SUPPORTSOFT INC
Form 10-Q
November 06, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended September 30, 2008

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 No. 000-30901

SUPPORTSOFT, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

1900 Seaport Boulevard, 3rd Floor

Redwood City, CA 94063

(Address of Principal Executive Offices)

(Zip Code)

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

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

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 small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 x

On October 31, 2008, 46,334,341 shares of the Registrant s Common Stock, $0.0001 par value, were outstanding.

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QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUPPORTSOFT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 30, 2008 (Unaudited)	December 31, 2007 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 71,304	$ 12,926
Short-term investments	4,765	100,014
Accounts receivable, net	8,157	10,087
Prepaid expenses and other current assets	2,153	2,531
Total current assets	86,379	125,558
Long-term investments	22,212	
Property and equipment, net	1,675	2,086
Goodwill	12,646	9,792
Purchased technology	1,375	
Intangible assets, net	459	340
Other assets	573	682
Total assets	$ 125,319	$ 138,458
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 270	$ 461
Accrued compensation	2,114	2,320
Other accrued liabilities	3,032	3,421
Deferred revenue, less long-term portion	8,018	10,076
Total current liabilities	13,434	16,278
Deferred revenue, long-term portion	766	426
Other long-term liabilities	1,101	892
Total Liabilities	15,301	17,596
Commitments and contingencies		
Stockholders equity:		
Common stock	5	5
Additional paid-in capital	216,230	212,188
Accumulated other comprehensive loss	(3,340)	(772)
Accumulated deficit	(102,877)	(90,559)
Total stockholders equity	110,018	120,862

Total liabilities and stockholders equity	$ 125,319	$ 138,458

(1) Derived from the December 31, 2007 audited Consolidated Financial Statements included in the Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on March 13, 2008.

See accompanying notes.

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SUPPORTSOFT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenue:				
License	$ 2,861	$ 2,586	$ 8,732	$ 11,725
Maintenance	3,987	4,201	11,884	12,035
Services	3,822	4,258	11,705	10,721
Consumer	2,110	278	3,704	702
Total revenue	12,780	11,323	36,025	35,183
Costs and expenses:				
Cost of license	60	52	203	141
Cost of maintenance	473	630	1,487	1,929
Cost of services	3,424	3,891	10,673	11,725
Cost of consumer	2,582	1,420	5,692	3,296
Amortization of intangible assets	71	272	160	817
Research and development	2,231	2,366	6,651	7,071
Sales and marketing	5,639	6,909	17,735	22,938
General and administrative	2,614	2,229	7,695	7,290
Total costs and expenses	17,094	17,769	50,296	55,207
Loss from operations	(4,314)	(6,446)	(14,271)	(20,024)
Interest income and other, net	158	1,636	2,328	5,019
Loss before income taxes	(4,156)	(4,810)	(11,943)	(15,005)
Provision for income taxes	(184)	(212)	(375)	(558)
Net loss	$ (4,340)	$ (5,022)	$ (12,318)	$ (15,563)
Basic and diluted net loss per share	$ (0.09)	$ (0.11)	$ (0.27)	$ (0.34)
Shares used in computing basic and diluted net loss per share	46,119	45,614	46,083	45,449

See accompanying notes.

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SUPPORTSOFT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Operating Activities:		
Net loss	$ (12,318)	$ (15,563)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization and depreciation	1,072	1,804
Amortization of premiums and discounts on investments	(489)	(761)
Stock-based compensation	3,661	3,731
Realized loss on investments	73	
Changes in assets and liabilities:		
Accounts receivable, net	1,975	6,719
Prepaid expenses and other current assets	354	653
Other long-term assets	74	(57)
Accounts payable	(201)	95
Accrued compensation	(253)	(92)
Other accrued liabilities	(765)	65
Other long-term liabilities	141	597
Deferred revenue	(1,789)	(5,789)
Net cash used in operating activities	(8,465)	(8,598)
Investing Activities:		
Purchases of property and equipment	(377)	(2,367)
Purchased technology	(1,375)	
Purchases of investments	(38,276)	(78,781)
Sales of investments	39,840	37,250
Maturities of investments	69,467	54,656
Acquisition of business, net of cash acquired	(2,778)	
Net cash provided by investing activities	66,501	10,758
Financing Activities:		
Proceeds from issuances of common stock	381	4,564
Net cash provided by financing activities	381	4,564
Effect of exchange rate changes on cash and cash equivalents	(39)	(15)
Net increase in cash and cash equivalents	58,378	6,709
Cash and cash equivalents at beginning of period	12,926	15,369
Cash and cash equivalents at end of period	$ 71,304	$ 22,078
Supplemental schedule of cash flow information:		

Income taxes paid	$	360	$	363

See accompanying notes.

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SUPPORTSOFT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of SupportSoft, Inc. (the Company or SupportSoft) and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated. The balance sheet as of September 30, 2008 and the statements of operations for the three and nine months ended September 30, 2008 and 2007 and cash flows for the nine months ended September 30, 2008 and 2007 are unaudited. In the opinion of management, these unaudited interim Condensed Consolidated Financial Statements reflect all adjustments (consisting of normal recurring adjustments) that are necessary for a fair presentation of the results for, and as of, the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The Condensed Consolidated Financial Statement information as of December 31, 2007 is derived from audited financial statements as of that date. These unaudited interim Condensed Consolidated Financial Statements should be read with the consolidated financial statements and related notes included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 13, 2008.

Use of Estimates

The preparation of interim Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the Condensed Consolidated Financial Statements and the accompanying notes. Actual results could differ materially from these estimates.

Reclassifications

We have reclassified certain amounts previously reported in our financial statements to conform to current presentation. These reclassifications did not have a material impact on our consolidated financial statements.

Revenue Recognition

Enterprise Business

SupportSoft recognizes revenue from arrangements that contain a more than incidental software component in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition,* as amended by SOP 98-4 and SOP 98-9. License revenue is recognized when all of the following criteria are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred;
- Collection is considered probable; and
- The fees are fixed or determinable.

SupportSoft considers all arrangements with payment terms longer than 90 days not to be fixed or determinable. If the fee is determined not to be fixed or determinable, revenue is recognized as payments become due from the customer. Revenue is recognized net of any applicable state sales tax.

License revenue is comprised of fees for perpetual and term licenses of our software. Perpetual license revenue is recognized using the residual method, in compliance with SOP 98-9 for arrangements in which licenses are sold with multiple elements. We allocate revenues on these licenses based upon the fair value of each undelivered element including undelivered maintenance, consulting and training. The determination of fair value is based upon vendor specific objective evidence (VSOE). VSOE for maintenance is based upon separate renewals of maintenance from customers. VSOE for consulting or training is based upon separate sales of these services to customers. Assuming all other revenue recognition criteria are met, the difference between the total arrangement fee and the amount deferred for each undelivered element is recognized as license revenue.

Term licenses are sold with maintenance for which SupportSoft does not have VSOE of fair value for maintenance fees. As a result, license revenue for term licenses is recognized ratably over the duration of the agreement. License revenue in the accompanying financial statements includes maintenance for term licenses. We do not allocate maintenance revenue from term licenses to maintenance revenue, as we do not believe there is an allocation methodology that provides a meaningful and supportable allocation between license and maintenance revenues. Term license revenue was 2% and 3% of total revenue for the three months ended September 30, 2008 and 2007, respectively. For the nine months ended September 30, 2008 and 2007, term license revenue was 3% and 4% of total revenue, respectively.

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

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

Services revenue is primarily comprised of revenue from professional services such as consulting and training. Arrangements are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. In the event services are considered essential to the functionality of other elements of the arrangement, revenue under the arrangement is recognized using contract accounting. Non-essential consulting and training revenues, which form the majority of our services revenues, are generally recognized as the services are performed or project milestones are accepted by the customer.

In connection with licensing arrangements we may also provide hosting of our own software, a service for which SupportSoft does not have VSOE. If hosting services are sold with perpetual licenses, license revenue is recognized ratably over the term of the hosting contract. Hosting revenue is also recognized ratably over the duration of the hosting contract. Consulting services sold in conjunction with arrangements that include licenses and hosting services are recognized ratably over the duration of the hosting term.

Consumer Business

Revenue in our consumer business is derived primarily from fees for technology support services. These services include those that are delivered at the time of purchase of a new computer or device, attach services; diagnose-and-repair services, which are designed to resolve problems with computers and other devices; and set up services, which provide the initial provisioning for devices. We provide these services through channel partners and directly to consumers. Channel partners are generally invoiced monthly for services delivered during that period (i.e., a sale is made through to their end-user). Fees from transactions directly with consumers are generally paid with a credit card at the time of delivery. Revenue is recognized in the period the services are delivered. The Company provides an allowance for estimated refunds based on historical experience. Refunds have not been material to date. Our consumer business generally provides a five-day warranty. We also license certain of our consumer software products to partners who use our software to provide services to their customers. Partners are charged a per-use fee for the software and revenue is recognized in the period the product is used.

Cash, Cash Equivalents and Investments

All liquid instruments with an original maturity at the date of purchase of ninety days or less are classified as cash equivalents. Cash equivalents and short-term investments consist primarily of money market funds, commercial paper, corporate and municipal bonds and notes and securities issued by the United States government. Long-term investments consist of auction-rate debt securities. Our cash equivalents and investments are classified as available-for-sale, and are reported at fair value with unrealized gains and losses included in accumulated other comprehensive income within stockholders equity on the consolidated balance sheets. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in interest income and other, net in the consolidated statements of operations. We recorded net unrealized gains/(losses) on investments of $(2.4) million and $21,000 at September 30, 2008 and December 31, 2007, respectively.

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

The following is a summary of cash, cash equivalents and investments at September 30, 2008 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash	$ 6,643	$	$	$ 6,643
Money market funds	55,682			55,682
Commercial paper	10,757		(5)	10,752
Corporate bonds	3,000		(8)	2,992
Auction-rate securities	24,600		(2,388)	22,212
	$ 100,682	$	$ (2,401)	$ 98,281
Classified as:				
Cash and cash equivalents	$ 62,325	$	$	$ 62,325
Short-term investments	13,757		(13)	13,744
Long-term investments	24,600		(2,388)	22,212
	$ 100,682	$	$ (2,401)	$ 98,281

At September 30, 2008 and December 31, 2007 we had investments in AAA-rated auction-rate debt securities with various state student loan authorities with a fair value of $22.2 million and $38.9 million, respectively. All of the securities we have invested in are rated AAA, the highest rating issued by a rating agency, and the student loans made by these authorities are substantially guaranteed by the federal government through the Federal Family Education Loan Program (FFELP). Auction-rate securities are long-term floating rate bonds tied to short-term interest rates. After the initial issuance of the securities, the interest rate on the securities is reset periodically, at intervals established at the time of issuance (e.g., every seven days, twenty-eight days, thirty-five days, or every six months), based on market demand. Auction-rate securities are bought and sold in the marketplace through a competitive bidding process often referred to as a Dutch auction. If there is insufficient interest in the securities at the time of an auction, the auction may not be completed. Following such a failed auction, we cannot access our funds that are invested in the corresponding auction-rate securities until a future auction of these investments is successful, new buyers express interest in purchasing these securities in between reset dates, issuers establish a different form of financing to replace these securities, or final payments become due according to contractual maturities. In the months from February through October 2008 the auctions failed for all of the auction-rate securities we held as of September 30, 2008, and as a result our ability to liquidate our investment and fully recover the carrying value of our investment in the near term may be limited or not exist.

In August 2008, UBS, the broker-dealer for 85% of our auction-rate securities, announced a settlement under which it offers to provide liquidity solutions for, or purchase, the auction-rate securities held by its institutional clients. In October 2008, UBS extended an offer of rights to us to sell our eligible auction-rate securities at par value back to UBS during the time period from June 30, 2010 through July 2, 2012. All of the auction-rate securities we hold with UBS qualify as eligible for purposes of the rights offer. Under the offer, UBS will have sole discretion, without prior notice to the Company, to purchase or sell eligible securities and return par value to the Company up through July 2, 2012. In November 2008, we elected to accept the offer of rights from UBS. In addition, the offer of rights includes the right to a loan from UBS at no net cost, for up to the amount of the par value of our eligible auction-rate securities. The loan option is available until June 30, 2010. The rights represent a freestanding financial instrument for accounting purposes. As such, we expect to recognize the fair value of the repurchase right as an asset and a corresponding gain to earnings. In addition, we expect to recognize unrealized losses relating to the decline in value of our auction-rate securities through earnings as an other-than-temporary impairment, as we would no longer demonstrate the positive intent to hold the securities until related credit markets recover.

The fair value of our auction-rate securities at September 30, 2008 reflects an unrealized loss of $2.4 million. Fair value for such securities was based on a discounted cash flow valuation that takes into account a number of factors including estimated duration, credit quality, and the percentage of FFELP guarantee. We made assumptions about future cash flows based on contractual interest rate formulas and used estimates of market data, including yields of trading securities that we believe to be similar or comparable.

Presently we have determined the decline in value to be temporary because; i) we have the intent and ability to hold these securities in the near term in order to recoup their par values; ii) through September 30, 2008 all of the securities have maintained their AAA credit ratings; iii) loans made by the issuers are backed by the federal government; and iv) we have noted no deterioration in the credit quality of the issuers.

Fair Value Measurements

Effective January 1, 2008, SupportSoft adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices 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.

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.

In accordance with SFAS No. 157, the following table represents our fair value hierarchy for our financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of September 30, 2008 (in thousands):

	Level 1	Level 2	Level 3	Total
Money market funds	$ 55,682	$	$	$ 55,682
Commercial paper		10,752		10,752
Corporate bonds		2,992		2,992
Auction-rate securities			22,212	22,212
	$ 55,682	$ 13,744	$ 22,212	$ 91,638

Level 3 assets consist of auction-rate debt securities with various state student loan authorities. Beginning in February 2008 and through September 30, 2008, all auctions for these securities have failed. Based on the continued failure of these auctions and the underlying maturities of the securities, we have classified auction-rate securities as long-term assets on our balance sheets. The fair value of these investments as of September 30, 2008 was estimated by management. The following table provides a summary of changes in fair value of our Level 3 financial assets as of September 30, 2008 (in thousands):

Auction-rate securities	Three Months ended September 30, 2008	Nine Months ended September 30, 2008
Beginning balance	$ 23,265	$
Transfer into Level 3		25,300
Sales	(200)	(700)
Unrealized loss included in other comprehensive income	(853)	(2,388)

Ending balance	$	22,212	$	22,212

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, investments and trade accounts receivable. Our investment portfolio consists of investment grade securities. Except for obligations of the United States government and securities issued by agencies of the United States government, we diversify our investments by limiting our holdings with any individual issuer. We also limit the amount of credit risk exposure to any one country except the United States. We are exposed to credit risks in the event of default by the issuers of the securities we hold to the extent of the amount recorded on the balance sheet. At September 30, 2008, we held approximately $22.2 million of AAA-rated student loan auction-rate debt securities.

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The student loans made by the issuers of these securities are substantially guaranteed by the federal government through FFELP. Prior to February 2008, these securities had not experienced failed auctions, however, since February 2008 all auctions for these securities have failed. See the Cash, Cash Equivalents and Investments section of this Note 1 to the Condensed Consolidated Financial Statements for more information.

The credit risk in our trade accounts receivable is substantially mitigated by our credit evaluation process, reasonably short payment terms and because we sell our products primarily to large organizations in different industries. At September 30, 2008, Customer A and Customer B each accounted for 11% and 16% of our total accounts receivable, respectively. At December 31, 2007, the same Customer A and Customer C and Customer D accounted for 12%, 11% and 11%, respectively, of total accounts receivable.

For the three months ended September 30, 2008, three customers accounted for 10% or more of total revenue; Customer A accounted for 12%, Customer B accounted for 15% and Customer E accounted for 12% of total revenue. For the nine months ended September 30, 2008, the same Customer A accounted for 15% of total revenue. No other customer individually accounted for 10% or more of total revenue. For the three months ended September 30, 2007, one customer (Customer A) accounted for 21% of our total revenue. For the nine months ended September 30, 2007, the same customer, Customer A accounted for 18% of our revenue. For the three and nine months ended September 30, 2007, no customer other than Customer A accounted for more than 10% of our total revenue.

Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount. We perform evaluations of our customers financial condition and generally do not require collateral. We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically provided for, provisions are recorded at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current payment trends. If the historical data we use to calculate the allowance for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected. At September 30, 2008 and December 31, 2007, we had an allowance for doubtful accounts of $280,000 and $310,000, respectively.

Purchased Technology

Purchased technology consists of software that we licensed and incorporated into our product and service offerings. Purchased technology is accounted for in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.* Upon general release of the product that includes the licensed software, the costs will be amortized using the straight line method over an estimated useful life in a range of 3-5 years.

Goodwill and Purchased Intangible Assets

Goodwill is measured as the excess of the cost of acquisition over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed. We record purchased intangible assets at fair value. The original cost is amortized on a straight-line basis over the estimated useful life of each asset.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), we review goodwill and other intangible assets that have indefinite useful lives for impairment at least annually in our third fiscal quarter, or more frequently if an event occurs indicating the potential for impairment. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* , (SFAS No.144), we review intangible assets that have finite useful lives and other long-lived assets when an event occurs indicating the potential for impairment. In our reviews, we look for facts or circumstances, either internal or external, indicating that we may not recover the carrying value of the asset. We measure impairment losses related to long-lived assets based on the amount by which the carrying amounts of these assets exceed their fair values.

Stock-Based Compensation

We comply with SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R), which requires the measurement and recognition of compensation expense for all stock-based payment awards, including employee stock options and employee stock purchases, made to employees and directors based on estimated fair values.

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The fair value of our stock options granted to employees and employee stock purchases for the three and nine months ended September 30, 2008 and 2007 was estimated using the following assumptions:

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Stock Option Plan:				
Risk-free interest rate	2.7%	4.1%	2.5%	4.7%
Expected term	4.1 years	3.8 years	4.1 years	3.8 years
Volatility	51.4%	51.2%	51.4%	51.2%
Estimated forfeitures	9%	8%	9%	8%
Expected dividend	0%	0%	0%	0%
Weighted average fair value	$ 1.48	$ 2.32	$ 1.57	$ 2.47
Employee Stock Purchase Plan (ESPP):				
Risk-free interest rate	1.5%	4.7%	1.5%	4.7%
Expected term	0.5 years	0.5 to 2.0 years	0.5 years	0.5 to 2.0 years
Volatility	58.6%	54.1%	58.6%	54.1%
Estimated forfeitures	8%	8%	8%	8%
Expected dividend	0%	0%	0%	0%
Weighted average fair value	$ 1.15	$ 1.66	$ 1.15	$ 1.66

We recorded the following stock-compensation expense for the three and nine months ended September 30, 2008 and 2007 (in thousands):

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Stock option compensation expense recognized in:				
Cost of maintenance	$ 18	$ 21	$ 55	$ 55
Cost of services	129	184	472	530
Cost of consumer	19		49	
Research and development	144	122	397	345
Sales and marketing	453	482	1,304	1,389
General and administrative	364	387	1,302	1,291
	$ 1,127	$ 1,196	$ 3,579	$ 3,610
ESPP compensation expense recognized in:				
Cost of maintenance	$ 1	$ 1	$ 2	$ 4
Cost of services	4	9	13	34
Cost of consumer	3		21	
Research and development	8	7	15	21
Sales and marketing	6	11	19	42
General and administrative	5	5	12	20
	$ 27	$ 33	$ 82	$ 121
Stock-based compensation expense included in total costs and expenses	$ 1,154	$ 1,229	$ 3,661	$ 3,731

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The following table represents stock option activity for the nine months ended September 30, 2008:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding options at the beginning of the period	12,738,765	$ 4.98		
Granted	2,186,574	3.67		
Exercised	(2,333)	0.10		
Forfeited	(1,702,366)	5.47		
Outstanding options at the end of the period	13,220,640	$ 4.70	5.05	$ 517
Options vested and expected to vest	12,148,791	$ 4.75	4.94	$ 517
Outstanding exercisable at the end of the period	6,875,060	$ 5.12	4.52	$ 517

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value that would have been received by the option holders had they all exercised their options on September 30, 2008. This amount changes based on the fair market value of our stock. During the three and nine months ended September 30 2008, aggregate intrinsic value of options exercised under our stock option plans was 8,000. During the three and nine months ended September 30, 2007, the aggregate intrinsic value of options exercised under our stock option plans was $89,000 and $1.5 million, respectively. The total fair value of options vested during the three and nine months ended September 30, 2008 was $1.2 million and $3.6 million, respectively. The total fair value of options vested during the three and nine months ended September 30, 2007 was $1.2 million and $3.6 million, respectively.

At September 30, 2008, there was $11.3 million of unrecognized compensation cost related to existing options outstanding, which is expected to be recognized over a weighted average period of 2.6 years.

Net Loss Per Share

Basic and diluted net loss per share are presented in accordance with SFAS No. 128, *Earnings per Share* (SFAS No. 128), for all periods presented. In accordance with SFAS No. 128, basic and diluted net loss per share have been computed using the weighted-average number of common shares outstanding during the periods. For the three and nine months ended September 30, 2008 and 2007, the outstanding options were excluded from the computation of diluted net loss per share since their effect would have been anti-dilutive.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net loss	$ (4,340)	$ (5,022)	$ (12,318)	$ (15,563)
Shares used in computing basic and diluted net loss per share	46,119	45,614	46,083	45,449
Basic and diluted net loss per share	$ (0.09)	$ (0.11)	$ (0.27)	$ (0.34)

Warranties and Indemnifications

Our enterprise business generally provides a warranty for its software products and services to its customers and accounts for its warranties under SFAS No. 5, *Accounting for Contingencies* (SFAS No. 5). Our standard warranty period is 90 days, but warranty periods can sometimes be longer and vary from customer to customer. In the event there is a breach of such warranties, we generally

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are obligated to correct the product or service to conform to the warranty provision or, if we are unable to do so, the customer is entitled to seek a refund of the purchase price of the product or service. In certain contracts a material breach of warranty may involve penalties payable to the customer. We did not provide for a warranty accrual as of September 30, 2008 or December 31, 2007. To date, our product warranty expense has not been significant.

Our consumer business generally provides a five-day warranty in which we will use reasonable efforts to re-perform the services we provide to consumers. If those efforts are unsuccessful within the applicable warranty period, consumers are entitled to seek a refund of the fees they paid for those services. The consumer warranties provided through our consumer channel partners vary, depending on the structure of our relationships with those channel partners and the partners warranty commitments to their customers. To date, our consumer services refunds have not been significant.

We generally agree to indemnify customers who license software from us against legal claims that our software products infringe certain third-party intellectual property rights. We account for our indemnification obligations under SFAS No.5. To date, we have not been required to make any payment resulting from infringement claims asserted against our customers and have not recorded any related accruals.

Recent Accounting Pronouncements

In December 2007, FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R). SFAS No. 141R will significantly change the accounting for business combinations in a number of areas, including the measurement of assets and liabilities acquired and the treatment of contingent consideration, contingencies, acquisition costs, in-process research and development and restructuring costs. In addition, under SFAS No. 141R, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will affect the income tax provision. SFAS No. 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning after December 15, 2008, which means that it will be effective for our fiscal year beginning January 1, 2009. Early adoption is prohibited. We are currently evaluating the impact of adopting SFAS No. 141 on our consolidated financial statements.

In December 2007, FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS No. 160) which establishes accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for business arrangements entered into in fiscal years beginning on or after December 15, 2008, which means that it will be effective for our fiscal year beginning January 1, 2009. Early adoption is prohibited. We are currently evaluating the impact of adopting SFAS No. 160 on our consolidated financial statements. We do not expect the adoption of SFAS No. 160 to have a significant impact on our financial statements.

In March 2008, FASB issued SFAS No. 161 *Disclosures About Derivative Instruments and Hedging Activities* (SFAS No. 161). SFAS No. 161 is intended to enhance the current disclosure framework in FASB Statement 133 *Accounting for Derivative Instrument and Hedging Activities.* SFAS No. 161 requires enhanced disclosures about an entity s derivative and hedging activities. SFAB No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We are currently evaluating the impact of adopting SFAS No. 161 on our consolidated financial statements. We do not expect the adoption of SFAS No. 161 to have a significant impact on our financial statements.