FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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FILER

KANA SOFTWARE INC

CIK:**1089907**| IRS No.: **770435679** | State of Incorp.:**DE** | Fiscal Year End: **1231**
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2007

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

For the transition period from ______ to ______

Commission File number 000-27163

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

Delaware	**77-0435679**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

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

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

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

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

Large Accelerated Filer ☐ Accelerated Filer ☐ Non-Accelerated Filer ☒

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

On April 30, 2007, approximately 36,208,055 shares of the registrant' s Common Stock, $0.001 par value per share, were outstanding.

Kana Software, Inc.
Form 10-Q
Quarter Ended March 31, 2007

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

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

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$5,313	$5,719
Restricted cash	75	74
Accounts receivable, net of allowance of $200 and $155 at March 31, 2007 and December 31, 2006, respectively	7,789	8,756
Prepaid expenses and other current assets	2,121	1,967
Total current assets	15,298	16,516
Restricted cash, long-term	991	990
Property and equipment, net	1,175	1,221
Goodwill	8,623	8,623
Acquired intangible assets, net	–	15
Other assets	2,820	2,970

Total assets	$28,907	$30,335
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Loan payable	$2,000	$–
Note payable	221	327
Accounts payable	4,024	2,684
Accrued liabilities	5,617	6,880
Accrued restructuring	1,955	1,844
Deferred revenue	15,511	15,825
Total current liabilities	29,328	27,560
Deferred revenue, long-term	281	410
Accrued restructuring, long-term	3,608	4,258
Other long-term liabilities	1,120	1,239
Total liabilities	34,337	33,467
Commitments and contingencies (Note 6)		
Stockholders' equity deficit:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	–	–

Common stock, $0.001 par value; 250,000,000 shares authorized; 36,204,944 and 35,972,283 shares issued and outstanding	36	36
Additional paid-in capital	4,303,974	4,302,495
Accumulated other comprehensive income	144	171
Accumulated deficit	(4,309,584)	(4,305,834)
Total stockholders' deficit	(5,430)	(3,132)
Total liabilities and stockholders' deficit	$28,907	$30,335

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2007	2006 Restated (2)
	(unaudited)	
Revenues:		
License fees	$3,616	$ 2,861
Services	9,418	8,572
Total revenues	13,034	11,433
Costs and expenses (1):		
Cost of license fees	287	451
Cost of services	3,068	2,287
Amortization of acquired intangible assets	15	33
Sales and marketing	6,193	3,749
Research and development	3,652	2,570
General and administrative	3,503	2,289
Restructuring	–	10
Total costs and expenses	16,718	11,389

Income (loss) from operations	(3,684)	44
Interest and other income (expense), net	(19)	(658)
Registration rights penalty	–	(337)
Loss before income tax expense	(3,703)	(951)
Income tax expense	(47)	(28)
Net loss	$(3,750)	$ (979)
Basic and diluted net loss per share	$(0.10)	$ (0.03)
Shares used in computing basic and diluted net loss per share	36,019	33,924

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

Cost of services	$68	$ 54
Sales and marketing	223	190
Research and development	69	92
General and administrative	392	44

(2) Subsequent to the issuance of the Company' s interim condensed consolidated statements for the quarter ended March 31, 2006, the Company determined that non-cash compensation expenses relating to certain options granted in 1999 were incorrectly recorded in the first quarter of 2006. Additionally, certain other expense items were recorded in the improper quarter within 2006. As a result, the operating results for the quarter ended March 31, 2006 have been restated. See "*Restatement relating to stock-based compensation and other revenue and expense items*" included in Note 1 to the condensed consolidated financial statements.

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2007	2006 Restated (1)
	(unaudited)	
Cash flows from operating activities:		
Net loss	$(3,750)	$ (979)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	265	396
Loss on the disposal of property and equipment	–	46
Amortization of acquired intangible assets	15	33
Stock-based compensation	870	606
Provision for doubtful accounts	45	55
Restructuring	–	10
Registration rights penalty	–	337
Non-cash interest accretion	34	23
Change in fair value of warrant liability	–	562
Changes in operating assets and liabilities, net of effects of acquisitions:		

Accounts receivable	955	(146)
Prepaid expenses and other assets	–	486
Accounts payable and accrued liabilities	(45)	(2,688)
Accrued restructuring	(543)	(750)
Deferred revenue	(487)	(1,010)
Net cash used in operating activities	(2,641)	(3,019)
Cash flows from investing activities:		
Purchases of property and equipment	(219)	(51)
(Increase) decrease in restricted cash	(2)	18
Net cash used in investing activities	(221)	(33)
Cash flows from financing activities:		
Borrowings on loan payable, net	2,000	457
Borrowings on note payable	71	–
Repayments on note payable	(219)	–
Net proceeds from issuances of common stock and warrants	609	–
Net cash provided by financing activities	2,461	457
Effect of exchange rate changes on cash and cash equivalents	(5)	25

Net decrease in cash and cash equivalents	(406)	(2,570)
Cash and cash equivalents at beginning of period	5,719	6,216
Cash and cash equivalents at end of period	$5,313	$ 3,646

(1) Subsequent to the issuance of the Company' s interim condensed consolidated financial statements for the quarter ended March 31, 2006, the Company determined that non-cash compensation expenses relating to certain options granted in 1999 were incorrectly recorded in the first quarter of 2006. Additionally, certain other expense items were recorded in the improper quarter within 2006. As a result, the statement of cash flows for the quarter ended March 31, 2006 has been restated. See "*Restatement relating to stock-based compensation and other revenue and expense items*" included in Note 1 to the condensed consolidated financial statements.

See accompanying notes to unaudited condensed consolidated financial statements.

KANA SOFTWARE, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Nature of Operations

Kana Software, Inc. and its subsidiaries (the "Company" or "KANA") were incorporated in July 1996 in California and reincorporated in Delaware in September 1999. KANA develops, markets and supports customer communications software products. The Company sells its products primarily in the United States and Europe, and to a lesser extent, in Asia, through its direct sales force and third party integrators. References to "we," "our" and "us" collectively refer to KANA, our predecessor and our subsidiaries and its predecessors.

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of KANA and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Unaudited Interim Financial Information

The unaudited condensed consolidated financial statements have been prepared by KANA and reflect all normal, recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the interim financial information. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2007. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted under the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with KANA' s audited consolidated financial statements and notes included in KANA' s Annual Report on Form 10-K for the year ended December 31, 2006, filed with the SEC on April 2, 2007. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Restatement relating to stock-based compensation and other revenue and expense items

The financial information as of and for the three months ended March 31, 2006 is restated since it has been revised from the amounts previously stated in our Quarterly Report on Form 10-Q filed with the SEC on July 28, 2006. Subsequent to the issuance of the Company' s interim condensed consolidated financial statements for the quarter ended March 31, 2006, the Company determined that non-cash compensation expenses relating to certain options granted in 1999 were incorrectly recorded in the first quarter of 2006. Additionally, certain other expense items were recorded in the improper quarter within 2006. The restatement is further discussed in Note 14 of the consolidated financial statements in the Company' s Form 10-K for the year ended December 31, 2006 filed with the SEC on April 2, 2007.

Use of Estimates

The preparation of the interim unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ materially from those estimates.

Revenue Recognition

The Company recognizes revenues in accordance with the American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended.

Revenue from software license agreements is recognized when the basic criteria of software revenue recognition have been met (i.e. persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, and collection is probable).

The Company uses the residual method described in AICPA SOP 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions" ("SOP 98-9"), to recognize revenue when a license agreement includes one or more elements to be delivered at a future date and vendor-specific objective evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as license revenue. If evidence of the fair value of one or more undelivered elements does not exist, all revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established.

For all sales the Company uses either a signed license agreement, a signed amendment to an existing license agreement, a signed order form, a binding purchase order where we either have a signed master license agreement or an order form signed by the Company, or a signed statement of work as evidence of an arrangement.

Software delivery is primarily by electronic means. If the software or other deliverable is subject to acceptance for a specified period after the delivery, revenue is deferred until the acceptance period has expired or the acceptance provision has been met.

When licenses are sold together with consulting services, license fees are recognized upon delivery, provided that (1) the basic criteria of software revenue recognition have been met, (2) payment of the license fees is not dependent upon the performance of the consulting services, and (3) the consulting services do not provide significant customization of the software products and are not essential to the functionality of the software that was delivered. The Company does not provide significant customization of its software products.

Revenue arrangements with extended payment terms are generally considered not to be fixed or determinable, and the Company generally does not recognize revenue on these arrangements until the customer payments become due and all other revenue recognition criteria have been met.

Probability of collection is based upon assessment of the customer' s financial condition through review of their current financial statements or publicly-available credit reports. For sales to existing customers, prior payment history is also considered in assessing probability of collection. The Company is required to exercise significant judgment in deciding whether collectibility is reasonably assured, and such judgments may materially affect the timing of our revenue recognition and our results of operations.

Services revenues include revenues for consulting services, customer support and training, OnDemand and hosting. Consulting services revenues and the related cost of services are generally recognized on a time and materials basis. For consulting services contracts that have a fixed fee, the Company recognizes the license and professional consulting services revenues using either the percentage-of-completion method or the completed contract method as prescribed by AICPA SOP No. 81-1, "Accounting for Performance of Construction-Type and Certain Product-Type Contracts" ("SOP 81-1"). KANA' s consulting arrangements do not include significant customization of the software. Customer support agreements provide technical support and the right to unspecified future upgrades on an if-and-when available basis. Customer support revenues are recognized ratably over the term of the support period (generally one year). Training services revenues are recognized as the related training services are delivered. The unrecognized portion of amounts billed in advance of delivery for services is recorded as deferred revenue. OnDemand includes our KANA OnDemand 'software as a service' and outsourcing offerings as well as Advanced Customer Services. OnDemand revenue is recognized in accordance with the SEC Staff Accounting Bulletin No. 104, "Revenue Recognition, corrected copy" ("SAB 104"). Revenues from OnDemand services are recognized ratably over the term of the arrangement, while application fees are recognized ratably over the sum of the term of the arrangement and the term of expected renewals. Hosting service arrangements are a means of deployment whereby the customer' s software and data is physically located in third party facilities. Customers pay a fee to remotely access the hosted software and data via a secure internet connection. Hosting fees are recognized as the hosting service is delivered in accordance with SAB 104.

Vendor-specific objective evidence for consulting and training services are based on the price charged when an element is sold separately or, in the case of an element not yet sold separately, the price established by authorized management, if it is probable that the price, once established, will not change before market introduction. Vendor-specific objective evidence for support services is generally based on the price charged when an element is sold separately or the stated contractual renewal rates.

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors, including employee stock options and employee stock purchases under an employee stock purchase plan, based on estimated fair values.

Stock-based compensation expense recognized during the three months ended March 31, 2007 is based on awards ultimately expected to vest and has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We use the Black-Scholes option pricing model for determining the estimated fair value for stock-based awards. The Black-Scholes model requires the use of highly subjective and complex assumptions which determine the fair value of stock-based awards, including the option' s expected term and the price volatility of the underlying stock.

Employee stock-based compensation expense recognized under SFAS 123(R) for the three months ended March 31, 2007 and 2006 was $752,000 and $380,000, respectively.

For stock options granted to non-employees, the Company recognizes compensation expense in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services", which require such equity instruments to be recorded at their fair value on the measurement date. The measurement of stock-based compensation is subject to periodic adjustment as the underlying equity instruments vest. The Company amortizes compensation expense related to non-employee stock options in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28"). In 2005 and 2006, Company extended the vesting period of approximately 1,000,000 stock options held by four terminated employees who had agreements to provide consulting services. In fiscal year 2006, the Company granted a total of 57,500 stock options to four non-employees who had agreements to provide consulting services. During the three months ended March 31, 2007 there were no stock option grants to non-employees.

As a result of these stock option modifications to former employees and the stock option grants to consultants, the Company recorded non-employee stock-based compensation expense of $118,000 and $226,000 for the three months ended March 31, 2007 and 2006, respectively, allocated as follows:

	Three Months Ended March 31,	
	2007	2006 Restated (1)
Sales and marketing	$16,000	$–
Research and development	–	10,000
General and administrative	102,000	216,000
	$118,000	$226,000

(1) See "*Restatement relating to stock-based compensation and other revenue and expense items*" included in Note 1 to the condensed consolidated financial statements.

Effect of Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of a company' s choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which a company has chosen to use fair value on the face of the balance sheet. This statement is effective as of the beginning of an entity' s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS 157. The Company is currently evaluating whether the adoption of SFAS 159 will have a material effect on its financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employer' s Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 88, 106 and 132R" ("SFAS 158"). SFAS 158 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan' s over funded status or a liability for a plan' s under funded status. The requirement to recognize the funded status of a defined postretirement plan and the disclosure requirements are effective for fiscal years ending after December 31, 2006. The Company does not expect the adoption of SFAS 158 to have a material impact on its financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). The purpose of SFAS 157 is to define fair value, establish a framework for measuring fair value and enhance disclosures about fair value measurements. The measurement and disclosure requirements are effective for the Company beginning in the first quarter of fiscal 2008. The Company is currently evaluating the effects of implementing SFAS 157.

In June 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertain Tax Positions – 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". It 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, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 on January 1, 2007. During the implementation, the Company identified, evaluated, and measured the amount of income tax benefits to be recognized for all material income tax positions. The net income tax assets recognized under FIN 48 did not materially differ from the net assets recognized before adoption, and, therefore, the Company did not record an adjustment related to the adoption of FIN 48. At the adoption date of January 1, 2007, the Company had $145,000 of unrecognized tax benefits, all of which would affect the Company' s effective tax rate if recognized. At March 31, 2007, the Company had $145,000 of unrecognized tax benefits.

Our continuing practice is to recognize interest and/or penalties related to income tax matters as a component of income tax expense. As of March 31, 2007, we have approximately $28,000 of accrued interest and penalties related to uncertain tax positions.

The tax years 2003-2006 remain open to examination by the major taxing jurisdiction to which the Company is subject.

Note 2. Goodwill and Intangible Assets

Purchased intangible assets are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the assets, which is three years. The Company reported amortization expense on purchased intangible assets of $15,000 and $33,000 for the three month ended March 31, 2007 and 2006, respectively. The Company' s identifiable intangible assets have been fully amortized as of March 31, 2007. The components of goodwill and other intangibles are as follows (in thousands):

	March 31, 2007	December 31, 2006

Goodwill	$8,623	$ 8,623
Intangibles:		
Customer Relationships	$150	$ 150
Purchased technology	14,650	14,650
Less: accumulated amortization	(14,800)	(14,785)
Intangibles, net	$–	$ 15

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Note 3. Stockholders' Deficit

(a) Issuance of Common Stock and Warrants

In May 2006, the Company amended the registration agreement related to the June and September 2005 private placements (collectively referred to as "Private Placements") to extend the registration deadline of the shares of common stock and underlying shares of common stock of the warrants issued to September 30, 2006 from January 27, 2006 and to change the penalty for failure to register the underlying shares of common stock from a cash penalty to a share-based payment, in exchange for the issuance of 593,854 shares of common stock. The shares were valued at approximately $1.0 million based on the fair market value of the Company' s common stock on the date of the amendment less a 10% discount to reflect that unregistered stock was issued. Registration rights penalties of $337,000 and $695,000 were recorded as non-operating expenses during the first and second quarters of 2006, respectively. The September 30, 2006 registration deadline was not met and an additional 59,383 shares of common stock was issued. The shares were valued at approximately $166,000 based on the fair market value of the Company' s common stock on September 30, 2006 less a 10% discount to reflect that unregistered stock was issued. This amount was recorded as a non-operating expense during the third quarter of 2006.

On November 9, 2006, the Company completed the registration of the shares of common stock and shares of common stock underlying the warrants issued to the Investors.

(b) Stock Compensation Plans

The Company' s 1999 Stock Incentive Plan (the "1999 Stock Incentive Plan"), as successor to the 1997 Stock Option Plan (the "1997 Stock Option Plan"), provides for shares of the Company' s common stock to be granted to employees, independent contractors, officers, and directors. Options are granted at an exercise price equivalent to the closing fair market value on the date of grant. All options are granted at the discretion of the Company' s Board of Directors and have a term not greater than 10 years from the date of grant. Options are immediately exercisable when vested and generally vest monthly over four years.

The following table summarizes activity under the equity incentive plans for the indicated periods:

	Options Outstanding			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balances, December 31, 2006	9,201,921	$ 6.12		
Options cancelled and retired	(231,847)	3.97		
Options exercised	(232,661)	2.59		$218,319
Options granted	1,487,400	3.19		
Balances, March 31, 2007	10,224,813	$ 5.82	7.53	$8,048,851

Options vested and exercisable and expected to be vested and exercisable at March 31, 2007	8,575,556	$ 6.26	7.22	$6,718,135
Options vested and exercisable at March 31, 2007	5,142,126	$ 7.74	6.07	$3,790,755

At March 31, 2007, the Company had 7,047,768 options available for grant under its equity incentive plans.

Options vested and exercisable at March 31, 2007 exclude certain options which are vested but not yet exercisable. In certain situations, a stock option will be vested but not exercisable. The number of shares vested and exercisable at March 31, 2007 was 5,142,126 and the weighted average exercise price of such shares was $7.74 per share. At March 31, 2007, the total number of vested but unexercisable shares was 309,517 and had a weighted average exercise price of $28.81.

At March 31, 2007, the Company had $4.5 million of total unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options that will be recognized over the weighted average remaining period of 2.7 years. This amount excludes unrecognized stock-based compensation expense that relates to non-employee stock options, which cannot be estimated prior to the measurement date.

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The following table summarizes significant ranges of outstanding and exercisable options as of March 31, 2007:

Range of Exercise Prices	Options Outstanding: Number Outstanding	Options Outstanding: Weighted Average Remaining Contractual Life (in Years)	Options Outstanding: Weighted Average Exercise Price per Share	Options Vested and Exercisable: Number Exercisable	Options Vested and Exercisable: Weighted Average Exercise Price per Share
$ 0.10 - 1.73	1,501,583	7.20	$1.61	776,373	$ 1.59
1.75 - 2.88	687,406	3.71	2.40	616,824	2.42
2.95 - 2.95	3,639,686	8.99	2.95	1,361,577	2.95
3.01 - 3.13	1,666,943	8.72	3.11	423,187	3.10
3.22 - 4.74	1,360,445	7.86	3.81	632,038	4.13
4.74 - 889.40	1,368,584	4.18	24.98	1,331,961	21.75
998.50 - 998.50	166	2.76	998.50	166	998.50
Total	10,224,813	7.53	$5.82	5,142,126	$ 7.74

The Company uses the Black-Scholes option pricing model for estimating the fair value of options granted under the Company’ s equity incentive plans. There were no stock options granted or exercised during the three months ended March 31, 2006. The weighted average assumptions that were used to calculate the grant date fair value of the Company’ s employee stock option grants for the three months ended March 31, 2007 are as follows:

	Three Months Ended March 31, 2007
Risk-free interest rate	4.76%
Expected volatility	53%

Expected life (in years)	5
Dividend yield	0%

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

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

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

The weighted-average fair value of options granted during the three months ended March 31, 2007 was $1.58 per share.

The forfeiture rate of employee stock options for 2007 was calculated using the Company' s historical terminations data.

Note 4. Warrant Liability

The warrants issued in June, September and October 2005 (collectively referred to as the "Warrants") had cash penalties for the failure to register the underlying shares of common stock. Pursuant to Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company' s Own Stock" ("EITF 00-19"), the Company recorded the Warrants as liabilities at their fair value using the Black-Scholes valuation model with changes in value reported to other income or expense each period. For the three months ended March 31, 2006, $562,000 was recorded to other expense for the change in fair value of the Warrants.

The Warrants require physical settlement but allow for net-share settlement if the underlying shares of common stock are not registered. A maximum of 1,914,586 shares of common stock could be issued to settle the Warrants under a net-share settlement.

As noted above in Note 3, in May 2006, the Company amended the registration agreements related to the Private Placements to extend the registration deadline of the shares of common stock and underlying shares of common stock of the Warrants. The Company amended the penalty for failure to register the underlying shares of common stock from cash to share-based payments, with a maximum limit of 59,383 penalty shares to be issued. Pursuant to EITF 00-19, with the elimination of these cash penalties and a maximum limit on penalty shares, the fair value of the Warrants on the date of this amendment was reclassified to equity from liability, and gains or losses recorded to account for the contract at fair value during the period that the contract was classified as a liability were not reversed.

Note 5. Comprehensive Loss

Comprehensive loss is comprised of net loss and foreign currency translation adjustments. The total changes in comprehensive loss during the three month periods ended March 31, 2007 and 2006 were as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006 Restated (1)
Net Loss	$(3,750)	$(979)
Foreign currency translation gain (loss)	(27)	(44)
Comprehensive loss	$(3,777)	$(1,023)

(1) See *Restatement relating to stock-based compensation and other revenue and expense items* included in Note 1 to the condensed consolidated financial statements.

Note 6. Commitments and Contingencies

(a) Lease Obligations

The Company leases its facilities under non-cancelable operating leases with various expiration dates through January 2011. In connection with its existing leases, the Company entered into letters of credit totaling $781,000 expiring in 2007 and through 2011. The Company' s letters of credit can be supported by either restricted cash or the Company' s line of credit. At March 31, 2007, the Company had a $14.7 million in non-cancelable operating lease obligations off set by $5.0 million of sublease income from subleases that are under contract.

(b) Other Contractual Obligations

At March 31, 2007, the Company had other future contractual obligations requiring payments of $3.3 million. The obligation represents payments on a legal settlement, minimum payments to vendors for future royalty fees, marketing services, training services, consulting services, engineering services, and sales events.

(c) Litigation

On January 24, 2007, RightNow Technologies, Inc. ("RightNow") filed a suit against the Company and four former RightNow employees who had joined the Company in the Eighteenth Judicial District Court of Gallatin County, Montana. The suit alleges violation of certain provisions of employment agreements, misappropriation of trade secrets, as well as other claims, and seeks damages. The Company is undertaking to defend itself and the named individuals to the extent required by applicable laws. The Company believes it has meritorious defenses to these claims and intends to defend against this action vigorously.

On March 16, 2006, Polaris IP, LLC filed a suit against the Company, Sirius Satellite Radio, Inc., Priceline.com, Capital One, Continental Airlines, Inc., and E*Trade Financial in the U.S. District Court for the Eastern District of Texas alleging infringement of U.S. Patent Nos. 6,411,947 and 6,278,996 and seeking injunctive relief, damages and attorneys' fees. On March 23, 2007, the parties entered into a settlement agreement and this matter was dismissed with prejudice on April 26, 2007.

The underwriters for the Company' s initial public offering, Goldman Sachs & Co., Lehman Bros, Hambrecht & Quist LLC, Wit Soundview Capital Corp as well as the Company and certain current and former officers of the Company were named as defendants in federal securities class action lawsuits filed in the United States District Court for the Southern District of New York. The cases allege violations of various securities laws by more than 300 issuers of stock, including the Company, and the underwriters for such issuers, on behalf of a class of plaintiffs who, in the case of the Company, purchased the Company' s stock between September 21, 1999 and December 6, 2000 in connection with the Company' s initial public offering. Specifically, the complaints allege that the underwriter defendants engaged in a scheme concerning sales of the Company' s and other issuers' securities in the initial public offering and in the aftermarket. In July 2003, the Company decided to join in a settlement negotiated by representatives of a coalition of issuers named as defendants in this action and their insurers. In April 2005, the court requested a modification to the original settlement arrangement which was approved by the Company. Although the Company believes that the plaintiffs' claims have no merit, the Company has decided to accept the settlement proposal to avoid the cost and distraction of continued litigation. The proposed settlement agreement is subject to final approval by the court. Should the court fail to approve the settlement agreement, the Company believes it has meritorious defenses to these claims and would defend against the action vigorously. Because the settlement will be funded entirely by the Company' s insurers, the Company does not believe that the settlement will have any effect on its consolidated financial condition, results of operation or cash flows and accordingly, the Company has not accrued an amount for this loss contingency in its consolidated financial statements at March 31, 2007.

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

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

(d) Indemnification

Many of our software license agreements require us to indemnify our customers for any claim or finding of intellectual property infringement. We periodically receive notices from customers regarding patent license inquiries they have received which may or may not implicate our indemnity obligations. Any litigation, brought by others, or us could result in the expenditure of significant financial resources and the diversion of management' s time and efforts. In addition, litigation in which we are accused of infringement might cause product shipment delays, require us to develop alternative technology or require us to enter into royalty or license agreements, which might not be available on acceptable terms, or at all. If a successful claim of infringement was made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our business could be significantly harmed. Such indemnification provisions are accounted for in accordance with SFAS No. 5 “Accounting for Contingencies” (“SFAS 5”). In prior periods, the Company has incurred minimal costs related to such claims under such indemnifications provisions; accordingly, the amount of such obligations cannot be reasonably estimated. The Company did however record a settlement charge resulting from a settlement of an infringement claim on the Company' s consolidated statement of operations for the year ended December 31, 2006, which was not considered material. Except for those related to the Polaris matter, there were no outstanding claims of infringement at March 31, 2007.

As permitted by Delaware law, the Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer is, or was, serving at the Company' s request in such capacity. The term of the indemnification period is for the officer' s or director' s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and enables the Company to recover a portion of any such amounts. As a result of the Company' s insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is insignificant. Accordingly, the Company has no liabilities recorded for these agreements as of March 31, 2007.

Note 7. Restructuring Costs

The following table provides a summary of restructuring activity during the three months ended March 31, 2006 and 2007 (in thousands):

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	Facilities	Severance and Related	Total
Restructuring accruals:			
Accrual as of December 31, 2005	$7,270	$ 282	$7,552
Restructuring recoveries	46	(36)	10
Payments made	(796)	(173)	(969)
Sublease payments received	250	–	250
Accrual as of March 31, 2006	$6,770	$ 73	$6,843
Accrual as of December 31, 2006	$6,102	$ –	$6,102
Payments made	(1,078)	–	(1,078)
Sublease payments received	539	–	539
Accrual as of March 31, 2007	$5,563	$ –	$5,563

Note 8. Information About Geographic Areas

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

Geographic information on revenues for the three months ended March 31, 2007 and 2006 is as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006
North America	$9,224	$8,608

Europe	3,632	2,549
Asia Pacific	178	276
Total	$13,034	$11,433

During the three months ended March 31, 2007 and 2006, no customer represented 10% of total revenues.

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

	March 31, 2007	December 31, 2006
United States	$ 1,762	$ 1,974
International (primarily Europe)	2,233	2,217
Total	$ 3,995	$ 4,191

Note 9. Loan Payable and Note Payable

(a) Loan Payable

On November 30, 2005, the Company established a new banking relationship with Bridge Bank N.A. ("Bridge") and entered into a Business Financing Agreement and Intellectual Property Security Agreement with Bridge under which the Company has access to a Loan Facility of $7.0 million ("November Loan"). This November Loan is made up of two parts: (i) a Formula Revolving Line of Credit of up to $5.0 million and (ii) a Non-Formula Revolving Line of Credit of up to $6.0 million, of which $2.0 million is available for stand-by letters of credits, settlement limits on foreign exchange contracts or cash management products. The combined total borrowing under the two parts cannot exceed $7.0 million. The Formula Revolving Line of Credit is collateralized by all of our assets and expired on November 29, 2006. Interest for the Formula Revolving Line of Credit accrues at Bridge' s Prime Lending Rate plus 2% while interest for the Non-Formula Revolving Line of Credit accrues at Bridge' s Prime Lending Rate plus 0.50%. On December 29, 2005, the Company entered into a Business Financing Agreement with Bridge, which provided for additional advances up to $1.5 million based on an advance rate of 80% of eligible receivables. The overall November Loan was increased to $7.5 million.

On March 30, 2006, the Company modified the Business Financing Agreement with Bridge to increase the additional advances for accounts receivable to $2.0 million and the overall November Loan to $8.0 million.

On November 28, 2006 the Business Financing Agreement was further modified to extend the expiration date to February 28, 2007.

On February 27, 2007, the Company entered into an Amended and Restated Loan and Security Agreement with Bridge under which the Company has access to a Loan facility of $10.0 million (“February Loan”). The February Loan is a formula based revolving line of credit based on 80% of eligible receivables subject to two sub limits; a sub limit of $2.5 million that is available for stand-by letters of credit, settlement limits on foreign exchange contracts or cash management products and a maximum amount of $5.0 million available as a term loan. The total combined borrowing under the February Loan and sub limits cannot exceed $10.0 million. The February Loan is collateralized by all of the Company’ s assets and expires February 27, 2009 at which time the entire balance under the formula based line of credit will be due. The Company has a twelve month period to draw down against the term loan, which is repaid over a 36 month period. Interest for the formula based revolving line of credit accrues at the Wall Street Journal’ s (“WSJ”) Prime Lending Rate plus 1.25% while interest for the term loan accrues at the WSJ’ s Prime Lending Rate plus 1.75%. The February Loan contains certain restrictive covenants including but not limited to certain financial covenants such as maintaining profitability net of stock-based compensation and maintenance of certain key ratios. If the Company is not in compliance with the covenants of the February Loan, Bridge has the right to declare an event of default and all of the outstanding balances owed under the February Loan would become immediately due and payable. As of March 31, 2007, the Company had $2.0 million drawn against the February Loan all of which is shown as current on the condensed consolidated balance sheet as the Company was not in compliance with certain financial covenants. See Note 12 for further details.

(b) Note Payable

As of March 31, 2007, there was $221,000 classified as current portion of note payable and $200,000 classified as long-term. The long term portion was included in other long-term liabilities on the condensed consolidated balance sheet. The note payable consists of two obligations. The first is a promissory note with De Lage Landen Financial Services, Inc. for the financing of software license and support purchased and has a fixed interest rate of 3.15%, payable in monthly installments of principal and interest. The second obligation is with First Insurance Funding Corp of California for short-term financing of Errors and Omissions insurance and has a fixed interest rate of 9.87%, payable in monthly installments of principal and interest. At March 31, 2007, the Company had future payments of $179,000 for the nine months ending December 2007, and $170,000 and $72,000 for the years ending December 2008 and 2009, respectively, with no required payments thereafter. As of December 31, 2006, there was $327,000 classified as current portion of note payable and $242,000 classified as long-term.

Note 11. Related Party Transactions

On October 30, 2006, the Company entered into a consulting agreement (“the Consulting Agreement”) with William T. Clifford, a member of KANA’ s Board of Directors. Mr. Clifford provided consulting services to KANA’ s management as an independent contractor on matters pertaining to strategic planning and business (in addition to his role as a member of the Board of Directors) for a period of twelve months that commenced on January 24, 2006. During the three months ended March 31, 2007, the Company paid Mr. Clifford a fee of $59,900 in consideration for his consulting services pursuant to the terms of the Consulting Agreement.

Note 12. Subsequent Events

On May 4, 2007, the Company executed a definitive agreement with the members of eVergance Partners, LLC (“eVergance”) to acquire all of their membership interests. The transaction is subject to customary closing conditions and is expected to close during the second quarter of 2007.

On May 7, 2007, the Company entered into a First Amendment to Loan and Security Agreement with Bridge (“Amendment”), in which Bridge waived the Company’ s compliance with certain financial ratios for any period prior to the month and quarter ending June 30, 2007 and consented to the Company’ s acquisition of eVergance. The terms of the Amendment limit the maximum borrowing under the February Loan to $5 million until the Company has met certain restrictive covenants for two consecutive quarters.

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

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

The following discussion should be read in conjunction with our Annual Report on Form 10-K filed on April 2, 2007, and the consolidated financial statements and notes thereto. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Overview

Kana Software, Inc. and its subsidiaries (the "Company" or "KANA" and, references to "we," "our", "us", and similar pronouns refer to KANA) offer an innovative approach to customer service with cost-effective solutions that enhance the quality of customer interaction. Built on open standards for a high degree of adaptability and integration, KANA solutions intelligently automate the processes needed to successfully serve our clients' customers, so that our clients can deliver higher value service at lower cost. KANA provides an integrated solution which enables organizations to deliver consistent, managed service across all channels, including email, chat, call centers, and Web self-service, ensuring a consistent service experience across communication channels.

Our revenue is primarily derived from the sale of our software and related maintenance and support of the software. To a lesser extent, we derive revenues from consulting and training. Our larger customers often use a systems integrator, such as IBM, Accenture or BearingPoint, for the project to install KANA software as well as do the business process, workflow, and other associated required work. KANA' s professional services group assists the integrators as subject matter experts, and in some cases will act as the prime contractor for implementation of our software. While the Company continues this practice, the Company is increasingly providing consulting and implementation services directly to our customers. These services may be provided to our existing customers who would prefer us to review their KANA implementations or to new customers who are not large enough to gain the interest of a system integrator to provide such services. However, in the case of most of the initial installations of our applications that are generally installed by our customers using a system integrator, these services generally increase the cost of a project substantially and subject their purchase to more approval levels and cost savings reviews resulting in longer sales cycles. This contributes to the difficulty that we face in predicting the quarter in which sales to expected customers will occur and to the uncertainty of our future operating results. To the extent that significant sales occur earlier or later than anticipated, revenues for subsequent quarters may be lower or higher, respectively, than expected. In May 2007, we executed a definitive agreement with the members of eVergance Partners, LLC ("eVergance") to acquire all of their membership interests. eVergance is a management consulting and systems integration firm, and we expect our service revenues and related expenses to increase when we consummate this acquisition.

In addition, we recently began offering our software on a hosted basis for a subscription fee, through our OnDemand service.

In late 2005, we made a decision to eliminate outsourced product development and bring core technology development back to our personnel in the United States in a process that we refer to as "back-shoring" and, by the end of the third quarter of 2006, we brought back all core technology development to the United States, except for one product group. We also back-shored our technical support. As we continue to rebuild the sales organization and increase our marketing, our sales and marketing expenses increased in 2007 due to increases in headcount, commissions as a result of higher revenues, and marketing programs. We will strive to match our spending with the anticipated revenue but, given the unpredictability of our license revenue, we are unable to predict with any certainty the period(s) when the Company will be profitable, if at all.

Since 1997 we have incurred substantial costs to develop our products and to recruit, train and compensate personnel for our engineering, sales, marketing, client services, and administration departments. As a result, we have incurred substantial losses since inception. On March 31, 2007, the Company had ending cash and cash equivalents of $5.3 million including $2.0 million of borrowings outstanding under a loan payable. As of March 31, 2007, the Company had an accumulated deficit of $4.3 billion and a negative working capital of $14.0 million. Loss from operations was $3.7 million for the first three months of 2007. Income from operations was $44,000 for the first three months of 2006. Net cash used for operating activities was $2.6 million and $3.0 million for the first three months of 2007 and 2006, respectively.

As of March 31, 2007, we had 194 full-time employees which represent an increase from 181 employees at December 31, 2006 and an increase from 123 employees at March 31, 2006.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. This forms the basis of judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates.

We believe the following discussion addresses the Company’ s most critical accounting policies, which are those that are most important to the portrayal of the Company’ s financial condition and results of operations and require management’ s most difficult, subjective and complex judgments.

Revenue Recognition

The Company recognizes revenues in accordance with the American Institute of Certified Public Accountants (“AICPA”) Statement of Position (“SOP”) 97-2, “Software Revenue Recognition” (“SOP 97-2”), as amended.

Revenue from software license agreements is recognized when the basic criteria of software revenue recognition have been met (i.e. persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, and collection is probable). The Company uses the residual method described in AICPA SOP 98-9, “Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions” (“SOP 98-9”), to recognize revenue when a license agreement includes one or more elements to be delivered at a future date and vendor-specific objective evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as license revenue. If evidence of the fair value of one or more undelivered elements does not exist, all revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established.

For all sales, the Company uses either a signed license agreement, a signed amendment to an existing license agreement, a signed order form, a binding purchase order where we either have a signed master license agreement or an order form signed by the Company, or a signed statement of work as evidence of an arrangement.

Software delivery is primarily by electronic means. If the software or other deliverable is subject to acceptance for a specified period after the delivery, revenue is deferred until the acceptance period has expired or the acceptance provision has been met.

When licenses are sold together with consulting services, license fees are recognized upon delivery, provided that (1) the basic criteria of software revenue recognition have been met, (2) payment of the license fees is not dependent upon the performance of the consulting services, and (3) the consulting services do not provide significant customization of the software products and are not essential to the functionality of the software that was delivered. The Company does not provide significant customization of its software products.

Revenue arrangements with extended payment terms are generally considered not to be fixed or determinable, and the Company generally does not recognize revenue on these arrangements until the customer payments become due and all other revenue recognition criteria have been met.

Probability of collection is based upon assessment of the customer’ s financial condition through review of their current financial statements or publicly-available credit reports. For sales to existing customers, prior payment history is also considered in assessing probability of collection. The Company is required to exercise significant judgment in deciding whether collectibility is reasonably assured, and such judgments may materially affect the timing of our revenue recognition and our results of operations.

Services revenues include revenues for consulting services, customer support and training, and OnDemand and hosting. Consulting services revenues and the related cost of services are generally recognized on a time and materials basis. For consulting services contracts that have a fixed fee, the Company recognizes the license and professional consulting services revenues using either the percentage-of-completion method or the completed contract method as prescribed by AICPA SOP No. 81-1, "Accounting for Performance of Construction-Type and Certain Product-Type Contracts" ("SOP 81-1"). KANA' s consulting arrangements do not include significant customization of the software. Customer support agreements provide technical support and the right to unspecified future upgrades on an if-and-when available basis. Customer support revenues are recognized ratably over the term of the support period (generally one year). Training services revenues are recognized as the related training services are delivered. The unrecognized portion of amounts billed in advance of delivery for services is recorded as deferred revenue. OnDemand includes our KANA OnDemand 'software as a service' and outsourcing offerings as well as Advanced Customer Services. OnDemand revenue is recognized in accordance with the SEC Staff Accounting Bulletin No. 104, "Revenue Recognition, corrected copy" ("SAB 104"). Revenues from OnDemand services are recognized ratably over the term of the arrangement, while application fees are recognized ratably over the sum of the term of the arrangement and the term of expected renewals. Hosting service arrangements are a means of deployment whereby the customer' s software and data is physically located in third party facilities. Customers pay a fee to remotely access the hosted software and data via a secure internet connection. Hosting fees are recognized as the hosting service is delivered in accordance with SAB 104.

Vendor-specific objective evidence for consulting and training services are based on the price charged when an element is sold separately or, in the case of an element not yet sold separately, the price established by authorized management, if it is probable that the price, once established, will not change before market introduction. Vendor-specific objective evidence for support services is generally based on the price charged when an element is sold separately or the stated contractual renewal rates.

Accounting for Internal-Use Software

Internal-use software costs, including fees paid to third parties to implement the software, are capitalized beginning when we have determined various factors are present, including among others, that technology exists to achieve the performance requirements, we have made a decision as to whether we will purchase the software or develop it internally, and we have authorized funding for the project. Capitalization of software costs ceases when the software implementation is substantially complete and is ready for its intended use, and the capitalized costs are amortized over the software' s estimated useful life (generally five years) using the straight-line method.

When events or circumstances indicate the carrying value of internal use software might not be recoverable, we assess the recoverability of these assets by determining whether the amortization of the asset balance over its remaining life can be recovered through undiscounted future operating cash flows. The amount of impairment, if any, is recognized to the extent that the carrying value exceeds the projected discounted future operating cash flows and is recognized as a write down of the asset. In addition, if it is no longer probable that computer software being developed will be placed in service, the asset will be adjusted to the lower of its carrying value or fair value, if any, less direct selling costs. Any such adjustment would result in an expense in the period recorded, which could have a material adverse effect on our condensed consolidated statements of operations. In the first quarter ended March 31, 2005, the Company' s information technology department reviewed its operations and technology requirements, and decided to discontinue its use of certain internal use software, which resulted in a non-cash impairment charge of $6.3 million.

As of March 31, 2007, we had $561,000 of capitalized costs for internal use software less $551,000 of accumulated amortization for a net balance of $10,000.

Restructuring

During 2001, we recorded significant liabilities in connection with our restructuring program. These reserves included estimates pertaining to contractual obligations related to excess leased facilities in Menlo Park, California; Princeton, New Jersey; Framingham, Massachusetts; and Marlow in the United Kingdom. Remaining lease commitments terminate over various dates beginning in April 2007 and through January 2011. We are seeking to sublease or renegotiate the obligations associated with the excess space. We have subleased some of the excess space, but in all cases, the sublease income is less than the rent we pay the landlord. We had $5.6 million in accrued restructuring costs as of March 31, 2007, which was our estimate, as of that date, of the exit costs of these excess facilities. We have worked with real estate brokers in each of the markets where the properties are located to help us estimate the amount of the accrual. This process involves significant judgments regarding these markets. If we determine that any of these real estate markets has deteriorated further, additional adjustments to this accrual may be required, which would result in additional restructuring expenses in the period in which such determination is made. Likewise, if any of these real estate markets strengthen, and we are able to sublease the properties earlier or at more favorable rates than projected, or if we are otherwise able to negotiate early termination of obligations on favorable terms, adjustments to the accrual may be required that would increase income in the period in which such determination is made. As of March 31, 2007, our estimate of accrued restructuring cost included an assumption that we would receive $861,000 in sublease payments that are not subject to any contractual arrangement as of March 31, 2007. We have assumed that the majority of these assumed sublease payments will begin in 2007 and continue through the end of the related leases. In December 2006, we determined that we may not be able to sublease a leased facility in Princeton, New Jersey, and we changed our assumption of subleasing this excess space. We recorded a restructuring charge of $739,000 during the three months ended December 31, 2006 mainly related to this change in estimate of sublease assumption that is not subject to any contractual arrangement.

Goodwill and Intangible Assets

We regularly evaluate all potential indicators of impairment of goodwill and intangible assets, but at a minimum, test goodwill and intangible assets for impairment on an annual basis. Our judgments regarding the existence of impairment indicators are based on market conditions and operational performance. Future events could cause us to conclude that impairment indicators exist and that goodwill and other intangible assets associated with our acquired businesses are impaired.

The remaining amount of goodwill as of March 31, 2007 is $8.6 million. We continue to assess whether any potential indicators of impairment of goodwill have occurred and have determined that no such indicators have arisen since June 30, 2006, the date of our last annual goodwill impairment test. Any further impairment loss could have a material adverse impact on our financial condition and results of operations

Income Taxes

We estimate our income taxes in each of the jurisdictions in which we operate as part of the process of preparing our consolidated financial statements. This process involves us estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as net operating loss carryforwards, and stock-based compensation, for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We then assess the likelihood that our net deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not more likely than not, we establish a valuation allowance. We concluded that a full valuation allowance was required for all periods presented. While we have considered future taxable income in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would be made, increasing our income in the period in which such determination was made.

Pursuant to the Internal Revenue Code, the amounts of and benefits from net operating loss carryforwards may be impaired or limited in certain circumstances. Events which cause limitations in the amount of net operating losses that we may utilize include, but are not limited to, a cumulative change of more than 50% ownership of the company, as defined, over a three-year period. The portion of the net operating loss and tax credit carryforwards subject to potential expiration has not been included in deferred tax assets.

Contingencies and Litigation

We are subject to lawsuits and other claims and proceedings. We assess the likelihood of any adverse judgments or outcomes to these matters as well as ranges of probable losses. A determination of the amount of loss contingency required, if any, for these matters are made after careful analysis of each individual matter. The required loss contingencies may change in the future as the facts and circumstances of each matter changes.

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123(R)”), which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors including employee stock options and employee stock purchases under an employee stock purchase plan based on estimated fair values.

Stock-based compensation expense recognized during the three months ended March 31, 2007 is based on awards ultimately expected to vest and has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We use the Black-Scholes option pricing model for determining the estimated fair value for stock-based awards. The Black-Scholes model requires the use of highly subjective and complex assumptions which determine the fair value of stock-based awards, including the option' s expected term and the price volatility of the underlying stock.

Employee stock-based compensation expense recognized under SFAS 123(R) for the three months ended March 31, 2007 and 2006 were $752,000 and $380,000, respectively.

For stock options granted to non-employees, the Company recognizes compensation expense in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services", which require such equity instruments to be recorded at their fair value on the measurement date. The measurement of stock-based compensation is subject to periodic adjustment as the underlying equity instruments vest. The Company amortizes compensation expense related to non-employee stock options in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28"). In 2005 and 2006,, the company extended the vesting period of approximately 1,000,000 stock options held by four terminated employees who had agreements to provide consulting services. In fiscal year 2006, the Company granted a total of 57,500 stock options to four non-employees who had agreements to provide consulting services. As a result of these stock option modifications to former employees and the stock option grants to consultants, the Company recorded non-employee stock-based compensation expense of $118,000 and $226,000 for the three months ended March 31, 2007 and 2006, respectively.

Also see stock-based compensation in Note 1 to the condensed consolidated financial statements.

Effect of Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company' s choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. This Statement is effective as of the beginning of an entity' s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). The Company is currently evaluating whether the adoption of SFAS 159 will have a material effect on its financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employer' s Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 88, 106 and 132R" ("SFAS 158"). SFAS 158 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan' s over funded status or a liability for a plan' s under funded status. The requirement to recognize the funded status of a defined postretirement plan and the disclosure requirements are effective for fiscal years ending after December 31, 2006. The Company does not expect the adoption of SFAS 158 to have a material impact on its financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS 157. The purpose of SFAS 157 is to define fair value, establish a framework for measuring fair value and enhance disclosures about fair value measurements. The measurement and disclosure requirements are effective for the Company beginning in the first quarter of fiscal 2008. The Company is currently evaluating the effects of implementing SFAS 157.

In June 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertain Tax Positions - 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". It 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, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 on January 1, 2007. During the implementation the Company identified, evaluated, and measured the amount of income tax benefits to be recognized for all material income tax positions. The net income tax assets recognized under FIN 48 did not materially differ from the net assets recognized before adoption, and, therefore, the Company did not record an adjustment related to the adoption of FIN 48. At the adoption date of January 1, 2007, the Company had $145,000 of unrecognized tax benefits, all of which would affect the Company' s effective tax rate if recognized. At March 31, 2007 the Company had $145,000 of unrecognized tax benefits.

Our continuing practice is to recognize interest and/or penalties related to income tax matters as a component of income tax expense. As of March 31, 2007, we have approximately $28,000 of accrued interest and penalties related to uncertain tax positions.

The tax years 2003-2006 remain open to examination by the major taxing jurisdiction to which the Company is subject.

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Results of Operations Data

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

	Three Months Ended March 31,	
	2007	2006 Restated (1)
	(unaudited)	
Revenues:		
License fees	28 %	25 %
Services	72	75
Total revenues	100	100
Costs and Expenses:		
Cost of license fees	2	4
Cost of services	24	20
Amortization of acquired intangible assets	*	*
Sales and marketing	48	33
Research and development	28	23
General and administrative	27	20
Restructuring costs	–	*
Total costs and expenses	128	100

Income (loss) from operations	(28)	*
Interest and other income (expense), net	*	(6)
Registration rights penalty	–	(3)
Loss before income taxes	(28)	(8)
Income tax expense	*	*
Net loss	(29)%	(9)%

* Less than 1%

(1) See *Restatement relating to stock-based compensation and other revenue and expense items* included in Note 1 to the condensed consolidated financial statements.

Revenues

Total revenues increased by 14% to $13.0 million for the three months ended March 31, 2007 from $11.4 million for the three months ended March 31, 2006, as a result of higher license and services revenues in 2007 than in 2006.

License revenues include licensing fees only, and exclude associated support and consulting revenue. The majority of our licenses to customers are perpetual and associated revenues are recognized upon delivery provided that all revenue recognition criteria are met as discussed in "Revenue Recognition" under "Critical Accounting Policies" above. License revenues increased by 26% to $3.6 million for the three months ended March 31, 2007 from $2.9 million for the same period in the prior year. This increase in license revenue was based, in part, on increased demand for our products, with a greater number of license transactions, and increased average transaction value. While we are focused on increasing license revenue, we are unable to predict such revenue from period to period with any degree of accuracy because, among other things, the market for our products is unpredictable and intensely competitive, and our sales cycle is long and unpredictable.

Our service revenues consist of support revenues and professional services fees. Support revenues relate to providing customer support, product maintenance and updates to our customers. Professional services revenues relate to providing consulting, training and implementation services to our customers including OnDemand, software as a service option. Service revenues increased to $9.4 million for the three months ended March 31, 2007, compared to $8.6 million for the same period in 2006. Support revenues are the largest component of service revenues, and during the three months ended March 31, 2007, support revenues remained flat compared to the same period in 2006, because support revenues from new maintenance contracts associated with new license transactions offsetted support renewal cancellations. The other part of service revenues are professional services fees that increased for the three months ended March 2007 compared to the same period in 2006 mainly due to an increase in consulting, training and OnDemand revenues. Consulting and training revenues increased as a result of increased license sales in prior quarters. Customers who purchase licenses frequently purchase implementation consulting and training, which usually occur subsequent to the license sales.

Revenues from domestic sales were $9.2 million and $8.6 million for the three months ended March 31, 2007 and 2006, respectively. Revenues from international sales were $3.8 million and $2.8 million for the three months ended March 31, 2007 and 2006, respectively. Our international revenues were derived from sales in Europe and Asia Pacific.

Costs and Expenses

Total cost of revenues increased by 22% to $3.4 million for the three months ended March 31, 2007 from $2.8 million for the three months ended March 31, 2006.

License Fees. Cost of license fees consists of third party software royalties, costs of product packaging, documentation, and production and delivery costs for shipments to customers. Cost of license fees as a percentage of license fees was 8% for the three months ended March 31, 2007, compared to 16% for the same period in the prior year. The decrease was partially due to a reduction in royalty costs associated with a relatively lower proportion of non-revenue-related shipments, such as upgrades and updates, as we had a lower proportion of such shipments during the first three months in 2007. The decrease also reflected our increased license revenues. In addition, we reduced our royalty costs by replacing certain third-party technology with a lower cost alternative. Therefore, even though license revenue increased by 26% for the three months ended March 31, 2007 compared to the same period in the prior year, there was a significant decrease in cost of license in the first three months in 2007 compared to the same period in 2006. We expect that our cost of license fees as a percentage of sales will vary based on changes in the mix of products we sell and the timing of upgrades. We are not able to predict when customers will choose to upgrade their software which will then cause us to incur this royalty cost. We are continuing to look at alternatives for some original equipment manufacturer (“OEM”) products embedded in KANA products.

Services. Cost of services consists primarily of compensation and related expenses for our customer support, consulting and training and OnDemand services organizations, and allocation of facility costs and system costs incurred in providing customer support. Cost of services increased to 33% of service revenues, or $3.1 million, for the three months ended March 31, 2007 compared to 27% of service revenues, or $2.3 million, for the same period in 2006. The decrease in service margins in the first three months in 2007 compared to the same period in 2006 was due to OnDemand related costs as well as an increase in professional service staffing levels in 2007. As of March 31, 2007, we had 46 employees in the support, consulting, training and OnDemand organizations compared to 27 employees as of March 31, 2006, an increase of 70%.

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

Amortization of Acquired Intangible Assets. The amortization of acquired intangible assets is recorded in the three-month periods ended March 31, 2007 and 2006 related to $400,000 of identifiable intangibles purchased in connection with the Hipbone acquisition in February 2004. Acquired intangible assets are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the asset (three years) and was fully amortized in the first quarter of 2007. Amortization expense may increase if we acquire another company.

Sales and Marketing. Sales and marketing expenses consist primarily of compensation and related costs for sales and marketing personnel and promotional expenditures, including public relations, advertising, trade shows and marketing materials. Sales and marketing expenses increased by 65% to $6.2 million for the three months ended March 31, 2007, from $3.7 million for the same period in 2006. This was primarily due to an increase in compensation and related costs as a result of our strategy of increasing our sales and marketing personnel and an increase in our marketing programs. As of March 31, 2007, we had 68 employees in sales and marketing compared to 46 employees as of March 31, 2006, an increase of 48%.

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

Research and Development. Research and development expenses consist primarily of compensation and related costs for research and development employees and contractors and enhancement of existing products and quality assurance activities. Research and development expenses increased by 42% to $3.7 million for the three months ended March 31, 2007 from $2.6 million for the same period in 2006. This was attributable primarily to higher compensation and related costs as a result of an increase in head count as well as retention bonuses paid to some employees. As of March 31, 2007, we had 43 employees in research and development compared to 24 employees as of March 31, 2006, an increase of 79%.

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

General and Administrative. General and administrative expenses consist primarily of compensation and related costs for finance, legal, human resources, corporate governance, and bad debt expense. Information technology and facilities costs are allocated among all operating departments. General and administrative expenses increased by 53% to $3.5 million for the three months ended March 31, 2007 from $2.3 million for the three months ended March 31, 2006. The increase in expenses during the three months ended March 31, 2007 was primarily due to higher auditing and legal fees, an increase in employee stock-based compensation due to new grants, higher compensation and related costs as a result of new hires, and expenses related to the world-wide employee meeting held in February 2007. As of March 31, 2007, we had 37 employees in general and administrative and information technology combined compared to 27 employees as of March 31, 2006, a 37% increase.

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

Restructuring Costs. There was no restructuring cost during the three months ended March 31, 2007. During the three months ended March 31, 2006, there was a restructuring charge of $46,000 for lease-hold improvements off set by a recovery of $36,000 due to the changes in the assumptions related to severance of employees in our New Hampshire facility.

Interest and Other Income (Expense), Net

Interest and other income (expense), net consists primarily of interest income, interest expense and changes in fair value of warrant liabilities. Interest income consists primarily of interest earned on cash and cash equivalents and was approximately $22,000 and $58,000 for the three months ended March 31, 2007 and 2006, respectively. The decrease in interest income related to lower cash and cash equivalents balances in the three months ended 2007 compared to the same period in 2006. Interest expense relates primarily to our loan payable and was approximately $39,000 and $144,000 for the three months ended March 31, 2007 and 2006, respectively. The decrease in interest expense related to lower borrowings against the loan payable in the three months ended 2007 compared to the same period in 2006. Interest and other income (expense), net also consists of changes in the fair value of warrant liabilities of approximately $562,000 for the three month ended March 31, 2006.

Provision for Income Taxes

We have incurred net operating losses on a consolidated basis for all periods from inception through March 31, 2007. Accordingly, we have recorded a valuation allowance for the full amount of our gross deferred tax assets, as the future realization of the tax benefit is not currently more likely than not. During the three months ended March 31, 2007 and 2006, certain of our foreign subsidiaries were profitable, based upon application of our intercompany transfer pricing agreements, which resulted in us reporting income tax expense totaling approximately $47,000 and $28,000 for the three months ended March 31, 2007 and 2006, respectively, in those foreign jurisdictions.

Liquidity and Capital Resources

As of March 31, 2007, we had $5.3 million in cash and cash equivalents, compared to $5.7 million in cash and cash equivalents at December 31, 2006. As of March 31, 2007, we had negative working capital of $14.0 million, compared to negative working capital of $11.0 million as of December 31, 2006. As of March 31, 2007, our current liabilities included $15.5 million of deferred revenue (primarily reflecting payments received for future maintenance services to be provided to our customers).

History and Recent Trends

We have had negative cash flow from operating activities in each year since inception. To date, we have funded our operations primarily through issuances of common stock and, to a lesser extent, cash acquired in acquisitions. The rate of cash we have used in operations was

$13.1 million in 2004, $16.3 million in 2005, $1.7 million in 2006 and $2.6 million in the first three months of 2007. In 2003, 2004 and 2005, we implemented successive net workforce reductions of approximately 154, 30 and 56 employees, respectively. During 2006 and the first three months in 2007, we had a net increase of 56 and 12 employees, respectively. Staffing is expected to change from time to time based upon a number of factors, including anticipated demand for our products and the balancing of roles between employees and outsourced staffing. We experienced negative cash flow from operations during 2006 and during the first three months of 2007 due to continued net losses. While our cash flow has benefited from our continuing emphasis on cost management, that benefit has been partially offset by continued cash outflow for rent on excess facilities. Our cash collections during any quarter are driven primarily by the amount of sales booked in the previous quarter, and we cannot be certain that we will meet our revenue expectations in any given period.

Primary Driver of Cash Flow

Our ability to generate cash in the future depends upon our success in generating sufficient sales transactions, especially new license transactions. We expect our support renewals in 2007 to continue to be relatively flat from 2006. Since our new license transactions are relatively small in number and are difficult to predict, we may not be able to generate new license transactions as anticipated in any particular future period. From time to time, changes in assets and liabilities, such as changes in levels of accounts receivable and accounts payable, may also affect our cash flows.

Operating Cash Flow

We had negative cash flow from operating activities of $2.6 million for the first three months of 2007, which included a $3.8 million net loss, a $45,000 decrease in accounts payable and accrued liabilities, a $543,000 decrease in accrued restructuring and a $487,000 decrease in deferred revenue, partially offset by non-cash charges of $870,000 for stock-based compensation expense and $265,000 of depreciation, as well as a $955,000 decrease in accounts receivable. Our operating activities used $3.0 million of cash and cash equivalents for the three months ended March 31, 2006.

Investing Cash Flow

Our investing activities used $221,000 and $33,000 of cash for the first three months of 2007 and 2006, respectively, which consisted primarily of the purchase of property and equipment.

Financing Cash Flow

Our financing activities provided $2.5 million of cash for the three months ended March 31, 2007, which consisted primarily of $2.0 million of cash related to net borrowings under our bank loan payable, $609,000 in proceeds from issuances of common stock, and borrowings of $71,000 on note payable offset in part by the repayment of $219,000 on note payable. For the first three months of 2006, our financing activities provided $457,000 of cash and cash equivalents.

Existence and Timing of Contractual Obligations

On November 30, 2005, the Company established a new banking relationship with Bridge Bank N.A. (“Bridge”). In addition, on November 30, 2005, the Company entered into a Business Financing Agreement and Intellectual Property Security Agreement with Bridge under which the Company had access to a Loan Facility of $7.0 million. We have since amended our agreement with Bridge, and most recently on February 27, 2007, whereby the Company entered into an Amended and Restated Loan and Security Agreement with Bridge under which the Company has access to a Loan Facility of $10.0 million (“February Loan”). The February Loan is a formula based revolving line of credit based on 80% of eligible receivables subject to two sub limits; a sub limit of $2.5 million that is available for stand-by letters of credit, settlement limits on foreign exchange contracts or cash management products and a maximum amount of $5.0 million available as a term loan. The total combined borrowing under the February Loan and sublimits cannot exceed $10.0 million. The February Loan is collateralized by all of the Company’ s assets and expires February 27, 2009 at which time the entire balance under the formula based line of credit will be due. The Company has a twelve month period to draw down against the term loan, which is repaid over a 36 month period. Interest for the formula based revolving line of credit accrues at the Wall Street Journal’ s (“WSJ”) Prime Lending Rate plus 1.25% while interest for the term loan accrues at the WSJ’ s Prime Lending Rate plus 1.75%. The February Loan contains certain restrictive covenants including but not limited to certain financial covenants such as maintaining profitability net of stock-based compensation and maintenance of certain key ratios. If we are not in compliance with the covenants of the February Loan, Bridge Bank has the right to declare an event of default and all of the outstanding balances owed under the February Loan would become immediately due and payable. As of March 31, 2007, the Company had $2.0 million drawn against the February Loan all of which is shown as current on the condensed consolidated balance sheet as the Company was not in compliance with certain financial covenants. On March 30, 2006, the Company modified the Business Financing Agreement with Bridge to increase the additional advances for accounts receivable to $2.0 million and the overall November Loan to $8.0 million. As of March 31, 2006, the Company had $7.9 million drawn against the November Loan. On November 28, 2006, the Business Financing Agreement was modified to extend the expiration date to February 28, 2007.

On May 7, 2007, the Company entered into a First Amendment to Loan and Security Agreement with Bridge (“Amendment”), in which Bridge waived the Company’ s compliance with certain financial ratios for any period prior to the month and quarter ending June 30, 2007 and consented to the Company’ s acquisition of eVergance. The terms of the Amendment limit the maximum borrowing under the February Loan to $5 million until the Company has met certain restrictive covenants for two consecutive quarters.

Our future payments due under debt and lease obligations and other contractual commitments as of March 31, 2007 are as follows (in thousands):

	Payments Due By Period				
	Total	**Less than 1 year**	**1 - 3 years**	**3 - 5 years**	**More than 5 years**
Contractual obligations:					
Loan payable	$2,000	$2,000	$–	$–	$ –
Note payable	421	221	200	–	–
Non-cancelable operating lease obligation (1)	14,692	4,903	8,206	1,583	–
Less: Sublease income (2)	(4,950)	(1,495)	(2,755)	(700)	–

Other contractual obligations (3)	3,318	2,361	557	400	–
Total	$15,481	$7,990	$6,208	$1,283	$ –

(1) Includes leases for properties included in the restructuring liability.

(2) Includes only subleases that are under contract as of March 31, 2007, and excludes future estimated sublease income for agreements not yet signed.

(3) Represents payments on a legal settlement, minimum payments to vendors for future royalty fees, marketing services, training services, consulting services, engineering services, and sales events.

Outlook

Based on our current 2007 revenue expectations, we expect our cash and cash equivalents will be sufficient to meet our working capital and capital expenditure needs through March 31, 2008. However, if we do not experience anticipated demand for our products, we will need to further reduce costs, or issue equity securities or borrow money to meet our cash requirements. If we raise additional funds through the issuance of equity or convertible securities, the percentage ownership of our stockholders would be reduced and the securities we issue might have rights, preferences and privileges senior to those of our current stockholders. In addition, rising interest rates may impede our ability to borrow additional funds as well as maintain its current debt arrangements. If adequate funds were not available on acceptable terms, our ability to achieve or sustain positive cash flows, maintain current operations, fund any potential expansion, take advantage of unanticipated opportunities, develop or enhance products or services, or otherwise respond to competitive pressures would be significantly limited. Our expectations as to our future cash flows and our future cash balances are subject to a number of assumptions, including assumptions regarding anticipated increases in our revenue, improvements in general economic conditions and customer purchasing and payment patterns, many of which are beyond our control.

Risk Factors That Could Affect Future Results

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

Risks Related to Our Business and Industry

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

Since we began operations in 1997, our revenues have not been sufficient to support our operations, and we have incurred substantial operating losses every year. As of March 31, 2007, our accumulated deficit was approximately $4.3 billion, which includes approximately $2.7 billion related to goodwill impairment charges. Our stockholders' deficit at March 31, 2007 was $5.4 million. We continue to commit a substantial investment of resources to sales, product marketing, and developing new products and enhancements, and we will need to increase our revenue to achieve profitability and positive cash flows. Our expectations as to when we can achieve positive cash flows, and as to our future cash balances, are subject to a number of assumptions, including assumptions regarding improvements in general economic conditions and customer purchasing and payment patterns, many of which are beyond our control. Our history of losses has previously caused some of our potential customers to question our viability, which has in turn hampered our ability to sell some of our products. Additionally, our revenue has been affected by the uncertain economic conditions in recent years, both generally and in our market. As a result of these conditions, we have experienced and expect to continue to experience difficulties in attracting new customers, which means that, even if sales of our products and services grow, we may continue to experience losses, which may cause the price of our stock to decline.

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

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

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

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

The long sales cycle for our products may cause license revenue and operating results to vary significantly from period to period. To date, the sales cycle for most of our product sales has taken anywhere from 6 to 18 months. Our sales cycle typically requires pre-purchase evaluation by a significant number of individuals in our customers' organizations. Along with third parties that often jointly market our software with us, we invest significant amounts of time and resources educating and providing information to prospective customers regarding the use and benefits of our products. Many of our customers evaluate our software slowly and deliberately, depending on the specific technical capabilities of the customer, the size of the deployment, the complexity of the customer' s network environment, and the quantity of hardware and the degree of hardware configuration necessary to deploy our products.

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

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

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

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

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

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

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

In the future, we may be required to seek additional financing to fund our operations or growth, and such financing may not be available to us, or may impair the rights of our existing stockholders. Furthermore, any failure to raise sufficient capital in a timely fashion could prevent us from growing or pursuing our strategies or cause us to limit our operations and cause potential customers to question our financial viability. We had cash and cash equivalents of $5.3 million at March 31, 2007. It is possible that our cash position could decrease over the next few quarters and some customers could become increasingly concerned about our cash situation and our ongoing ability to update and maintain our products. This could significantly harm our sales efforts.

Factors such as the commercial success of our existing products and services, the timing and success of any new products and services, the progress of our research and development efforts, our results of operations, the status of competitive products and services, and the timing and success of potential strategic alliances or potential opportunities to acquire or sell technologies or assets may require us to seek additional funding sooner than we expect. In the event that we require additional cash, we may not be able to secure additional financing on terms that are acceptable to us, especially in the current uncertain market climate, and we may not be successful in implementing or negotiating other arrangements to improve our cash position. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders would be reduced and the securities we issue might have rights, preferences, and privileges senior to those of our current stockholders. If adequate funds were not available on acceptable terms, our ability to achieve or sustain positive cash flows, maintain current operations, fund any potential expansion, take advantage of unanticipated opportunities, develop or enhance products or services, or otherwise respond to competitive pressures would be significantly limited.

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

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

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

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

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

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

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

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

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

A significant percentage of our revenues depends on leads generated by SIs and their recommendations of our products. If SIs do not successfully market our products, our operating results will be materially harmed. In addition, many of our direct sales are to customers that will be relying on SIs to implement our products, and if SIs are not familiar with our technology or able to successfully implement our products, our operating results will be materially harmed. We expect to continue increasing our leverage of SIs as indirect sales channels and, if this strategy is successful, our dependence on the efforts of these third parties for revenue growth and customer service will remain high. Our reliance on third parties for these functions has reduced our control over such activities and reduced our ability to perform such functions internally. If we come to rely primarily on a single SI that subsequently terminates its relationship with us, becomes insolvent or is acquired by another company with which we have no relationship, or decides not to provide implementation services related to our products, we may not be able to internally generate sufficient revenue or increase the revenues generated by our other SI relationships to offset the resulting lost revenues. Furthermore, SIs typically suggest our solution in combination with other products and services, some of which may compete with our solution. SIs are not required to promote any fixed quantities of our products, are not bound to promote our products exclusively, and may act as indirect sales channels for our competitors. If SIs choose not to promote our products or if they develop, market, or recommend software applications that compete with our products, our business will be harmed.

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

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

One customer, IBM who resells our software to its customers, accounted for 9%, 11% and 11% of our revenue in 2006, 2005 and 2004 respectively. Given that we derive a significant portion of our license and service revenues from IBM, the loss of this customer could cause a decrease in revenues and operating results. Furthermore, if we lose major customers, or if a contract is delayed or cancelled or we do not contract with new major customers, our revenues and net loss would be adversely affected. In addition, customers that have accounted for significant revenues in the past may not generate revenues in any future period, and our failure to obtain new significant customers or additional orders from existing customers could materially affect our operating results.

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

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

Changes in our workforce may adversely affect our ability to release products and product updates in a timely manner.

We reduced our employee headcount in 2005 from a total of 181 as of December 31, 2004 to 125 as of December 31, 2005 and then increased to 181 as of December 31, 2006 and to 194 as of March 31, 2007. The majority of the 2005 reduction was the result of our decision to shift a significant portion of our software programming, quality assurance and technical documentation activities to international development partners in early 2003, a strategy we have since reversed through our "back-shoring" process. We reduced the size of our research and development department from 34 employees as of December 31, 2004, to 30 employees as of December 31, 2005 and then increased to 37 as of December 31, 2006 and to 43 as of March 31, 2007. In addition, we reduced the level of our expenditures on outsourced development in 2005, and, in December 2005, we consolidated a significant portion of our research and development operations into one location in Menlo Park, California to optimize our research and development processes and decrease overall operating expenses. As a result, we terminated the employment of 15 employees based in our New Hampshire office. The changes in our research and development headcount and the reductions in our outsourced development capacity may limit our ability to release products within expected timeframes. For example, many of the employees who were terminated in headcount reductions possessed specific knowledge or expertise that may prove to have been important to our operation, and which was not replaced in our more recent headcount increases. As a result, our ability to respond to unexpected challenges may be impaired and we may be unable to take advantage of new opportunities. Personnel reductions may also subject us to the risk of litigation, which may adversely impact our ability to conduct our operations and may cause us to incur significant expense. Our termination of two outsourcing arrangements in early 2005 may further reduce our ability to respond to development challenges and to introduce new products in expected timeframes.

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

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

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

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

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

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

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

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

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

- customer dissatisfaction;
- cancellation of orders and license agreements;
- negative publicity;
- loss of revenues; and

slower market acceptance.

Furthermore, delays in bringing new products or enhancements to market can result, for example, from potential difficulties with managing outsourced research and development or from loss of institutional knowledge through reductions in force, or the existence of defects in new products or their enhancements.

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

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

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

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

Our independent registered public accounting firm has identified material weaknesses in our internal controls that, if not remediated, could affect our ability to prepare timely and accurate financial reports, which could cause investors to lose confidence in our reported financial information and have a negative effect on the trading price of our stock.

In the course of the audit of our consolidated financial statements for the year ended December 31, 2004, our former independent registered public accounting firm identified and reported material weaknesses in our internal controls over financial reporting. A material weakness is a reportable condition in which our internal controls do not reduce to a low level the risk that undetected misstatements caused by error or fraud may occur in amounts that are material to our audited consolidated financial statements. Soon thereafter, our former Chief Executive Officer and current Chief Financial Officer performed an evaluation of our disclosure controls and procedures and found that they were not effective. We had weaknesses in our general accounting processes related to insufficient documentation and analyses to support our consolidated financial statements, failure to properly evaluate estimates of royalties due and insufficient staffing in the accounting and reporting function, which was exacerbated by changes in management and accounting personnel and insufficient training of our accounting department. Moreover, there was no independent review of journal entries, and insufficient documentation or support for journal entries and consolidation entries. In a number of cases, these required adjustments to our consolidated financial statements for the year ended December 31, 2004. Furthermore, during the first quarter of 2005, our Audit Committee of the Board of Directors (the "Audit Committee") completed an examination of certain of our internal controls relating to travel and entertainment expenses and determined that we had made erroneous expense reimbursements to our former Chief Executive Officer and certain other executive officers, primarily as a result of inconsistent travel and entertainment policies, inadequate review of expense reimbursement requests and carelessness.

The material weaknesses in our internal control over financial reporting delayed the completion of our consolidated financial statements for the years ended December 31, 2004 and 2005, as well as our financial statements for each of the quarters in 2005 and the first quarter of 2006, which prevented us from timely filing our Form 10-K for the each of the years ended December 31, 2004 and 2005 and our quarterly filings on Form 10-Q for all the quarters in 2005 and the first quarter of 2006. In particular, as a result of the lack of sufficient documentation and existing analysis to support the consolidated financial statements, significant analysis was required to support our consolidated financial statements, and the delay involved by the need for this analysis was exacerbated by insufficient staffing in our accounting and reporting function. This delay also impacted and continued to affect our ability to timely file our periodic reports throughout 2005 and up to the first quarter of 2006, as we were not able to commence preparation of these reports until we had completed and filed the Form 10-K for the year ended December 31, 2004 and completed the remediation of these material weaknesses.

We have determined that the material weaknesses mentioned as of December 31, 2004, with the exception of the material weakness relating to travel and entertainment expenses, continued to exist during 2005 and through the third quarter of 2006. We believe that these material weaknesses mentioned above did not have a material impact on our consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2006 due to the fact that the material weaknesses were remediated as of December 31, 2006, and we performed substantial analyses on the prior period consolidated financial statement balances, including historical account reconciliations, had our account balance analyses reviewed by senior management and reconstructed certain account balances. However, these material weaknesses mentioned above and our delay in timely completing our consolidated financial statements and thus, the filing of our periodic reports, increase the risk that a transaction will not be accounted for consistently and in accordance with established policy or generally accepted accounting principles, and increase the risk of error in our general accounting processes and consolidated financial statements.

Our management, with the oversight of the Audit Committee, has addressed the material weaknesses mentioned above and has implemented controls to remediate such weaknesses. Our management believes that it has corrected the material weakness relating to travel and entertainment expense reimbursement by the end of the first quarter of 2005. New processes and internal controls have been approved and implemented, and management concluded as of December 31, 2006, that these controls were operating effectively.

During the 2006 year-end close, however, we identified and reported a material weakness in our internal controls over financial reporting related to our stock-based compensation. This material weakness related to our failure to complete a proper analysis of historical stock option vesting data within our system. This resulted in a net overstatement of our stock-based compensation during the interim reporting periods for fiscal year 2006. As a result of this material weakness, the quarterly results of operations have been restated, as provided in Note 14 of the consolidated financial statements in the Company' s 2006 Form 10-K for the year ended December 31, 2006, and the prior period pro-forma informational disclosure of expenses has also been restated, as provided in Note 7 of the consolidated financial statements in the Company' s 2006 Form 10-K for the year ended December 31, 2006, and the Company was unable to conclude that our disclosure controls and procedures were effective as of December 31, 2006.

Our management, with the oversight of the Audit Committee of the Board of Directors, has begun to address this material weakness related to our stock-based compensation and is committed to effective remediation of these deficiencies as expeditiously as possible. We have implemented a procedure to review the stock option reports on a quarterly basis to assure that only current employee options that are expected to vest are included in the employee stock-based compensation expense for the period. Our material weakness will not be considered remediated until new internal controls are developed and implemented throughout the Company, are operational for a period of time and are tested, and management concludes that these controls are operating effectively.

Our remediation measures may not be successful in correcting the material weakness reported by our former and current independent registered public accounting firms. In addition, we cannot assure you that additional material weaknesses or significant deficiencies in our internal controls will not be discovered in the future. In addition, internal controls may become inadequate because of changes in conditions and the degree of compliance with the policies or procedures may deteriorate. Any failure to remediate the material weaknesses described above or to implement and maintain effective internal controls could harm our operating results, delay our completion of our consolidated financial statements and our independent registered public accounting firm' s audit or review of our consolidated financial statements which could cause us to fail to timely meet our periodic reporting obligations with the SEC or result in material misstatements in our consolidated financial statements which could also cause us to fail to timely meet our periodic reporting obligations with the SEC. Deficiencies in our internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock.

We face additional risks and costs as a result of the delayed filing of our Quarterly Reports on Form 10-Q for the quarters ended March 31, June 30, and September 30, 2005, and March 31, 2006, and our Annual Reports on Form 10-K for the years ended December 31, 2004 and 2005.

As a result of missing an established deadline with the NASDAQ Qualifications Panel for filing our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, we have experienced additional risks and costs. The March 31, 2005 10-Q was filed on October 11, 2005, past the NASDAQ Listing Qualifications Panel' s established deadline of October 7, 2005; thus, the NASDAQ Listing Qualifications Panel delisted the Company' s common stock effective as of the beginning of trading on October 17, 2005. Since our common stock was delisted from The NASDAQ Stock Market, the ability of our stockholders to sell our common stock has been severely limited, causing our stock price to decline.

As a result of our delayed filings, we will be ineligible to register our securities on Form S-3 for sale by us or resale by others until we have timely filed all periodic reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act") for one year. Instead, the Company may be required to use Form S-1 to raise capital or complete acquisitions, which would increase transaction costs and adversely affect our ability to raise capital or complete acquisitions of other companies during this period.

Our common stock was delisted from The NASDAQ National Market and is currently quoted on the OTCBB.

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

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

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

- variations in our actual and anticipated operating results;

- changes in our earnings estimates by analysts;
- the volatility inherent in stock prices within the emerging sector within which we conduct business; and
- the volume of trading in our common stock, including sales of substantial amounts of common stock issued upon the exercise of outstanding options and warrants.

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

Since becoming a publicly traded security listed on The NASDAQ National Market in September 1999, our common stock has reached a sales price high of $1,698.10 per share and a sales price low of $0.65 per share. On October 17, 2005, our common stock was delisted from The NASDAQ National Market due to the failure to timely file our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 with the SEC. Our common stock is currently quoted on the OTCBB. The last reported sale price of our shares on April 30, 2007 was $3.58 per share.

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

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

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

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

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

- laws and contractual restrictions may not be sufficient to prevent misappropriation of our technology or deter others from developing similar technologies;

- current federal laws that prohibit software copying provide only limited protection from software "pirates," and effective trademark, copyright, and trade secret protection may be unavailable or limited in foreign countries;

- other companies may claim common law trademark rights based upon state or foreign laws that precede the federal registration of our marks; and

- policing unauthorized use of our products and trademarks is difficult, expensive, and time-consuming, and we may be unable to determine the extent of this unauthorized use.

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

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

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

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

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

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

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

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

- loss of or delay in revenues expected from new products and an immediate and significant loss of market share;

- loss of existing customers that upgrade to new products and of new customers;

- failure to achieve market acceptance;

- diversion of development resources;
- injury to our reputation;
- increased service and warranty costs;
- legal actions by customers; and
- increased insurance costs.

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

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

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

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

A substantial proportion of our revenues are generated from sales outside North America, exposing us to additional financial and operational risks. Sales outside North America represented 29% of our total revenues for the three months ended March 31, 2007, compared to 25% of our total revenues for the three months ended March 31, 2006. We have established offices in the United States, Europe, Japan, and Hong Kong. Sales outside North America could increase as a percentage of total revenues as we attempt to expand our international operations. In addition to the additional costs and uncertainties of being subject to international laws and regulations, international operations require significant management attention and financial resources, as well as additional support personnel. To the extent our international operations grow, we will also need to, among other things, expand our international sales channel management and support organizations and develop relationships with international service providers and additional distributors and system integrators. International operations are subject to many inherent risks, including:

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

import and export license requirements and restrictions of the United States and each other country in which we operate.

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

We may suffer foreign exchange rate losses.

Our international revenues and expenses are denominated in local currency. Therefore, a weakening of other currencies compared to the U.S. dollar could make our products less competitive in foreign markets and could negatively affect our operating results and cash flows. We have not yet experienced, but may in the future experience, significant foreign currency transaction losses, especially because we generally do not engage in currency hedging. To the extent the international component of our revenues grows, our results of operations will become more sensitive to foreign exchange rate fluctuations.

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

We acquired Hipbone, Inc. in early 2004, and if we are presented with appropriate opportunities, we may make other investments in complementary companies, products, or technologies. In May 2007, we executed a definitive agreement with the members of eVergance Partners, LLC ("eVergance") to acquire all of their membership interests. We may not realize the anticipated benefits of the Hipbone or eVergance acquisition or any other acquisition or investment. For example, since inception, the Company has recorded $2.7 billion of impairment charges for the cost of goodwill obtained from acquisitions. Upon the acquisition of eVergance, or if we acquire another company, we will likely face risks, uncertainties, and disruptions associated with the integration process, including, among other things, difficulties in the integration of the operations, technologies, and services of the acquired company, the diversion of our management' s attention from other business concerns, the potential loss of key employees of the acquired businesses, and the failure of the acquired businesses, products or technologies to generate sufficient revenue to offset acquisition costs. If we fail to successfully integrate other companies that we may acquire, our business could be harmed. Also, acquisitions, including the acquisition of eVergance, can expose us to liabilities and risks facing the company we acquire, such as lawsuits or claims against the Company that are unknown at the time of the acquisition. Furthermore, we may have to incur debt or issue equity securities to pay for any additional future acquisitions or investments, the issuance of which could be dilutive to our existing stockholders. In addition, our operating results may suffer because of acquisition-related costs or amortization expenses or charges relating to acquired goodwill and other intangible assets. These factors could have an adverse effect on our business, results of operations, financial condition or cash flows.

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

Our continuing preparation for and implementation of various corporate governance reforms and enhanced disclosure laws and regulations adopted in recent years requires us to incur significant additional accounting and legal costs. We, like other non-accelerated public companies, are preparing for new accounting disclosures required by laws and regulations adopted in connection with the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"). In particular, we will be preparing to provide, if required, beginning with our Annual Report on Form 10-K for the fiscal year ending December 31, 2007, an Annual Report on our internal control over financial reporting and auditors' attestation with respect to our report required by Section 404 of the Sarbanes-Oxley Act. Any unanticipated difficulties in preparing for and implementing these and other corporate governance and reporting reforms could result in material delays in compliance or significantly increase our costs. Also, there can be no assurance that we will be able to fully comply with these new laws and regulations. Any failure to timely prepare for and implement the reforms required by these new laws and regulations could significantly harm our business, operating results, and financial condition.

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

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

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

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Risks Related to Our Industry

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

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

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

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

The imposition of new sales or other taxes could limit the growth of Internet commerce generally and, as a result, the demand for our products and services. Federal legislation that limits the imposition of state and local taxes on Internet-related sales will expire on November 1, 2007. Congress may choose to modify this legislation or to allow it to expire, in which case state and local governments would be free to impose taxes on electronically purchased goods. We believe that most companies that sell products over the Internet do not currently collect sales or other taxes on shipments of their products into states or foreign countries where they are not physically present. However, one or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies that engage in e-commerce within their jurisdiction. A successful assertion by one or more states or foreign countries that companies that engage in e-commerce within their jurisdiction should collect sales or other taxes on the sale of their products over the Internet, even though not physically in the state or country, could indirectly reduce demand for our products.

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

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

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

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

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

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We develop products in the United States and sell these products in North America, Europe, Asia, and Australia. In the three months ended March 31, 2007 and the year ended December 31, 2006, revenues from customers outside of the United States approximated 29% and 32%, respectively, of total revenues. Generally, our sales are made in the local currency of our customers. As a result, our financial results and cash flows could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. We rarely use derivative instruments to hedge against foreign exchange risk. As such, we are exposed to market risk from fluctuations in foreign currency exchange rates, principally from the exchange rate between the U.S. dollar and the Euro and the British pound. We manage exposure to variability in foreign currency exchange rates primarily due to the fact that liabilities and assets, as well as revenues and expenses, are denominated in the local currency. However, different durations in our funding obligations and assets may expose us to the risk of foreign exchange rate fluctuations. We have not entered into any derivative instrument transactions to manage this risk. Based on our overall foreign currency rate exposure at March 31, 2007, we do not believe that a hypothetical 10% change in foreign currency rates would materially adversely affect our financial position or results of operations. We do not consider our cash equivalents to be subject to interest rate risk due to their short maturities.

ITEM 4T. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Regulations under the Exchange Act require public companies, including our company, to maintain "disclosure controls and procedures," which are defined as controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC' s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer' s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer performed an evaluation of our disclosure controls and procedures as of the end of the period covered by this report and found that they were not effective as a result of the material weaknesses described below.

Changes in Internal Control Over Financial Reporting

Regulations under the Exchange Act require public companies, including our Company, to evaluate any change in our "internal control over financial reporting" as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. In connection with their evaluation of our disclosure controls and procedures as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer did not identify any change in our internal control over financial reporting during the fiscal quarter covered by this report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Material Weaknesses and Corrective Action Plans

As previously disclosed by us in our Form NT-10-K filed with the SEC on April 1, 2005, during the first quarter of 2005, our Audit Committee completed an examination of certain of our internal controls relating to travel and entertainment expenses and implemented a series of measures designed to enhance our internal controls with respect thereto.

As a result of the investigation, the Audit Committee concluded that from 2002 to 2004, our then Chairman of the Board of Directors and Chief Executive Officer, Chuck Bay, had received reimbursement for approximately $137,000 in expenses that did not comply with the Company' s policies, lacked sufficient documentation, or were otherwise erroneous or duplicative. The Audit Committee also concluded that certain other executive officers received travel, entertainment, and other expense reimbursements in lesser amounts that did not comply with the Company' s policies, lacked sufficient documentation, or were otherwise erroneous or duplicative. The Audit Committee did not conclude that the excess reimbursements were the result of willful misconduct on the part of Mr. Bay, or any other KANA employee. Rather, the Audit Committee primarily attributed the excess reimbursements to the existence of multiple and inconsistent travel and entertainment policies, inadequate review of expense reimbursement requests and carelessness.

During the first quarter of 2005, the Audit Committee adopted various remedial measures, including a requirement that Mr. Bay and others immediately repay the amounts that the Audit Committee determined were inappropriate. Mr. Bay and the other individuals have repaid these amounts in full. The Audit Committee has also directed that management adopt a single, comprehensive travel and entertainment reimbursement policy and implement enhanced procedures and controls for the submission and review of expense reimbursement requests. Our management has implemented these measures, and the Audit Committee will continue to monitor the effectiveness of these remedial measures. In addition, our independent directors determined that it would be advisable to separate the roles of Chairman of the Board of Directors and Chief Executive Officer. Accordingly, Mr. Bay resigned from his position as Chairman of the Board of Directors, effective May 23, 2005, but he retained his positions as a director and as Chief Executive Officer. Subsequently, on August 25, 2005, Mr. Bay resigned from his position as Chief Executive Officer, and Mr. Bay' s position as a director expired at the Annual Stockholders Meeting held in November 2005.

We have determined that the dollar amounts involved in the excess reimbursements were not material for the 2002-2004 financial periods. However, the existence of multiple and inconsistent travel and entertainment policies and inadequate processes and procedures for review of expense reimbursement requests represented a material weakness in our internal controls. A material weakness in internal control is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

In the course of the audit of our consolidated financial statements for the year ended December 31, 2004, our former independent registered public accounting firm identified and reported additional material weaknesses in our internal control over financial reporting. First, we had weaknesses in our general accounting processes related to insufficient documentation and analyses to support our consolidated financial statements, failure to properly evaluate estimates of royalties due, inadequate reconciliation of inter-company accounts, insufficient staffing in the accounting and reporting function, which was exacerbated by changes in management and accounting personnel, and insufficient training of our accounting department. Second, there was no independent review of journal entries, and insufficient documentation or support for journal entries and consolidation entries. In a number of cases, this required adjustments to our financial statements for the year ended December 31, 2004.

Our management has determined that the material weaknesses as of December 31, 2004 continued to exist during 2005. As a result, we concluded that our internal controls over financial reporting were not effective as of December 31, 2005. We believe that these material weaknesses did not have a material impact on our consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2006 due to the fact that we performed substantial analyses on the December 31, 2005 consolidated financial statements and prior period financial statement balances, including historical account reconciliations, review of account balance analyses by senior management, and reconstruction of certain account balances. However, these material weaknesses increase the risk that a transaction will not be accounted for consistently and in accordance with established policy or accounting principles generally accepted in the United States of America, and they increase the risk of error.

Our management, with the oversight of the Audit Committee, has addressed these material weaknesses and has implemented controls to remediate these internal control weaknesses. Our management believes that it corrected the material weakness relating to travel and entertainment expense reimbursement by the end of the first quarter of 2005. New processes and internal controls have been approved and implemented and management concluded as of December 31, 2006 that these controls were operating effectively.

During the 2006 year-end close, we identified and reported a material weakness in our internal controls over financial reporting related to stock-based compensation. This material weakness related to our failure to complete a proper analysis of historical stock option vesting data within our system, which resulted in a net overstatement of our stock-based compensation during the interim reporting periods for fiscal year 2006. Due to this material weakness, quarterly results of operations have been restated, as provided in Note 14 of the a consolidated financial statements in the Company' s Form 10-K for the year ended December 31, 2006, and prior period pro-forma informational disclosure of expenses in accordance with SFAS 123 have also been restated as provided in Note 7 of the of the a consolidated financial statements in the Company' s Form 10-K for the year ended December 31, 2006. As a result, we are unable to conclude that our disclosure controls and procedures were effective as of March 31, 2007.

Our management, with the oversight of the Audit Committee, has begun to address this material weakness and is committed to effective remediation as expeditiously as possible. Our management has implemented a procedure to review the stock option reports on a quarterly basis to assure that only current employee options that are expected to vest are included in the employee stock-based compensation expense for such period. This material weakness will not be considered remediated until new internal controls are developed and implemented throughout the Company, are operational for a period of time and are tested, and our management concludes that these controls are operating effectively.

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PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

On March 16, 2006, Polaris IP, LLC (“Polaris”) filed suit against the Company, Sirius Satellite Radio, Inc., Priceline.com, Capital One, Continental Airlines, Inc., and E*Trade Financial, in the U.S. District Court for the Eastern District of Texas, alleging infringement of U.S. Patent Nos. 6,411,947 and 6,278,996, and seeking injunctive relief, damages and attorneys’ fees. In exchange for payment of a quarterly license fee through 2011, Polaris granted the Company a perpetual license to certain patents, including those at issue in the litigation, and the parties dismissed their claims against each other with prejudice on April 26, 2007. The terms of the settlement included the release and dismissal of the Company’ s customers named in the lawsuit.

The underwriters for our initial public offering, Goldman Sachs & Co., Lehman Bros., Hambrecht & Quist LLC and Wit Soundview Capital Corp., the Company and certain current and former officers of the Company were named as defendants in federal securities class action lawsuits filed in the U. S. District Court for the Southern District of New York. The cases allege violations of various securities laws by more than 300 issuers of stock, including the Company, and the underwriters for such issuers, on behalf of a class of plaintiffs who, in the case of the Company, purchased the Company’ s common stock between September 21, 1999 and December 6, 2000 in connection with our initial public offering. Specifically, the complaints allege that the underwriter defendants engaged in a scheme concerning sales of the Company’ s and other issuers’ securities in the initial public offering and in the aftermarket. In July 2003, we decided to join in a settlement negotiated by representatives of a coalition of issuers named as defendants in this action and their insurers. Although we believe that the plaintiffs’ claims have no merit, we have decided to accept the settlement proposal to avoid the cost and distraction of continued litigation. Because the settlement will be funded entirely by the Company’ s insurers, we do not believe that the settlement will have any effect on our financial condition, results of operation or cash flows. The proposed settlement agreement is subject to final approval by the court. Should the court fail to approve the settlement agreement, we believe we have meritorious defenses to these claims and will defend against the action vigorously.

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

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

ITEM 1A. RISK FACTORS.

Information regarding the Company’ s risk factors appears in “Part I. Financial Information − Item 2. Management’ s Discussion and Analysis of Financial Condition and Results of Operations” of this Quarterly Report on Form 10-Q and in “Part I. - Item 1A. Risk Factors” on our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 other than the material changes set forth below:

> We have added our entry into a definitive agreement with eVergance in May 2007 to the risk factor entitled “If we acquire companies, products, or technologies, we may face risks associated with those acquisitions.” This amended risk factor is provided in Part I. Financial Information − Item 2. Management’ s Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

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

Not applicable.

ITEM 5. OTHER INFORMATION.

Not applicable.

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ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Provided Herewith
10.01	Amended and Restated Loan and Security Agreement, dated February 27, 2007, between Kana Software, Inc. and Bridge Bank, N.A., as modified by Loan and Security Agreement, dated February 28, 2007 and as amended on May 7, 2007.					X
10.02	Patent License and Settlement Agreement, dated March 23, 2007, between Kana Software, Inc. and Polaris IP, LLC.±					X
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act and Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act and Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.01	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X
32.02	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X

± Confidential treatment has been requested with regard to portions of the exhibit. Such portions were filed separately with the Securities and Exchange Commission.

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

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SIGNATURES

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

May 14, 2007

Kana Software, Inc.

/s/ Michael S. Fields

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

/s/ John M. Thompson

John M. Thompson
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit Index

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EXHIBIT 10.01

KANA SOFTWARE, INC.

BRIDGE BANK, N.A.

AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT

This AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT is entered into as of February 27, 2007, by and between BRIDGE BANK, N.A. ("Bank") and KANA SOFTWARE, INC. ("Borrower").

RECITALS

A. Bank and Borrower are parties to that certain Business Financing Agreement dated as of November 30, 2005, as amended from time to time (the "Original Agreement").

B. Borrower and Bank wish to amend and restate the terms of the Original Agreement. This Agreement sets forth the terms on which Bank will advance credit to Borrower, and Borrower will repay the amounts owing to Bank.

AGREEMENT

The parties agree as follows:

1. DEFINITIONS AND CONSTRUCTION.

1.1 Definitions. As used in this Agreement, the following terms shall have the following definitions:

"Accounts" means all presently existing and hereafter arising accounts, contract rights, payment intangibles, and all other forms of obligations owing to Borrower arising out of the sale or lease of goods (including, without limitation, the licensing of software and other technology) or the rendering of services by Borrower, whether or not earned by performance, and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by Borrower and Borrower' s Books relating to any of the foregoing.

"Advance" or "Advances" means a cash advance or cash advances under the Revolving Facility.

"Affiliate" means, with respect to any Person, any Person that owns or controls directly or indirectly such Person, any Person that controls or is controlled by or is under common control with such Person, and each of such Person' s senior executive officers, directors, and partners.

"Bank Expenses" means all: reasonable costs or expenses (including reasonable attorneys' fees and expenses) incurred in connection with the preparation, negotiation, administration, and enforcement of the Loan Documents; reasonable Collateral audit fees; and Bank' s reasonable attorneys' fees and expenses incurred in amending, enforcing or defending the Loan Documents (including fees and expenses of appeal), incurred before, during and after an Insolvency Proceeding, whether or not suit is brought.

"Borrower' s Books" means all of Borrower' s books and records including: ledgers; records concerning Borrower' s assets or liabilities, the Collateral, business operations or financial condition; and all computer programs, or tape files, and the equipment, containing such information.

"Borrowing Base" means an amount equal to eighty percent (80%) of Eligible Accounts, as determined by Bank with reference to the most recent Borrowing Base Certificate delivered by Borrower.

"Business Day" means any day that is not a Saturday, Sunday, or other day on which banks in the State of California are authorized or required to close.

"Cash" means unrestricted cash and cash equivalents.

"Cash Management Sublimit" means a sublimit for cash management transactions approved by Bank under the Revolving Line subject to the availability under the Revolving Line and the Borrowing Base in an aggregate amount not to exceed $2,500,000 *minus*, in each case, any amounts outstanding under the Letter of Credit Sublimit and the Foreign Exchange Sublimit.

"Change in Control" shall mean a transaction in which any "person" or "group" (within the meaning of Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934) becomes the "beneficial owner" (as defined in Rule 13d-3 under the Securities Exchange Act of 1934), directly or indirectly, of a sufficient number of shares of all classes of stock then outstanding of Borrower ordinarily entitled to vote in the election of directors, empowering such "person" or "group" to elect a majority of the Board of Directors of Borrower, who did not have such power before such transaction.

"Closing Date" means the date of this Agreement.

"Code" means the California Uniform Commercial Code.

"Collateral" means the property described on **Exhibit A** attached hereto.

"Consolidated Net Income (or Deficit)" means the consolidated net income (or deficit) of any Person and its Subsidiaries, after deduction of all expenses, taxes, and other proper charges, determined in accordance with GAAP, after eliminating therefrom all extraordinary nonrecurring items of income.

"Consolidated Total Interest Expense" means with respect to any Person for any period, the aggregate amount of interest required to be paid or accrued by a Person and its Subsidiaries during such period on all Indebtedness of such Person and its Subsidiaries outstanding during all or any part of such period, whether such interest was or is required to be reflected as an item of expense or capitalized, including payments consisting of interest in respect of any capitalized lease or any synthetic lease, and including commitment fees, agency fees, facility fees, balance deficiency fees and similar fees or expenses in connection with the borrowing of money.

"Contingent Obligation" means, as applied to any Person, any direct or indirect liability, contingent or otherwise, of that Person with respect to (i) any indebtedness, lease, dividend, letter of credit or other obligation of another; (ii) any obligations with respect to undrawn letters of credit, corporate credit cards, or merchant services issued or provided for the account of that Person; and (iii) all obligations arising under any agreement or arrangement designed to protect such Person against fluctuation in interest rates, currency exchange rates or commodity prices; provided, however, that the term "Contingent Obligation" shall not include endorsements for collection or deposit in the ordinary course of business. The amount of any Contingent Obligation shall be deemed to be an amount equal to the stated or determined amount of the primary obligation in respect of which such Contingent Obligation is made or, if not stated or determinable, the maximum reasonably anticipated liability in respect thereof as determined by Bank in good faith; provided, however, that such amount shall not in any event exceed the maximum amount of the obligations under the guarantee or other support arrangement.

"Copyrights" means any and all copyright rights, copyright applications, copyright registrations and like protections in each work or authorship and derivative work thereof.

"Credit Extension" means each Advance, Term Advance, Letter of Credit, or any other extension of credit by Bank for the benefit of Borrower hereunder.

"Current Liabilities" means, as of any applicable date, all amounts that should, in accordance with GAAP, be included as current liabilities on the consolidated balance sheet of Borrower and its Subsidiaries, as at such date, plus, to the extent not already included therein, all outstanding Credit Extensions made under this Agreement.

"Daily Balance" means the amount of the Obligations owed at the end of a given day.

"Deferred Revenue" means all amounts received in advance of performance under maintenance contracts and not yet recognized as revenue.

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

"Eligible Accounts" means those Accounts that arise in the ordinary course of Borrower' s business that comply with all of Borrower' s representations and warranties to Bank set forth in Section 5.4; provided, that standards of eligibility may be fixed and revised from time to time by Bank in Bank' s reasonable judgment and upon notification thereof to Borrower in accordance with the provisions hereof. Unless otherwise agreed to by Bank, Eligible Accounts shall not include the following:

(a) Accounts that the account debtor has failed to pay within ninety (90) days of invoice date;

(b) Accounts with respect to an account debtor, thirty-five percent (35%) of whose Accounts the account debtor has failed to pay within ninety (90) days of invoice date;

(c) Accounts with respect to which the account debtor is an officer, employee, or agent of Borrower;

(d) Accounts with respect to which services have not been rendered (other than pre-billed maintenance), goods are placed on consignment, guaranteed sale, sale or return, sale on approval, bill and hold, or other terms by reason of which the payment by the account debtor may be conditional;

(e) Accounts with respect to which the account debtor is an individual or an Affiliate of Borrower;

(f) Accounts with respect to which the account debtor does not have its principal place of business in the United States, except for Eligible Foreign Accounts;

(g) Accounts with respect to which the account debtor is the United States or any department, agency, or instrumentality of the United States;

(h) Accounts with respect to which Borrower is liable to the account debtor for goods sold or services rendered by the account debtor to Borrower or for deposits or other property of the account debtor held by Borrower, but only to the extent of any amounts owing to the account debtor against amounts owed to Borrower;

(i) Accounts with respect to an account debtor, including Subsidiaries and Affiliates, whose total obligations to Borrower exceed thirty percent (30%) of all Accounts (the "Concentration Limit"), to the extent such obligations exceed the aforementioned percentage, except as approved in writing by Bank and except that the Concentration Limit for Accounts with respect to which the account debtor is IBM shall be fifty percent (50%);

(j) Accounts with respect to which the account debtor disputes liability or makes any claim with respect thereto as to which Bank believes, in its sole discretion, that there may be a basis for dispute (but only to the extent of the amount subject to such dispute or claim), or is subject to any Insolvency Proceeding, or becomes insolvent, or goes out of business; and

(k) Accounts the collection of which Bank reasonably determines to be doubtful.

"Eligible Foreign Accounts" means Accounts with respect to which the account debtor does not have its principal place of business in the United States and (i) that are supported by one or more letters of credit in an amount and of a tenor, and issued by a financial institution, acceptable to Bank, (ii) that Bank approves on a case-by-case basis, or (ii) Accounts with respect to which the account debtor is IBM.

"Equipment" means all present and future machinery, equipment, tenant improvements, furniture, fixtures, vehicles, tools, parts and attachments in which Borrower has any interest.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended, and the regulations thereunder.

"Event of Default" has the meaning assigned in Article 8.

"Foreign Exchange Sublimit" means a sublimit for foreign exchange contracts under the Revolving Line, subject to the availability under the Revolving Line and the Borrowing Base, in an aggregate amount not to exceed $2,500,000 less, in each case, any amounts outstanding under the Letter of Credit Sublimit and the Cash Management Sublimit.

"GAAP" means generally accepted accounting principles as in effect from time to time.

"Indebtedness" means (a) all indebtedness for borrowed money or the deferred purchase price of property or services, including without limitation reimbursement and other obligations with respect to surety bonds and letters of credit, (b) all obligations evidenced by notes, bonds, debentures or similar instruments, (c) all capital lease obligations and (d) all Contingent Obligations.

"Insolvency Proceeding" means any proceeding commenced by or against any person or entity under any provision of the United States Bankruptcy Code, as amended, or under any other bankruptcy or insolvency law, including assignments for the benefit of creditors, formal or informal moratoria, compositions, extension generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

"Intellectual Property Collateral" means all of Borrower' s right, title, and interest in and to the following: Copyrights, Trademarks and Patents; all trade secrets, all design rights, claims for damages by way of past, present and future infringement of any of the rights included above, all licenses or other rights to use any of the Copyrights, Patents or Trademarks, and all license fees and royalties arising from such use to the extent permitted by such license or rights; all amendments, renewals and extensions of any of the Copyrights, Trademarks or Patents; and all proceeds and products of the foregoing, including without limitation all payments under insurance or any indemnity or warranty payable in respect of any of the foregoing.

"Inventory" means all inventory in which Borrower has or acquires any interest, including work in process and finished products intended for sale or lease or to be furnished under a contract of service, of every kind and description now or at any time hereafter owned by or in the custody or possession, actual or constructive, of Borrower, including such inventory as is temporarily out of its custody or possession or in transit and including any returns upon any accounts or other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above, and Borrower' s Books relating to any of the foregoing.

"Investment" means any beneficial ownership of (including stock, partnership interest or other securities) any Person, or any loan, advance or capital contribution to any Person.

"IRC" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

"Letter of Credit" means a commercial or standby letter of credit or similar undertaking issued by Bank at Borrower' s request in accordance with Section 2.1(c).

"Letter of Credit Sublimit" means a sublimit for Letters of Credit under the Revolving Line, subject to the availability under the Revolving Line and the Borrowing Base, in an aggregate amount not to exceed $2,500,000 less, in each case, any amounts outstanding under the Foreign Exchange Sublimit and the Cash Management Sublimit.

"Lien" means any mortgage, lien, deed of trust, charge, pledge, security interest or other encumbrance.

"Loan Documents" means, collectively, this Agreement, any note or notes executed by Borrower, and any other agreement entered into in connection with this Agreement, all as amended or extended from time to time.

"Material Adverse Effect" means a material adverse effect on (i) the business operations, condition (financial or otherwise) or prospects of Borrower and its Subsidiaries taken as a whole or (ii) the ability of Borrower to repay the Obligations or otherwise perform its obligations under the Loan Documents or (iii) the value or priority of Bank' s security interests in the Collateral:

"Negotiable Collateral" means all letters of credit of which Borrower is a beneficiary, notes, drafts, instruments, securities, documents of title, and chattel paper, and Borrower' s Books relating to any of the foregoing.

"Obligations" means all debt, principal, interest, Bank Expenses and other amounts owed to Bank by Borrower pursuant to this Agreement or any other agreement, whether absolute or contingent, due or to become due, now existing or hereafter arising, including any interest that accrues after the commencement of an Insolvency Proceeding and including any debt, liability, or obligation owing from Borrower to others that Bank may have obtained by assignment or otherwise.

"Patents" means all patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations-in-part of the same.

"Periodic Payments" means all installments or similar recurring payments that Borrower may now or hereafter become obligated to pay to Bank pursuant to the terms and provisions of any instrument, or agreement now or hereafter in existence between Borrower and Bank.

"Permitted Indebtedness" means:

(a) Indebtedness of Borrower in favor of Bank arising under this Agreement or any other Loan Document;

(b) Indebtedness existing on the Closing Date and disclosed in the Schedule;

(c) Indebtedness secured by a lien described in clause (c) of the defined term "Permitted Liens," provided (i) such Indebtedness does not exceed the lesser of the cost or fair market value of the equipment financed with such Indebtedness and (ii) such Indebtedness does not exceed $100,000 in the aggregate at any given time; and

(d) Subordinated Debt.

"Permitted Investment" means:

(a) Investments existing on the Closing Date disclosed in the Schedule; and

(b) (i) marketable direct obligations issued or unconditionally guaranteed by the United States of America or any agency or any State thereof maturing within one (1) year from the date of acquisition thereof, (ii) commercial paper maturing no more than one (1) year from the date of creation thereof and currently having rating of at least A-2 or P-2 from either Standard & Poor' s Corporation or Moody' s Investors Service, (iii) certificates of deposit maturing no more than one (1) year from the date of investment therein issued by Bank and (iv) Bank' s money market accounts.

"Permitted Liens" means the following:

(a) Any Liens existing on the Closing Date and disclosed in the Schedule or arising under this Agreement or the other Loan Documents;

(b) Liens for taxes, fees, assessments or other governmental charges or levies, either not delinquent or being contested in good faith by appropriate proceedings, provided the same have no priority over any of Bank' s security interests;

(c) Liens (i) upon or in any equipment which was not financed by Bank acquired or held by Borrower or any of its Subsidiaries to secure the purchase price of such equipment or indebtedness incurred solely for the purpose of financing the acquisition of such equipment, or (ii) existing on such equipment at the time of its acquisition, provided that the Lien is confined solely to the property so acquired and improvements thereon, and the proceeds of such equipment;

(d) Liens incurred in connection with the extension, renewal or refinancing of the indebtedness secured by Liens of the type described in clauses (a) through (c) above, provided that any extension, renewal or replacement Lien shall be limited to the property encumbered by the existing Lien and the principal amount of the indebtedness being extended, renewed or refinanced does not increase.

"Person" means any individual, sole proprietorship, partnership, limited liability company, joint venture, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or governmental agency.

"Prime Rate" means the variable rate of interest, per annum, most recently announced by Bank, as its prime rate," whether or not such announced rate is the lowest rate available from Bank.

"Profitability" means Borrower' s net income after tax, net of any stock-based compensation expense.

"Responsible Officer" means each of the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer and the Controller of Borrower.

"Revolving Facility" means the facility under which Borrower may request Bank to issue Advances, as specified in Section 2.1(a) hereof.

"Revolving Line" means a credit extension of up to Ten Million Dollars ($10,000,000).

"Revolving Maturity Date" means the second anniversary of the Closing Date.

"Schedule" means the schedule of exceptions attached hereto and approved by Bank, if any.

"Subordinated Debt" means any debt incurred by Borrower that is subordinated to the debt owing by Borrower to Bank on terms acceptable to Bank (and identified as being such by Borrower and Bank).

"Subsidiary" means any corporation, company or partnership in which (i) any general partnership interest or (ii) more than 50% of the stock or other units of ownership which by the terms thereof has the ordinary voting power to elect the Board of Directors, managers or trustees of the entity, at the time as of which any determination is being made, is owned by Borrower, either directly or through an Affiliate.

"Term Advance" means a cash advance under Section 2.1(b).

"Term Line" means a credit extension of up to Five Million Dollars ($5,000,000).

"Term Maturity Date" means the fourth anniversary of the Closing Date.

"Total Liabilities" means at any date as of which the amount thereof shall be determined, all obligations that should, in accordance with GAAP be classified as liabilities on the consolidated balance sheet of Borrower, including in any event all Indebtedness.

"Trademarks" means any trademark and servicemark rights, whether registered or not, applications to register and registrations of the same and like protections, and the entire goodwill of the business of Borrower connected with and symbolized by such trademarks.

1.2 Accounting Terms. All accounting terms not specifically defined herein shall be construed in accordance with GAAP and all calculations made hereunder shall be made in accordance with GAAP. When used herein, the terms "financial statements" shall include the notes and schedules thereto.

2. LOAN AND TERMS OF PAYMENT.

2.1 Credit Extensions.

Borrower promises to pay to the order of Bank, in lawful money of the United States of America, the aggregate unpaid principal amount of all Credit Extensions made by Bank to Borrower hereunder. Borrower shall also pay interest on the unpaid principal amount of such Credit Extensions at rates in accordance with the terms hereof.

(a) Revolving Advances.

(i) Subject to and upon the terms and conditions of this Agreement, Borrower may request Advances in an aggregate outstanding amount not to exceed the lesser of (i) the Revolving Line or (ii) the Borrowing Base, *minus*, in each case, the aggregate amount of the outstanding Term Advances and any amounts outstanding under the Letter of Credit Sublimit, the Cash Management Sublimit and the Foreign Exchange Sublimit. Subject to the terms and conditions of this Agreement, amounts borrowed pursuant to this Section 2.1(a) may be repaid and reborrowed at any time prior to the Revolving Maturity Date, at which time all Advances under this Section 2.1(a) shall be immediately due and payable. Borrower may prepay any Advances without penalty or premium.

(ii) Whenever Borrower desires an Advance, Borrower will notify Bank by facsimile transmission or telephone no later than 3:00 p.m. Pacific time, on the Business Day that the Advance is to be made. Each such notification shall be promptly confirmed by a Payment/ Advance Form in substantially the form of **Exhibit B** hereto. Bank is authorized to make Advances under this Agreement, based upon instructions received from a Responsible Officer or a designee of a Responsible Officer, or without instructions if in Bank' s discretion such Advances are necessary to meet Obligations which have become due and remain unpaid. Bank shall be entitled to rely on any telephonic notice given by a person who Bank reasonably believes to be a Responsible Officer or a designee thereof, and Borrower shall indemnify and hold Bank harmless for any damages or loss suffered by Bank as a result of such reliance. Bank will credit the amount of Advances made under this Section 2.1(a) to Borrower' s deposit account.

(b) Term Advances. Subject to and upon the terms and conditions of this Agreement, at any time from the date hereof through the first anniversary of the Closing Date (the "Availability End Date"), Bank agrees to make Term Advances to Borrower in an aggregate amount not to exceed the lesser of (i) the Term Line or (ii) the Borrowing Base. Interest shall accrue from the date of each Term Advance at the rate specified in Section 2.3, and shall be payable monthly on the first day of each month so long as any Term Advances are outstanding. Any Term Advances that are outstanding on the Availability End Date shall be payable in thirty six (36) equal monthly installments of principal, plus all accrued interest, beginning on February 1, 2008, and continuing on the same day of each month thereafter through the Term Maturity Date, at which time all amounts owing under this Section 2.1(b) and any other amounts owing under this Agreement shall be immediately due and payable. Term Advances, once repaid, may not be reborrowed. Borrower may prepay any Term Advances without penalty or premium. When Borrower desires to obtain a Term Advance, Borrower shall notify Bank (which notice shall be irrevocable) by facsimile transmission to be received no later than 3:00 p.m. Pacific time three (3) Business Days before the day on which the Term Advance is to be made. Such notice shall be substantially in the form of **Exhibit B**. The notice shall be signed by a Responsible Officer or its designee.

(c) Letters of Credit. Subject to the terms and conditions of this Agreement and the availability under the Revolving Line and the Borrowing Base, at any time prior to the Revolving Maturity Date, Bank agrees to issue letters of credit for the account of Borrower (each, a "Letter of Credit" and collectively, the "Letters of Credit") in an aggregate outstanding face amount not to exceed $2,500,000 less any amounts outstanding under the Cash Management Sublimit and the Foreign Exchange Sublimit, and that availability under the Revolving Line shall be reduced by, the Letters of Credit. All Letters of Credit shall be, in form and substance, acceptable to Bank in its sole discretion and shall be subject to the terms and conditions of Bank' s form of standard application and letter of credit agreement (the "Application"), which Borrower hereby agrees to execute, including Bank' s standard fee. On any drawn but unreimbursed Letter of Credit, the unreimbursed amount shall be deemed an Advance under Section 2.1(a). If at any time the Revolving Facility is terminated or otherwise ceases to exist, Borrower shall immediately secure in cash all obligations under any outstanding Letters of Credit on terms acceptable to Bank. The obligation of Borrower to reimburse Bank for drawings made under Letters of Credit shall be absolute, unconditional and irrevocable, and shall be performed strictly in accordance with the terms of this Agreement, the Application, and such Letters of Credit, under all circumstances whatsoever. Borrower shall indemnify, defend, protect, and hold Bank harmless from any loss, cost, expense or liability, including, without limitation, reasonable attorneys' fees, arising out of or in connection with any Letters of Credit, except for expenses caused by Bank' s gross negligence or willful misconduct.

(d) Cash Management Sublimit. Subject to the terms and conditions of this Agreement and the availability under the Revolving Line and the Borrowing Base, Borrower may request cash management services which may include merchant services, direct deposit of payroll, business credit card, and check cashing services identified in various cash management services agreements related to such services (the "Cash Management Services") by delivering to Bank such applications on Bank' s standard forms as requested by Bank; provided, however, that the total amount of the Cash Management Services shall not exceed $2,500,000 less any amounts outstanding under the Letter of Credit Sublimit and the Foreign Exchange Sublimit, and that availability under the Revolving Line shall be reduced by, the Cash Management Sublimit. In addition, Bank may, in its sole discretion, charge as Advances any amounts that become due or owing to Bank in connection with the Cash Management Services. If at any time the Revolving Facility is terminated or otherwise ceases to exist, Borrower shall immediately secure to Bank' s satisfaction its obligations with respect to any Cash Management Services, and, effective as of such date, the balance in any deposit accounts held by Bank and the certificates of deposit issued by Bank in Borrower' s name (and any interest paid thereon or proceeds thereof, including any amounts payable upon the maturity or liquidation of such certificates), shall automatically secure such obligations to the extent of the then outstanding Cash Management Services. Borrower authorizes Bank to hold such balances in pledge and to decline to honor any drafts thereon or any requests by Borrower or any other Person to pay or otherwise transfer any part of such balances for so long as the Cash Management Services continue.

(e) Foreign Exchange Sublimit. Subject to and upon the terms and conditions of this Agreement and any other agreement that Borrower may enter into with the Bank in connection with foreign exchange transactions ("FX Contracts") and subject to the availability under the Revolving Line and the Borrowing Base, Borrower may request Bank to enter into FX Contracts with Borrower due not later than the Revolving Maturity Date unless cash secured on terms satisfactory to Bank. Borrower shall pay any standard issuance and other fees that Bank notifies Borrower will be charged for issuing and processing FX Contracts for Borrower. The FX Amount shall at all times be equal to or less than $2,500,000 minus any amounts outstanding under the Letter of Credit Sublimit and the Cash Management Sublimit. The "FX Amount" shall equal the amount determined by multiplying (i) the aggregate amount, in United States Dollars, of FX Contracts between Borrower and Bank remaining outstanding as of any date of determination by (ii) the applicable Foreign Exchange Reserve Percentage as of such date. The "Foreign Exchange Reserve Percentage" shall be a percentage as determined by Bank, in its sole discretion from time to time. If at any time the Revolving Facility is terminated or otherwise ceases to exist, Borrower shall immediately secure in cash all obligations under the Foreign Exchange Sublimit on terms acceptable to Bank.

2.2 Overadvances. If the sum of aggregate amount of the outstanding Advances plus the aggregate amount of the outstanding Term Advances plus any amounts outstanding under the Letter of Credit Sublimit, the Cash Management Sublimit and the Foreign Exchange Sublimit exceeds the lesser of the Revolving Line or the Borrowing Base at any time, Borrower shall immediately pay to Bank, in cash, the amount of such excess.

2.3 Interest Rates, Payments, and Calculations.

(a) Interest Rates.

(i) **Advances.** Except as set forth in Section 2.3(b), the Advances shall bear interest, on the outstanding Daily Balance thereof, at a rate equal to one and one quarter of one percent (1.25%) above the Prime Rate.

(ii) **Term Advances.** Except as set forth in Section 2.3(b), the Term Advances shall bear interest, on the outstanding Daily Balance thereof, at a rate equal to (a) beginning on the Closing Date through the Availability End Date, one and one quarter of one percent (1.25%) above the Prime Rate, and (b) beginning on the Availability End Date through the Term Maturity Date, one and three quarters of one percent (1.75%) above the Prime Rate.

(b) Late Fee; Default Rate. If any payment is not made within ten (10) days after the date such payment is due, Borrower shall pay Bank a late fee equal to the lesser of (i) five percent (5%) of the amount of such unpaid amount or (ii) the maximum amount permitted to be charged under applicable law. All Obligations shall bear interest, from and after the occurrence and during the continuance of an Event of Default, at a rate equal to five (5) percentage points above the interest rate applicable immediately prior to the occurrence of the Event of Default.

(c) Payments. Interest hereunder shall be due and payable on the first calendar day of each month during the term hereof. Bank shall, at its option, charge such interest, all Bank Expenses, and all Periodic Payments against any of Borrower' s deposit accounts or against the Revolving Line, in which case those amounts shall thereafter accrue interest at the rate then applicable hereunder. Any interest not paid when due shall be compounded by becoming a part of the Obligations, and such interest shall thereafter accrue interest at the rate then applicable hereunder. All payments shall be free and clear of any taxes, withholdings, duties, impositions or other charges, to the end that Bank will receive the entire amount of any Obligations payable hereunder, regardless of source of payment.

(d) Computation. In the event the Prime Rate is changed from time to time hereafter, the applicable rate of interest hereunder shall be increased or decreased, effective as of the day the Prime Rate is changed, by an amount equal to such change in the Prime Rate. All interest chargeable under the Loan Documents shall be computed on the basis of a three hundred sixty (360) day year for the actual number of days elapsed.

2.4 Crediting Payments. Prior to the occurrence of an Event of Default, Bank shall credit a wire transfer of funds, check or other item of payment to such deposit account or Obligation as Borrower specifies. After the occurrence of an Event of Default, the receipt by Bank of any wire transfer of funds, check, or other item of payment shall be immediately applied to conditionally reduce Obligations, but shall not be considered a payment on account unless such payment is of immediately available federal funds or unless and until such check or other item of payment is honored when presented for payment. Notwithstanding anything to the contrary contained herein, any wire transfer or payment received by Bank after 12:00 noon Pacific time shall be deemed to have been received by Bank as of the opening of business on the immediately following Business Day. Whenever any payment to Bank under the Loan Documents would otherwise be due (except by reason of acceleration) on a date that is not a Business Day, such payment shall instead be due on the next Business Day, and additional fees or interest, as the case may be, shall accrue and be payable for the period of such extension.

2.5 Fees. Borrower shall pay to Bank the following:

(a) Facility Fee. On the Closing Date, a Facility Fee equal to $25,000, which shall be nonrefundable; and

(b) Non-Usage Fee. A per annum fee equal to one quarter of one percent (0.25%) of the difference between (1) the amount of the Revolving Line available on each date of determination, and (2) the average daily balance owing on account of the Revolving Line during the term hereof, paid quarterly in arrears, which shall be nonrefundable provided however that such fee shall not be assessed during a calendar quarter during which (i) the average aggregate amount outstanding under the Revolving Line and the Term Line exceeds $4,500,000, or (ii) the average amount of cash maintained by Borrower at Bank exceeds $5,000,000; and

(c) Bank Expenses. On the Closing Date, all Bank Expenses incurred through the Closing Date, including reasonable attorneys' fees and expenses and, after the Closing Date, all Bank Expenses, including reasonable attorneys' fees and expenses, as and when they are incurred by Bank.

2.6 Term. This Agreement shall become effective on the Closing Date and, subject to Section 12.8, shall continue in full force and effect for so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions under this Agreement. Notwithstanding the foregoing, Bank shall have the right to terminate its obligation to make

Credit Extensions under this Agreement immediately and without notice upon the occurrence and during the continuance of an Event of Default. Notwithstanding termination, Bank’ s Lien on the Collateral shall remain in effect for so long as any Obligations are outstanding.

3. CONDITIONS OF LOANS.

3.1 Conditions Precedent to Initial Credit Extension. The obligation of Bank to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance satisfactory to Bank, the following:

(a) this Agreement;

(b) a certificate of the Secretary of Borrower with respect to incumbency and resolutions authorizing the execution and delivery of this Agreement;

(c) UCC National Form Financing Statement;

(d) an intellectual property security agreement;

(e) an agreement to provide insurance;

(f) payment of the fees and Bank Expenses then due specified in Section 2.5 hereof;

(g) current financial statements of Borrower;

(h) an audit of the Collateral, the results of which shall be satisfactory to Bank; and

(i) such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

3.2 Conditions Precedent to all Credit Extensions. The obligation of Bank to make each Credit Extension, including the initial Credit Extension, is further subject to the following conditions:

(a) timely receipt by Bank of the Payment/Advance Form as provided in Section 2.1; and

(b) the representations and warranties contained in Section 5 shall be true and correct in all material respects on and as of the date of such Payment/Advance Form and on the effective date of each Credit Extension as though made at and as of each such date, and no Event of Default shall have occurred and continuing, or would exist alter giving effect to such Credit Extension. The making of each Credit Extension shall be deemed to be a representation and warranty by Borrower on the date of such Credit Extension as to the accuracy of the facts referred to in this Section 3.2.

4. **CREATION OF SECURITY INTEREST.**

4.1 Grant of Security Interest. Borrower grants and pledges to Bank a continuing security interest in all presently existing and hereafter acquired or arising Collateral in order to secure prompt repayment of any and all Obligations and in order to secure prompt performance by Borrower of each of its covenants and duties under the Loan Documents. Except as set forth in the Schedule, such security interest constitutes a valid, first priority security interest in the presently existing Collateral, and will constitute a valid, first priority security interest in Collateral acquired after the date hereof.

4.2 Delivery of Additional Documentation Required. Borrower shall from time to time execute and deliver to Bank, at the request of Bank, all Negotiable Collateral, all financing statements and other documents that Bank may reasonably request, in form satisfactory to Bank, to perfect and continue the perfection of Bank' s security interests in the Collateral and in order to fully consummate all of the transactions contemplated under the Loan Documents. Borrower from time to time may deposit with Bank specific time deposit accounts to secure specific Obligations. Borrower authorizes Bank to hold such balances in pledge and to decline to honor any drafts thereon or any request by Borrower or any other Person to pay or otherwise transfer any part of such balances for so long as the Obligations are outstanding.

4.3 Right to Inspect. Bank (through any of its officers, employees, or agents) shall have the right, upon reasonable prior notice, from time to time during Borrower' s usual business hours but no more than twice a year (unless an Event of Default has occurred and is continuing), to inspect Borrower' s Books and to make copies thereof and to check, test, and appraise the Collateral in order to verify Borrower' s financial condition or the amount, condition of, or any other matter relating to, the Collateral.

5. **REPRESENTATIONS AND WARRANTIES.**

Borrower represents and warrants as follows:

5.1 Due Organization and Qualification. Borrower and each Subsidiary is a corporation duly existing under the laws of its state of incorporation and qualified and licensed to do business in any state in which the conduct of its business or its ownership of property requires that it be so qualified.

5.2 Due Authorization; No Conflict. The execution, delivery, and performance of the Loan Documents are within Borrower' s powers, have been duly authorized, and are not in conflict with nor constitute a breach of any provision contained in Borrower' s Articles of Incorporation or Bylaws, nor will they constitute an event of default under any material agreement to which Borrower is a party or by which Borrower is bound. Borrower is not in default under any material agreement to which it is a party or by which it is bound.

5.3 No Prior Encumbrances. Borrower has good and marketable title to its property, free and clear of Liens, except for Permitted Liens.

5.4 Bona Fide Eligible Accounts. The Eligible Accounts are bona fide existing obligations. The property and services giving rise to such Eligible Accounts has been delivered or rendered to the account debtor or to the account debtor' s agent for immediate and unconditional acceptance by the account debtor. Borrower has not received notice of actual or imminent Insolvency Proceeding of any account debtor that is included in any Borrowing Base Certificate as an Eligible Account.

5.5 Merchantable Inventory. All Inventory is in all material respects of good and marketable quality, free from all material defects, except for Inventory for which adequate reserves have been made.

5.6 Intellectual Property Collateral. Borrower is the sole owner of the Intellectual Property Collateral, except for non-exclusive licenses granted by Borrower to its customers in the ordinary course of business. Each of the Patents is valid and enforceable, and no part of the Intellectual Property Collateral has been judged invalid or unenforceable, in whole or in part, and no claim has been made that any part of the Intellectual Property Collateral violates the rights of any third party. Except as set forth in the Schedule, Borrower' s rights as a licensee of intellectual property do not give rise to more than five percent (5%) of its gross revenue in any given month, including without limitation revenue derived from the sale, licensing, rendering or disposition of any product or service. Except as set forth in the Schedule, Borrower is not a party to, or bound by, any agreement that restricts the grant by Borrower of a security interest in Borrower' s rights under such agreement.

5.7 Name; Location of Chief Executive Office. Except as disclosed in the Schedule, Borrower has not done business under any name other than that specified on the signature page hereof. The chief executive office of Borrower is located at the address indicated in Section 10 hereof. All Borrower' s Inventory and Equipment is located only at the location set forth in Section 10 hereof.

5.8 Litigation. Except as set forth in the Schedule, there are no actions or proceedings pending by or against Borrower or any Subsidiary before any court or administrative agency in which an adverse decision could have a Material Adverse Effect, or a material adverse effect on Borrower' s interest or Bank' s security interest in the Collateral.

5.9 No Material Adverse Change in Financial Statements. All consolidated and consolidating financial statements related to Borrower and any Subsidiary that Bank has received from Borrower fairly present in all material respects Borrower' s financial condition as of the date thereof and Borrower' s consolidated and consolidating results of operations for the period then ended. There has not been a material adverse change in the consolidated or the consolidating financial condition of Borrower since the date of the most recent of such financial statements submitted to Bank.

5.10 Solvency, Payment of Debts. Borrower is solvent and able to pay its debts (including trade debts) as they mature.

5.11 Regulatory Compliance. Borrower and each Subsidiary have met the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA, and no event has occurred resulting from Borrower' s failure to comply with ERISA that could result in Borrower' s incurring any material liability. Borrower is not an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940. Borrower is not engaged principally, or as one of the important activities, in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulations T and U of the Board of Governors of the Federal Reserve System). Borrower has complied with all the provisions of the Federal Fair Labor Standards Act. Borrower has not violated any statutes, laws, ordinances or rules applicable to it, violation of which could have a Material Adverse Effect.

5.12 Environmental Condition. Except as disclosed in the Schedule, none of Borrower' s or any Subsidiary' s properties or assets has ever been used by Borrower or any Subsidiary or, to the best of Borrower' s knowledge, by previous owners or operators, in the disposal of, or to produce, store, handle, treat, release, or transport, any hazardous waste or hazardous substance other than in accordance with applicable law; to the best of Borrower' s knowledge, none of Borrower' s properties or assets has ever been designated or identified in any manner pursuant to any environmental protection statute as a hazardous waste or hazardous substance disposal site, or a candidate for closure pursuant to any environmental protection statute; no lien arising under any environmental protection statute has attached to any revenues or to any real or personal property owned by Borrower or any Subsidiary; and neither Borrower nor any Subsidiary has received a summons, citation, notice, or directive from the Environmental Protection Agency or any other federal, state or other governmental agency concerning any action or omission by Borrower or any Subsidiary resulting in the releasing, or otherwise disposing of hazardous waste or hazardous substances into the environment.

5.13 Taxes. Borrower and each Subsidiary have filed or caused to be filed all tax returns required to be filed, and have paid, or have made adequate provision for the payment of all taxes reflected therein.

5.14 Subsidiaries. Borrower does not own any stock, partnership interest or other equity securities of any Person, except for Permitted Investments.

5.15 Government Consents. Borrower and each Subsidiary have obtained all material consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all governmental authorities that are necessary for the continued operation of Borrower' s business as currently conducted.

5.16 Accounts. None of Borrower' s nor any Subsidiary' s property is maintained or invested with a Person other than Bank, except as disclosed in the Schedule provided that Bank has received a control agreement in form satisfactory to Bank covering such property, or as otherwise consented to by Bank in writing.

5.17 Full Disclosure. No representation, warranty or other statement made by Borrower in any certificate or written statement furnished to Bank contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained in such certificates or statements not misleading.

6. AFFIRMATIVE COVENANTS.

Borrower shall do all of the following:

6.1 Good Standing. Borrower shall maintain its and each of its Subsidiaries' corporate existence and good standing in its jurisdiction of incorporation and maintain qualification in each jurisdiction in which it is required under applicable law. Borrower shall maintain, and shall cause each of its Subsidiaries to maintain, in force all licenses, approvals and agreements, the loss of which could have a Material Adverse Effect.

6.2 Government Compliance. Borrower shall meet, and shall cause each Subsidiary to meet, the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. Borrower shall comply, and shall cause each Subsidiary to comply, with all statutes, laws, ordinances and government rules and regulations to which it is subject, noncompliance with which could have a Material Adverse Effect.

6.3 Financial Statements, Reports, Certificates. Borrower shall deliver the following to Bank: (a) as soon as available, but in any event within thirty (30) days after the end of each calendar month, a company prepared consolidated balance sheet and income statement covering Borrower' s consolidated operations during such period, prepared in accordance with GAAP, consistently applied, in a form acceptable to Bank and certified by a Responsible Officer; (b) copies of all statements, reports and notices sent or made available generally by Borrower to its security holders or to any holders of Subordinated Debt and as soon as available, but in any event within five (5) days after the filing thereof, all reports filed with the Securities and Exchange Commission including without limitation on Forms 10-K and 10-Q; (c) promptly upon receipt of notice thereof, a report of any legal actions pending or threatened against Borrower or any Subsidiary that could result in damages or costs to Borrower or any Subsidiary of Fifty Thousand Dollars ($50,000) or more; (d) as soon as available, but in any event within thirty (30) days after Borrower' s fiscal year end, an operating budget in form reasonably acceptable to Bank and approved by Borrower' s board of directors; and (e) such budgets, sales projections, operating plans or other financial information as Bank may reasonably request from time to time.

Within thirty (30) days after the last day of each month, Borrower shall deliver to Bank a Borrowing Base Certificate signed by a Responsible Officer in substantially the form of **Exhibit C** hereto, together with aged listings of accounts receivable and accounts payable.

Borrower shall deliver to Bank with the monthly financial statements a Compliance Certificate signed by a Responsible Officer in substantially the form of **Exhibit D** hereto.

Bank shall have a right from time to time hereafter to audit Borrower' s Accounts and appraise Collateral at Borrower' s expense, provided that such audits will be conducted no more often than every six (6) months unless an Event of Default has occurred and is continuing.

6.4 Taxes. Borrower shall make, and shall cause each Subsidiary to make, due and timely payment or deposit of all material federal, state, and local taxes, assessments, or contributions required of it by law, and will execute and deliver to Bank, on demand, appropriate certificates attesting to the payment or deposit thereof, and Borrower will make, and will cause each Subsidiary to make, timely payment or deposit of all material tax payments and withholding taxes required of it by applicable laws, including, but not limited to, those laws concerning F.I.C.A., F.U.T.A., state disability, and local, state, and federal income taxes, and will, upon request, furnish Bank with proof satisfactory to Bank indicating that Borrower or a Subsidiary has made such payments or deposits; provided that Borrower or a Subsidiary need not make any payment if the amount or validity of such payment is contested in good faith by appropriate proceedings and is reserved against (to the extent required by GAAP) by Borrower.

6.5 Insurance.

(a) Borrower, at its expense, shall keep the Collateral insured against loss or damage by fire, theft, explosion, sprinklers, and all other hazards and risks, and in such amounts, as ordinarily insured against by other owners in similar businesses conducted in the locations where Borrower' s business is conducted on the date hereof. Borrower shall also maintain insurance relating to Borrower' s business, ownership and use of the Collateral in amounts and of a type that are customary to businesses similar to Borrower' s.

(b) All such policies of insurance shall be in such form, with such companies, and in such amounts as are reasonably satisfactory to Bank. All such policies of property insurance shall contain a lender' s loss payable endorsement, in a form satisfactory to Bank, showing Bank as an additional loss payee thereof, and all liability insurance policies shall show the Bank as an additional insured and shall specify that the insurer must give at least twenty (20) days notice to Bank before canceling its policy for any reason. Upon Bank' s request, Borrower shall deliver to Bank certified copies of such policies of insurance and evidence of the payments of all premiums therefor. All proceeds payable under any such policy shall, at the option of Bank, be payable to Bank to be applied on account of the Obligations.

6.6 Accounts. Borrower shall maintain and shall cause each of its Subsidiaries to maintain its primary depository, operating, and investment accounts with Bank Borrower shall cause any securities intermediary or depositary institution in which Borrower maintains any accounts outside Bank in accordance with the terms of this Section 6.6 to execute a control agreement in form and substance satisfactory to Bank.

6.7 Adjusted Quick Ratio. Borrower shall maintain, measured monthly, a ratio of Cash in which Bank has a first priority perfected security interest plus Accounts to Current Liabilities plus (to the extent not already included therein) all Indebtedness to Bank less Deferred Revenue of at least 1.00 to 1.00.

6.8 Profitability. Borrower shall maintain a Profitability, measured on a quarterly basis, of not less than One Dollar ($1.00).

6.9 Debt Service Coverage. Borrower shall maintain, measured quarterly beginning with the quarter immediately preceding the amortization of the Term Advances, a ratio of EBITDA (net of stock based compensation), annualized for the preceding three-month period to the current portion of all long-term Indebtedness plus annualized interest expense of at least 1.50 to 1.00.

6.10 Intellectual Property Rights.

(a) Borrower shall promptly give Bank written notice of any applications or registrations of intellectual property rights filed with the United States Patent and Trademark Office, including the date of such filing and the registration or application numbers, if any. Borrower shall (i) give Bank not less than 30 days prior written notice of the filing of any applications or registrations with the United States Copyright Office, including the title of such intellectual property rights to be registered, as such title will appear on such applications or registrations, and the date such applications or registrations will be filed, and (ii) prior to the filing of any such applications or registrations, shall execute such documents as Bank may reasonably request for Bank to maintain its perfection in such intellectual property rights to be registered by Borrower, and upon the request of Bank, shall file such documents simultaneously with the filing of any such applications or registrations. Upon filing any such applications or registrations with the United States Copyright Office, Borrower shall promptly provide Bank with (i) a copy of such applications or registrations, without the exhibits, if any, thereto, (ii) evidence of the filing of any documents requested by Bank to be filed for Bank to maintain the perfection and priority of its security interest in such intellectual property rights, and (iii) the date of such filing.

(b) Bank may audit Borrower' s Intellectual Property Collateral to confirm compliance with this Section, provided such audit may not occur more often than twice per year, unless an Event of Default has occurred and is continuing. Bank shall have the right, but not the obligation, to take, at Borrower' s sole expense, any actions that Borrower is required under this Section to take but which Borrower fails to take, after 15 days' notice to Borrower. Borrower shall reimburse and indemnify Bank for all reasonable costs and reasonable expenses incurred in the reasonable exercise of its rights under this Section.

6.11 Further Assurances. At any time and from time to time Borrower shall execute and deliver such further instruments and take such further action as may reasonably be requested by Bank to effect the purposes of this Agreement.

7. NEGATIVE COVENANTS.

Borrower will not do any of the following:

7.1 Dispositions. Convey, sell, lease, transfer or otherwise dispose of (collectively, a "Transfer"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, other than: (i) Transfers of Inventory in the ordinary course of business; (ii) Transfers of non-exclusive licenses and similar arrangements for the use of the property of Borrower or its Subsidiaries in the ordinary course of business; or (iii) Transfers of worn-out or obsolete Equipment which was not financed by Bank.

7.2 Change in Business; Change in Control or Executive Office. Engage in any business, or permit any of its Subsidiaries to engage in any business, other than the businesses currently engaged in by Borrower and any business substantially similar or related thereto (or incidental thereto); or cease to conduct business in the manner conducted by Borrower as of the Closing Date; or suffer or permit a Change in Control; or without thirty (30) days prior written notification to Bank, relocate its chief executive office or state of incorporation or change its legal name; or without Bank' s prior written consent, change the date on which its fiscal year ends.

7.3 Mergers or Acquisitions. Merge or consolidate, or permit any of its Subsidiaries to merge or consolidate, with or into any other business organization, or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person without Bank' s prior written consent which consent shall not be unreasonably withheld.

7.4 Indebtedness. Create, incur, assume or be or remain liable with respect to any Indebtedness, or permit any Subsidiary so to do, other than Permitted Indebtedness.

7.5 Encumbrances. Create, incur, assume or suffer to exist any Lien with respect to any of its property, or assign or otherwise convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries so to do, except for Permitted Liens, or agree with any Person other than Bank not to grant a security interest in, or otherwise encumber, any of its property, or permit any Subsidiary to do so.

7.6 Distributions. Pay any dividends or make any other distribution or payment on account of or in redemption, retirement or purchase of any capital stock, or permit any of its Subsidiaries to do so, except that Borrower may repurchase the stock of former employees pursuant to stock repurchase agreements as long as an Event of Default does not exist prior to such repurchase or would not exist after giving effect to such repurchase.

7.7 Investments. Directly or indirectly acquire or own, or make any Investment in or to any Person, or permit any of its Subsidiaries so to do, other than Permitted Investments; or maintain or invest any of its property with a Person other than Bank or permit any of its Subsidiaries to do so unless such Person has entered into an account control agreement with Bank in form and substance satisfactory to Bank; or suffer or permit any Subsidiary to be a party to, or be bound by, an agreement that restricts such Subsidiary from paying dividends or otherwise distributing property to Borrower.

7.8 Transactions with Affiliates. Directly or indirectly enter into or permit to exist any material transaction with any Affiliate of Borrower except for transactions that are in the ordinary course of Borrower' s business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm' s length transaction with a non-affiliated Person.

7.9 Subordinated Debt. Make any payment in respect of any Subordinated Debt, or permit any of its Subsidiaries to make any such payment, except in compliance with the terms of such Subordinated Debt, or amend any provision contained in any documentation relating to the Subordinated Debt without Bank' s prior written consent.

7.10 Inventory and Equipment. Store the Inventory or the Equipment with a bailee, warehouseman, or other third party unless the third party has been notified of Bank' s security interest and Bank (a) has received an acknowledgment from the third party that it is holding or will hold the Inventory or Equipment for Bank' s benefit or (b) is in pledge possession of the warehouse receipt, where negotiable, covering such Inventory or Equipment. Store or maintain any Equipment or Inventory at a location other than the location set forth in Section 10 of this Agreement.

7.11 Compliance. Become an "investment company" or be controlled by an "investment company," within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Credit Extension for such purpose. Fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur, fail to comply with the Federal Fair Labor Standards Act or violate any law or regulation, which violation could have a Material Adverse Effect, or a material adverse effect on the Collateral or the priority of Bank' s Lien on the Collateral, or permit any of its Subsidiaries to do any of the foregoing.

8. EVENTS OF DEFAULT.

Any one or more of the following events shall constitute an Event of Default by Borrower under this Agreement:

8.1 Payment Default. If Borrower fails to pay, when due, any of the Obligations;

8.2 Covenant Default.

(a) If Borrower fails to perform any obligation under Article 6 or violates any of the covenants contained in Article 7 of this Agreement; or

(b) If Borrower fails or neglects to perform or observe any other material term, provision, condition, covenant contained in this Agreement, in any of the Loan Documents, or in any other present or future agreement between Borrower and Bank and as to any default under such other term, provision, condition or covenant that can be cured, has failed to cure such default within ten days after Borrower receives notice thereof or any officer of Borrower becomes aware thereof; provided, however, that if the default cannot by its nature be cured within the ten day period or cannot after diligent attempts by Borrower be cured within such ten day period, and such default is likely to be cured within a reasonable time, then Borrower shall have an additional reasonable period (which shall not in any case exceed 30 days) to attempt to cure such default, and within such reasonable time period the failure to have cured such default shall not be deemed an Event of Default but no Credit Extensions will be made.

8.3 Material Adverse Effect. If there occurs any circumstance or circumstances that could have a Material Adverse Effect;

8.4 Attachment. If any portion of Borrower' s assets is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes into the possession of any trustee, receiver or person acting in a similar capacity and such attachment, seizure, writ or distress warrant or levy has not been removed, discharged or rescinded within ten (10) days, or if Borrower is enjoined, restrained, or in any way prevented by court order from continuing to conduct all or any material part of its business affairs, or if a judgment or other claim becomes a lien or encumbrance upon any material portion of Borrower' s assets, or if a notice of lien, levy, or assessment is filed of record with respect to any of Borrower' s assets by the United States Government, or any department, agency, or instrumentality thereof, or by any state, county, municipal, or governmental agency, and the same is not paid within ten (10) days after Borrower receives notice thereof, provided that none of the foregoing shall constitute an Event of Default where such action or event is stayed or an adequate bond has been posted pending a good faith contest by Borrower (provided that no Credit Extensions will be required to be made during such cure period);

8.5 Insolvency. If Borrower becomes insolvent, or if an Insolvency Proceeding is commenced by Borrower, or if an Insolvency Proceeding is commenced against Borrower and is not dismissed or stayed within thirty (30) days (provided that no Credit Extensions will be made prior to the dismissal of such Insolvency Proceeding);

8.6 Other Agreements. If there is a default or other failure to perform in any agreement to which Borrower is a party or by which it is bound resulting in a right by a third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount in excess of Fifty Thousand Dollars ($50,000) or which could have a Material Adverse Effect;

8.7 Judgments. If a judgment or judgments for the payment of money in an amount, individually or in the aggregate, of at least Fifty Thousand Dollars ($50,000) shall be rendered against Borrower and shall remain unsatisfied and unstayed for a period of ten (10) days (provided that no Credit Extensions will be made prior to the satisfaction or stay of such judgment); or

8.8 Misrepresentations. If any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth herein or in any certificate delivered to Bank by any Responsible Officer pursuant to this Agreement or to induce Bank to enter into this Agreement or any other Loan Document.

9. BANK' S RIGHTS AND REMEDIES.

9.1 Rights and Remedies. Upon the occurrence and during the continuance of an Event of Default, Bank may, at its election, without notice of its election and without demand, do any one or more of the following, all of which are authorized by Borrower:

(a) Declare all Obligations, whether evidenced by this Agreement, by any of the other Loan Documents, or otherwise, immediately due and payable (provided that upon the occurrence of an Event of Default described in Section 8.5, all Obligations shall become immediately due and payable without any action by Bank);

(b) Cease advancing money or extending credit to or for the benefit of Borrower under this Agreement or under any other agreement between Borrower and Bank;

(c) Settle or adjust disputes and claims directly with account debtors for amounts, upon terms and in whatever order that Bank reasonably considers advisable;

(d) Make such payments and do such acts as Bank considers necessary or reasonable to protect its security interest in the Collateral. Borrower agrees to assemble the Collateral if Bank so requires, and to make the Collateral available to Bank as Bank may designate. Borrower authorizes Bank to enter the premises where the Collateral is located, to take and maintain possession of the Collateral, or any part of it, and to pay, purchase, contest, or compromise any encumbrance, charge, or lien which in Bank' s determination appears to be prior or superior to its security interest and to pay all expenses incurred in connection therewith. With respect to any of Borrower' s owned premises, Borrower hereby grants Bank a license to enter into possession of such premises and to occupy the same, without charge, in order to exercise any of Bank' s rights or remedies provided herein, at law, in equity, or otherwise;

(e) Set off and apply to the Obligations any and all (i) balances and deposits of Borrower held by Bank, or (ii) indebtedness at any time owing to or for the credit or the account of Borrower held by Bank;

(f) Ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell (in the manner provided for herein) the Collateral. Bank is hereby granted a license or other right, solely pursuant to the provisions of this Section 9.1, to use, without charge, Borrower' s labels, patents, copyrights, rights of use of any name, trade secrets, trade names, trademarks, service marks, and advertising matter, or any property of a similar nature, as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Bank' s exercise of its rights under this Section 9.1, Borrower' s rights under all licenses and all franchise agreements shall inure to Bank' s benefit;

(g) Dispose of the Collateral by way of one or more contracts or transactions, for cash or on terms, in such manner and at such places (including Borrower' s premises) as Bank determines is commercially reasonable, and apply any proceeds to the Obligations in whatever manner or order Bank deems appropriate;

(h) Bank may credit bid and purchase at any public sale; and

(i) Any deficiency that exists after disposition of the Collateral as provided above will be paid immediately by Borrower.

9.2 Power of Attorney. Effective only upon the occurrence and during the continuance of an Event of Default, Borrower hereby irrevocably appoints Bank (and any of Bank' s designated officers, or employees) as Borrower' s true and lawful attorney to: (a) send requests for verification of Accounts or notify account debtors of Bank' s security interest in the Accounts; (b) endorse Borrower' s name on any checks or other forms of payment or security that may come into Bank' s possession; (c) sign Borrower' s name on any invoice or bill of lading relating to any Account, drafts against account debtors, schedules and assignments of Accounts, verifications of Accounts, and notices to account debtors; (d) dispose of any. Collateral; (e) make, settle, and adjust all claims under and decisions with respect to Borrower' s policies of insurance; (f) settle and adjust disputes and claims respecting the accounts directly with account debtors, for amounts and upon terms which Bank determines to be reasonable; and (g) to file, in its sole discretion, one or more financing or continuation statements and amendments thereto, relative to any of the Collateral. The appointment of Bank as Borrower' s attorney in fact, and each and every one of Bank' s rights and powers, being coupled with an interest, is irrevocable until all of the Obligations have been fully repaid and performed and Bank' s obligation to provide Credit Extensions hereunder is terminated.

9.3 Accounts Collection. At any time after the occurrence of an Event of Default, Bank may notify any Person owing funds to Borrower of Bank' s security interest in such funds and verify the amount of such Account. Borrower shall collect all amounts owing to Borrower for Bank, receive in trust all payments as Bank' s trustee, and immediately deliver such payments to Bank in their original form as received from the account debtor, with proper endorsements for deposit.

9.4 Bank Expenses. If Borrower fails to pay any amounts or furnish any required proof of payment due to third persons or entities, as required under the terms of this Agreement, then Bank may do any or all of the following after reasonable notice to Borrower: (a) make payment of the same or any part thereof; (b) set up such reserves under a loan facility in Section 2.1 as Bank deems necessary to protect Bank from the exposure created by such failure; or (c) obtain and maintain insurance policies of the type discussed in Section 6.5 of this Agreement, and take any action with respect to such policies as Bank deems prudent. Any amounts so paid or deposited by Bank shall constitute Bank Expenses, shall be immediately due and payable, and shall bear interest at the then applicable rate hereinabove provided, and shall be secured by the Collateral. Any payments made by Bank shall not constitute an agreement by Bank to make similar payments in the future or a waiver by Bank of any Event of Default under this Agreement.

9.5 Bank' s Liability for Collateral. So long as Bank complies with reasonable banking practices, Bank shall not in any way or manner be liable or responsible for: (a) the safekeeping of the Collateral; (b) any loss or damage thereto occurring or arising in any manner or fashion from any cause; (c) any diminution in the value thereof; or (d) any act or default of any carrier, warehouseman, bailee, forwarding agency, or other person whomsoever. All risk of loss, damage or destruction of the Collateral shall be borne by Borrower.

9.6 Remedies Cumulative. Bank' s rights and remedies under this Agreement, the Loan Documents, and all other agreements shall be cumulative. Bank shall have all other rights and remedies not inconsistent herewith as provided under the Code, by law, or in equity. No exercise by Bank of one right or remedy shall be deemed an election, and no waiver by Bank of any Event of Default on Borrower' s part shall be deemed a continuing waiver. No delay by Bank shall constitute a waiver, election, or acquiescence by it. No waiver by Bank shall be effective unless made in a written document signed on behalf of Bank and then shall be effective only in the specific instance and for the specific purpose for which it was given.

9.7 Demand; Protest. Borrower waives demand, protest, notice of protest, notice of default or dishonor, notice of payment and nonpayment, notice of any default, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees at any time held by Bank on which Borrower may in any way be liable.

10. NOTICES.

Unless otherwise provided in this Agreement, all notices or demands by any party relating to this Agreement or any other agreement entered into in connection herewith shall be in writing and (except for financial statements and other informational documents which may be sent by first-class mail, postage prepaid) shall be personally delivered or sent by a recognized overnight delivery service, certified mail, postage prepaid, return receipt requested, or by telefacsimile to Borrower or to Bank, as the case may be, at its addresses set forth below:

If to Borrower:	KANA Software, Inc. 181 Constitution Drive Menlo Park, CA 94025 Fax: (650) 614-8350 Attn: ________________________
If to Bank:	Bridge Bank, N.A. 55 Almaden Blvd. San Jose, CA 95113 Attn: Technology Banking Group FAX: (408) 282-1681

The parties hereto may change the address at which they are to receive notices hereunder, by notice in writing in the foregoing manner given to the other.

11. CHOICE OF LAW AND VENUE; JURY TRIAL WAIVER.

This Agreement shall be governed by, and construed in accordance with, the internal laws of the State of California, without regard to principles of conflicts of law. Each of Borrower and Bank hereby submits to the exclusive jurisdiction of the state and Federal courts located in the County of Santa Clara, State of California. BORROWER AND BANK EACH HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF ANY OF THE LOAN DOCUMENTS OR ANY OF THE TRANSACTIONS CONTEMPLATED THEREIN, INCLUDING CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW OR STATUTORY CLAIMS. EACH PARTY RECOGNIZES AND AGREES THAT THE FOREGOING WAIVER CONSTITUTES A MATERIAL INDUCEMENT FOR IT TO ENTER INTO THIS AGREEMENT. EACH PARTY REPRESENTS AND WARRANTS THAT IT HAS REVIEWED THIS WAIVER WITH ITS LEGAL COUNSEL AND THAT IT KNOWINGLY AND VOLUNTARILY WAIVES ITS JURY TRIAL RIGHTS FOLLOWING CONSULTATION WITH LEGAL COUNSEL.

If the jury waiver set forth in Section is not enforceable, then any dispute, controversy or claim arising out of or relating to this Agreement, the Loan Documents or any of the transactions contemplated therein shall be settled by judicial reference pursuant to Code of Civil Procedure Section 638 et seq. before a referee sitting without a jury, such referee to be mutually acceptable to the parties or, if no agreement is reached, by a referee appointed by the Presiding Judge of the California Superior Court for Santa Clara County. This Section shall not restrict a party from exercising remedies under the Code or from exercising pre-judgment remedies under applicable law.

12. GENERAL PROVISIONS.

12.1 Successors and Assigns. This Agreement shall bind and inure to the benefit of the respective successors and permitted assigns of each of the parties; provided, however, that neither this Agreement nor any rights hereunder may be assigned by Borrower without Bank' s prior written consent, which consent may be granted or withheld in Bank' s sole discretion. Bank shall have the right without the consent of or notice to Borrower to sell, transfer, negotiate, or grant participation in all or any part of, or any interest in, Bank' s obligations, rights and benefits hereunder.

12.2 Indemnification. Borrower shall defend, indemnify and hold harmless Bank and its officers, employees, and agents against: (a) all obligations, demands, claims, and liabilities claimed or asserted by any other party in connection with the transactions contemplated by this Agreement; and (b) all losses or Bank Expenses in any way suffered, incurred, or paid by Bank as a result of or in any way arising out of, following, or consequential to transactions between Bank and Borrower whether under this Agreement, or otherwise (including without limitation reasonable attorneys' fees. and expenses), except for losses caused by Bank' s gross negligence or willful misconduct.

12.3 Time of Essence. Time is of the essence for the performance of all obligations set forth in this Agreement.

12.4 Severability of Provisions. Each provision of this Agreement shall be severable from every other provision of this Agreement for the purpose of determining the legal enforceability of any specific provision.

12.5 Amendments in Writing, Integration. Neither this Agreement nor the Loan Documents can be amended or terminated orally. All prior agreements, understandings, representations, warranties, and negotiations between the parties hereto with respect to the subject matter of this Agreement and the Loan Documents, if any, are merged into this Agreement and the Loan Documents.

12.6 Effect of Amendment and Restatement. This Agreement is intended to and does completely amend and restate, without novation, the Original Agreement. All security interests granted under the Original Agreement are hereby confirmed and ratified and shall continue to secure all Obligations under this Agreement.

12.7 Counterparts. This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, shall be deemed to be an original, and all of which, when taken together, shall constitute but one and the same Agreement.

12.8 Survival. All covenants, representations and warranties made in this Agreement shall continue in full force and effect so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions to Borrower. The obligations of Borrower to indemnify Bank with respect to the expenses, damages, losses, costs and liabilities described in Section 12.2 shall survive until all applicable statute of limitations periods with respect to actions that may be brought against Bank have run.

12.9 Confidentiality. In handling any confidential information Bank and all employees and agents of Bank, including but not limited to accountants, shall exercise the same degree of care that it exercises with respect to its own proprietary information of the same types to maintain the confidentiality of any non-public information thereby received or received pursuant to this Agreement except that disclosure of such information may be made (i) to the subsidiaries or affiliates of Bank in connection with their present or prospective business relations with Borrower, (ii) to prospective transferees or purchasers of any interest in the Loans, provided that they have entered into a comparable confidentiality agreement in favor of Borrower and have delivered a copy to Borrower, (iii) as required by law, regulations, rule or order, subpoena, judicial order or similar order, (iv) as may be required in connection with the examination, audit or similar investigation of Bank and (v) as Bank may determine in connection with the enforcement of any remedies hereunder. Confidential information hereunder shall not include information that either: (a) is in the public domain or in the knowledge or possession of Bank when disclosed to Bank, or becomes part of the public domain after disclosure to Bank through no fault of Bank; or (b) is disclosed to Bank by a third party, provided Bank does not have actual knowledge that such third party is prohibited from disclosing such information.

12.10 Patriot Act. To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account. WHAT THIS MEANS FOR YOU: when you open an account, we will ask your name, address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver' s license or other identifying documents.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first above written.

KANA Software, Inc.

/s/ Michael S. Fields

By:

Chairman and CEO

Title:

BRIDGE BANK, N.A.

/s/ Deborah Bowman

By: Deborah Bowman
Title: SVP

LOAN AND SECURITY MODIFICATION AGREEMENT

This Loan and Security Modification Agreement is entered into as of February 28, 2007, by and between KANA SOFTWARE, INC. (the "Borrower") and Bridge Bank, National Association ("Bank").

1. DESCRIPTION OF EXISTING INDEBTEDNESS. Among other indebtedness which may be owing by Borrower to Bank, Borrower is indebted to Bank pursuant to, among other documents, an Amended and Restated Loan and Security Agreement, dated as of February 27, 2007, by and between Borrower to Bank, (the "Loan and Security Agreement"). Capitalized terms used without definition herein shall have the meanings assigned to them in the Loan and Security Agreement.

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

2. DESCRIPTION OF CHANGE IN TERMS.

A. Modification(s) to Loan and Security Agreement:

1. The defined term Permitted Investments is amended to include the following Permitted Investment:

(c) cash and cash equivalents Borrower or its Subsidiaries maintains in foreign depository institutions in an aggregate amount not to exceed $2,000,000.

2. The defined term Revolving Line is amended to read as follows:

"Revolving Line" means a credit extension of up to Ten Million Dollars ($10,000,000), however, capped at $5,000,000 until Bank is in receipt of the account control agreements as identified in Section 6.6.

3. Section 6.6 is amended add the following:

Notwithstanding the foregoing, Borrower shall cause Bank of America and Silicon Valley Bank to execute an Account Control Agreement with respect to all of Borrower' s Cash held at such financial institutions, in a form and substance acceptable to Bank, no later than 60 days from the date of this Loan and Security Modification Agreement.

4. Section 6.7 is amended in its entirety to read as follows:

6.7 Adjusted Quick Ratio. Borrower shall maintain, measured monthly, a ratio of the sum of (i) Cash in which Bank has a first priority perfected security interest plus (ii) Permitted investments plus (iii) Accounts, to Current Liabilities plus (to the extent not already included therein) all indebtedness to Bank less Deferred Revenue of at least 1.00 to 1.00.

5. Section 6.8 is amended in its entirety to read as follows:

6.8 Profitability. Beginning with the quarter ending March 2007 and each quarter thereafter, Borrower shall maintain a Profitability of not less than One Dollar ($1.00).

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

4. NO DEFENSES OF BORROWER. Borrower agrees that, as of this date, it has no defenses against the obligations to pay any amounts under the Indebtedness.

5. CONTINUING VALIDITY. Borrower understands and agrees that in modifying the existing Indebtedness, Bank is relying upon Borrower' s representations, warranties, and agreements, as set forth in the Existing Documents. Except as expressly modified pursuant to this Loan and Security Modification Agreement, the terms of the Existing Documents remain unchanged and in full force and effect. Bank' s agreement to modifications to the existing Indebtedness pursuant to this Loan and Security Modification Agreement in no way shall obligate Bank to make any future modifications to the Indebtedness. Nothing in this Loan and Security Modification Agreement shall constitute a satisfaction of the Indebtedness. It is the intention of Bank and Borrower to retain as liable parties all makers and endorsers of Existing Documents, unless the party is expressly released by Bank in writing. No maker, endorser, or guarantor will be released by virtue of this Loan and Security Modification Agreement. The terms of this paragraph apply not only to this Loan and Security Modification Agreement, but also to any subsequent Loan and Security modification agreements.

6. COUNTERSIGNATURE. This Loan and Security Modification Agreement shall become effective only when executed by Bank and Borrower.

BORROWER:	**BANK:**
KANA SOFTWARE, INC.	BRIDGE BANK, NATIONAL ASSOCIATION
/s/ William Feichtmann	/s/ Deborah Bowman
By:	By:
William Feichtmann	Deborah Bowman
Name:	Name:
VP Finance	SVP
Title:	Title:

FIRST AMENDMENT

TO

LOAN AND SECURITY AGREEMENT

This First Amendment to Loan and Security Agreement is entered into as of May 7, 2007 (the "***Amendment***"), by and between BRIDGE BANK, N.A. ("***Bank***") and KANA SOFTWARE, INC. ("***Borrower***").

RECITALS

Borrower and Bank are parties to that certain Loan and Security Agreement dated as of February 27, 2006 (the "***Agreement***"). The parties desire to amend the Agreement in accordance with the terms of this Amendment.

NOW, THEREFORE, the parties agree as follows:

1. Bank waives the obligation of Borrower to comply with Section 6.7 for any period prior to the month ending June 30, 2007. Beginning the month ending June 30, 2007, Borrower shall comply with Section 6.7. Borrower represents that, as calculated in Section 6.7, the Adjusted Quick Ratio at March 31, 2007 was no less than 0.95 to 1.00, and at April 30, 2007, was no less than 0.55 to 1.00. Borrower covenants that the Adjusted Quick Ratio at May 31, 2007 will not be less than 0.55 to 1.00.

2. Bank waives the obligation of Borrower to comply with Section 6.8 for the quarter ending March 31, 2007. Beginning the quarter ending June 30, 2007, Borrower shall comply with Section 6.8. Borrower represents that its Net Loss for the quarter ended March 31, 2007, excluding non-cash compensation, is not more than ($2,998,000).

3. Until Borrower is profitable on a quarterly basis, and Borrower maintains as of quarter end an Adjusted Quick Ratio of at least 1.00 to 1.00, Borrower shall deliver to Bank a Borrowing Base Certificate, together with accounts receivable agings certified by a Responsible Officer, within 5 days of the first and 15th days of each month. After Borrower achieves both financial results, Borrower shall deliver to Bank the Borrowing Base and accounts receivable agings certified by a Responsible Officer, within 20 days of the last day of each month.

4. By June 30, 2007, Borrower shall close all accounts with Bank of America, and transfer the balance in those accounts to Bank.

5. By May 31, 2007, Borrower shall cause an account control agreement with Silicon Valley Bank in form reasonably acceptable to Bank to be completely executed.

6. Until Bank (i) receives a fully executed account control agreement from Silicon Valley Bank and (ii) Borrower complies with Sections 6.7, 6.8 and 6.9 for two consecutive quarters, the aggregate outstanding Obligations under the Agreement may not exceed $5,000,000, and Borrower shall immediately pay to Bank, in cash, the amount by which the Obligations exceed $5,000,000 from time to time.

7. Bank consents to Borrower' s acquisition of eVergance. After that acquisition, Borrower may include the Accounts of eVergance in the Borrowing Base after (i) Bank completes legal and credit diligence on eVergance and (ii) Bank obtains a first priority security interest in those Accounts.

8. As a condition to the effectiveness of this Amendment, Bank shall have received, in form and substance satisfactory to Bank, the following:

(a) this Amendment, duly executed by Borrower;

(b) corporate resolutions and incumbency certification;

(c) payment of a fee of $10,000 plus Bank Expenses incurred in connection with this Amendment; and

(d) such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

9. Unless otherwise defined, all initially capitalized terms in this Amendment shall be as defined in the Agreement. The Agreement, as amended hereby, shall be and remain in full force and effect in accordance with its respective terms and hereby is ratified and confirmed in all respects. Except as expressly set forth herein, the execution, delivery, and performance of this Amendment shall not operate as a waiver of, or as an amendment of, any right, power, or remedy of Bank under the Agreement, as in effect prior to the date hereof. Borrower ratifies and reaffirms the continuing effectiveness of all agreements entered into in connection with the Agreement.

10. Borrower represents and warrants that the representations and warranties contained in the Agreement are true and correct as of the date of this Amendment, and that no Event of Default has occurred and is continuing. If any representation made in Section 2 or Section 3 of this Amendment is untrue in any respect, or if Borrower fails to perform any covenant set forth in this Amendment, it shall be an Event of Default under the Agreement.

11. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

IN WITNESS WHEREOF, the undersigned have executed this Amendment as of the first date above written.

KANA SOFTWARE, INC.

By: /s/ John M. Thompson
Title: Executive Vice President and Chief Financial Officer

BRIDGE BANK, N.A.

By: /s/ Dan Pistone
Title: Senior Vice President

*****CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AND THE NON-PUBLIC INFORMATION HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. CONFIDENTIAL TREATMENT HAS BEEN REQUESTED WITH RESPECT TO OMITTED PORTIONS**

PATENT LICENSE AND SETTLEMENT AGREEMENT

This PATENT LICENSE AND SETTLEMENT AGREEMENT (this "**Agreement**") is made and entered into as of March 23, 2007 (the "**Effective Date**") by and between Polaris IP, LLC, a limited liability corporation organized and existing under the laws of Texas and having offices at 207 C North Washington Avenue Marshall, Texas 75670 ("**Polaris**"), and Kana Software, Inc., a corporation organized and existing under the laws of Delaware and having offices at 181 Constitution Drive, Menlo Park, CA 94025 ("Kana"). Polaris and Kana are individually referred to herein as a "**Party**," and collectively as the "**Parties**."

WITNESSETH

WHEREAS, Polaris has filed an action against Kana for patent infringement and related claims in an action styled: Polaris IP, LLC v. Sirius Satellite Radio, Inc., Kana Software, Inc., Priceline.com, Inc., Capital One Financial Corporation, Capital One Services, Inc., Capital One Bank, Capital One Auto Finance, Inc., Continental Airlines, Inc., and E*TRADE Financial Corp.; Civil Action No. 2-06-CV 103, pending in the United States District Court for the Eastern District of Texas, Marshall Division (the "**Litigation**");

WHEREAS, Kana has denied liability and asserted counterclaims against Polaris in the Litigation; and

WHEREAS, Kana, on behalf of itself and the Kana Related Companies (as defined below), desires to license the Polaris Patents (as that term is defined below) and to settle the Litigation for itself and for the Kana Customers specifically named in the Litigation pursuant to the terms and conditions of this Agreement.

NOW, THEREFORE, in consideration of the above promises and mutual covenants hereinafter contained, the parties agree as follows:

ARTICLE I.

DEFINITIONS

As used in this Agreement, the following terms shall have the following meanings:

"**Related Company**" means with respect to Kana, those Entities that are owned by, own, or are under common control with Kana and listed in Schedule I; and with respect to Polaris, those Entities that are owned by, own, or are under common control with Polaris and listed in Schedule II. Related Company also shall include all other current and future Entities

(Except as provided for under Article VII) that are owned by, own, or are under common control with a Party. An Entity will be a Related Company hereunder only during the period of time such Entity is owned by, owns, or is under common control with a Party.

"**Kana Customers**" means any and all direct and indirect customers of Kana or any Kana Related Company, including without limitation, resellers, distributors, OEM customers, system integration partners and end-users. The following defendants named in the Litigation meet the definition of Kana Customers: Sirius Satellite Radio, Inc., Priceline.com, Inc., Capital One Financial Corporation, Capital One Services, Inc., Capital One Bank, Capital One Auto Finance, Inc., and E*TRADE Financial Corp.

"**Kana Product**" means any and all software, hardware, products, methods and/or services (including without limitation, training, professional services, and maintenance and support) made, used, sold, licensed, offered for sale, offered for license, imported, exported or distributed by or for the benefit of Kana or any Kana Related Company prior to, on or after the Effective Date. Kana Product also includes software, hardware, and/or products or services, or components thereof which are used, sold, licensed, offered for sale or offered for license under a Third Party brand (e.g., an OEM product), so long as any such Third Party branded product or service is made or provided by or for Kana or a Kana Related Company.

"**Polaris Patents**" means: (i) any and all Patents owned or controlled by Polaris now or at any time in the future, including but not limited to those Patents listed in Exhibit A to this Agreement; and (ii) any and all Patents in the fields of e-mail response management or natural language processing (or a combination thereof) that are owned or controlled by a Polaris Related Company now or at any time in the future.

"**Patents**" means (i) all classes and types of patents, including utility patents, utility models, design patents, invention certificates, reexaminations, reissues, extensions and renewals, in all jurisdictions of the world; and (ii) all applications (including provisional and nonprovisional applications), continuations, divisionals, continuations-in-part, and rights to inventions for which applications may be filed, for these classes or types of patents in all jurisdictions of the world. The term "Patents" does not include any copyrights, trademarks, mask work rights, or trade secret rights.

"**Entity**" means an individual, trust, corporation, partnership, joint venture, limited liability company, association, unincorporated organization or other legal or governmental entity.

"**Third Party**" means an Entity other than a party to this Agreement or a Related Company of a party to this Agreement.

"**Kana Vendors**" means any and all Entities in Kana' s or any Kana Related Company' s supply chain, including suppliers, development partners, vendors, joint venture partners, outsource manufacturers and independent contractors.

ARTICLE II.

RELEASES AND COVENANTS

2.1. Polaris Release of Kana. Polaris, on behalf of itself and the Polaris Related Companies and its and their respective predecessors, successors and assigns, irrevocably releases, acquits and forever discharges: (i) Kana and the Kana Related Companies and its and their respective officers, directors, employees, agents, successors, assigns, representatives, and attorneys, and (ii) solely with respect to activities that would have been licensed under this Agreement if they had been performed on or after the Effective Date, the Kana Vendors and the Kana Customers, in each case (i) and (ii), from any and all claims or liabilities of any kind and nature, at law, in equity, or otherwise, known and unknown, suspected and unsuspected, disclosed and undisclosed, relating in any way to the Litigation or the Polaris Patents.

2.2. Polaris Covenant Not to Sue Kana. In further consideration of the terms herein, Polaris, on behalf of itself and the Polaris Related Companies, forever covenants not to sue, or aid any other Entity to sue, bring any claim or any cause of action whatsoever against Kana or any Kana Related Company, which claim or cause of action is related to or arises from the Polaris Patents, the Litigation or this Agreement (other than with respect to a breach by Kana of the obligations set forth in this Agreement). Polaris, on behalf of itself and the Polaris Related Companies, additionally forever covenants not to sue, or aid any other Entity to sue, bring any claim or any cause of action whatsoever against Kana Vendors or Kana Customers, but such covenant with respect to Kana Vendors and Kana Customers applies solely with respect to activities that would have been licensed under this Agreement if they had been performed on or after the Effective Date.

2.3. Kana Release of Polaris. Kana, on behalf of itself and the Kana Related Companies and their respective successors and assigns, irrevocably releases, acquits and forever discharges Polaris and the Polaris Related Companies and their respective officers, directors, members, employees, agents, successors, assigns, representatives, and attorneys, from any and all claims or liabilities of any kind and nature, at law, in equity, or otherwise, known and unknown, suspected and unsuspected, disclosed and undisclosed, relating in any way to the Litigation or the Polaris Patents. Notwithstanding the foregoing, Kana and the Kana Related Companies shall be entitled to assert that any Polaris Patent is invalid and/or unenforceable as an affirmative defense or counterclaim to any claim of infringement of any Polaris Patent brought by Polaris, a Polaris Related Company, or its or their successors or assigns.

2.4. Kana Covenant Not to Sue Polaris. In further consideration of the terms herein, Kana, on behalf of itself and the Kana Related Companies, forever covenant not to sue, or aid any other person to sue, bring any claim or any cause of action whatsoever against Polaris or any Polaris Related Company related to or arising from the Polaris Patents, the Litigation or this Agreement (other than with respect to a breach by Polaris or a Polaris Related Company of the obligations set forth in this Agreement). Notwithstanding the above, Kana and/or any Kana Related Company shall be entitled to assert that any Polaris Patent is invalid and/or unenforceable as an affirmative defense or counterclaim to any claim of infringement of a Polaris Patent brought against Kana, a Kana Related Company or a Kana Customer or Kana Vendor (but for Kana Customers and Kana Vendors, solely with respect to any claims of infringement of a

Kana Product). Kana and/or any Kana Related Company also shall be entitled to challenge the validity and/or enforceability of any Polaris Patent in any administrative proceeding (e.g., in a patent office or alternative dispute resolution proceeding) responsive to an allegation of infringement of a Polaris Patent brought against Kana, a Kana Related Company, or a Kana Customer or Kana Vendor (but for Kana Customers and Kana Vendors, solely with respect to any Kana Product), or in any circumstance where a Kana Product has been accused of infringement of a Polaris Patent and Kana or a Kana Related Company has a indemnity or defense obligation with respect to the accused Kana Product.

2.5. Scope of Releases. Subject only to the preservation of defenses set forth in this Article II and Article IV below, the releases by Polaris and Kana, and their respective Related Companies in this Agreement include an express, informed, knowing and voluntary waiver and relinquishment to the fullest extent permitted by law. In this connection, the Parties acknowledge that they may have sustained damages, losses, costs or expenses which are presently unknown and unsuspected and that such damages, losses, costs or expenses as may have been sustained may give rise to additional damages, losses, costs or expenses in the future. The Parties hereto further acknowledge that they have negotiated this Agreement taking into account presently unsuspected and unknown claims, counterclaims, causes of action, damages, losses, costs and expenses arising from or relating to the Litigation, the Polaris Patents and the relationship between the Parties, and the Parties hereto voluntarily and with full knowledge of its significance, expressly waive and relinquish any and all rights they may have under any state or federal statute, rule or common law principle, in law or equity, relating to limitations on general releases. The Parties voluntarily and with full knowledge of its significance, expressly waive and relinquish any and all rights they may have under any state or federal statute, rule or common law principle, in law or equity, relating to limitations on general releases. Specifically, each party, for itself and its Affiliates, hereby expressly waives any rights it may have under California Civil Code Section 1542 which provides that: "A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the relates, which if known by him must have materially affected his settlement with the debtor."

2.6. Additional Polaris Five (5) Year Covenant Not to Sue. Polaris, on behalf of itself and the Polaris Related Companies, covenants not to sue, bring any claim or any cause of action, or aid any other Entity to sue, bring any claim or any cause of action alleging infringement of any Patent whatsoever (including but not limited to the Polaris Patents) by Kana, any Kana Related Company, Kana Vendors or Kana Customers, but such covenant applies solely with respect to the alleged infringement of any Patent by Kana Products. The covenant granted pursuant to this Section 2.6 shall expire on the fifth anniversary of the Effective Date, and is in addition to the covenants not to sue granted by Polaris and the Polaris Related Companies pursuant to Section 2.2 above.

ARTICLE III.

GRANTS AND COVENANTS

3.1. Polaris License to Kana. Subject only to the full and complete payment by Kana of the consideration contemplated under Section 5.1 of this Agreement, but effective as of the Effective Date, Polaris, on behalf of itself and its Related Companies, hereby grants a worldwide, non-exclusive, non-transferable (except as provided for in Article VII), royalty-free, license, without the right to sublicense under the Polaris Patents to:

3.1.1. Kana and Kana Related Companies to make, have made, use, sell, offer for sale, license, offer for license, import, export and otherwise distribute the Kana Products;

3.1.2. Kana Customers to use, sell, offer for sale, license, offer for license, import, export and otherwise distribute (directly and/or indirectly through partners) the Kana Products; and

3.1.3. Kana Vendors to make, sell and use the Kana Products, and portions thereof, solely for and on behalf of Kana and the Kana Related Companies.

In the event any Kana Related Company ceases to meet the definition of Kana Related Company (such Entity thus becoming a "Former Kana Related Company"), then the license granted to that Former Kana Related Company pursuant to this Section 3.1 above will terminate, except to the extent that such Former Kana Related Company makes, has made, uses, imports, sells, offers to sell, licenses, offers to license, exports, otherwise distributes and/or exploits any Kana Product prior to becoming a Former Kana Related Company. In such event, the license to the Former Kana Related Company to make, have made, use, import, sells, offer to sell, license, offer to license, export and otherwise distribute and exploit such Kana Products shall continue, but only with respect to those products and any future versions and improvements thereof.

3.2. No License for Third Party Products or Services. The licenses set forth in Article III only extend to Kana Products (and portions thereof) that are used, designed, built, licensed and/or sold by or for Kana or any Kana Related Company (or any Former Kana Related Company) and do not extent to the products of any Third Party, provided however, that such licenses do extend to the whole and any portion of a Third Party product or service which is designed by or for Kana or a Kana Related Company but sold or licensed under a Third Party brand.

3.3. Validity. Except as expressly permitted under Article II above, and Article IV below, Kana and each Kana Related Company shall not, directly or indirectly, contest that the Polaris Patents are valid and enforceable in any court proceeding, before United States Patent and Trademark Office or otherwise. Notwithstanding the foregoing, nothing in this Agreement shall be interpreted as an admission by either Party of the validity or invalidity of any Polaris Patent, or as an admission by either Party of its direct or contributory or inducement of infringement of any Polaris Patent, or as an admission by either Party of any issue relating to the Litigation. Except as expressly permitted under Article II above, and Article IV below, Kana further covenants not to voluntarily render aid or counsel, directly or indirectly, to any Entity in connection with challenging the validity of the Polaris Patents or contending that such Entity does not infringe the Polaris Patents.

3.4. No Other Rights. No rights or licenses are granted under any Patents except as expressly provided herein, whether by implication, estoppel or otherwise. Without limiting the foregoing sentence no right to grant sublicenses is granted under any of the licenses set forth in this Agreement.

ARTICLE IV.

DISMISSAL OF LITIGATION

4.1. Within five (5) court days after the initial payment of the consideration to Polaris under Section 5.1 below, the Parties shall cause their respective counsel to execute and file the stipulated motion in the form set forth in Exhibit B dismissing with prejudice all claims, affirmative defenses, and counterclaims between the parties in the Litigation, except that Kana, Kana Related Companies and the Kana Customers named in the Litigation shall preserve all defenses to any claim for infringement, including without limitation the ability to assert a patent' s invalidity or unenforceability, which can be asserted only in the event that Polaris alleges infringement by any of said entities of any Polaris Patent. The Parties shall promptly proceed with any and all additional procedures needed to dismiss with prejudice the Litigation. The Parties agree that the settlement of the Litigation is intended solely as a compromise of disputed claims, counterclaims and defenses.

4.2. The Parties acknowledge and agree that this Agreement is enforceable according to its terms with respect to final dismissal with prejudice of all claims in the Litigation, subject to Article II above and Section 4.1 regarding the preservation of defenses.

4.3. The Parties agree that they shall bear their own costs and attorneys' fees relating to the Litigation and to the negotiation of this Agreement.

ARTICLE V.

CONSIDERATION

5.1. In consideration of the license, release and covenants granted by Polaris and the dismissal by Polaris of the Litigation hereunder, Kana agrees to pay to Polaris a total of *** U.S. Dollars ($*** USD), payable in twenty (20) equal quarterly installments of *** dollars ($***) (due and payable no later than each March 15, June 15, September 15 and December 15 (or if such date is not a business day, the next occurring business day), except for the first payment which shall be made on April 16, 2007) over a period of five years, by wire transfer to an account specified by Polaris and attached hereto as Exhibit C. In the event that Kana fails to make any payment hereunder following written notice to Kana describing the alleged failure with reasonable specificity and a 30-day opportunity to cure such alleged failure following receipt of such notice, then (i) Polaris shall be entitled to (a) maintain all the benefits (including any amount previously collected) provided to Polaris under this Agreement, (b) selectively at any time terminate any or all of Sections 2.1, 2.2, 3.1, 7, 8.1(a) and 8.4 and Article IV, (c) collect all fees and costs (including attorneys' fees and costs) incurred by Polaris in attempting to effect collection and (d) collect interest on any unpaid amounts at the maximum rate allowed by law from the specified date of non-payment through the date of payment and (ii) the Kana shall be deemed to have waived its ability to assert the provisions related to its ability to bring any actions in response to any claim of related to or arising from the infringement of any Polaris Patents as set forth in Section 2.3, 2.4, and 3.3 (and all of the foregoing rights shall be in addition to any other rights Polaris may have under this Agreement or at law or equity).

5.2. All taxes imposed as a result of the existence of this Agreement or the performance hereunder shall be paid by the Party required to do so by applicable law.

ARTICLE VI.

TERM

6.1. Term. The term of this Agreement shall commence upon the Effective Date and shall continue until the expiration of the last-to-expire Polaris Patent, unless earlier terminated as set forth below.

6.2. Termination.

6.2.1. Termination by Kana. In the event that Polaris or any Polaris Related Company, or any of its or their predecessors, successors or assigns: (i) sues Kana or a Kana Related Company for patent infringement alleging that a Kana Product infringes a Polaris Patent; or (ii) asserts a claim of patent infringement against any Kana Customer or Kana Vendor alleging that a Kana Product infringes a Polaris Patent; or (iii) prior to the fifth (5^{th}) anniversary of the Effective Date, sues Kana or a Kana Related Company for patent infringement alleging that a Kana Product infringes any Patent; or (iv) prior to the fifth (5^{th}) anniversary of the Effective Date, asserts a claim of patent infringement against any Kana Customer or Kana Vendor alleging that a Kana Product infringes any Patent, then Kana must adhere to the provisions of Section 8.8 of this Agreement. If upon Kana' s compliance with Section 8.8 of this Agreement, Polaris or the Polaris Related Company fails to withdraw any such action or claim with respect to a Kana Product, then Kana may terminate this Agreement, including its obligation to make any further payments to Polaris notwithstanding Section 6.3, and Section 3.1 shall survive. Kana may not otherwise terminate this Agreement.

6.2.2. Termination by Polaris. If and only if Kana fails to timely make any payment required hereunder for any reason or if Kana breaches its obligations pursuant to Section 3.3 of this Agreement, then Polaris may, following written notice to Kana describing the alleged failure with reasonable specificity and a 30-day opportunity to cure such alleged failure following receipt of such notice, terminate this Agreement. Polaris may not otherwise terminate this Agreement.

6.2.3. Effect of Termination. In the event of termination pursuant to Section 6.2.2, Polaris shall retain any benefit and disavow any obligations under this Agreement, and reassert any claims Polaris may have against any or all of Kana, any Kana Related Company and the Kana Customers and Kana Vendors.

6.3. Survival. In the event of termination pursuant to Section 6.2, the license and covenants granted to the breaching party and its Related Companies hereunder shall terminate as of the date that such termination takes effect and the non-breaching party shall retain its remedies for such breach. The provisions of Articles I, II, IV, V, VI, VII and VIII, and Sections 3.2 and 3.4 will survive any termination or expiration of this Agreement.

ARTICLE VII.

ASSIGNMENT AND CHANGE OF CONTROL

7.1. No Assignment. In the event of a merger of Kana or a Kana Related Company into a Third Party, this Agreement shall continue to benefit and obligate the merged Entity and its or their successor entities, and may be assigned to such Entity and any successor entity, provided that the licenses granted in Section 3.1 will extend only to the existing designs of Kana Products, and to future versions and improvements thereof. For the avoidance of doubt, the license granted pursuant to Section 3.1 shall not apply to any products, methods or services of any Third Party, which products, methods or services any such Third Party made, used or sold prior to, on or after the effective date of any such assignment (other than the Kana Products otherwise covered under this Agreement, and future versions and improvements thereof). Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the Parties and their permitted successors and assigns.

7.2. In the event Kana or a Kana Related Company sells or transfers all or a portion of its assets or business to which the licenses granted in Section 3.1 relate to another Entity ("Spin-Off Entity"), and such Spin-Off Entity agrees in writing to the terms set forth in this Agreement, then this Agreement may be assigned to such Spin-Off Entity and the licenses granted herein will continue in effect with regard to the sold or transferred portion, but will not extend to any products, methods or services of any such Spin-Off Entity (other than the Kana Products otherwise covered under this Agreement, and future versions and improvements thereof). If this Agreement is assigned to the Spin-Off Entity, the Agreement will no longer provide any benefit to Kana or any Kana Related Company. Notwithstanding any assignment of this Agreement to a Spin-Off Entity, or any subsequent assignment of this Agreement by the Spin-Off Entity, Kana shall not be relieved of its obligation to make the payments to Polaris set forth in Section 5.1 above.

7.3. Except as set forth in Sections 7.1 and 7.2, this Agreement may not be assigned by Kana without the prior written permission of Polaris, which permission shall not be unreasonably withheld or delayed, and any attempt to assign without such permission will be void. Polaris may not assign or transfer this Agreement to any Third Party.

7.4. Polaris, on behalf of itself and the Polaris Related Companies, covenants and agrees that it and they shall not assign or otherwise transfer any Polaris Patents to any Third Party unless such Third Party shall first agree, in a binding and legally enforceable document, to be bound by the licenses and covenants applicable to such Patents pursuant to this Agreement.

ARTICLE VIII.

MISCELLANEOUS PROVISIONS

8.1. Representations and Warranties.

(a) Polaris, on behalf of itself and the Polaris Related Companies, represents and warrants as of the Effective Date that (i) Polaris or the Polaris Related Companies own the Polaris Patents, and has the right to grant the releases, covenants and licenses of the full scope set forth herein without payment of any consideration to any Polaris Related Company or Third Party, (ii) to the knowledge of Polaris and the Polaris Related Companies, the Polaris Patents are valid and enforceable, and (iii) neither Polaris or any of the Polaris Related Companies has assigned or otherwise transferred to any other Entity any rights to any causes of action, damages or other remedies, or any Polaris Patents, claims, counterclaims or defenses, relating to the Litigation or any Polaris Patent.

(b) Nothing contained in this Agreement shall be construed as:

(i) a warranty or representation by either Party that any manufacture, sale, use or other disposition of products by the other party has been or will be free from infringement of any Patents;

(ii) an agreement by either Party to bring or prosecute actions or suits against third parties for infringement, or conferring any right to the other Party to bring or prosecute actions or suits against third parties for infringement;

(iii) conferring any right to the other Party to use in advertising, publicity, or otherwise, any trademark, trade name or names of either Party, or any contraction, abbreviation or simulation thereof without the prior written consent of the other Party;

(iv) conferring by implication, estoppel or otherwise, upon either Party, any right or license under other Patents except for the rights and licenses expressly granted hereunder; or

(v) an obligation to furnish any technical information or know-how.

8.2. Confidentiality. From and after the Effective Date, neither Party shall disclose the existence or terms of this Agreement except:

(a) with the prior written consent of the other Party;

(b) to any governmental body having jurisdiction and specifically requiring such disclosure;

(c) in response to a valid subpoena or as otherwise may be required by law;

(d) for the purposes of disclosure in connection with the Securities and Exchange Act of 1934, as amended, the Securities Act of 1933, as amended, and any other reports filed with the Securities and Exchange Commission, or any other filings, reports or disclosures that may be required under applicable laws or regulations, or rules of any stock exchange or the NASDAQ national market or the OTC market;

(e) to a party' s accountants, legal counsel, tax advisors and other financial, business and legal advisors, subject to obligations of confidentiality and/or privilege;

(f) as required during the course of litigation and subject to protective order; provided however, that any production under a protective order would be protected under an "Attorneys Eyes Only" or higher confidentiality designation; and

(g) in confidence, in connection with a proposed merger, financing, acquisition, or similar transaction;

provided, however, that prior to any such disclosure pursuant to paragraph (c) hereof, the Party making the disclosure shall notify the other Party and, that prior to any such disclosure pursuant to paragraphs (c) and/or (g) hereof, the Party making the disclosure shall take reasonable actions in an effort to minimize the nature and extent of such disclosure.

8.3. Notices. All notices required or permitted to be given hereunder shall be in writing and shall be delivered by hand, by prepaid air courier with package tracing capabilities, or by registered or certified airmail, postage prepaid, and shall be addressed as follows:

If to Polaris to:

c/o

Managing Member
Polaris IP, LLC
207 C North Washington Avenue
Marshall, Texas 75670
Facsimile: (903) 938-7404

With simultaneous copy to:

General Counsel
Intellectual Property Navigation Group, LLC
207 C North Washington Avenue
Marshall, Texas 75670
Facsimile: 903-938-7404

If to Kana to:

c/o

General Counsel
Kana Software, Inc.
181 Constitution Drive
Menlo Park, CA 94025
Facsimile: 650-614-8301

With simultaneous copy to:

Darryl M. Woo, Esq.
Fenwick & West LLP
555 California Street, 12th Floor
San Francisco, CA 94104
Facsimile: 415-281-1350

Such notices shall be deemed to have been served when received by addressee. Either Party may give written notice of a change of address and, after notice of such change has been received, any notice or request shall thereafter be given to such Party as above provided at such changed address.

8.4. Publicity. Except for a single press release substantially in the form and having the content of the press release in Exhibit D attached hereto, neither Party will issue a press release nor any other announcement regarding this Agreement or the relationship contemplated herein unless the other Party provides prior consent in writing. The Parties shall direct their representatives not to make any disclosures of the terms of this Agreement. Notwithstanding the foregoing and Section 8.2, upon inquiry either Party may state that "Polaris and Kana have entered into a patent license agreement."

8.5. Governing Law. This Agreement and matters connected with the performance thereof shall be construed, interpreted, applied and governed in all respects in accordance with the laws of the United States of America and the State of Texas, without reference to conflict of laws principles.

8.6. Jurisdiction. Polaris and Kana agree (a) that all disputes and litigation regarding this Agreement, its construction and matters connected with its performance shall be subject to the exclusive jurisdiction of the state and federal courts in the Eastern District of Texas located in Marshall, Texas (the "Court"), and (b) to submit any disputes, matters of interpretation, or enforcement actions arising with respect to the subject matter of this Agreement exclusively to the Court. The Parties hereby waive any challenge to the jurisdiction or venue of the Court over these matters.

8.7. Bankruptcy. Each party acknowledges that all rights and licenses granted by it under or pursuant to this Agreement are, and shall otherwise be deemed to be, for purposes of Section 365(n) of the United States Bankruptcy Code (the "Bankruptcy Code"), licenses of rights to "intellectual property" as defined under Section 101(35A) of the Bankruptcy Code. Each party acknowledges that if such Party, as a debtor in possession or a trustee-in-bankruptcy in a case under the Bankruptcy Code, rejects this Agreement, the other party may elect to retain its rights under this Agreement as provided in Section 365(n) of the Bankruptcy Code. Each party irrevocably waives all arguments and defenses arising under 11 U.S.C. 365(c)(1) or successor provisions to the effect that applicable law excuses the Party, other than the debtor, from accepting performance from or rendering performance to an entity other than the debtor or debtor in possession as a basis for opposing assumption of the Agreement by the other Party in a case under Chapter 11 of the Bankruptcy Code to the extent that such consent is required under 11 U.S.C. § 365(c)(1) or any successor statute. Any change of control resulting from any such bankruptcy proceeding shall remain subject to Article VII above.

8.8. Licensor Notification. In the event that Kana believes that Polaris or any Polaris Related Company has: (i) breached an obligation under the last sentence of Section 2.2; (ii) breached an obligation under the second sentence of Section 2.6; or (iii) brought a lawsuit against a Kana Customer or Kana Vendor alleging or based upon infringement of a Polaris Patent as a result of activities which are released under Section 2.1 or licensed under Section 3.1 of this Agreement, then Kana shall promptly notify Polaris in writing. Upon receipt of such notice, Polaris shall (or shall cause the Polaris Related Company to) within thirty (30) days of receipt of such notice: (a) dismiss that portion of the lawsuit solely with respect to the activities of any such Kana Customer or Kana Vendor that are licensed, released, or subject to the covenants or other rights granted under the terms of this Agreement, and take any other actions necessary to come into compliance with Section 2.2; or (b) notify Kana that it needs more information; or (c) notify Kana of the reasons why Polaris believes that the Kana Customer or Kana Vendor is not covered by this Agreement. In the event Polaris needs more information or does not believe the Kana Customer or Kana Vendor is covered by this Agreement, then the Parties shall cooperate and negotiate in good faith for the remainder of the thirty (30) day period with regard reaching agreement as to whether the Kana Customer or Kana Vendor is covered by this Agreement. Kana shall not bring any action against Polaris or its Related Companies, as the case may be, for breach of this Agreement if such lawsuit is dismissed within such thirty (30) day period or the breach is otherwise resolved within such thirty (30) days pursuant to the terms of this Section 8.8.

8.9. Severability. If any provision of this Agreement is held to be illegal or unenforceable, such provision shall be limited or eliminated to the minimum extent necessary so that the remainder of this Agreement will continue in full force and effect and be enforceable. The Parties agree to negotiate in good faith an enforceable substitute provision for any invalid or unenforceable provision that most nearly achieves the intent of such provision.

8.10. Entire Agreement. This Agreement, including its Exhibits, embodies the entire understanding of the Parties with respect to the subject matter hereof, and merges all prior discussions between them, and neither of the Parties shall be bound by any conditions, definitions, warranties, understandings, or representations with respect to the subject matter hereof other than as expressly provided herein. No oral explanation or oral information by either Party hereto shall alter the meaning or interpretation of this Agreement. The Patent Purchase Agreement attached hereto is an integral part of this Agreement.

8.11. Modification; Waiver. No modification or amendment to this Agreement, nor any waiver of any rights, will be effective unless assented to in writing by the Party to be charged, and the waiver of any breach or default will not constitute a waiver of any other right hereunder or any subsequent breach or default.

8.12. Construction; Language. Any rule of construction to the effect that ambiguities are to be resolved against the drafting party will not be applied in the construction or interpretation of this Agreement. As used in this Agreement, the words "include" and "including" and variations thereof, will not be deemed to be terms of limitation, but rather will be deemed to be followed by the words "without limitation." The headings in this Agreement will not be referred to in connection with the construction or interpretation of this Agreement. This Agreement is in the English language only, which language shall be controlling in all respects, and all notices under this Agreement shall be in the English language.

8.13. Counterparts. This Agreement may be executed in counterparts or duplicate originals, both of which shall be regarded as one and the same instrument, and which shall be the official and governing version in the interpretation of this Agreement. This Agreement may be executed by facsimile signatures and such signatures shall be deemed to bind each Party as if they were original signatures.

IN WITNESS WHEREOF, the Parties hereto have caused this Agreement to be signed below by their respective duly authorized officers.

POLARIS IP, LLC		KANA SOFTWARE, INC.	
By:	/s/ Erich Spangenberg	By:	/s/ Jay Jones
Name:	Erich Spangenberg	Name:	Jay Jones
Title:	Managing Member	Title:	Chief Administrative Officer

EXHIBIT 31.01

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO RULE 13A-14(A) OF THE SECURITIES EXCHANGE ACT AND SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

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

1. I have reviewed this quarterly report on Form 10-Q of Kana Software, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting.

5. The registrant' s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Dated: May 14, 2007

/s/ Michael S. Fields

Michael S. Fields
Chief Executive Officer

EXHIBIT 31.02

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO RULE 13A-14(A) OF THE SECURITIES EXCHANGE ACT AND SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, John M. Thompson, Chief Financial Officer of the registrant, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kana Software, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting.

5. The registrant' s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Dated: May 14, 2007

/s/ John M. Thompson

John M. Thompson
Chief Financial Officer

EXHIBIT 32.01

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350

In connection with the Quarterly Report of KANA Software, Inc. (the "Registrant") on Form 10-Q for the quarter ended March 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael S. Fields, Chief Executive Officer of the Registrant, certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act, that to the best of my knowledge:

(1) The Report, to which this certification is attached as Exhibit 32.01, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: May 14, 2007

/s/ Michael S. Fields

Michael S. Fields
Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 32.02

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350

In connection with the Quarterly Report of Kana Software, Inc. (the "Registrant") on Form 10-Q for the quarter ended March 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John M. Thompson, Chief Financial Officer of the Registrant, certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act, that to the best of my knowledge:

(1) The Report, to which this certification is attached as Exhibit 32.02, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: May 14, 2007

/s/ John M. Thompson

John M. Thompson
Chief Financial Officer
(Principal Financial Officer)