue	786	783
Accruals	1,852	2,053
Property, equipment and purchased intangible assets	384	1,148
Foreign deferred tax asset	142	
Tax credit carryforwards	4,799	4,433
SFAS 123R	421	504
Valuation allowance	(83,515)	(82,708)
Total deferred tax assets	3,563	4,971
Deferred tax liabilities:		
Purchased intangible assets	(3,438)	(4,846)
Other	17	(125)
Net deferred tax assets	\$ 142	\$

A reconciliation of income tax expense at the statutory federal income tax rate to net income tax expense included in the accompanying consolidated statement of operations is as follows:

	Years ended May 31,		
	2009	2008	2007
	(in thousands)		
Income tax benefit at the federal statutory rate	\$ (175)	\$ (769)	\$ (2,672)
State taxes, net of federal benefit	36	24	25
Change in valuation allowance	808	688	
Use of acquired net operating losses	453	589	
Non-deductible expenses and other	239	47	68
Non-deductible stock compensation	907	727	453
Foreign tax at lower rates	(352)	(180)	35
Prior year true up and other	70	91	
R&D credits	(195)	(50)	(179)
Tax Reserve	65	177	
Losses not benefited			2,611
Total	\$ 1,856	\$ 1,344	\$ 341

The Company's India subsidiary operates under a 10 year tax holiday which will expire in 2010. The net impact of the tax holiday is immaterial.

As of May 31, 2009, the Company had net operating loss carryforwards of approximately \$210.0 million for federal tax purposes and approximately \$101.0 million for state tax purposes. Saba also has research credit carryforwards of federal tax purposes of approximately \$3.0 million and approximately \$2.5 million for state tax purposes. If not utilized, the federal net operating loss and research credit carryforwards will expire in various amounts from fiscal 2010 through fiscal 2029. The state net operating loss carryforwards will expire in fiscal 2009 through 2029 and the California state research credit will carry forward indefinitely. The Massachusetts

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

research credit carryforward will expire beginning in 2015. Utilization of net operating loss and tax credit carryforwards may be subject to substantial annual limitations in the future due to any ownership changes as provided by the Internal Revenue Code and similar state provisions. The annual limitations based on such potential ownership changes could result in the expiration of the net operating loss and tax credit carryforwards before utilization.

A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. Based on available evidence, including the Company's history of operating losses, and lack of any carryback potential, the Company has determined that a valuation allowance continues to be necessary for all US deferred tax assets. The deferred taxes of the Company's India subsidiary are more likely than not to be realized and therefore no valuation allowance is established against them.

During the year the Company reported net income which was offset by the utilization of acquired net operating losses. The acquired net operating losses were subject to a full valuation allowance. The tax benefits applicable to the net operating losses of the acquired entities amounted to \$1.3 m and were credited directly to goodwill with the offsetting entry being to income tax expense.

The aggregate changes in the balance of the gross unrecognized tax benefits were as follows (in thousands):

Gross unrecognized tax benefit as of June 1, 2007 (FIN48 adoption date)	\$ 7,348
Increase related to tax positions taken from prior fiscal years, including acquisitions	43
Increase related to tax positions taken during Fiscal 2008	173
Settlements with tax authorities	(275)
Total gross unrecognized tax benefit as of May 31, 2008	7,289
Increase related to tax positions taken from prior fiscal years, including acquisitions	2,528
Increase related to tax positions taken during Fiscal 2009	883
Settlements with tax authorities	(82)
Total gross unrecognized tax benefit as of May 31, 2009	\$ 10,618

As of May 31, 2009, \$0.9 million of unrecognized benefits would affect the Company's effective tax rate if realized. The Company recognized interest and penalties related to uncertain tax positions in the provision for income tax line of the consolidated statements of operations of \$0.1 million during fiscal 2009. The gross amount of interest and penalties accrued as of May 31, 2009 was \$0.5 million. Domestically, there are currently no examinations for U. S federal and state taxing authorities. Internationally, tax authorities from a number of non-U.S. jurisdictions are examining returns affecting unrecognized tax benefits. The Company believes that, as of May 31, 2009, the gross unrecognized tax benefits will not materially change in the next twelve months. The Company believes that it has adequately provided for any reasonably foreseeable outcomes related to any tax audits and that any settlement will not have a material adverse effect on the consolidated financial position or results of operations. However, there can be no assurances as to the possible outcomes.

9. Retirement Plan

Saba has established the Saba Software 401(k) Plan (the "401(k) Plan") under section 401(k) of the Internal Revenue Code, covering substantially all of its U.S. employees. Under the 401(k) Plan, participating employees may defer a portion of their pretax earnings subject to an annual contribution limit. Saba may also make matching contributions equal to a discretionary percentage of the employees' deferral. To date, no matching contributions have been made.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****10. Segment Information**

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

Geographic Information

The following tables represent revenue and long-lived assets information by geographic area as of and for the fiscal years ended May 31, 2009, 2008 and 2007. Long-lived assets consist of property and equipment, goodwill and purchased intangible assets:

	2009	Total Revenue 2008	2007	Long-Lived Assets 2009	2008
	(in thousands)				
United States	\$ 72,602	\$ 77,767	\$ 66,384	\$ 48,836	\$ 54,657
United Kingdom	14,090	12,789	11,842	429	643
Rest of the World	16,129	17,221	21,641	328	310
Total	\$ 102,821	\$ 107,777	\$ 99,867	\$ 49,593	\$ 55,610

Long-lived assets located in the United Kingdom have been classified with the Rest of the World.

Major Customers

For fiscal years 2009, 2008 and 2007, no customer accounted for greater than 10% of revenues.

11. Litigation*Litigation Relating to Initial Public Offering of Saba*

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

On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all of the actions, including the action involving the Company. On July 15, 2002, the Company, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On February 19, 2003, the District Court ruled on the motions. The District Court granted the Company's motion to dismiss the claims against it under

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Rule 10b-5, due to the insufficiency of the allegations against the defendants. The District Court also granted the motion of the individual defendants, Bobby Yazdani and Terry Carlitz, the Company's Chief Executive Officer and Chairman of the Board and former Chief Financial Officer and a member of the Company's Board of Directors, to dismiss the claims against them under Rule 10b-5 and Section 20 of the Exchange Act. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including the Company.

In June 2003, a proposed collective partial settlement of this litigation was structured between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. In June 2004, an agreement of partial settlement was submitted to the District Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the District Court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" rather than in all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing has been scheduled for September 10, 2009. Following the hearing, if the Court determines that the settlement is fair to the class members, the settlement will be approved and the case against the Company and the individual defendants will be dismissed with prejudice. There can be no assurance that this proposed settlement will be approved and implemented in its current form, or at all.

Due to the inherent uncertainties of litigation and because the settlement approval process is at a preliminary stage, the ultimate outcome of the matter is uncertain.

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The Company intends to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, the ultimate outcome of the litigation is uncertain. An unfavorable outcome in litigation could materially and adversely affect the Company's business, financial condition and results of operations.

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Litigation Relating to Centra's Initial Public Offering

Centra, certain of its former officers and directors and the managing underwriters of Centra's initial public offering were named as defendants in an action filed in the District Court. The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve the Centra defendants on or about March 18, 2002. The original complaint has been superseded by an amended complaint filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, is purportedly brought on behalf of the class of persons who purchased Centra's common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act and Sections 10(b) and 20(a) of the Exchange Act. The complaint alleges that, in connection with Centra's initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the aftermarket at pre-determined prices. The complaint asserts that Centra's registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92.

On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all the actions, including the action involving Centra. On July 15, 2002, Centra, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On October 9, 2002, the plaintiffs dismissed, without prejudice, the claims against the named Centra officers and directors in the above-referenced action. On February 19, 2003, the District Court issued an order denying the motion to dismiss the claims against Centra under Rule 10b-5. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including Centra.

In June 2003, a proposed collective partial settlement of this litigation was structured between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. In June 2004, an agreement of settlement was submitted to the District Court for preliminary approval. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005 the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The District Court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the District Court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" rather than in all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing. In light of the Second Circuit opinion, counsel for the issuer defendants informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing has been scheduled for September 10, 2009. Following the hearing, if the Court determines that the settlement is fair to the class members, the settlement will be approved and the case against the Company and the individual defendants will be dismissed with prejudice. There can be no assurance that this proposed settlement will be approved and implemented in its current form, or at all.

Due to the inherent uncertainties of litigation and because the settlement approval process is at a preliminary stage, the ultimate outcome of the matter is uncertain.

On December 28, 2007, the underwriter defendants moved to strike class allegations in 26 cases, including Centra's, in which the plaintiffs failed to identify proposed class representatives, and the issuer defendants joined in the motion. On May 13, 2008, the District Court granted the motion in part and struck the class allegations in eight cases in which the proposed class representative was not a member of the class. The District Court denied the motion with respect to the remaining 18 cases, including Centra's case. For those 18 cases, the District Court ordered the plaintiffs to notify the defendants and the District Court of the identity of the putative class representatives and the basis of each putative representative's claim, and indicate whether the putative representatives are members of the proposed class. On April 2, 2009, the plaintiffs submitted a list of proposed class representatives for each action in conjunction with the motion for preliminary approval of the settlement.

The Company, on behalf of Centra, intends to dispute these claims and defend the law suit vigorously. However, due to the inherent uncertainties of litigation, the ultimate outcome of the litigation is uncertain. An unfavorable outcome in litigation could materially and adversely affect the Company's business, financial condition and results of operations.

Litigation Relating to Claim of Patent Infringement by Centra

On August 19, 2003, a complaint was filed against Centra and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)) (the Colorado District Court). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. Centra has filed an answer to the complaint denying all of the allegations. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred. Centra filed a request for reexamination of the patents at issue with the U.S. Patent and Trademark Office (the Patent Office). The Company's patent counsel is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the Colorado District Court had approved the parties' motion to stay the court proceedings during the re-examination

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proceedings. A reexamination certificate has issued for one of the patents that canceled all of the patent's claims, thus rendering that patent of no further force or effect. The Patent Office issued a reexamination certificate for the other patent confirming the rejection of all of the patent's original claims and allowing certain newly-added claims. The Company believes it is free from liability for past actions, as it believes the newly-added claims would be enforceable only prospectively as of the issue date of the reexamination certificate. The Company believes that it has meritorious defenses with respect to any future

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SABA SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Litigation Relating to Claim of Patent Infringement by Saba

On November 19, 2007, a complaint was filed against the Company and ten other defendants by Gemini IP, LLC, in the United States District Court for the Eastern District of Texas (No. 07-CV-521) (the "Texas District Court"). The complaint alleges infringement of a patent directed to a method for processing client help requests using a computer network and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. The Company has filed an answer to the complaint denying all of the allegations. At the Company's request, the United States Patent and Trademark Office (the "Patent Office") has instituted reexamination proceedings against the asserted patent and the Texas District Court has stayed the action pending the outcome of those proceedings. The Company believes that it has meritorious defenses with respect to the asserted patent and intends to vigorously defend this action. However, due to the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of the litigation. An unfavorable outcome of the litigation could materially and adversely affect the Company's business, financial condition and results of operations.

Other Litigation

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

12. Guarantees

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

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

Other guarantees include promises to indemnify, defend and hold harmless each of the Company's executive officers, non-employee directors and certain key employees from and against losses, damages and costs incurred by each such individual in administrative, legal or investigative proceedings arising from alleged wrongdoing by the individual while acting in good faith within the scope of his or her job duties on behalf of the Company. Historically, minimal costs have been incurred relating to such indemnifications and, as such, no accruals for these guarantees have been made.

13. Restructuring

During fiscal year 2009, management approved and initiated a plan to decrease costs during the third and fourth quarters by eliminating approximately 5% of the workforce across all functions (the 2009 Plan). The

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

restructuring eliminated 23 positions during the third quarter, 19 positions in the fourth quarter and charges for the workforce reduction consisted primarily of severance and fringe benefits. The restructuring charges are classified as Restructuring on the statement of operations and totaled approximately \$0.5 million during the six months ended May 31, 2009 of which approximately \$0.4 million had been paid as of May 31, 2009.

During fiscal 2009, the components of accrued restructuring charges and movements within these components through May 31, 2009 for the 2009 Plan were as follows

	Workforce Reduction Charges (in thousands)
Additions	\$ 539
Deductions cash payments	(402)
Impact of exchange rates	9
Accrual as of May 31, 2009	\$ 146

During fiscal 2006, as part of the acquisition of Centra, management approved and initiated a plan to restructure and eliminate duplicative pre-merger activities and reduce the Company's cost structure (the Centra Restructuring). Total restructuring costs associated with exiting activities of Centra at January 31, 2006 were preliminarily estimated to be approximately \$2.0 million. During fiscal 2006, additional costs related to facilities were identified and accrued as of May 31, 2006. These costs were included as part of the Centra preliminary purchase price allocation. During the year ending May 31, 2007, management made certain additional adjustments to the accrued Centra Restructuring, including an additional accrual for abandoned facilities related to a change in estimates used to calculate the accrual and settlement of employee termination benefits.

During fiscal 2009, the components of accrued restructuring charges and movements within these components through May 31, 2009 for the Centra Restructuring were as follows:

	Workforce Reduction Charges	Facilities Related Charges (in thousands)	Total
Accrual as of May 31, 2006	\$ 927	\$ 593	\$ 1,520
Adjustments	(32)	312	280
Deductions cash payments	(803)	(553)	(1,356)
Impact of exchange rates		2	2

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Accrual as of May 31, 2007	92	354	446
Adjustments	(9)		(9)
Deductions cash payments	(83)	(312)	(395)
Impact of exchange rates			
Accrual as of May 31, 2008		42	42
Adjustments		(42)	(42)
Accrual as of May 31, 2009	\$	\$	\$

During fiscal 2007, the Company reduced its general and administrative expenses by the amount of the remaining portion of the restructuring accrual of \$0.2 million.

Table of Contents**SABA SOFTWARE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****14. Related Party Transactions**

During fiscal years 2009, 2008 and 2007, Saba licensed its software and sold related support and services to Varian Medical Systems, Inc. (Varian), Masimo Corporation (Masimo) and Duck Creek Technologies, Inc. (Duck Creek). The Executive Vice President of Varian, the Chairman and Chief Executive Officer of Masimo and a member of Duck Creek's Board of Directors serve as directors on Saba's Board of Directors.

During fiscal 2009, the components of related party transactions and movements were as follows:

	Sales to Related Party			Accounts Receivable	
	2009	2008	2007	2009	2008
	(in thousands)				
Varian Medical Systems, Inc.	\$ 291	\$ 290	\$ 523	\$ 15	\$ 20
Masimo Corporation	11	102	21	1	29
Duck Creek Technologies, Inc.	43	32	181		2
Total	\$ 273	\$ 424	\$ 725	\$ 125	\$ 55

15. Subsequent Events***Credit Facility***

As stated in Note 5 of Notes to Consolidated Financial Statements, on July 29, 2009, the Company entered into a new credit facility with a bank. The new facility provides for a new revolving line of credit with a maturity date of July 28, 2010. An aggregate principal amount of up to \$9.0 million may be outstanding at any time under the revolving line. With respect to borrowings in excess of \$4.0 million, the revolving line is a receivables borrowing base credit facility. The revolving line also includes a sublimit of up to \$4.0 million for letters of credit, cash management and foreign exchange services. The interest rate applicable to the revolving line is, at the Company's option, equal to either (i) the sum of the bank's prime rate (as defined in the facility) plus 0.25%, or (ii) the sum of LIBOR (as defined in the facility) plus 3.25%.

Shareholder Rights Plan

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On June 2, 2009, the Company entered into a Rights Agreement (the "Rights Agreement") with Mellon Investor Services LLC, as rights agent. In connection with the Rights Agreement the Board of Directors of the Company authorized and declared a dividend of one right for each outstanding share of the Company's common stock to stockholders of record at the close of business on June 15, 2009. Each right entitles the registered holder, subject to the terms of the Rights Agreement, to purchase from the Company one one-thousandth of a share (a "Unit") of Series A Preferred Stock, par value \$0.001 per share at a purchase price of \$12.50 per Unit, subject to adjustment. The rights will expire at the close of business June 2, 2012 unless earlier redeemed or exchanged. Until a right is exercised, the holder thereof, as such, will have no rights as one of the Company's stockholders, including the right to vote or to receive dividends. The rights are not immediately exercisable. Subject to the terms and conditions of the Rights Agreement, they will become exercisable ten business days after a person or group acquires, or commences a tender or exchange offer which would lead to the acquisition of, beneficial ownership of 15% or more of the Company's outstanding common stock. Once a person or group acquires beneficial ownership of 15% or more of the Company's outstanding common stock, subject to the terms of the rights agreement, each right not owned by that person or group or certain related parties will entitle its holder to purchase, at the right's then-current purchase price, units of Series A Preferred Stock or, at the Company's option, shares of common stock or cash, property or other securities of the Company having a market value equal to twice the then-current purchase price.

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ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A: CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.*

Saba Software maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of May 31, 2009 to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) *Changes in internal control over financial reporting.*

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting during our fiscal fourth quarter ended May 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

(c) *Management's report on internal control over financial reporting.*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for Saba. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Saba's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Saba; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures

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are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

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Saba's management assessed the effectiveness of our internal control over financial reporting as of May 31, 2009, utilizing the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on the assessment by our management, we determined that Saba's internal control over financial reporting was effective as of May 31, 2009. The effectiveness of our internal control over financial reporting as of May 31, 2009 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included in Part IV, Item 15 of this Annual Report.

/s/ BOBBY YAZDANI Bobby Yazdani	Chief Executive Office and Chairman of the Board (Principal Executive Officer)	August 11, 2009
/s/ WILLIAM SLATER William Slater	Chief Financial Officer (Principal Financial and Accounting Officer)	August 11, 2009

ITEM 9B: OTHER INFORMATION

None.

Table of Contents**PART III****ITEM 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Information with respect to this item is incorporated by reference from our definitive proxy statement for our 2009 annual meeting of stockholders to be filed with the SEC within 120 days of the end of our fiscal year ended May 31, 2009.

We have adopted a code of ethics that is designed to qualify as a code of ethics within the meaning of Section 406 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder. This code of ethics is available on our website at www.saba.com. To the extent required by law, any amendments to, or waivers from, any provision of the code of ethics will be promptly disclosed to the public. To the extent permitted by such legal requirements, we intend to make such public disclosure by posting the relative material on our website in accordance with SEC rules.

ITEM 11: EXECUTIVE COMPENSATION

Information with respect to this item is incorporated by reference from our definitive proxy statement for our 2009 annual meeting of stockholders to be filed with the SEC within 120 days of the end of our fiscal year ended May 31, 2009.

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS***Equity Compensation Plan Information***

The following table gives information about our common stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans as of May 31, 2009 including the 1997 Stock Incentive Plan, the 2000 Stock Incentive Plan and the 2000 Employee Stock Purchase Plan.

	(a) Number of securities to be issued upon exercise of outstanding options, warrants, and rights	(b) Weighted-average exercise price of outstanding options, warrants, and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column(a))
Equity compensation plans approved by security holders:			
Option Plans	4,933,143	\$ 4.06	761,345
Restricted Stock Units	352,200	\$	

Employee Stock Purchase Plan

\$

770,832

Information with respect to this item is incorporated by reference from our definitive proxy statement for our 2009 annual meeting of stockholders to be filed with the SEC within 120 days of the end of our fiscal year ended May 31, 2009.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information with respect to this item is incorporated by reference from our definitive proxy statement for our 2009 annual meeting of stockholders to be filed with the SEC within 120 days of the end of our fiscal year ended May 31, 2009.

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ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information with respect to this item is incorporated by reference from our definitive proxy statement for our 2009 annual meeting of stockholders to be filed with the SEC within 120 days of the end of our fiscal year ended May 31, 2009.

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PART IV

ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. *Financial Statements*

	Page
<u>Reports of Independent Registered Public Accounting Firm</u>	52
<u>Consolidated Balance Sheets</u>	54
<u>Consolidated Statements of Operations</u>	55
<u>Consolidated Statements of Stockholders' Equity</u>	56
<u>Consolidated Statements of Cash Flows</u>	57
<u>Notes to Consolidated Financial Statements</u>	58

2. *Financial Statement Schedules*

All schedules have been omitted as they are either not required or not applicable, or the required information is included in the consolidated financial statements or notes thereto.

3. *Index to Exhibits*

See Index to Exhibits on page 90.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SABA SOFTWARE, INC.

By: */s/ BOBBY YAZDANI*
 Bobby Yazdani
Chief Executive Officer and

Chairman of the Board

Dated: August 12, 2009

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints each of Bobby Yazdani and William Slater as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
<i>/s/ BOBBY YAZDANI</i> Bobby Yazdani	Chief Executive Office and Chairman of the Board (Principal Executive Officer)	August 12, 2009
<i>/s/ WILLIAM SLATER</i> William Slater	Chief Financial Officer (Principal Financial and Accounting Officer)	August 12, 2009
<i>/s/ GEORGE DE URIOSTE</i> George de Urioste	Director	August 12, 2009

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/s/ JOE E. KIANI

Director

August 12, 2009

Joe E. Kiani

/s/ DOW R. WILSON

Director

August 12, 2009

Dow R. Wilson

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EXHIBIT INDEX

Exhibit	
Number	Document
3.1 ⁽¹⁾	Amended and Restated Certificate of Incorporation of the Company effective as of April 12, 2000.
3.2 ⁽²⁾	Amendment to Amended and Restated Certificate of Incorporation of the Company effective as of May 12, 2003.
3.3 ⁽³⁾	Amendment to Amended and Restated Certificate of Incorporation of the Company effective as of November 19, 2004.
3.4 ⁽¹⁰⁾	Certificate of Designation of the Series A Preferred Stock, as filed with the Secretary of State of Delaware on June 2, 2009.
3.5 ⁽¹¹⁾	Amended and Restated Bylaws of the Company effective as of June 2, 2009.
4.1 ⁽¹⁰⁾	Rights Agreement by and between the Company and Mellon Investor Services LLC dated June 2, 2009.
4.2	Reference is made to Exhibits 3.1 through 3.5.
10.1 ⁽⁴⁾	Form of Indemnification Agreement between the Company and each of its officers and directors.
*10.2 ⁽⁴⁾	1997 Stock Incentive Plan.
*10.3 ⁽⁴⁾	Form of 2000 Stock Incentive Plan.
*10.4 ⁽⁴⁾	Form of 2000 Employee Stock Purchase Plan.
*10.5.1 ⁽⁵⁾	Form of Notice of Option Grant for Certain Executive Officers.
*10.5.2	Form of Restricted Stock Unit Agreement Under 2000 Stock Incentive Plan.
10.7 ⁽⁴⁾	Lease Agreement dated March 16, 1999 between the Company and Westport Joint Venture for the Company's Redwood Shores, California headquarters.
10.8 ⁽¹³⁾	Amended and Restated Loan and Security Agreement dated as of July 29, 2009, by and between the Company and Silicon Valley Bank.
10.12 ⁽⁶⁾	Form of Warrant.
*10.13 ⁽⁹⁾	Amended and Restated Employment Agreement, effective April 8, 2009, by and between the Company and Bobby Yazdani
*10.14 ⁽⁹⁾	Amended and Restated Employment Agreement, effective April 8, 2009, by and between the Company and Peter E. Williams III.
*10.20.1 ⁽⁷⁾	Executive Officers' Incentive Plan (Second Half Fiscal Year 2009).
*10.20.2 ⁽¹²⁾	Executive Officers' Incentive Plan (Fiscal Year 2010).
*10.21.1 ⁽⁸⁾	Employment agreement, effective December 8, 2008, by and between the Company and William Slater.
*10.21.1 ⁽⁹⁾	Amended and Restated Employment agreement, effective April 8, 2009, by and between the Company and William Slater.
21.1	List of Subsidiaries of the Company.
23.1	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney. (See page 89.)
31.1	Certification of Bobby Yazdani, Chief Executive Officer and Chairman of the Board, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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Exhibit

Number Document

- | | |
|------|---|
| 31.2 | Certification of William Slater, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Bobby Yazdani, Chief Executive Officer and Chairman of the Board, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of William Slater, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
-
- (1) Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (Registration No. 333-95761).
 - (2) Incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 2003.
 - (3) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended November 30, 2004.
 - (4) Incorporated by reference to the same number exhibit previously filed with the Company's Registration Statement on Form S-1 (Registration No. 333-95761).
 - (5) Incorporated by reference to the Company's Annual Report on Form 10-K filed August 30, 2004.
 - (6) Incorporated by reference to the Company's Current Report on Form 8-K filed August 11, 2004.
 - (7) Incorporated by reference to the Company's Current Report on Form 8-K filed January 9, 2009.
 - (8) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed January 9, 2009.
 - (9) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed April 8, 2009.
 - (10) Incorporated by reference to the Company's Current Report on Form 8-K filed June 2, 2009.
 - (11) Incorporated by reference to Exhibit 3.3 to the Company's Current Report on Form 8-K filed June 2, 2009.
 - (12) Incorporated by reference to the Company's Current Report on Form 8-K filed July 21, 2009.
 - (13) Incorporated by reference to the Company's Current Report on Form 8-K filed July 31, 2009.

* Management contracts or compensatory plans or arrangements.