CHORDIANT SOFTWARE INC
Form 10-K
November 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

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

For the fiscal year ended September 30, 2007

OR

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

For the transition period from __________ to

Commission File Number: 000-29357

CHORDIANT SOFTWARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	93-1051328
(State or other jurisdiction of incorporation or organization)	(IRS Employer identification No.)

20400 Stevens Creek Blvd., Suite 400
Cupertino, California 95014
(Address of principal executive offices, including zip code)

(408) 517-6100
(Registrant’s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock $.001 Par Value per Share	The NASDAQ Stock Market LLC

(NASDAQ Global Market)

Securities Registered Pursuant to Section 12(g) of the Act:
None

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

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

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

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

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.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of March 31, 2007, the last business day of the registrant's most recently completed second fiscal quarter: $327,939,833.

As of October 31, 2007, there were 33,289,780 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III-Portions of the registrant's definitive proxy statement to be issued in conjunction with registrant's 2008 Annual Stockholder's meeting.

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CHORDIANT SOFTWARE, INC.

ANNUAL REPORT ON FORM 10-K

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PART I

FORWARD-LOOKING INFORMATION

Except for the historical information contained herein, this Annual Report contains certain information that is forward-looking in nature. This information is based on our current expectations, assumptions, estimates and projections about our business and our industry, and involves known and unknown risks, uncertainties and other factors that may cause our or our industry's results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied in, or contemplated by the forward-looking statements. Words such as "believe," "anticipate," "expect," "intend," "plan," "will," "may," "should," "estimate," "predict," "guidance," "potential," "continue" or the negative of such terms or other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors more fully described under the caption "Risk Factors" and those discussed elsewhere in this document. These and many other factors could affect the future financial and operating results of Chordiant. Chordiant undertakes no obligation to update any forward-looking statement to reflect events after the date of this report. All references to "Chordiant", "we", "us", or "the Company" means Chordiant Software, Inc. and its subsidiaries except where it's made clear that the term means only the parent company.

ITEM 1. BUSINESS

Chordiant is an enterprise software company that delivers products and services that improve the "customer experience" in front-office processes for leading global companies primarily in the banking, insurance, healthcare, and telecommunications markets. Chordiant provides companies in these markets with innovative solutions that help them more effectively manage their customer interactions, offering "next best offers" for those customers based on pre-built business rules.

Our enterprise-scale software utilizes predictive decisioning, analytical modeling, and strategy formulation in real-time for decision management and execution at the point of sale. This capability enables organizations to improve the accuracy of marketing offers for retention, up-selling, cross selling, and modeling risk scenarios such as customer churn and the likelihood of default on payments.

We believe our solutions add business value and return-on-investment for our customers by reducing operational costs, and increasing employee productivity. These improvements are realized by automating key business processes and supporting organizational decision-making associated with the servicing, selling, marketing and fulfillment of customer requests across the enterprise. We offer solutions to our clients that include software applications, business processes, tools and services that will integrate their customer information and corporate systems to produce a real-time view of customers across multiple business channels. Our solutions offer businesses additional flexibility to create and set their policies and processes to control the quality of servicing, fulfillment and marketing offers to their customers.

On December 21, 2004, we acquired KiQ Limited, a privately held United Kingdom software company or KiQ, for an aggregate purchase price of approximately $20 million, which was comprised of $9.7 million in cash, $9.4 million in our common stock and approximately $0.9 million in associated transaction costs. Through this transaction, we acquired a decision management system that advances the state of analytics by exploiting the power of predictive data mining, analytical modeling, and strategy formulation into real-time decision management and execution. Products and patented technology acquired by us in this transaction enable organizations to significantly increase the accuracy of marketing offers for retention, up-selling, cross selling, and to model risk scenarios such as customer churn and

likelihood to default on payments. With the addition of KiQ’s products and patented technology we are able to deliver a range of applications for real-time recommendation, retention, risk management and recruitment.

Product Solutions

Our products are designed for global enterprises seeking to optimize their customer experiences through effective decision analysis, marketing, selling and servicing efforts. We have designed our products to integrate customer information from different data sources and systems of record, automate business processes based on a customer’s specific profile and requests, and provide uniform service and information to customers across multiple communication channels. Our products are designed to enable companies to deliver appropriate recommendations (also known as “next best action”), services, offers and information to a targeted customer at the time of customer need while complying with relevant business policy and industry regulatory requirements.

Our solutions are designed to address the enterprise requirements of global consumer companies serving millions of customers across multiple business channels integrating multiple lines of business. The solution suite is typically licensed as an integrated set of software products that include one or more vertical market applications running on top of a common layer of

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foundational technology and supporting tools. Chordiant's software is based on open systems software standards that are widely adopted by our industry and capable of deployment throughout an enterprise's information technology infrastructure. Chordiant software is built to be highly scalable and adaptable to a customer's specific business requirements or technology infrastructure.

Products and Solutions

Historically, our products have been categorized into three general groups: Enterprise solutions (including the "Cx" Enterprise Foundation and Call Center and Customer Service Desktop products), Decision Management products, and the Marketing Director Suite of products. Our solutions are designed to address a variety of business needs within our four target vertical markets of banking, insurance, healthcare, and telecommunications:

- **Call Center and Customer Service Desktop (Call Center Advisor – Browser Edition)**: This product is a browser-based guided desktop for the effective management of customer contacts, service requests, and customer case history in the call center channel. The desktop is integrated with leading computer telephony integration products, working with our own queue-based work management to deliver 'universal queues' to the enterprise. This product is used by customer services professionals across all our target markets. It is designed to meet the high volume transaction and business processes common in enterprise contact centers. The desktop also acts as a delivery channel for our decision management and marketing products together with the other business applications that Chordiant offers.

- **Marketing Director**: We provide applications for driving unified, personalized marketing campaigns and response management across multiple media types and multiple channels including email, web, phone, and mobile messaging (MMS/SMS). These products are used by marketing professionals across all our target markets to segment and target prospects and customers and deliver to them effective marketing campaigns. The Marketing Director suite of products integrates with our Decision Management products to provide an integrated campaign management system.

- **Recommendation Advisor**: An application which provides flexible lead collection and routing in a common guided selling desktop, integrated with marketing campaigns and product fulfillment. Predictive and adaptive analytics guide staff toward best offers and "next best action" in the context of inbound or outbound customer interactions. This product is used by sales and service professionals across our target markets to manage leads and deliver highly effective sales messages.

- **Credit Card Disputes, Chargebacks and Fraud**: These modular applications are designed to automate and optimize customer and mid-office functions associated with credit card dispute handling and fraud investigation and recovery. The products use Chordiant technology to implement the dispute and chargeback regulatory requirements of credit card associations to assist organizations in managing their compliance of these complex regulations. This application is used by customer service professionals in the credit card segment of banking to drive more cost effective, compliant handling of disputes and fraud cases.

- **Teller**: A guided desktop product and supporting financial transaction components for retail bank tellers/cashiers or other cash-based desktop applications. This product is used in the banking and lending sectors by customer-facing staff in bank branches or stores to effectively process cash and related financial transactions on behalf of the customer. The solution utilizes the "Cx" (Customer Experience) Enterprise Foundation (described below) in providing company-wide case management, customer history, and work management between front office and back office operations.

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Lending: Solutions and services which provide a common process-driven lending infrastructure across an organization to increase efficiency of loan originations, quoting, account opening and loan risk assessment and management such as required by Basel II. Our lending solutions are used in banking and lending by a variety of users and desktop applications.

- **Insurance**: Solutions and services which provide a common process-driven insurance infrastructure and services across an organization to increase efficiency of case management, claims processing, quoting, and risk management. Our insurance solutions and services are used in the insurance sector by a variety of users and desktop applications.

    - **Collections**: This product is designed to deliver automation and operational efficiency to debt recovery and collections professionals. The first generally available release, consisting of core collections functions, was shipped in the third fiscal quarter of 2007. The product is designed to make extensive use of Chordiant's Decision Management (CDM) technology to deliver real-time decisioning.

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Technology

Chordiant applications share a common technology platform and set of development and configuration tools through our Cx Enterprise Foundation. Chordiant technology is built to scale to tens of thousands of users and integrate seamlessly into our customer's IT infrastructure. Chordiant technology is generally built based on standards as defined in Java 2 Enterprise Edition (J2EE). Chordiant technology works alongside third party J2EE Application Servers, such as those from International Business Machines Corporation (IBM) and BEA Systems Inc.

Chordiant technology is based on Service Oriented Architecture (SOA). This architecture provides a framework for large or growing businesses to provide multi-channel interaction and process orchestration across multiple lines of business. The Cx Enterprise Foundation framework provides a pre-integrated environment that supports the business applications required by these large scale organizations. With predictive decisioning built-in, organizations can utilize Chordiant technology to obtain customer behavioral insight and use this to drive the most appropriate business processes, guide staff through the best tasks to increase responsiveness, reduce errors, shorten cycle times, and present the most relevant offers to customers in each interaction.

- **Cx Enterprise Foundation: Foundation Server, Café, and Tools Platform**: Consisting of a family of products with enterprise-wide process orchestration and case management at its core, the Chordiant Cx Enterprise Foundation product family provides a common, highly scalable base platform for all Chordiant solutions. The product family incorporates industry standards such as J2EE, model driven development, AJAX high performance thin client desktops, Java Server Faces (JSF), and enterprise open source technologies including Hibernate, and Apache Trinidad. The products are supported by process development and administration tools that use the Eclipse integrated development environment.

The Enterprise Platform incorporates module 'servers' to deliver additional functionality as needed including business rules, decision management, telephony integration, connectivity to systems of record and interaction channel management. These allow organizations to implement only those functions that are required for their particular business requirement without interfering with future project requirements.

- **Decisioning**: Consisting of flexible products and tools for adaptive decisioning, predictive decisioning, and rules, our Chordiant Decision Management (CDM) product family allows organizations to effectively drive application behavior based on industry or organizational models and logic. This capability allows business users advanced control over business priorities, and enables the business to refine offer and service management in real-time. CDM is a suite of products and comprises:

- Chordiant Data Preparation Director—Chordiant Data Preparation Director allows non-IT users to combine, manipulate and aggregate customer data using an easy to use visual interface.

- Chordiant Predictive Analytics Director—Chordiant Predictive Analytics Director provides marketing professionals functionality which enables in-depth analysis of significant amounts of customer information using data-mining and predictive analytical capabilities.

- Chordiant Strategy Director—Chordiant Strategy Director allows users to design customer interaction strategies and marketing offers based on decisions and rules that reflect customer behavior, preferences, legislation, corporate policies and desired business outcomes. The resulting decision logic is executed in our campaign management solution for outbound communication or executed in real-time in multiple channels of communication.

- Chordiant Decision Monitor—Chordiant Decision Monitor provides management with insight into business results, measures data analysis effectiveness, and allows an organization to learn from current and future data models. It is a

software module in which decisions are automatically logged and stored in a monitoring database together with the relevant data as well as subsequent customer information and behavior. This module can be integrated and analyzed by third party business intelligence tools.

- Chordiant Deployment Manager—Chordiant Deployment Manager provides the administrative function to prepare available data in the operational environment and implement the decision logic into production campaigns, business processes and applications.

- Chordiant Real-Time Decisioning Services—Chordiant Real-Time Decisioning Server generates a decisioning service that can be hosted in industry-standard application servers.

- Chordiant Database Decisioning Services—The Chordiant Database Decisioning Server provides an application for data mining, analysis, and modeling to create the optimal decision logic and the appropriate decisions outcomes.

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Chordiant Mesh Collaboration

Announced in fiscal year 2006, Chordiant Mesh is a collaborative development network where customers, partners, and Chordiant staff can work together on solutions to respond to customer initiatives. Chordiant Mesh is a development infrastructure layer that allows organizations to collaborate on a wide variety of solutions, components, and tools. By applying principles from open source projects to a member-driven high-end ecosystem, Chordiant Mesh facilitates far greater collaboration, agility, speed to market, transparency, and quality than customers are accustomed to receiving from traditional high-end enterprise software providers.

Key benefits of Chordiant Mesh are:

- A fabric for the maintenance of infrastructure level code and reduction of customization and cost of ownership.
- A set of tools and methodologies for building applications collaboratively with Chordiant and its partners.
- Enables and enhances the IT systems "grid" to better support high value SOA – based applications.
- Enhancement of the ability of IT departments to provide support, control and flexibility.
- By leveraging open-source development models, Chordiant can take code revisions submitted by community members – customers, partners and Chordiant itself – and allow these to be incorporated into its products when appropriate.

This new Mesh development approach enables Chordiant to be in closer collaboration with its enterprise customers.

Strategic Direction

The Company is focused on solving problems for our global accounts through helping them improve the quality of the customer experience they deliver in the banking, insurance, healthcare, and telecommunications markets. Chordiant anticipates that it will increasingly deliver business-focused applications based on an open and adaptable core information technology, or IT, infrastructure that provides high levels of business agility and fast return on investment for enterprises by allowing rapid changes to their IT systems. Within the markets above, Chordiant will continue to develop domain-level solutions for these markets, focusing on the most mission-critical business processes facing our customers.

Customers

We target global brand leaders in our core markets. Our customers include: ING, Canada, Inc., HSBC Technology and Services (USA), Inc., Capital One Services, Inc., O2 (UK) Limited, Time Warner Cable, Inc., Covad Communication Company, 21st Century Insurance, T-Mobile, Lloyds TSB Bank plc, Bank of Ireland Group, The Royal Bank of Scotland plc, Metropolitan Life Insurance Company, Signal Iduna, Deutsche Bank AG, Canadian Tire Financial Services, Canadian Imperial Bank of Commerce, Halifax plc, British Telecommunications plc, Connecticut General Life Insurance Company, Citibank Credit Services Inc. (USA), and Sky Subscribers Services Limited. As we deploy new applications, we anticipate that a certain percentage of these and new customers will adopt these new applications and expand their investment in Chordiant products. For the year ended September 30, 2007, Citicorp Credit Services Inc. and IBM accounted for 23% and 16% of our total revenues, respectively.

Technology

Chordiant's solutions and core technology are implemented using industry standard software that includes J2EE, XML, and Web Services. This industry standard set of development specifications leverages the strengths of the Java programming language to enable software applications that are easier to develop, configure and integrate with legacy and third party information technology systems.

Chordiant's architecture leverages J2EE and Web Services extensively to provide a services oriented architecture for use by Chordiant applications and other systems. The business services and related business components use a data persistence foundation with built-in support for Oracle and DB2 databases as well as IBM WebSphere MQ messaging. Generally, our software is easily integrated with other data sources, including those built on the Java Connector Architecture (JCA).

Chordiant's web browser technology delivers consistent self-service and agent-driven customer interaction processes using a rich web-based application platform that provides desktop interface behavior in a browser-based technology with high performance, low maintenance costs, and flexibility to meet the differing demands of a diverse user population.

Certain of our products use technology modules from third party technology providers including IBM, BEA Systems, Sun Microsystems, and certain other non-public entities. Our enterprise platform solutions support industry standard J2EE application servers including IBM WebSphere and BEA WebLogic. Our server software runs on UNIX server platforms from Sun Microsystems, IBM and Linux.

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Sales and Marketing

We license our solutions and sell services primarily through a direct sales organization that is complemented by selling and support efforts through business alliance partners such as IBM, Tata Consulting, Cap Gemini, BearingPoint, and Accenture, systems integrators and technology vendors. Our market focus is the business-to-consumer segment of the economy with a targeted effort on leading consumer focused industries and companies using multiple channels as the means of conducting business and serving customers.

The sales process generally ranges from six to eighteen months depending on the level of knowledge that prospective customers need about the use and benefits of our solutions and the involvement of systems integrators. During the sales process, we typically approach the senior management teams of the business and information technology departments of a prospective customer's organization. We utilize sales teams consisting of sales and technical professionals who work with our systems integration partners to create company specific proposals, presentations and proof of concept demonstrations that address the needs of the business and its technology requirements.

Our corporate offices are located in Cupertino, California, and we maintain an applications development center in Bedford, New Hampshire. In Europe, we have offices in the greater metropolitan areas of London, Madrid, Amsterdam, and Munich. We have sales and support personnel in various additional locations in North America and Europe.

Our Services

We offer a comprehensive set of customer services including professional consulting services and product support and training services. We believe that providing high quality customer service is critical to achieving rapid product implementation and customer success.

Professional Services

We provide implementation consulting and customer support services to licensed customers through our worldwide professional services organization. Our professional services consulting teams often assist customers and systems integrator partners in the configuration and implementation of our software solutions.

Our professional services organization deploys consultants as part of the project team alongside systems integration partners and members of the customer's internal team to provide subject matter expertise, technical knowledge, business engineering, project guidance and quality assessments during the entire solution lifecycle. In the design stage, we provide a variety of professional services that help determine a customer's business processes and the technical requirements of the solutions implementation. In the implementation stage, we use a delivery methodology to assist customers and integration partners in planning and managing the implementation. Typically, systems integrators, supported by our consultants, provide overall program management and coordinate the implementation of our products with a customer's existing communications, applications, databases and transaction systems. In the final phases of an implementation, the systems integrators provide deployment services to enable a customer's internal team to implement the system, train internal users and provide first-level end-user support.

Although our primary strategy is to leverage our strategic systems integration partners for implementations, our internal professional services organization is often integral in implementing our enterprise platform software solutions for our customers. We believe that our consulting services enhance the use and administration of our software solutions, facilitate the implementation of our solutions and result in sharing best business practices with client and systems integrator project teams. In addition to implementing our software, our professional services organization works closely with our internal research and development organization to enhance existing software solutions.

In addition to our internal professional services organization, in calendar 2007, we renewed for one year our agreement with Ness Technologies Inc., Ness Global Services, Inc. and Ness Technologies India, Ltd. (collectively, “Ness”), that we originally entered into in 2003. Ness provides Chordiant with resources focused on technical product support, sustaining engineering product testing and product development through their global technical resources and operations center in Bangalore, India. Ness is an independent contracting company with global technical resources. The agreement with Ness may be extended for additional one year terms at our discretion. Our agreement with Ness enables them, at our direction, to attract, train, assimilate and retain sufficient highly qualified personnel to perform technical support and certain sustaining engineering functions.

Educational Services

We provide educational services to train and enable our systems integrators and customers to use our products and technologies. We offer a comprehensive series of training modules to provide the knowledge and skills to successfully deploy, use and maintain our products. These training courses focus on the technical aspects of our products as well as business issues and processes. We provide on-site customized training courses for a fee and, also, through classroom and lab instructions. In addition, we provide certification programs for our partners and customers.

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Customer Support

We provide our customers with unspecified support and maintenance services including telephone support, web-based support and updates to our products and documentation. We believe that providing a high level of technical support is critical to customer satisfaction. We also offer training programs to our customers and other companies with which we have relationships to accelerate the implementation and adoption of our solutions by the users within a company. Fees for our training services are typically charged separately from our software license, maintenance and consulting fees.

Our customers have a choice of support and maintenance options depending on the level of service desired. Our technical support services are available to clients by telephone, over the web, by email and on-site. Additionally, we provide unspecified product enhancement releases to all customers as part of our support and maintenance contracts. We use a customer service automation system to track each customer inquiry until it is resolved. We also make use of our website and a secured customer forum to provide product information and technical support information worldwide 24 hours a day, seven days a week.

Strategic Partnerships

Establishing partnerships and alliances with third parties that provide additional services and resources for implementing our solutions to enhance our sales and service organizations' productivity is an important element of our strategy. These relationships and alliances fall into the following categories:

Consulting and System Integration Relationships. To enhance the productivity of our sales and service organizations, we have established relationships with systems integrators, complementary technology providers, and alternative service providers. We have established relationships and trained professionals at a number of systems integrators including: Accenture, IBM Global Services, Ness Technologies, Tata Consultancy Services, Patni Telecom Solutions (UK), LTD, and Infogain Corporation. We plan to expand these relationships to increase our capacity to license and implement our products. We believe that expanding our relationships with systems integrators and independent consulting firms will enable us to gain a greater share of our target markets.

Technology Partnerships. We make extensive use of industry platforms and embrace a number of core technologies in our solution offerings. We have formed partnerships with vendors of software and hardware technology platforms. We currently maintain technology relationships with vendors such as Avaya/Lucent, Alcatel/Genesys, BEA Systems, Cisco Systems, IBM, Oracle, and Sun Microsystems. Many of these companies voluntarily provide us with early releases of new technology platforms, education related to those platforms and limited access to their technical resources to facilitate adoption of their technology.

Product Development

We have made substantial investments in research and development through internal development, acquisitions and technology licensing. Our product development efforts are focused on extending our enterprise software solutions, application components, industry specific processes and business process functionality, and continued integration of industry-specific transaction systems and services. Our product development organization is responsible for new software products, product architecture, core technologies, product testing, quality assurance and enabling the compatibility of our products with third party hardware and software platforms.

Our product development resources are organized into a number of development teams including:

- Cx Enterprise Platform, which includes Foundational Server, Tools, and Decision Management Products;

- Operations, which includes Mesh, Fulfillment, Performance Labs, and Release Management;
- Applications, which includes our vertical and Marketing Applications;
- Product Test and Quality.

Our product development teams have experience in enterprise and distributed computing, J2EE and object oriented development, data management, process and workflow engineering, transaction system interfaces, Internet and Web-Services technologies. Our research and development expenditures were $27.5 million, $25.9 million and $20.3 million for the years ended September 30, 2007, 2006, and 2005, respectively.

Competition

The market for our products is competitive, rapidly evolving, and can be affected by new product introductions and other market activities of industry participants. The competitive landscape is quickly evolving to address the need for enterprise-wide

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integration of IT assets and the convergence of customer interaction applications, back-office systems and business processes. The most significant competition we face is from customers' internal development efforts, custom system integration, as well as other software providers that offer integration and development platforms.

Internal Development

Many of our customers and potential customers have in the past attempted to develop customer service, call center, customer relationship management and new front-office systems in-house or with the help of systems integrators. Internal information technology departments have staffed projects to build their own systems utilizing a variety of tools. In some cases, such internal development projects have been successful in satisfying the needs of an organization. The cost of internal development and total cost-of-ownership have risen to become a primary concern of the business and management. We expect that internal development will continue to be a significant source of competition.

Custom System Integration Projects

Another source of competition results from systems integrators engaged to build a custom development application. The introduction of a systems integrator typically increases the likelihood of success for the customer. The competitive factors in this area require that we demonstrate to the customer the cost savings and advantages of configurable, upgradeable and commercially supported software products developed by a dedicated professional software organization.

We frequently rely on system consulting and systems integration firms for implementation and other global services, as well as recommendations of our products during the evaluation stage of the purchase process. Many of these third parties have similar and often more established relationships with our competitors. We cannot assure that these third parties, many of whom have significantly greater resources than us, will not market software products in competition with us.

Application Software Competitors

As discussed, our primary competition is from internal development at our customers and potential customers. However, other competitors include providers of traditional, first-generation customer relationship management, enterprise resources planning, call center, marketing automation software and sales force automation software. These vendors include, among others, companies such as: Oracle Corporation, SAP, Pegasystems, Inc., Unica Corporation, SSA Global Technologies, Inc., Fidelity National Information Systems, Inc., S1 Corporation, and Amdocs Limited.

Some of these companies have longer operating histories, greater financial, marketing and other resources, greater name recognition in other markets and a larger base of customers than we do. In addition, some companies have well-established relationships with our current and potential customers. As a result, these competitors may be able to devote greater resources to the development, promotion and sale of their products than we can.

We believe that we compete favorably in the industries we serve based on the following competitive advantages: process-driven solutions for servicing and selling; real-time and transactional processes; real-time decision management and vertical processes implemented in a multi-channel architecture. The technology advantages include: Chordiant architecture providing an open services oriented architecture providing for integration with multiple legacy systems, third party applications and communication channels and advanced browser based application environment for high volume call center, mid-office and branch operations.

There is no one competitor, nor are there a small number of competitors that are dominant in our market. There are many factors that may increase competition in the enterprise customer relationship management market, including (i) entry of new competitors, (ii) mergers and alliances among existing competitors, (iii) consolidation in the software industry and (iv) technological changes or changes in the use of the Internet. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which could materially and adversely affect our business, operating results and financial condition. Continuing consolidation in the software industry during 2007 may indicate that we will face new competitors in the future. Within the year Oracle announced the acquisitions of Agile Software, an enterprise solutions software maker and Hyperion Software, a business performance software maker. Also in 2007, IBM acquired Palisades, a provider of lending software to companies in the mortgage industry and SAP has made an offer to purchase Business Objects. In 2006, IBM acquired Webify, a provider of middleware to companies primarily in the insurance industry. In January 2006, Oracle acquired Siebel Systems, Inc., a maker of customer relationship management software products and acquired Portal Software, a provider of billing and revenue management solutions for the communications and media industry. Siebel Systems, Inc. was a competitor of ours. In September 2005, IBM had acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In 2005, Oracle acquired I-flex Solutions, Ltd., a banking software maker headquartered in Mumbai, India. While we do not believe that Agile Software, Hyperion Software, Palisades, Webify, Portal Software, DWL, or I-flex Solutions have been significant competitors of Chordiant in the past, the acquisition of these companies by Oracle and IBM may indicate that we will face increased competition from significantly larger and more established entities in the future.

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We cannot assure that we will be able to compete successfully against current and future competitors or that the competitive pressure faced by us will not materially and adversely affect our business, operating results and financial condition.

Intellectual Property and Proprietary Rights

Our success is in part dependent upon our ability to develop and protect proprietary technology and intellectual proprietary rights. We rely primarily on a combination of contractual provisions, confidentiality procedures, patents pending, trade secrets, and copyright and trademark laws to protect our intellectual property and proprietary rights.

We license our products through non-exclusive license agreements that impose restrictions on customers' ability to utilize the software. In addition, we seek to avoid disclosure of our trade secrets, including requiring employees, customers and others with access to our proprietary information to execute confidentiality agreements with us and restricting access to our source code. We also seek to protect our rights in our products, documentation and other written materials under trade secret and copyright laws. Due to rapid technological change, we believe factors such as the technological and creative skills of our personnel, new product developments and enhancements to our existing products are more important than the various legal protections of our technology to establishing and maintaining a technology leadership position.

We integrate third party software into our products. Costs associated with integrated technology provided by third parties historically accounts for approximately 2% to 5% of total license revenues. The third party software may not continue to be available on commercially reasonable terms or at all. If we cannot maintain licenses to key third party software, shipments of our products could be delayed until equivalent software is developed or licensed and integrated into our products. Moreover, although we are generally indemnified against claims if technology licensed from third parties infringes the intellectual property and proprietary rights of others, this indemnification is not always available for all types of intellectual property and proprietary rights and in some cases the scope of this indemnification is limited. There can be no assurance that infringement or invalidity claims arising from the incorporation of third party technology or claims for indemnification from our customers resulting from these claims will not be asserted or prosecuted against us. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources, in addition to potential product redevelopment costs and delays.

Despite our efforts to protect our proprietary rights, existing laws afford only limited protection. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. There can be no assurance that we will be able to protect our proprietary rights against unauthorized third party copying or use. Use by others of our proprietary rights could materially harm our business. Furthermore, policing the unauthorized use of our products is difficult and expensive litigation may be necessary in the future to enforce our intellectual property rights.

Third parties may claim, and have claimed, that we have infringed, or currently infringe, their current or future products. We expect that software developers will increasingly be subject to infringement claims as the number of products in different industry segments overlap. Any claims, with or without merit, can be time-consuming, result in costly litigation, prevent product shipment, cause delays, or require us to enter into royalty or licensing agreements, any of which could harm our business. Patent litigation in particular has complex technical issues and inherent uncertainties. If an infringement claim against us was successful and we could not obtain a license on acceptable terms, license a substitute technology or redesign to avoid infringement, our business could be harmed.

For fiscal year 2007, Chordiant received 2 patents from the US Patent and Trademark Office. The first patent was US Patent Number 7,178,109 for innovative user interface design, first introduced in its family of browser-based

applications in 2003. The second was US Patent Number 7,194,380 covers the Decision Management Suite.

Employees

As of September 30, 2007, we employed 285 full time employees. Of that total, 85 were primarily engaged in product development, engineering or systems engineering, 85 were engaged in sales and marketing, 58 were engaged in professional services and 57 were engaged in operational, financial and administrative functions.

None of our employees are represented by a labor union and we have never experienced a work stoppage. We believe that our relations with our employees are good. We believe our future success will depend in part on our continued ability to recruit and retain highly skilled technical, sales, finance, management and marketing personnel.

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Financial Information About Geographic Areas

For a detailed description of our sales by geographic region, we incorporate by reference the information in Note 14 to our consolidated financial statements contained in Item 8 of this Annual Report on Form 10-K. Although the Company's revenues are not considered seasonal, our international operations do experience a slow down in the summer months and professional services provided on an hourly basis decline due to the holidays in the quarterly periods ended December 31. For information relating to the risks attendant to our foreign operations, we incorporate by reference the information under the headings "—Risk Factors—If we fail to adequately address the difficulties of managing our international operations, our revenues and operating expenses will be adversely affected" and "—Risk Factors—Fluctuations in the value of the U.S. Dollar relative to foreign currencies could make our products less competitive in international markets and could adversely affect our operating results and cash flows."

Backlog

For a detailed discussion of backlog, we incorporate by reference the information in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading Financial Trends.

Available Information

We were incorporated in California in March 1991 and were reincorporated in Delaware in October 1997.

We maintain a site on the world-wide web at www.chordiant.com; however, information found on our website is not incorporated by reference into this Annual Report on Form 10-K. We make available free of charge on or through our website our filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

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ITEM 1A. RISK FACTORS

The matters relating to the Audit Committee of the Board's review of our historical stock option granting practices and the restatement of our consolidated financial statements have required us to incur substantial expenses, have resulted in litigation, and may result in additional litigation.

On July 24, 2006, the Company announced that the Audit Committee of the Company's Board of Directors, with the assistance of independent legal counsel, was conducting a review of our stock option practices covering the time from the Company's initial public offering in 2000 through June 2006. As described in Note 3 "Restatement of Previously Issued Consolidated Financial Statements" in Notes to Consolidated Financial Statements in the 2006 Form 10-K, the Audit Committee reached a conclusion that incorrect measurement dates were used for financial accounting purposes for stock option grants in certain prior periods. As a result, the Company has recorded additional non-cash stock-based compensation expense, and related tax effects, related to certain stock option grants, and the Company has restated certain previously filed financial statements included in the 2006 Annual Report on Form 10-K.

This review of our historical stock option granting practices has required us to incur substantial expenses for legal, accounting, tax and other professional services, has diverted our management's attention from our business, and any litigation or future government enforcement actions could in the future adversely affect our business, financial condition, results of operations and cash flows.

Our historical stock option granting practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation proceedings. Several derivative complaints have been filed pertaining to allegations relating to stock option grants. We cannot assure you that these or future similar complaints or any future litigation or regulatory action will result in the same conclusions reached by the Audit Committee. The conduct and resolution of these matters will be time consuming, expensive and distracting from the conduct of our business.

We contacted the SEC regarding the Audit Committee's review and, in July 2006, the SEC commenced an investigation into our historical stock option grant practices. In November 2006, a representative of the Audit Committee and its informal advisors met with the enforcement staff of the SEC and provided them with a report of the Audit Committee's investigation and findings. In January 2007, the enforcement staff of the SEC notified the Company that its investigation had been terminated and no enforcement action had been recommended to the Commission.

The findings of the Audit Committee's review are more fully described in Note 3 to the Consolidated Financial Statements and in Item 9A of the Annual Report on Form 10-K for the year ended September 30, 2006.

Prior to 2007, we were not profitable and we may incur losses in the future, which may raise vendor viability concerns thereby making it more difficult to close license transactions with new and existing customers.

While the Company was profitable in the amount of $6.0 million for the year ended September 30, 2007, we incurred losses of $16.0 million and $19.9 million for the years ended September 30, 2006 and 2005, respectively. As of September 30, 2007, we had an accumulated deficit of $226.9 million. We may incur losses in future periods and cannot be certain that we can generate sufficient revenues to maintain profitability. Continued losses may leave many customers reluctant to enter into new large value license transactions without some assurance that we will operate profitably. If we fail to enter into new large value license transactions due to viability concerns, our revenues will decline, which could further adversely affect our operating results.

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

We derive a significant portion of our license and service revenues from a limited number of customers. The loss of a major customer could cause a decrease in revenues and net income. For the year ended September 30, 2007, Citicorp Credit Services, Inc. and International Business Machines (IBM) accounted for 23% and 16% of our total revenue, respectively. While our customer concentration has fluctuated, we expect that a limited number of customers will continue to account for a substantial portion of our revenues in any given period. As a result, if we lose a major customer, or if a contract is delayed or cancelled or we do not contract with new major customers, our revenues and net income would be adversely affected. In addition, customers that have accounted for significant revenues in the past may not generate revenues in any future period, causing our failure to obtain new significant customers or additional orders from existing customers to materially affect our operating results.

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If we fail to adequately address the difficulties of managing our international operations, our revenues and operating expenses will be adversely affected.

For the year ended September 30, 2007, international revenues were $58.8 million or approximately 47% of our total revenues. While North American revenues have increased recently as a percentage of our overall revenues, international revenues will continue to represent a significant portion of our total revenues in future periods. We have faced, and will continue to face, difficulties in managing international operations which include:

- Difficulties in hiring qualified local personnel;
- Seasonal fluctuations in customer orders;
- Longer accounts receivable collection cycles;
- Expenses associated with licensing products and servicing customers in foreign markets;
- Economic downturns and political uncertainty in international economies;
- Income tax withholding issues in countries in which we do not have a physical presence, resulting in non-recoverable tax payments;
- Complex transfer pricing arrangements between legal entities;
- Doing business and licensing our software to customers in countries with weaker intellectual property protection laws and enforcement capabilities; and
- Difficulties in commencing new operations in countries where the Company has not previously conducted business, including those associated with tax laws, employment laws, government regulation, product warranty laws and adopting to local customs and culture.

Any of these factors could have a significant impact on our ability to license products on a competitive and timely basis and could adversely affect our operating expenses and net income. Additionally, we closed our only French office in fiscal year 2007. The absence of a business office in France may harm our ability to attract and retain customers in that country.

Our known backlog of business may not result in revenue.

An increasingly material portion of our revenues has been derived from large orders, as major customers deployed our products. We define backlog as contractual commitments by our customers through purchase orders or contracts. Backlog is comprised of software license orders which have not been accepted by customers or have not otherwise met all of the required criteria for revenue recognition, deferred revenue from customer support contracts, and deferred consulting and education orders for services not yet completed or delivered. Backlog is not necessarily indicative of revenues to be recognized in a specified future period. There are many factors that would impact the Company’s filling of backlog, such as the Company’s progress in completing projects for its customers and Chordiant’s customers’ meeting anticipated schedules for customer-dependent deliverables. The Company provides no assurances that any portion of its backlog will be filled during any fiscal year or at all or that its backlog will be recognized as revenues in any given period. In addition, it is possible that customers from whom we expect to derive revenue from backlog will default and as a result we may not be able to recognize expected revenue from backlog.

Fluctuations in the value of the U.S. Dollar relative to foreign currencies could adversely affect our operating results and cash flows.

A significant portion of our sales and operating expenses result from transactions outside of the United States, often in foreign currencies. These currencies include the United Kingdom Pound Sterling, the Euro and the Canadian Dollar. Our international sales comprised 47% of our total sales for the year ended September 30, 2007. Our international sales comprised 38% of our total sales for the year ended September 30, 2006. Our future operating results will continue to be subject to fluctuations in foreign currency rates, especially if international sales grow as a percentage of our total sales, and we may be adversely impacted by fluctuations in foreign currency rates in the future. For the year ended September 30, 2007, we had an unrealized foreign currency transaction gain of approximately $0.6 million. See Item 7A for further discussion about foreign currency risk.

Geopolitical concerns could make the closing of license transactions with new and existing customers difficult.

Our revenues may decrease in fiscal year 2008 or beyond if we are unable to enter into new large-scale license transactions with new and existing customers. The current state of world affairs and geopolitical concerns have left many customers reluctant to enter into new large value license transactions without some assurance that the economy both in the customer's home country and worldwide will have some economic and political stability. Geopolitical instability will continue to make closing large license transactions difficult. In addition, we cannot predict what effect the U.S. military presence overseas or potential or actual political or military conflict have had or are continuing to have on our existing and prospective customers' decision-making process with respect to licensing or implementing enterprise-level products such as ours. Our ability to enter into new large license transactions also directly affects our ability to create additional consulting services and post customer support revenues, on which we also depend.

Competition in our markets is intense and could reduce our sales and prevent us from achieving profitability.

Increased competition in our markets could result in price reductions for our products and services, reduced gross margins and loss of market share, any one of which could reduce our future revenues. The market for our products is intensely competitive, evolving and subject to rapid technological change. Historically, our primary competition has been from internal development, custom systems integration projects and application software competitors. In particular, we compete with:

- *Internal information technology departments:* in-house information technology departments of potential customers have developed or may develop systems that provide some or all of the functionality of our products. We expect that internally developed application integration and process automation efforts will continue to be a significant source of competition.

- *Custom systems integration projects:* we compete with large systems integrators who may develop custom solutions for specific companies which may reduce the likelihood that they would purchase our products and services.

- *Point application vendors:* we compete with providers of stand-alone point solutions for web-based customer relationship management and traditional client/server-based, call-center service customer and sales-force automation solution providers.

In addition, recent continuing consolidation in the software industry during 2007 may indicate that we will face new competitors in the future. Within the year Oracle announced the acquisitions of Agile Software, an enterprise solutions software maker and Hyperion Software, a business performance software maker. Also in 2007, IBM acquired Palisades, a provider of lending software to companies in the mortgage industry and SAP has made an offer to purchase Business Objects. In 2006, IBM acquired Webify, a provider of middleware to companies primarily in the insurance industry. In January 2006, Oracle acquired Siebel Systems, Inc., a maker of customer relationship management software products and acquired Portal Software, a provider of billing and revenue management solutions for the communications and media industry. Siebel Systems, Inc. was a competitor of ours. In September 2005, IBM had acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In 2005, Oracle acquired I-flex Solutions, Ltd., a banking software maker headquartered in Mumbai, India. While we do not believe that Agile Software, Hyperion Software, Palisades, Webify, Portal Software, DWL, or I-flex Solutions have been significant competitors of Chordiant in the past, the acquisition of these companies by Oracle and IBM may indicate that we will face increased competition from significantly larger and more established entities in the future.

Many of our competitors have greater resources and broader customer relationships than we do. In addition, many of these competitors have extensive knowledge of our industry. Current and potential competitors have established, or

may establish, cooperative relationships among themselves or with third parties to offer a single solution and to increase the ability of their products to address customer needs.

We may experience a shortfall in bookings, revenue, earnings, cash flow or otherwise fail to meet public market expectations, which could materially and adversely affect our business and the market price of our common stock.

Our revenues and operating results may fluctuate significantly because of a number of factors, many of which are outside of our control. Some of these factors include:

- Size and timing of individual license transactions;
- Delay or deferral of customer implementations of our products and subsequent impact on revenues;
- Lengthening of our sales cycle;

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- Potential deterioration and changes in domestic and foreign markets and economies;
- Success in expanding our global services organization, direct sales force and indirect distribution channels;
- Timing of new product introductions and product enhancements;
- Appropriate mix of products licensed and services sold;
- Levels of international transactions;
- Activities of and acquisitions by competitors;
- Product and price competition; and
- Our ability to develop and market new products and control costs.

One or more of the foregoing factors may cause our operating expenses to be disproportionately high during any given period or may cause our revenues and operating results to fluctuate significantly. Based upon the preceding factors, we may experience a shortfall in revenues and earnings or otherwise fail to meet public market expectations, which could materially and adversely affect our business, financial condition, results of operations and the market price of our common stock.

Our operating results and cash flows fluctuate significantly and delays in delivery or implementation of our products or changes in the payment terms with customers may cause unanticipated declines in revenues or cash flow, which could disappoint investors and result in a decline in our stock price.

Our quarterly revenues depend primarily upon product implementation by our customers. We have historically recognized a significant portion of our license and services revenue through the percentage-of-completion method, using labor hours incurred as the measure of progress towards completion of implementation of our products and we expect this practice to continue. The percentage of completion accounting method requires ongoing estimates of progress of complicated and frequently changing technology projects. Documenting the measure of progress towards completion of implementation is subject to potential errors and changes in estimates. As a result, even minor errors or minor changes in estimates may lead to significant changes in accounting results which may be revised in later quarters due to subsequent information and events. Thus, delays or changes in customer business goals or direction when implementing our software may adversely impact our quarterly revenue. Additionally, we may increasingly enter into term, subscription or transaction based licensing transactions that would cause us to recognize license revenue for such transactions over a longer period of time than we have historically experienced for our perpetual licenses. In addition, a significant portion of new customer orders have been booked in the third month of each calendar quarter, with many of these bookings occurring in the last two weeks of the third month. We expect this trend to continue and, therefore, any failure or delay in bookings would decrease our quarterly revenue and cash flows. The terms and conditions of individual license agreements with customers vary from transaction to transaction. Historically, the Company has been able to obtain prepayments for product in some cases. Other transactions link payment to the delivery or acceptance of products. If we are unable to negotiate prepayments of fees our cash flows and financial ratios with respect to accounts receivable would be adversely impacted. If our revenues, operating margins or cash flows are below the expectations of the investment community, our stock price is likely to decline.

If we fail to maintain and expand our relationships with systems integrators and other business partners, our ability to develop, market, sell, and support our products may be adversely affected.

Our development, marketing and distribution strategies rely on our ability to form and maintain long-term strategic relationships with systems integrators, in particular, our existing business alliance partners, IBM, and Accenture. These business relationships often consist of joint marketing programs, technology partnerships and resale and distribution arrangements. Although most aspects of these relationships are contractual in nature, many important aspects of these relationships depend on the continued cooperation between the parties. Divergence in strategy, change in focus, competitive product offerings or potential contract defaults may interfere with our ability to develop, market, sell, or support our products, which in turn could harm our business. If either IBM or Accenture were to terminate their agreements with us or our relationship were to deteriorate, it could have a material adverse effect on our business, financial condition and results of operations. In many cases, these parties have extensive relationships with our existing and potential customers and influence the decisions of these customers. A number of our competitors have stronger relationships with IBM and Accenture and, as a result, these systems integrators may be more likely to recommend competitors' products and services. In addition, in September 2005, IBM had acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In 2006, IBM acquired Webify, a

provider of middleware to companies primarily in the insurance industry. In 2007, IBM acquired Palisades, a provider of lending software to companies in the mortgage industry and SAP has made an offer to purchase Business Objects. While we do not believe that either DWL, Webify, or Palisades had been a direct competitor of Chordiant in the past, IBM's acquisition of DWL, Webify, and Palisades may indicate that IBM will become a competitor of ours in the future. While the Company currently has a good relationship with IBM, this relationship and the Company's strategic relationship agreement with IBM may be harmed if the Company increasingly finds itself competing with IBM. Our relationships with systems integrators and their willingness to recommend our products to their customers could be harmed if the Company were to be subject to a take over attempt from a competitor of such systems integrators.

If systems integrators fail to properly implement our software, our business, reputation and financial results may be harmed.

We are increasingly relying on systems integrators to implement our products, and this trend may continue. As a result, we have less quality control over the implementation of our software with respect to these transactions and are more reliant on the ability of our systems integrators to correctly implement our software. If these systems integrators fail to properly implement our software, our business, reputation and financial results may be harmed.

Our primary products have a long sales and implementation cycle, which makes it difficult to predict our quarterly results and may cause our operating results to vary significantly.

The period between initial contact with a prospective customer and the implementation of our products is unpredictable and often lengthy, ranging from approximately three to twenty-four months. Thus, revenue and cash receipts could vary significantly from quarter to quarter. Any delays in the implementation of our products could cause reductions in our revenues. The licensing of our products is often an enterprise-wide decision that generally requires us to provide a significant level of education to prospective customers about the use and benefits of our products. The implementation of our products involves significant commitment of technical and financial resources and is commonly associated with substantial implementation efforts that may be performed by us, by the customer or by third party systems integrators. If we underestimate the resources required to meet the expectations we have set with a customer when we set prices, then the timing of revenue could be impacted. If this happens with a large customer engagement, then this could have a material adverse effect on our financial results. Customers generally consider a wide range of issues before committing to purchase our products, including product benefits, ability to operate with existing and future computer systems, vendor financial stability and longevity, ability to accommodate increased transaction volume and product reliability.

If we do not maintain effective internal controls over financial reporting, investors could lose confidence in our financial reporting and customers may delay purchasing decisions, which would harm our business and the market price of our common stock.

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our business could be harmed. We are a complex company with complex accounting issues and thus subject to related risks of errors in financial reporting which may cause problems in corporate governance, the costs of which may outweigh the costs of the underlying errors themselves. For example, the Audit Committee of the Company's Board of Directors, with the assistance of outside legal counsel, conducted a review of our stock option practices covering the time from the Company's initial public offering in 2000 through September 2006. The Audit Committee reached a conclusion that incorrect measurement dates were used for financial accounting purposes for stock option grants in certain prior periods. As a result, the Company has recorded additional non-cash stock-based compensation expense, and related tax effects, related to stock option grants and concluded that a material weakness surrounding the control activities relating to the stock option grants existed at September 30, 2006. To correct these accounting errors, we restated the consolidated financial statements contained in our Annual Report on Form 10-K for

the year ended September 30, 2006 and our Quarterly Report on Form 10-Q for the three months ended June 30, 2006. As a result of this need to restate financial statements, management and the Audit Committee determined that material weaknesses in our internal control over financial reporting existed as of September 30, 2006. These material weaknesses have contributed to increased expenses and efforts required for our financial reporting.

If we are not successful in implementing effective internal controls over financial reporting, customers may delay purchasing decisions or we may lose customers, create investor uncertainty, face litigation and the market price of our common stock may decline. For more information, please refer to the discussion under the heading "Item 9A. Controls and Procedures" in the 2006 Annual Report on Form 10-K.

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If we are not able to successfully manage our partner operations in India, our operations and financial results may be adversely affected.

In fiscal year 2003, we entered into an agreement with Ness Technologies Inc., Ness USA Inc. (formerly Ness Global Services, Inc.) and Ness Technologies India, Ltd. (collectively, "Ness"), an independent contracting company with global technical resources and an operations center in Bangalore, India and operations in other locations. The agreement provides for Ness, at our direction, to attract, train, assimilate and retain sufficient highly qualified personnel to perform staffing for consulting projects, technical support, product test and certain sustaining engineering functions. As of September 30, 2007, we use the services of approximately 146 consultants through Ness. In addition, as a result of the reduction in our workforce that took place in July 2005, and the reduction in our workforce that took place in October 2006, by approximately 10% in each instance, we are now more dependent on Ness. The expansion of this agreement is an important component of our strategy to address the business needs of our customers and manage our expenses. The success of this operation will depend on our ability and Ness's ability to attract, train, assimilate and retain highly qualified personnel in the required periods. A disruption of our relationship with Ness could adversely affect our operations. Failure to effectively manage the organization and operations will harm our business and financial results.

If our products do not operate effectively in a company-wide environment, we may lose sales and suffer decreased revenues.

If existing customers have difficulty deploying our products or choose not to fully deploy our products, it could damage our reputation and reduce revenues. Our success requires that our products be highly scalable, and able to accommodate substantial increases in the number of users. Our products are expected to be deployed on a variety of computer software and hardware platforms and to be used in connection with a number of third party software applications by personnel who may not have previously used application software systems or our products. These deployments present very significant technical challenges, which are difficult or impossible to predict. If these deployments do not succeed, we may lose future sales opportunities and suffer decreased revenues. If we underestimate the resources required to meet the expectations we have set with a customer when we set prices, then the timing of revenue could be impacted. If this happens with a large customer engagement then this could have a material adverse effect on our financial results.

Defects in our products could diminish demand for our products and result in decreased revenues, decreased market acceptance and injury to our reputation.

Errors may be found from time-to-time in our new, acquired or enhanced products. Any significant software errors in our products may result in decreased revenues, decreased sales, and injury to our reputation and/or increased warranty and repair costs. Although we conduct extensive product testing during product development, we have in the past discovered software errors in our products as well as in third party products, and as a result have experienced delays in the shipment of our new products.

Because competition for qualified personnel is intense, we may not be able to retain or recruit personnel, which could impact the development and sales of our products.

If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or fail to reach expected levels of productivity, our ability to develop and market our products will be weakened. Our success depends largely on the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel. In particular in prior years, we have had significant turnover of our executives as well in our sales, marketing and finance organizations and many key positions are held by people who have less than two years of experience in their roles with one Company. If these people are not well suited to their

new roles, then this could result in the Company having problems in executing its strategy or in reporting its financial results. Because of the dependency on a small number of large deals, we are uniquely dependent upon the talents and relationships of a few executives and have no guarantee of their retention. Changes in key sales management could affect our ability to maintain existing customer relationships or to close pending transactions. We have been targeted by recruitment agencies seeking to hire our key management, finance, engineering, sales and marketing and professional services personnel. In addition, in July 2005 and again in October of 2006, we reduced the size of our workforce by approximately 10% in each instance, which may have a negative effect on our ability to attract and retain qualified personnel.

To date, our sales have been concentrated in the banking, insurance, healthcare, and telecommunications markets, and if we are unable to continue sales in these markets or successfully penetrate new markets, or if these industries reduce their spending in reaction to the difficulties in the subprime lending market, our revenues may decline.

Sales of our products and services in five large markets—banking, insurance, healthcare, telecommunications and retail markets accounted for approximately 99% and 96 % of our total revenues for the year ended September 30, 2007 and 2006, respectively. We expect that revenues from these five markets will continue to account for a substantial portion of our total revenues for the foreseeable future. If we are unable to successfully increase penetration of our existing markets or achieve sales

in additional markets, or if the overall economic climate of our target markets deteriorates, our revenues may decline. Some of our current or prospective customers, especially those in the banking and insurance industries are in businesses that have or could have exposure, directly or indirectly, to the residential mortgage sector or homebuilder sector which has recently been facing financial difficulties. If this causes our current or prospective customers to reduce their spending on technology, then this could have an adverse impact on our sales and revenues

Low gross margin in services revenues could adversely impact our overall gross margin and operating results.

Our services revenues have had lower gross margins than our license revenues. Service revenues comprised 57% and 58% of our total revenues for the year ended September 30, 2007 and 2006, respectively. Gross margin on service revenues was 57% and 46% for the year ended September 30, 2007 and 2006, respectively. License revenues comprised 43% and 42% of our total revenues for the years ended September 30, 2007 and 2006, respectively. Gross margins on license revenues were 97% and 96% for the years ended September 30, 2007 and 2006, respectively.

As a result, an increase in the percentage of total revenues represented by services revenues, or an unexpected decrease in license revenues, could have a detrimental impact on our overall gross margins. An increase to services revenues would require us to expand our services organization, successfully recruit and train a sufficient number of qualified services personnel, enter into new implementation projects and obtain renewals of current maintenance contracts by our customers. Such an expansion could further reduce gross margins in our services revenues.

We may not have the workforce necessary to support our platform of products if demand for our products substantially increased, and, if we need to rebuild our workforce in the future, we may not be able to recruit personnel in a timely manner, which could adversely impact the development and sales of our products which would directly impact our operating results.

In July 2005 and again in October of 2006, we reduced the size of our workforce by approximately 10% in each instance. In the event that demand for our products increases, we may need to rebuild our workforce or increase outsourced functions to companies based in foreign jurisdictions and we may be unable to hire, train or retain qualified personnel in a timely manner, which may weaken our ability to market our products in a timely manner, adversely impacting our operations. Our success depends largely on ensuring that we have adequate personnel to support our platform of products as well as the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel.

If we fail to introduce new versions and releases of functional and scalable products in a timely manner, customers may license competing products and our revenues may decline.

If we are unable to ship or implement enhancements to our products when planned, or fail to achieve timely market acceptance of these enhancements, we may suffer lost sales and could fail to achieve anticipated revenues. We have in the past, and expect in the future, to derive a significant portion of our total revenues from the license of our primary product suite. Our future operating results will depend on the demand for the product suite by future customers, including new and enhanced releases that are subsequently introduced. If our competitors release new products that are superior to our products in performance or price, or if we fail to enhance our products or introduce new features and functionality in a timely manner, demand for our products may decline and we may not be able to recover our R&D expenditures from such products. We have in the past experienced delays in the planned release dates of new versions of our software products and upgrades. New versions of our products may not be released on schedule or may contain defects when released.

We depend on technology licensed to us by third parties, and the loss or inability to maintain these licenses could prevent or delay sales of our products.

We license from several software providers technologies that are incorporated into our products. We anticipate that we will continue to license technology from third parties in the future. This software may not continue to be available on commercially reasonable terms, if at all. While currently we are not materially dependent on any single third party for such licenses, the loss of the technology licenses could result in delays in the license of our products until equivalent technology is developed or identified, licensed and integrated into our products. Even if substitute technologies are available, there can be no guarantee that we will be able to license these technologies on commercially reasonable terms, if at all.

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

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functionality of our products, delay new product introductions or injure our reputation. In the past, while our business has not been materially harmed, product releases have been delayed as a result of errors in third party software and we have incurred significant expenses fixing and investigating the cause of these errors.

Our customers and systems integration partners may have the ability to alter our source code and resulting inappropriate alterations could adversely affect the performance of our products, cause injury to our reputation and increase operating expenses.

Customers and systems integration partners may have access to the computer source code for certain elements of our products and may alter the source code. Alteration of our source code may lead to implementation, operation, technical support and upgrade problems for our customers. This could adversely affect the market acceptance of our products, and any necessary investigative work and repairs could cause us to incur significant expenses and delays in implementation.

If our products do not operate with the hardware and software platforms used by our customers, our customers may license competing products and our revenues will decline.

If our products fail to satisfy advancing technological requirements of our customers and potential customers, the market acceptance of these products could be reduced. We currently serve a customer base with a wide variety of constantly changing hardware, software applications and networking platforms. Customer acceptance of our products depends on many factors such as:

- Our ability to integrate our products with multiple platforms and existing or legacy systems; and,
- Our ability to anticipate and support new standards, especially Internet and enterprise Java standards.

A failure in our initial attempt to deploy our software through a Software as a Service (SaaS) model could cause injury to our reputation and impair our ability to develop, market and sell our products under a SaaS model.

We recently entered into a license with a third party that will allow that third party to develop and host in their data centers, applications based on our software to provide services to their customers, most of whom are in markets that we do not currently penetrate. As we have no previous experience in deploying our software in a SaaS model, a failure of this effort could have a detrimental effect to our ability to attract other third parties to use our software in their SaaS businesses.

Our failure to successfully integrate with future acquired or merged companies and technologies could prevent us from operating efficiently.

Our business strategy includes pursuing opportunities to grow our business, both through internal growth and through merger, acquisition and technology and other asset transactions. To implement this strategy, we may be involved in merger and acquisition activity and additional technology and asset purchase transactions. Merger and acquisition transactions are motivated by many factors, including, among others, our desire to grow our business, acquire skilled personnel, obtain new technologies and expand and enhance our product offerings. Growth through mergers and acquisitions has several identifiable risks, including difficulties associated with successfully integrating distinct businesses into new organizations, the substantial management time devoted to integrating personnel, technology and entire companies, the possibility that we might not be successful in retaining the employees, undisclosed liabilities, the failure to realize anticipated benefits (such as cost savings and synergies) and issues related to integrating acquired technology, merged/acquired companies or content into our products (such as unanticipated expenses). Realization of

any of these risks in connection with any technology transaction or asset purchase we have entered into, or may enter into, could have a material adverse effect on our business, operating results, cash balances, and financial condition.

If we become subject to intellectual property infringement claims, including patent infringement claims, these claims could be costly and time-consuming to defend, divert management's attention, cause product delays and have an adverse effect on our revenues and net income.

We expect that software product developers and providers of software in markets similar to our target markets will increasingly be subject to infringement claims as the number of products and competitors in our industry grows and the functionality of products overlap. Any claims, with or without merit, could be costly and time-consuming to defend, divert our management's attention or cause product delays. If any of our products were found to infringe a third party's proprietary rights, we could be required to enter into royalty or licensing agreements to be able to sell our products. Royalty and licensing agreements, if required, may not be available on terms acceptable to us or at all.

In particular, if we were sued for patent infringement by a patent holding company, one which has acquired large numbers of patents solely for the purpose of bringing suit against alleged infringers rather than practicing the patents, it may be costly to

defend such a suit. We have received a letter from one such patent holding company alleging that our products may infringe one or more of their patents. If any of our products were found to infringe such patent, the patent holder could seek an injunction to enjoin our use of the infringing product. If we were not able to remove or replace the infringing portions of software with non-infringing software, and were no longer able to license some or all of our software products, such an injunction would have an extremely detrimental effect on our business. If we were required to settle such claim, it could be extremely costly. A patent infringement claim could have a material adverse effect on our business, operating results and financial condition.

The application of percentage of completion and completed contract accounting to our business is complex and may result in delays in the reporting of our financial results and revenue not being recognized as we expect.

Although we attempt to use standardized license agreements designed to meet current revenue recognition criteria under generally accepted accounting principles, we must often negotiate and revise terms and conditions of these standardized agreements, particularly in multi-product transactions. At the time of entering into a transaction, we assess whether any services included within the arrangement require us to perform significant implementation or customization essential to the functionality of our products. For contracts involving significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenues using the percentage-of-completion method using labor hours incurred as the measure of progress towards completion. The application of the percentage of completion method of accounting is complex and involves judgments and estimates, which may change significantly based on customer requirements. This complexity combined with changing customer requirements could result in delays in the proper determination of our percentage of completion estimates and revenue not being recognized as we expect.

We have also entered into co-development projects with our customers to jointly develop new vertical applications, often over the course of a year or longer. In such cases we may only be able to recognize revenue upon delivery of the new application. The accounting treatment for these co-development projects could result in delays in the recognition of revenue. The failure to successfully complete these projects to the satisfaction of the customer could have a material adverse effect on our business, operating results and financial condition.

Changes in our revenue recognition model could result in short term declines to revenue.

Historically, a high percentage of license revenues have been accounted for on the percentage of completion method of accounting or recognized as revenue upon the delivery of product. If we were to enter into new types of transactions accounted for on a subscription or term basis, revenues might be recognized over a longer period of time. The impact of this change would make revenue recognition more predictable over the long term, but it might also result in a short term reduction of revenue as the new transactions took effect.

We may identify material weaknesses relating to internal control over financial reporting in the future, which may result in additional expenses and diversion of management’s time as a result of performing future system and process evaluation, testing and remediation required to comply with future management assessment and auditor attestation requirements.

In connection with the Company’s compliance with Section 404 under SOX for the fiscal years ended September 30, 2006 and 2005, we identified certain material weaknesses. In future periods, we will continue to document our internal controls to allow management to report on, and our independent registered public accounting firm to attest to, our internal control, over financial reporting as required by Section 404 of SOX, within the time frame required by Section 404. In the future, we may incur additional expenses and diversion of management’s time as a result of performing the system and process evaluation, testing and remediation required to comply with management’s assessment and auditor attestation requirements. If we are not able to timely comply with the requirements set forth in

Section 404 in future periods, we might be subject to sanctions or investigation by the regulatory authorities. Any such action could adversely affect our business or financial results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located in offices that are approximately 25,000 square feet in Cupertino, California pursuant to an office lease expiring in December 2008. We also lease office space in Mahwah, New Jersey and Bedford, New Hampshire. Outside of the United States, we have offices in the greater metropolitan areas of London, Madrid, Amsterdam, and Munich. We believe our existing facilities meet our current needs and that we will be able to obtain additional commercial space as needed.

ITEM 3. LEGAL PROCEEDINGS

Beginning in July 2001, the Company and certain of our officers and directors, or Individuals, were named as defendants in a series of class action stockholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, “In re Chordiant Software, Inc. Initial Public Offering Securities Litigation, Case No. 01-CV-6222”. In the amended complaint, filed in April 2002, the plaintiffs allege that the Company, the Individuals, and the underwriters of our initial public offering, or IPO, violated section 11 of the Securities Act of 1933 and section 10(b) of the Exchange Act of 1934 based on allegations that our registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, our IPO underwriters. The complaint also contains claims against the Individuals for control person liability under Securities Act section 15 and Exchange Act section 20. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies, or Issuers, that conducted IPO’s of their common stock in the late 1990’s or in the year 2000 (collectively, the “IPO Lawsuits”).

In August 2001, all of the IPO Lawsuits were consolidated for pretrial purposes before United States Judge Shira Scheindlin of the Southern District of New York. In July 2002, the Company joined in a global motion to dismiss the IPO Lawsuits filed by all of the Issuers (among others). In October 2002, the Court entered an order dismissing the Individuals from the IPO Lawsuits without prejudice, pursuant to an agreement tolling the statute of limitations with respect to the Individuals. In February 2003, the court issued a decision denying the motion to dismiss against Chordiant and many of the other Issuers.

In June 2003, Issuers and plaintiffs reached a tentative settlement agreement that would, among other things, result in the dismissal with prejudice of all claims against the Issuers and Individuals in the IPO Lawsuits, and the assignment to plaintiffs of certain potential claims that the Issuers may have against the underwriters. The tentative settlement also provides that, in the event that plaintiffs ultimately recover less than a guaranteed sum of $1 billion from the IPO underwriters, plaintiffs would be entitled to payment by each participating Issuer’s insurer of a pro rata share of any shortfall in the plaintiffs’ guaranteed recovery. In September 2003, in connection with the possible settlement, those Individuals who had entered tolling agreements with plaintiffs (described above) agreed to extend those agreements so that they would not expire prior to any settlement being finalized. In June 2004, Chordiant and almost all of the other Issuers entered into a formal settlement agreement with the plaintiffs. On February 15, 2005, the Court issued a decision certifying a class action for settlement purposes, and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. On August 31, 2005, the Court reaffirmed class certification and preliminary approval of the modified settlement in a comprehensive Order, and directed that Notice of the settlement be published and mailed to class members beginning November 15, 2005. On February 24, 2006, the Court dismissed litigation filed against certain underwriters in connection with the claims to be assigned to the

plaintiffs under the settlement. On April 24, 2006, the Court held a Final Fairness Hearing to determine whether to grant final approval of the settlement. On December 5, 2006, the Second Circuit Court of Appeals vacated the lower Court's earlier decision certifying as class actions the six IPO Lawsuits designated as "focus cases." Thereafter, the District Court ordered a stay of all proceedings in all of the IPO Lawsuits pending the outcome of plaintiffs' petition to the Second Circuit for rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit denied plaintiffs' rehearing petition, holding that the actions could not be maintained as pled but clarifying that the plaintiffs may seek to certify a more limited class in the District Court. Accordingly, the settlement as originally negotiated will not be finally approved. Plaintiffs had until July 31, 2007 in which to file amended complaints against all Issuers, including Chordiant.

Plaintiffs filed amended complaints in the six focus cases on or about August 14, 2007. In September 2007, the Company's named officers and directors again extended the tolling agreement with plaintiffs. On or about September 27, 2007, plaintiffs moved to certify the classes alleged in the focus cases and to appoint class representatives and class counsel in those cases. On or about November 13, 2007, Issuers in the focus cases filed a motion to dismiss the claims alleged against them in the amended complaints. This action may divert the efforts and attention of our management and, if determined adversely to us, could have a material impact on our business, results of operations, financial condition or cash flows.

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On August 1, 2006, a stockholder derivative complaint was filed in the United States District Court for the Northern District of California by Jesse Brown under the caption Brown v. Kelly, et al. Case No. C06-04671 JW (N.D. Cal.). On September 13, 2006, a second stockholder derivative complaint was filed in the United States District Court for the Northern District of California by Louis Suba under the caption Suba v. Kelly et al., Case No. C06-05603 JW (N.D. Cal.). Both complaints were brought purportedly on behalf of the Company against certain current and former officers and directors. On November 27, 2006, the court entered an order consolidating these actions and requiring the plaintiffs to file a consolidated complaint. The consolidated complaint was filed on January 11, 2007. The consolidated complaint alleges, among other things, that the named officers and directors: (a) breached their fiduciary duties as they colluded with each other to backdate stock options, (b) violated section 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder through their alleged actions, and (c) were unjustly enriched by their receipt and retention of such stock options. On May 21, 2007, the Company filed a motion to dismiss the entire action on the grounds that the plaintiffs failed to take the steps necessary to bring a derivative action. The individual defendants filed motions to dismiss as well. The parties have agreed that the plaintiffs' opposition to the motions to dismiss would not be due until October 25, 2007, in order to permit the parties an opportunity to explore a resolution of this dispute. The hearing on the motion to dismiss is set for November 26, 2007. The Plaintiffs have recently informed Chordiant that they intend to file an amended derivative complaint. This will render the currently filed motion to dismiss moot and a new motion to dismiss will have to be filed in response to the amended pleading. The parties have stipulated to a schedule for filing the amended complaint and for briefing motions to dismiss, but the court has not yet entered this stipulation as an order.

In September 2006, the Company received a letter from Acacia Technologies Group, a patent holding company, suggesting that the Company may be infringing on two patents, designated by United States Patent Numbers 5,537,590 and 5,701,400, which are held by one of their patent licensing and enforcement subsidiaries. The Company is currently reviewing the validity of these patents and whether the Company’s products may infringe upon them. The Company has not formed a view of whether the Company may have liability for infringement of these patents. Any related claims, whether or not they have merit, could be costly and time-consuming to defend, divert our management’s attention or cause product delays. If any of our products were found to infringe such patents, the patent holder could seek an injunction to enjoin our use of the infringing product. If the Company was required to settle such a claim, it could have a material impact on our business, results of operations, financial condition or cash flows.

The Company is also subject to various other claims and legal actions arising in the ordinary course of business. The ultimate disposition of these various other claims and legal actions is not expected to have a material effect on our business, financial condition, results of operations or cash flows. However, litigation is subject to inherent uncertainties.

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

None.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq Global Market under the symbol "CHRD." The following table shows, for the periods indicated, the high and low per share sales prices of our common stock, as reported by the NASDAQ Global Market. The prices appearing in the tables below reflect over-the-counter market quotations, which reflect inter-dealer prices, without retail mark-up, markdown or commission and may not necessarily represent actual transactions. The high and low per share prices reflects the 1 for 2.5 reverse stock split on February 20, 2007.

	High		Low	
Year Ended September 30, 2007				
First Quarter (October 1 - December 31)	$	8.27	$	6.95
Second Quarter (January 1 - March 31)	$	10.35	$	7.82
Third Quarter (April 1 - June 30)	$	16.02	$	10.37
Fourth Quarter (July 1 - September 30)	$	16.25	$	12.94
Year Ended September 30, 2006				
First Quarter (October 1 - December 31)	$	7.50	$	6.22
Second Quarter (January 1 - March 31)	$	8.82	$	6.40
Third Quarter (April 1 - June 30)	$	9.00	$	7.15
Fourth Quarter (July 1 - September 30)	$	8.00	$	5.72

As of October 31, 2007, there were approximately 194 holders of record of our common stock who together held approximately 204,362 shares of our common stock. The remainder of our outstanding shares is held by brokers and other institutions on behalf of stockholders. We have never paid or declared any cash dividends and do not intend to pay dividends for the foreseeable future. We currently expect to retain working capital for use in the operation and expansion of our business and therefore do not anticipate paying any cash dividends.

In response to the SEC's adoption of Rule 10b5-1 under the Securities Exchange Act of 1934, we approved amendments to our insider trading policy on July 20, 2001 to permit our directors, executive officers and certain key employees to enter into trading plans or arrangements for systematic trading in our securities. We have been advised that certain of our directors, officers and key employees have entered into trading plans for selling shares in our securities. As of September 30, 2007, the directors and executive officers who have entered into trading plans include Derek Witte, Frank Florence, and James D. St. Jean. We anticipate that, as permitted by Rule 10b5-1 and our insider trading policy, some or all of our directors, executive officers and employees may establish trading plans at some date in the future.

Securities Authorized for Issuance Under Equity Compensation Plans

Information regarding our equity compensation plans, including both stockholder approved plans and non-stockholder approved plans, will be contained in our definitive Proxy Statement with respect to our Annual Meeting of Stockholders under the caption "Equity Compensation Plan Information," and is incorporated by reference into this report.

Recent Sales of Unregistered Securities

None.

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PERFORMANCE MEASUREMENT COMPARISON

The following graph shows the five-year cumulative total stockholder return of an investment of $100 in cash on September 30, 2002 for:

(i) Our common stock;

(ii) The Nasdaq Stock Market (U.S.) Index;

(iii) The Standard & Poor's Application Software Index.

Historic stock price performance is not necessarily indicative of future stock price performance. All values assume reinvestment of the full amount of all dividends, of which there were none, and are calculated as of September 30 of each year.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

We derived the selected financial data as of September 30, 2007 and 2006 and for the years ended September 30, 2007, 2006, and 2005 from our audited consolidated financial statements and notes thereto appearing in this Form 10-K. We derived the selected financial data as of September 30, 2005 and for the nine-months ended September 30, 2004 from our 2006 Consolidated Financial Statements in the 2006 Annual Report on Form 10-K. The consolidated statements of operations data for the year ended December 31, 2003 and the consolidated balance sheets as of September 30, 2004 and December 31, 2003 have been restated to conform to the restated consolidated financial statements and are presented herein on an unaudited basis. The following selected financial data set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related notes thereto included in Item 8 of this Annual Report on Form 10-K to fully understand factors that may affect the comparability of the information presented below. The financial data below reflects the 1 for 2.5 reverse stock split on February 20, 2007.

	Years Ended September 30,			Nine Months Ended September 30,	Year Ended December 31,
	2007	2006	2005	2004	2003 (unaudited)
	(amounts in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues	$ 124,547	$ 97,536	$ 83,725	$ 61,023	$ 68,266
Net income (loss)	6,028	(16,001)	(19,865)	(1,371)	(17,932)
Net income (loss) per share—basic	0.19	(0.51)	(0.67)	(0.05)	(0.76)
Net income (loss) per share—diluted	$ 0.18	$ (0.51)	$ (0.67)	$ (0.05)	$ (0.76)
Weighted average shares used in computing net income (loss) per share—basic	32,425	31,073	29,780	27,904	23,741
Weighted average shares used in computing net income (loss) per share—diluted	33,261	31,073	29,780	27,904	23,741

	As of September 30,				As of December 31,
	2007	2006	2005	2004 (unaudited)	2003 (unaudited)
	(amounts in thousands)				

Consolidated Balance Sheets Data:					
Cash, cash equivalents, and marketable securities	$ 90,146	$ 45,278	$ 38,546	$ 59,748	$ 36,399
Working capital	56,447	22,323	23,733	46,296	19,480
Total assets	164,815	111,503	107,250	115,340	83,811
Current and long term portion of capital lease obligations	—	95	309	508	—
Short-term and long-term deferred revenue	67,982	29,505	26,197	20,581	18,396
Stockholders' equity	$ 73,361	$ 57,225	$ 65,157	$ 75,912	$ 48,350

No dividends have been paid or declared since our inception. Effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards, or SFAS, No. 142, or SFAS 142, “Goodwill and Other Intangible Assets,” and ceased amortizing goodwill balances. Effective October 1, 2005, the Company adopted SFAS No. 123R as more fully described in Note 2 to the Consolidated Financial Statements contained in this Annual Report.

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

Safe Harbor

The following discussion and analysis contains forward-looking statements. These statements are based on our current expectations, assumptions, estimates and projections about our business and our industry, and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's results, levels of activity, performance or achievement to be materially different from any future results, levels of activity, performance or achievements expressed or implied in or contemplated by the forward-looking statements. Words such as "believe," "anticipate," "expect," "intend," "plan," "will," "may," "should," "estimate," "predict," "guidance," "potential," "continue" or the negative of such terms or other similar expressions, identify forward-looking statements. Our actual results and the timing of events may differ significantly from those discussed in the forward-looking statements as a result of various factors, including but not limited to, those discussed in Item 1 of this Form 10-K under the caption "Risk Factors" and those discussed elsewhere in this Annual Report and in our other filings with the Securities and Exchange Commission. Chordiant undertakes no obligation to update any forward-looking statement to reflect events after the date of this report.

Reverse Stock Split

On December 13, 2006, Chordiant's Board of Directors approved a reverse two and a half to one stock split. On February 15, 2007 at a special meeting, stockholders approved the reverse stock split such that each outstanding two and one half (2.5) shares of common stock were combined into and became one (1) share of common stock. The reverse stock split was effective February 20, 2007. All share and per share amounts in this form 10-K has been retroactively adjusted to reflect the reverse stock split for all periods presented.

Executive Overview

As an enterprise software vendor, we generate substantially all of our revenues from the banking, insurance, healthcare, telecommunications, and retail industries. Our customers typically fund purchases of our software and services out of their lines of business and information technology budgets. As a result, our revenues are heavily influenced by our customers' long-term business outlook and willingness to invest in new enterprise information systems and business applications.

In fiscal year 2007, we recorded revenue of $124.5 million. In fiscal year 2007, we generated $6.0 million of net income and ended the fiscal year with over $90.1 million in cash, cash equivalents and marketable securities as compared to $45.3 million for the year ended September 30, 2006.

Total revenue for the year ended September 30, 2007 increased 28% to $124.5 million from $97.5 million of the prior year. The growth in revenue was evenly distributed between license and service revenue, each increasing by $13.5 million. The increase in license revenue was primarily driven by an increase in the transaction size of license transactions in excess of $1 million as compared to the prior year. The increase in service revenue was primarily composed of an increase in consulting revenue of $5.2 million, an increase in support and maintenance revenue of $8.9 million and an increase of $0.5 million in expense reimbursement revenue offset by a decrease in training revenue of $1.0 million.

In the past an increase in license revenue has resulted in a related increase in consulting revenue as our customers request us to assist with their implementation efforts. The increase in support and maintenance revenue is expected to continue if we are able to add new licenses to our existing base of licenses at a rate greater than customers opting not

to renew their annual support and maintenance contracts.

Software Industry Consolidation and Possible Increased Competition

The software industry in general is continuing to undergo a period of consolidation, and there has been recent consolidation in sectors of the software industry in which we operate. Within the year Oracle announced the acquisitions of Agile Software, an enterprise solutions software maker and Hyperion Software, a business performance software maker. Also in 2007, IBM acquired Palisades, a provider of lending software to companies in the mortgage industry and SAP has made an offer to purchase Business Objects. In 2006, IBM acquired Webify, a provider of middleware to companies primarily in the insurance industry. In January 2006, Oracle acquired Siebel Systems, Inc., a maker of customer relationship management software products and acquired Portal Software, a provider of billing and revenue management solutions for the communications and media industry. Siebel Systems, Inc. was a competitor of ours. In September 2005, IBM had acquired DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In 2005, Oracle acquired I-flex Solutions, Ltd., a banking software maker headquartered in Mumbai, India. While we do not believe that Agile Software, Hyperion Software, Palisades, Webify, Portal Software, DWL, or I-flex Solutions have been significant competitors of Chordiant in the past, the acquisition of these companies by Oracle and IBM may indicate that we will face increased competition from larger and more established entities in the future.

Financial Trends

Backlog. An increasingly material portion of our revenues have been derived from large customer transactions. For some of these transactions, the associated professional services provided to the customer can span over a period greater than one year. If the services delivery period is over a prolonged period of time, it will cause the associated backlog to be recognized as revenue over a similar period of time. As of September 30, 2007 and 2006, we had approximately $75.4 million and $36.0 million in backlog, respectively, which we define as contractual commitments by our customers through purchase orders or contracts. This increase in backlog is partially reflected in the growth of deferred revenue recorded on our balance sheet. For the period ended September 30, 2006 to September 30, 2007 deferred revenue increased $38.4 million due to an increase of $20.6 million in short-term deferred revenue and a $17.8 million increase in long-term deferred revenue. The increase in long-term deferred revenue was primarily driven by entering into multi-year support and maintenance contracts with our customers. Backlog is comprised of:

- software license orders for which the delivered products have not been accepted by customers or have not otherwise met all of the required criteria for revenue recognition. This component includes billed amounts classified as deferred revenue;
- deferred revenue from customer support contracts;
- consulting service orders representing the unbilled remaining balances of consulting contracts not yet completed or delivered, plus deferred consulting revenue where we have not otherwise met all of the required criteria for revenue recognition.

Backlog is not necessarily indicative of revenues to be recognized in a specified future period. There are many factors that would impact Chordiant's conversion of backlog as recognizable revenue, such as Chordiant's progress in completing projects for its customers, Chordiant's customers' meeting anticipated schedules for customer-dependent deliverables and customers increasing the scope or duration of a contract causing license revenue to be deferred for a longer period of time.

Chordiant provides no assurances that any portion of its backlog will be recognized as revenue during any fiscal year or at all, or that its backlog will be recognized as revenues in any given period. In addition, it is possible that customers from whom we expect to derive revenue from backlog will default, and as a result, we may not be able to recognize expected revenue from backlog.

For the year ended September 30, 2007, we entered into several large customer orders resulting in a significant portion of our near term license revenues being recognized under the percentage-of-completion method of accounting such that our deferred revenue balance increased. These orders will require consulting services that are essential to the functionality of the respective licenses.

Implementation by Third Parties. Over time, as our products mature and system integrators become more familiar with our products, our involvement with implementations has diminished on some projects. If this trend continues to evolve, certain agreements with customers may transition from a contract accounting model (SOP 81-1) to a more traditional revenue model whereby revenues are recorded upon delivery.

Service Revenues. Service revenues as a percentage of total revenues were 57%, 58%, and 62% for the years ended September 30, 2007, 2006, and 2005, respectively. We expect that service revenues will represent between 50% and 60% of our total revenues in the foreseeable future.

Revenues from International Customers versus North America. For all periods presented, revenues were principally derived from customer accounts in North America and Europe. For the years ended September 30, 2007, 2006, and 2005, international revenues were $58.8 million, $37.5 million, and $42.0 million or approximately 47%, 38%, and 50% of our total revenues, respectively. We believe international revenues will continue to represent a significant portion of our total revenues in future periods. The significant increase in international revenue for year ended September 30, 2007, as compared to the prior fiscal year was due to an improved economy for the region as well as an improved sales production for the region resulting from the new management team that was put in place over the past several quarters. International revenues were favorably impacted for the year ended September 30, 2007, as compared to the year ended September 30, 2006, as both the British Pound and the Euro increased in average value by approximately 9% and 8%, respectively, as compared to the U.S. Dollar. International revenues were negatively impacted for the year ended September 30, 2006, as compared to the year ended September 30, 2005, as both the British Pound and the Euro decreased in average value by less than 1% and approximately 3%, respectively, as compared to the U.S. Dollar.

For the years ended September 30, 2007, 2006, and 2005, North America revenues were $65.7 million, $60.0 million, and $41.7 million or approximately 53%, 62%, and 50% of our total revenues, respectively. As the U.S. economy has remained

strong, we have seen an increase in North America revenues. Large customers have become more willing to invest in new enterprise infrastructure projects. We believe North America revenues will continue to represent 50% to 60% of our total revenues in the future.

Gross margins. Management focuses on license and service gross margin in evaluating our financial condition and operating performance. Gross margins on license revenues were 97%, 96%, and 97% for the years ended September 30, 2007, 2006, and 2005, respectively. The changes in gross margins are primarily related to the amortization expense associated with capitalized software development costs pertaining to a banking product. We expect license gross margin on current products to range from 95% to 97% in the foreseeable future. The margin will fluctuate with the mix of products sold. Historically, the enterprise solution products have higher associated third party royalty expense than the marketing solution products and decision management products.

Gross margins on service revenues were 57%, 46%, and 42% for the years ended September 30, 2007, 2006, and 2005, respectively. The increase in gross margins for the year ended September 30, 2007 is primarily due to improved consulting services utilization rates and increased support and maintenance revenue. We expect that gross margins on service revenue to range between 55% and 60% in the foreseeable future. Margins can be negatively impacted during, and immediately following, periods in which professional service department headcounts increase, as resources are not immediately billable.

Acquisition of KiQ Limited. On December 21, 2004, we acquired KiQ Limited, a privately-held United Kingdom software company with branch offices in the Netherlands, or KiQ, specializing in the development and sales of decision management systems. The year ended September 30, 2005 includes the revenue and expense of KiQ from the acquisition date, December 21, 2004, through the end of the fiscal year, September 30, 2005. The years ended September 30, 2007 and 2006 include the revenues and expenses of KiQ for the entire fiscal year.

Costs Related to Compliance with the Sarbanes-Oxley Act of 2002. Significant professional service expenses are included in general and administrative costs relating to efforts to comply with the Sarbanes-Oxley Act of 2002. For the years ended September 30, 2007, 2006, and 2005, these costs were $1.0 million, $1.8 million, and $4.5 million, respectively. While these costs are expected to continue into the next fiscal year, the decline in amount and timing of the costs through fiscal year 2008 is uncertain as compared to the costs incurred for the year ended September 30, 2007.

Costs Related to Stock Option Investigation. Significant outside professional services are included in general and administrative costs associated with the Company's stock option investigation which began in July 2006 and was completed during the quarter ended March 31, 2007. This issue is more fully described in the in Note 3, "Restatement of Previously Issued Consolidated Financial Statements" in Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for the fiscal year ended September 30, 2006. For the year ended September 30, 2007 and 2006, these costs were $1.8 and $1.2 million, respectively. We have not incurred any additional costs since the quarter ended March 31, 2007 and do not expect to incur such costs in future periods.

Cost to Amend Eligible Options. In July 2006, our Board of Directors (the "Board") initiated a review of our historical stock option grant practices and appointed the Audit Committee to oversee the investigation. The Audit Committee determined that the correct measurement dates for a number of stock option grants made by us during the period 2000 to 2006, or Review Period, differ from the measurement dates previously used to account for such option grants. The Audit Committee identified errors related to the determination of the measurement dates for grants of options where the price of our common stock on the selected grant date was lower than the price on the actual grant date which would permit recipients to exercise these options at a lower exercise price. As such, these affected stock options are deemed, for accounting purposes, to have been granted at a discount. Based on the determination made for accounting purposes, the discounted options (for accounting purposes) may now be deemed to have been granted at a discount for

tax purposes, which may expose the holders of these impacted stock option grants to potentially adverse tax treatment under Section 409A of the Internal Revenue Code and state law equivalents. As more fully described on Form SC TO-I filed with the SEC on March 29, 2007, Chordiant offered certain optionees the opportunity to increase the exercise price of the discounted options to limit the potential adverse personal tax consequences that may apply to those stock options under Section 409A of the Internal Revenue Code and state law equivalents. On April 26, 2007, eligible optionees finalized their elections under the offer and were awarded a future cash payment equal to the price differential of the Amended Options. These payments will be treated as bonus payments. These cash payments will be approximately $0.3 million and will be paid out in January 2008. The cost of these bonus payments were fully accrued as of September 30, 2007.

Reduction in Workforce. In October 2006, the Company initiated a restructuring plan intended to align its resources and cost structure with expected future revenues. The restructuring plan included a balancing of services resources worldwide, an elimination of duplicative functions internationally, and a shift in the U.S. field organization toward a focus on domain-based sales and pre-sales teams.

The restructuring plan included an immediate reduction in positions of slightly more than ten percent of the Company's workforce, consolidation of our European facilities, and the closure of our France office. A majority of the positions eliminated were in Europe. The plan was committed to on October 24, 2006, and we began notifying employees on October 25, 2006.

We recorded a pre-tax cash restructuring expense of $6.1 million as calculated using the net present value of the related costs as required by SFAS 146. The expense was composed of $1.8 million for severance costs and $4.4 million for exiting excess facilities of which $1.0 million of the excess facility expense is associated with non-cash expenses for the write-off of leasehold improvements and the reversal of a favorable purchase price adjustment related to the France office lease. We anticipated that $5.1 million of the expense would result in cash expenditures. As of September 30, 2007, we have paid $2.7 million in cash payments and expect to pay the remaining $2.5 million during the first six months of fiscal year 2008. In November 2007, we expect to negotiate a break clause in the lease allowing for an early termination of the United Kingdom facility which will release us of any future rent liabilities subsequent to January 2008. As of September 30, 2007, we expect the current accrued restructuring balance to be sufficient in amount to cover all future rental and lease termination payments; therefore, we do not anticipate any incremental restructuring expenses to terminate this lease early. All obligations related to severance and benefits have been paid as of September 30, 2007.

In July 2005, we undertook an approximate 10% reduction in our workforce. In connection with this action, we incurred a one-time cash expense of approximately $1.0 million in the fourth quarter ended September 30, 2005 for severance benefits. As of September 30, 2007, $0.1 million of the cash charges remains outstanding.

During fiscal year 2002, we restructured several areas of the Company to reduce expenses and improve revenues. As part of this restructuring, we closed an office facility in Boston, Massachusetts and recorded an expense associated with the long-term lease which expires in January 2011. During the three months ended March 31, 2007, we completed a new sublease with a sub-lessee for the remaining term of our lease at a rate lower than that which was forecasted when the original restructuring expense was recorded in 2002. This change in estimate resulted in a $0.4 million restructuring expense for the year ended September 30, 2007.

Past Results may not be Indicative of Future Performance. We believe that period-to-period comparisons of our operating results should not be relied upon as indicative of future performance. Our prospects must be considered given the risks, expenses and difficulties frequently encountered by companies in new and rapidly evolving businesses. There can be no assurance we will be successful in addressing these risks and difficulties. Moreover, we may not achieve or maintain profitability in the future.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, we evaluate the estimates, including those related to our allowance for doubtful accounts, valuation of stock-based compensation, valuation of goodwill and intangible assets, valuation of deferred tax assets, restructuring expenses, contingencies, vendor specific objective evidence, or VSOE, of fair value in multiple element arrangements and the estimates associated with the percentage-of-completion method of accounting for certain of our revenue contracts. We base our estimates on historical experience and on various other assumptions that are believed

to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting judgments and estimates are used in the preparation of our consolidated financial statements:

- Revenue recognition, including estimating the total estimated time required to complete sales arrangements involving significant implementation or customization essential to the functionality of our products;

- Estimating valuation allowances and accrued liabilities, specifically the allowance for doubtful accounts, and assessment of the probability of the outcome of our current litigation;

- Stock-based compensation expense;

- Accounting for income taxes;

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- Valuation of long-lived and intangible assets and goodwill;
- Restructuring expenses; and
- Determining functional currencies for the purposes of consolidating our international operations.

Revenue Recognition. We derive revenues from licenses of our software and related services, which include assistance in implementation, customization and integration, post-contract customer support, training and consulting. The amount and timing of our revenue is difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in operating losses. The accounting rules related to revenue recognition are complex and are affected by interpretation of the rules and an understanding of industry practices, both of which are subject to change. Consequently, the revenue recognition accounting rules require management to make significant estimates based on judgment.

Software license revenue is recognized in accordance with Statement of Position No. 97-2 "Software Revenue Recognition," as amended by Statement of Position No. 98-9 "Software Revenue Recognition with Respect to Certain Arrangements", or collectively SOP 97-2.

For arrangements with multiple elements, we recognize revenue for services and post-contract customer support based upon the fair value VSOE of the respective elements. The fair value VSOE of the services element is based upon the standard hourly rates we charge for the services when such services are sold separately. The fair value VSOE for annual post-contract customer support is generally established with the contractual future renewal rates included in the contracts, when the renewal rate is substantive and consistent with the fees when support services are sold separately. When contracts contain multiple elements and fair value VSOE exists for all undelivered elements, we account for the delivered elements, principally the license portion, based upon the "residual method" as prescribed by SOP 97-2. In multiple element transactions where VSOE is not established for an undelivered element, we recognize revenue upon the establishment of VSOE for that element or when the element is delivered.

At the time we enter into a transaction, we assess whether any services included within the arrangement related to significant implementation or customization essential to the functionality of our products. For contracts for products that do not involve significant implementation or customization essential to the product functionality, we recognize license revenues when there is persuasive evidence of an arrangement, the fee is fixed or determinable, collection of the fee is probable and delivery has occurred as prescribed by SOP 97-2. For contracts that involve significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenue using either the percentage-of-completion method or the completed contract method as prescribed by Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Product-Type Contracts", or SOP 81-1.

The percentage-of-completion method is applied when we have the ability to make reasonably dependable estimates of the total effort required for completion using labor hours incurred as the measure of progress towards completion. The progress toward completion is measured based on the "go-live" date. We define the "go-live" date as the date the essential product functionality has been delivered or the application enters into a production environment or the point at which no significant additional Chordiant supplied professional service resources are required. Estimates are subject to revisions as the contract progresses to completion. We account for the changes as changes in accounting estimates when the information becomes known. Information impacting estimates obtained after the balance sheet date but before the issuance of the financial statements is used to update the estimates. Provisions for estimated contract losses, if any, are recognized in the period in which the loss becomes probable and can be reasonably estimated. When we sell additional licenses related to the original licensing agreement, revenue is recognized upon delivery if the project

has reached the go-live date, or if the project has not reached the go-live date, revenue is recognized under the percentage-of-completion method. We classify revenues from these arrangements as license and service revenue based upon the estimated fair value of each element using the residual method.

The completed contract method is applied when we are unable to obtain reasonably dependable estimates of the total effort required for completion. Under the completed contract method, all revenue and related costs of revenue are deferred and recognized upon completion.

For product co-development arrangements relating to software products in development prior to the consummation of the individual arrangements where we retain the intellectual property being developed and intend to sell the resulting products to other customers, license revenue is deferred until the delivery of the final product, provided all other requirements of SOP 97-2 are met. Expenses associated with these co-development arrangements are accounted for under SFAS 86 and are normally expensed as incurred as they are considered to be research and development costs that do not qualify for capitalization or deferral.

Revenue from subscription or term license agreements, which include software and rights to unspecified future products or maintenance, is recognized ratably over the term of the subscription period. Revenue from subscription or term license agreements, which include software, but exclude rights to unspecified future products and maintenance, is recognized upon delivery of the software if all conditions of recognizing revenue have been met including that the related agreement is non-cancelable, non-refundable and provided on an unsupported basis.

We recognize revenue for post-contract customer support ratably over the support period which ranges from one to five years.

Our training and consulting services revenues are recognized as such services are performed on an hourly or daily basis for time and material contracts. For consulting services arrangements with a fixed fee, we recognize revenue on a percentage-of-completion method.

For all sales we use either a signed license agreement or a binding purchase order where we have a master license agreement as evidence of an arrangement. Sales through our third party systems integrators are evidenced by a master agreement governing the relationship together with binding purchase orders or order forms on a transaction-by-transaction basis. Revenues from reseller arrangements are recognized on the “sell-through” method, when the reseller reports to us the sale of our software products to end-users. Our agreements with customers and resellers do not contain product return rights.

We assess collectibility based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We generally do not request collateral from our customers. If we determine that the collection of a fee is not probable, we recognize revenue at the time collection becomes probable, which is generally upon the receipt of cash. If a transaction includes extended payment terms, we recognized revenue as the payments become due and payable.

Allowance for Doubtful Accounts. We must make estimates of the uncollectability of our accounts receivables. We specifically analyze accounts receivable and analyze historical bad debts, customer concentrations, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Generally, we require no collateral from our customers. Our gross accounts receivable balance was $28.5 million (including long-term accounts receivable of $0.9 million) with an allowance for doubtful accounts of $0.2 million as of September 30, 2007. Our gross accounts receivable balance was $19.1 million with an allowance for doubtful accounts of $0.1 million as of September 30, 2006. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required. To date, bad debts have not been material and have been within management’s expectations.

Stock-based Compensation Expense. Upon adoption of SFAS 123(R) on October 1, 2005, we began estimating the value of employee stock options on the date of grant using the Black-Scholes model. Prior to the adoption of SFAS 123(R), the value of each employee stock option was estimated on the date of grant using the Black-Scholes model for the purpose of the pro forma financial disclosure in accordance with SFAS 123. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

With the adoption of SFAS 123(R) on October 1, 2005, we used the trinomial lattice valuation technique to determine the assumptions used in the Black-Scholes model. The trinomial lattice valuation technique was used to provide better estimates of fair values and meet the fair value objectives of SFAS 123(R). The expected term of options granted is

derived from historical data on employee exercises and post-vesting employment termination behavior. The expected volatility is based on the historical volatility of our stock.

As stock-based compensation expense recognized in the Consolidated Statement of Operations for fiscal year 2007 is based on awards ultimately expected to vest, it 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. Forfeitures were estimated based on historical experience.

If factors change and we employ different assumptions in the application of SFAS 123(R) in future periods, the compensation expense that we record under SFAS 123(R) may differ significantly from what we have recorded in the current period. The estimated value of a stock option is most sensitive to the volatility assumption. Based on the September 30, 2007 variables, it is estimated that a change of 10% in either the volatility, expected life or interest rate assumption would result in a corresponding 7%, 5% or 1% change in the estimated value of the option being valued using the Black-Scholes model.

Accounting for Income Taxes. As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax

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exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the Consolidated Statement of Operations.

We have recorded a valuation allowance equal to 100% of the deferred tax assets as of September 30, 2007, due to uncertainties related to our ability to utilize our net deferred tax assets, primarily consisting of certain net operating losses carried forward and research and development tax credits. Deferred tax assets have been fully reserved for in all periods presented. We were profitable for the quarters ended March 31, 2007, June 30, 2007, and September 30, 2007 and if we continue to be profitable in the near term, we will need to re-evaluate the 100% valuation allowance.

Valuation of Long-lived and Intangible Assets and Goodwill. We assess the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Furthermore, we assess the impairment of goodwill annually. Factors we consider important which could trigger an impairment review include the following:

- Significant underperformance relative to expected historical or projected future operating results;
- Significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- Significant negative industry or economic trends;
- Significant decline in our stock price for a sustained period;
- Market capitalization declines relative to net book value; and
- A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

When one or more of the above indicators of impairment occurs we estimate the value of long-lived assets and intangible assets to determine whether there is impairment. We measure any impairment based on the projected discounted cash flow method, which requires us to make several estimates including the estimated cash flows associated with the asset, the period over which these cash flows will be generated and a discount rate commensurate with the risk inherent in our current business model. These estimates are subjective and if we made different estimates, it could materially impact the estimated fair value of these assets and the conclusions we reached regarding impairment. To date, we have not identified any triggering events noted above.

We are required to perform an impairment review of our goodwill balance on at least an annual basis. This impairment review involves a two-step process as follows:

Step 1—We compare the fair value of our reporting units to the carrying value, including goodwill, of each of those units. For each reporting unit where the carrying value, including goodwill, exceeds the unit’s fair value, we proceed on to Step 2. If a unit’s fair value exceeds the carrying value, no further work is performed and no impairment charge is necessary.

Step 2—We perform an allocation of the fair value of the reporting unit to our identifiable tangible and non-goodwill intangible assets and liabilities. This derives an implied fair value for the reporting unit’s goodwill. We then compare

the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. If the carrying amount of the reporting unit's goodwill is greater than the implied fair value of its goodwill, an impairment charge would be recognized for the excess.

We determined that we have one reporting unit. We completed a goodwill impairment review for the period including September 30, 2007 and 2006 and performed Step 1 of the goodwill impairment analysis required by SFAS No. 142, "Goodwill and Other Intangible Assets," and concluded that goodwill was not impaired as of September 30, 2007 and 2006 using the methodology described above. Accordingly, Step 2 was not performed. We will continue to test for impairment on an annual basis and on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting units below their carrying amount.

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Restructuring Expenses. In the past five years, we have implemented cost-reduction plans as part of our continued effort to streamline our operations to reduce ongoing operating expenses. These plans resulted in restructuring expenses related to, among others, the consolidation of excess facilities. These charges relate to facilities and portions of facilities we no longer utilize and either seek to terminate early or sublease. Lease termination costs and brokerage fees for the abandoned facilities were estimated for the remaining lease obligations and were offset by estimated sublease income. Estimates related to sublease costs and income are based on assumptions regarding the period required to locate and contract with suitable sub-lessees and sublease rates which can be achieved using market trend information analyses provided by a commercial real estate brokerage retained by us. Each reporting period we review these estimates and to the extent that these assumptions change due to new agreements with landlords, new subleases with tenants, or changes in the market, the ultimate restructuring expenses for these abandoned facilities could vary by material amounts.

Determining Functional Currencies for the Purpose of Consolidation. We have several foreign subsidiaries that together account for a significant portion of our revenues, expenses, assets and liabilities.

In preparing our consolidated financial statements, we are required to translate the financial statements of the foreign subsidiaries from the currency in which they keep their accounting records, generally the local currency, into United States Dollars. This process results in exchange gains and losses which, under the relevant accounting guidance are either included within the Consolidated Statement of Operations or as a separate part of the Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss) under the caption “accumulated other comprehensive income (loss).” Under the relevant accounting guidance, the treatment of these translation gains or losses is dependent upon management’s determination of the functional currency of each subsidiary. The functional currency is determined based on management’s judgment and involves consideration of all relevant economic facts and circumstances affecting the subsidiary. Generally, the currency in which the subsidiary conducts a majority of its transactions, including billings, financing, payroll and other expenditures would be considered the functional currency but any dependency upon the parent and the nature of the subsidiary’s operations must also be considered.

If any subsidiary’s functional currency were deemed to be the local currency, then any gain or loss associated with the translation of that subsidiary’s financial statements would be included in cumulative translation adjustments. However, if the functional currency were deemed to be the United States Dollar then any gain or loss associated with the translation of these financial statements would be included within our Consolidated Statement of Operations. If we dispose of any of our subsidiaries, any cumulative translation gains or losses would be recognized in our Consolidated Statement of Operations. If we determine that there has been a change in the functional currency of a subsidiary to the United States Dollar, any translation gains or losses arising after the date of change would be included within our Consolidated Statement of Operations.

Based on our assessment of the factors discussed above, we consider the relevant subsidiary’s local currency to be the functional currency for each of our international subsidiaries. Accordingly, foreign currency translation gains and loses are included as part of accumulated other comprehensive income within our balance sheet for all periods presented.

The foreign currency gains or losses are dependent upon movements in the exchange rates of the foreign currencies in which we transact business against the United States Dollar. These currencies include the United Kingdom Pound Sterling, the Euro and the Canadian Dollar. Any future translation gains or losses could be significantly different than those reported in previous periods. At September 30, 2007, approximately $48.4 million of our cash and cash equivalents were held by our subsidiaries outside of the United States.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board, or FASB, issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities", or SFAS 159. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company has evaluated the new pronouncement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In December 2006, the FASB issued Staff Position, or FSP, EITF 00-19-2, "Accounting for Registration Payment Arrangements." This FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, "Accounting for Contingencies." The guidance is effective for fiscal years beginning after December 15, 2006. The Company has evaluated the new pronouncement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

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In September 2006, the SEC issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements”, or SAB 108. SAB 108 provides guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The guidance is applicable for fiscal years ending after November 15, 2006. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurement”, or SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value, and also expands disclosures about fair value measurements. The SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has evaluated the new pronouncement and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes”, an interpretation of SFAS No. 109, “Accounting for Income Taxes” or FIN 48. FIN 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e. a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Upon adoption, the cumulative effect of applying the recognition and measurement provisions of FIN 48, if any, shall be reflected as an adjustment to the opening balance of retained earnings.

FIN 48 also requires expanded disclosures including identification of tax positions for which it is reasonably possible that the total amount of unrecognized tax benefits will significantly change in the next twelve months, a description of tax years that remain subject to examination by major tax jurisdictions, a tabular reconciliation of the total amount of unrecognized tax benefits at the beginning and end of each annual reporting period, the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate and the total amounts of interest and penalties recognized in the statements of operations and financial position. FIN 48 is effective for fiscal years beginning after December 15, 2006, and the Company expects to adopt this standard in the fiscal year commencing on October 1, 2007. The Company has not yet determined the impact of the recognition and measurement requirements of FIN 48 on our existing tax positions.

In May 2007, the FASB issued FSP FIN 48-1, “Definition of Settlement in FASB Interpretation No. 48”, which provides guidance on how a company should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits.

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Results of Operations

The following table sets forth, in dollars (in thousands) and as a percentage of total revenues, consolidated statements of operations data for the periods indicated. This information has been derived from the consolidated financial statements included elsewhere in this Annual Report.

	Years Ended September 30,					
	2007		2006		2005	
Statements of Operations Data:						
Revenues:						
License	$ 54,052	43%	$ 40,514	42%	$ 31,678	38%
Service	70,495	57	57,022	58	52,047	62
Total revenues	124,547	100	97,536	100	83,725	100
Cost of revenues:						
License	1,813	2	1,690	2	1,079	1
Service	30,329	24	30,566	31	30,155	36
Amortization of intangible assets	1,211	1	1,211	1	1,068	2
Total cost of revenues	33,353	27	33,467	34	32,302	39
Gross profit	91,194	73	64,069	66	51,423	61
Operating expenses:						
Sales and marketing	32,597	26	33,616	34	29,561	36
Research and development	27,546	22	25,858	27	20,272	24
General and administrative	19,898	16	20,445	21	18,549	22
Amortization of intangible assets	—	—	—	—	117	—
Restructuring expense	6,543	6	—	—	1,052	1
Purchased in-process research and development	—	—	—	—	1,940	2
Total operating expenses	86,584	70	79,919	82	71,491	85
Income (loss) from operations	4,610	3	(15,850)	(16)	(20,068)	(24)
Interest income, net	2,198	2	1,120	1	755	1
Other income (expense), net	822	1	(627)	—	(103)	—
Income (loss) before income taxes	7,630	6	(15,357)	(15)	(19,416)	(23)
Provision for income taxes	1,602	1	644	1	449	1
Net income (loss)	$ 6,028	5%	$ (16,001)	(16)%	$ (19,865)	(24)%

Comparison of the Year Ended September 30, 2007 to the Year Ended September 30, 2006

Revenues

License Revenue. The increase or decrease of license revenue occurring within the three different product groups is dependent on the timing of when a sales transaction is completed and whether a license transaction was sold with essential consulting services. Products licensed with essential consulting services are generally recognized as revenue under the percentage-of-completion method of accounting. The timing and amount of revenue for those transactions being recognized under the percentage-of-completion is influenced by the progress of work performed relative to the

project length of customer contracts and the dollar value of such contracts. The following table sets forth our license revenue by product emphasis for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	2006	Change	%
License Revenue:				
Enterprise solutions	$ 37,648	$ 30,351	$ 7,297	24%
Marketing solutions	6,013	6,396	(383)	(6)
Decision management solutions	10,391	3,767	6,624	176
Total license revenue	$ 54,052	$ 40,514	$ 13,538	33%

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Total license revenue increased $13.5 million, or 33%, for the year ended September 30, 2007 compared to the same period of the prior year. A significant portion of this increase is attributable to a single customer that purchased a perpetual product license as part of a $20.0 million agreement. The value of this agreement has been allocated as follows: $12.2 million to license fees, $7.1 million to support and maintenance fees expected to be recognized over the next five year period, and $0.7 million to consulting fees. The license amount was recorded as deferred license revenue at the inception of the agreement and is being recognized on a percentage-of-completion basis due to the essential services required for the functionality of the software. For the year ended September 30, 2007, $11.3 million of license revenue has been recognized in connection with this agreement.

In addition to the revenue contribution from the aforementioned customer, the increase in license revenue for the year ended September 30, 2007 was primarily due to the growth in the absolute dollar size of transactions in excess of $1 million as compared to the same period of the prior year.

Service Revenue. Service revenue is primarily composed of consulting implementation and integration, consulting customization, training, post-contract customer support services, or PCS, and certain reimbursable out-of-pocket expenses. The increase or decrease of service revenue within the three different product emphases is primarily due to the timing of when license transactions are completed, whether or not the license was sold with essential consulting services, the sophistication of the customer's application, and the expertise of the customer's internal development team. For other service transactions, service revenue will lag in timing compared to the period of when the license revenue is recognized. The following table sets forth our service revenue by product emphasis for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	**2006**	**Change**	**%**
Service Revenue:				
Enterprise solutions	$ 51,584	$ 39,911	$ 11,673	29%
Marketing solutions	12,369	12,996	(627)	(5)
Decision management solutions	6,542	4,115	2,427	59
Total license revenue	$ 70,495	$ 57,022	$ 13,473	24%

Total service revenue increased $13.5 million or 24% for the year ended September 30, 2007 compared to the same period of the prior year. The $13.5 million increase is primarily related to increases of $8.9 million in PCS revenue, $5.2 million in consulting revenue, $0.5 million in reimbursement of out-of-pocket expense revenue offset by a decrease of $1.0 million in training revenue. The increase in PCS revenue is a function of the growth in new license bookings sold with PCS agreements combined with the renewal of existing PCS customers at a rate in excess of existing customers, declining the service in the year of renewal. The increase in consulting revenue is a direct result of the growth in license revenue as the majority of our customers will use some form of our consulting services in connection with their project.

Cost of Revenues

License. Cost of license revenues includes third party software royalties and amortization of capitalized software development costs. Royalty expenses can vary depending upon the mix of products sold within the period. The capitalized software development costs pertain to a banking product that was completed and available for general release in August 2005 and the third party costs associated with the porting of a product to a new platform. The porting project was completed in August 2007 and the aggregate costs capitalized were $0.5 million. Amortization expense for the banking product and porting project for the year ended September 30, 2007 were $0.9 million and less than $0.1 million, respectively. Amortization costs for the banking product are expected through 2008 and

amortization costs of the porting project are expected through 2010. The following table sets forth our cost of license revenues for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	2006	Change	%
Cost of license revenue	$ 1,813	$ 1,690	$ 123	7%
Percentage of total revenue	2%	2%		

Cost of license revenues increased $0.1 million or 7% for the year ended September 30, 2007 as compared to the same period of the prior year. The primary reason for the increase was due to the growth of license revenue year-over-year leading to an increase in third party royalty costs.

Service. Cost of service revenues consists primarily of personnel, third party consulting, facility and travel costs incurred to provide consulting implementation and integration, consulting customization, training, PCS support services. The following table sets forth our cost of service revenues for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

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	Years Ended September 30,			
	2007	2006	Change	%
Cost of service revenue	$ 30,329	$ 30,566	$ (237)	(1)%
Percentage of total revenue	24%	31%		

Cost of service revenue decreased by $0.2 million or 1% for the year ended September 30, 2007 as compared to the same period of the prior year. This change is primarily due to a decrease in personnel and related costs of $2.5 million associated with a decrease in headcount which was offset by an increase in third party consulting costs of $2.1 million and third party PCS costs of $0.1 million. Service costs were able to remain constant while service revenue increased due to improved utilization of our internal consultant teams, replacing full time employees with third party consultants (converting a fixed cost to a variable cost) and increasing PCS revenue, which to a limited degree is not based on a variable cost model, so there is not a direct relationship of revenue to costs.

Amortization of Intangible Assets (included in Cost of Revenues). Amortization of intangible assets cost consists primarily of the amortization of amounts paid for developed technologies, customer lists and trade-names resulting from business acquisitions. The following table sets forth our costs associated with amortization of intangible assets for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	2006	Change	%
Amortization of intangible assets	$ 1,211	$ 1,211	$ —	—%
Percentage of total revenue	1%	1%		

These costs are solely related to the $6.1 million of intangible assets associated with the acquisition of KiQ in December 2004. We expect amortization expense for intangible assets to be $1.2 million in fiscal year 2008, $1.2 million in fiscal year 2009 and $0.3 million in fiscal year 2010.

Operating Expenses

Sales and Marketing. Sales and marketing expenses is composed primarily of costs associated with selling, promoting and advertising our products, product demonstrations and customer sales calls. These costs consist primarily of employee salaries, commissions and bonuses, benefits, facilities, travel expenses and promotional and advertising expenses. The following table sets forth our sales and marketing expenses in terms of absolute dollars for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	2006	Change	%
Sales and marketing costs	$ 32,597	$ 33,616	$ (1,019)	(3)%
Percentage of total revenue	26%	34%		

Sales and marketing expenses decreased $1.0 million or 3% for the year ended September 30, 2007 as compared to the same period of the prior year. The primary reason for the decrease was due to a decrease of $1.5 million in personnel related costs and a decrease of $0.4 million in travel costs offset by an increase of $0.7 million in sales and marketing program costs. The decrease in personnel costs is mainly attributed to a 22% decrease in average headcount year-over-year.

Research and Development. Research and development expenses is composed primarily of costs associated with the development of new products, enhancements of existing products and quality assurance activities. These costs consist

primarily of employee salaries and benefits, facilities, the cost of software and development tools and equipment and consulting costs, including costs for offshore consultants. The following table sets forth our research and development expenses in terms of absolute dollars for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	**2006**	**Change**	**%**
Research and development costs	$ 27,546	$ 25,858	$ 1,688	7%
Percentage of total revenue	22%	27%		

Research and development expense increased $1.7 million or 7% for the year ended September 30, 2007 as compared to the same period of the prior year. The primarily reason for the increase was due to a $3.4 million increase in personnel related expense offset by a decrease of $1.6 million in third party consulting costs and a decrease of $0.2 million in travel costs. The

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increase in personnel costs was driven by a 13% increase in average headcount for the comparative periods. Third party consulting costs decreased as the result of the completion of a large co-development project in September 2006 that utilized a large number of outside consultants.

General and Administrative. General and administrative expenses is composed primarily of costs associated with our executive and administrative personnel (e.g. the CEO, legal, human resources and finance personnel). These costs consist primarily of employee salaries, bonuses, stock compensation expense, benefits, facilities, professional fees, including costs for Sarbanes-Oxley Act of 2002 (SOX) consultants and the recently concluded stock option review. The following table sets forth our general and administrative expenses in terms of absolute dollars for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	**2006**	**Change**	**%**
General and administrative costs	$ 19,898	$ 20,445	$ (547)	(3)%
Percentage of total revenue	16%	21%		

General and administrative expense decreased $0.5 million or 3% for the year ended September 30, 2007 as compared to the same period of the prior year. This decrease is primarily due to a decrease of $0.6 million in professional fees and a decrease of $0.3 million in personnel and related costs offset by an increase of $0.4 million in other miscellaneous costs of which $0.2 million of the miscellaneous costs were related to U.S. state franchise taxes.

Restructuring Expense. In October 2006, we initiated a restructuring plan that included an immediate reduction in positions of slightly more than ten percent of the Company's workforce, consolidation of our European facilities, and the closure of our French office. A majority of the positions eliminated were in Europe. We recorded a pre-tax cash restructuring expense of $6.1 million as calculated using the net present value of the related costs as required by SFAS 146. The expense was composed of $1.8 million for severance costs and $4.4 million for exiting excess facilities of which $1.0 million of the excess facility expense is associated with non-cash charges for the write-off of leasehold improvements and the reversal of a favorable purchase price adjustment related to the France office lease. We anticipated that $5.1 million of the expense would result in cash expenditures. As of September 30, 2007, we have paid $2.7 million in cash payments and expect to pay the remaining $2.5 million during the first six months of fiscal year 2008.

During fiscal year 2002, we restructured several areas of the Company to reduce expenses and improve revenues. As part of this restructuring, we closed an office facility in Boston, Massachusetts and recorded an expense associated with the long term lease which expires in January 2011. During 2007, we completed a new sublease for this facility with a new sub-tenant for the remaining term of our lease at a rate lower than that which was forecasted when the original restructuring expense was recorded in 2002. This change in estimate resulted in an additional $0.4 million in restructuring expenses for the year ended September 30, 2007.

Stock-based Compensation (included in individual Operating Expense and Cost of Revenue Categories). The following table sets forth our stock-based compensation expense in terms of absolute dollars and functional breakdown for the years ended September 30, 2007 and 2006 (in thousands):

	Years Ended September 30,	
	2007	**2006**
Stock-based compensation expense:		
Cost of revenues	$ 313	$ 248
Sales and marketing	744	2,327
Research and development	546	332

General and administrative		1,417		1,788
Total stock-based compensation expense	$	3,020	$	4,695

For the year ended September 30, 2007, the aggregate stock-based compensation cost included in cost of revenues and in operating expenses was $3.0 million which is a combination of $2.8 million related to stock options and $0.2 million associated with restricted stock awards. For the year ended September 30, 2006, the aggregate stock-based compensation cost included in cost of revenues and in operating expenses was $4.7 million which was a combination of $2.7 million related to stock options and $2.0 million associated with restricted stock awards. The decrease in total compensation expense of $1.7 million year-over-year is primarily attributed to a reduction in restricted stock expense of $1.8 million, of which $1.0 million of the reduction is due to the restricted stock associated with the KIQ acquisition which became fully amortized during 2007. The remaining decrease is the result of restricted stock cancellations granted in prior years to two key executives who left the company in the quarter ending December 2006.

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Interest Income, Net. Interest income, net, consists primarily of interest income generated from our cash, cash equivalents and marketable securities, offset by interest expense incurred in connection with our capital leases and letters of credit and imputed under SFAS 146 restructuring accruals. The following table sets forth our interest income, net, in terms of absolute dollars for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	2006	Change	%
Interest income, net	$ 2,198	$ 1,120	$ 1,078	96%
Percentage of total revenue	2%	1%		

Interest income, net, increased $1.1 million or 97% for the year ended September 30, 2007 as compared to the same period of the prior year. This increase is primarily due to improved interest rates related to interest-bearing cash and cash equivalents accounts and a higher average cash balance during 2007 as compared to 2006. In addition, during the quarter ended June 30, 2007, a portion of our funds were transferred into marketable securities which earned a higher return of interest than other investments we utilized in the prior year. During the quarter ended June 30, 2007, the capital equipment lease obligations were paid in full and the associated interest expense was eliminated.

Other Income (Expense), Net. These gains and losses are primarily associated with foreign currency transaction gains or losses and the re-measurement of our short-term intercompany balances between the U.S. and our foreign subsidiaries with different functional currencies than the U.S. Dollar. The following table sets forth our other income (expense), net in terms of absolute dollars for the years ended September 30, 2007 and 2006 (in thousands, except percentages):

	Years Ended September 30,			
	2007	2006	Change	%
Other income (expense), net	$ 822	$ (627)	$ 1,449	231%
Percentage of total revenue	1%	—%		

Other income increased $1.4 million or 231% for the year ended September 30, 2007 as compared to the same period of the prior year primarily due to transaction gains as well as gains associated with the re-measurement of our short-term intercompany balances. The intercompany gains are due to the majority of our subsidiaries holding net payable balances due to the U.S., denominated in U.S. Dollars; consequently, during the year as the Euro and the British Pound increased in strength against the U.S. Dollar, foreign currency gains resulted.

Provision for Income Taxes. Our provision for income taxes is $1.6 million and $0.6 million for the years ended September 30, 2007 and 2006, respectively. The $1.0 million increase in income taxes is primarily due to $0.8 million of unrecoverable withholding tax payments related to sales transactions that occurred in Turkey and Poland during the year ended September 30, 2007. The remainder of our provision is attributable to taxes on earnings from our foreign subsidiaries, U.S. federal alternative minimum taxes and certain U.S. state income taxes.

Our deferred tax assets primarily consist of net operating loss carryforwards, nondeductible allowances and research and development tax credits. We have recorded a valuation allowance for the full amount of our net deferred tax assets, as the future realization of the tax benefit is not considered by management to be more-likely-than-not.

Comparison of the Year Ended September 30, 2006 to the Year Ended September 30, 2005

Revenues

License Revenue. The increase or decrease of license revenue occurring within the three different product emphases is dependent on the timing of when a sales transaction is completed and whether a license transaction was sold with essential consulting services. Products licensed with essential consulting services are generally recognized as revenue under the percentage-of-completion method of accounting. The timing and amount of revenue for those transactions being recognized under the percentage-of-completion is influenced by the progress of work performed relative to the project length of customer contracts and the dollar value of such contracts. The following table sets forth our license revenue by product emphasis for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

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	Years Ended September 30,			
	2006	2005	Change	%
License Revenue:				
Enterprise solutions	$ 30,351	$ 24,587	$ 5,764	23%
Marketing solutions	6,396	2,450	3,946	161
Decision management solutions	3,767	4,641	(874)	(19)
Total license revenue	$ 40,514	$ 31,678	$ 8,836	28%

Total license revenue increased $8.8 million, or 28%, to $40.5 million for the year ended September 30, 2006 compared to $31.7 million for the year ended September 30, 2005. License revenues for enterprise solutions increased $5.8 million, or 23%, to $30.4 million for the year ended September 30, 2006 compared to $24.6 million for the year ended September 30, 2005. This increase was primarily due to an increase in value of the average customer transaction. License revenues for marketing solutions increased $3.9 million, or 161%, to $6.4 million for the year ended September 30, 2006 compared to $2.5 million for the year ended September 30, 2005. License revenues for decision management solutions relate to the products acquired in the KiQ transaction. License revenues for decision management solutions decreased $0.8 million, or 19% to 3.8 million for the year ended September 30, 2006 compared to $4.6 million for year ended September 30, 2005.

Service Revenue. Service revenue is primarily composed of consulting implementation and integration, consulting customization, training, post-contract customer support services, and certain reimbursable out-of-pocket expenses. The increase or decrease of service revenue within the three different product emphases is primarily due to the timing of when license transactions are completed, whether or not the license was sold with essential consulting services, the sophistication of the customer's application, and the expertise of the customer's internal development team. For other service transactions, service revenue will lag in timing compared to the period of when the license revenue is recognized. The following table sets forth our service revenue by product emphasis for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	2005	Change	%
Service Revenue:				
Enterprise solutions	$ 39,911	$ 40,441	$ (530)	(1)%
Marketing solutions	12,996	9,680	3,316	34
Decision management solutions	4,115	1,926	2,189	114
Total license revenue	$ 57,022	$ 52,047	$ 4,975	10%

Total service revenue, which includes reimbursement of out-of-pocket expenses, increased $5.0 million, or 10%, to $57.0 million for the year ended September 30, 2006 compared to $52.0 million for the year ended September 30, 2005. This increase is primarily related to a $2.3 million increase in support and maintenance revenue, a $2.1 million increase in training revenue and a $0.5 million increase in consulting revenue. Service revenue associated with enterprise solution products decreased $0.5 million, or 1%, to $39.9 million for the year ended September 30, 2006 compared to $40.4 million for the year ended September 30, 2005. Service revenues associated with marketing solution products increased $3.3 million, or 34%, to $13.0 million for the year ended September 30, 2006 compared to $9.7 million for the year ended September 30, 2005. Service revenues associated with decision management solution products relate to the products acquired in the KiQ transaction. Service revenues associated with decision management increased $2.2 million or 114% to $4.1 million for the year ended September 30, 2006 compared to $1.9 million for the year ended September 30, 2005.

Reimbursement of out-of-pocket expenses (which are included in total service revenues) decreased $0.2 million, or 4%, to $3.3 million for the year ended September 30, 2006 compared to $3.5 million for the year ended September 30, 2005.

Cost of Revenues

License. Cost of license revenues includes third party software royalties and amortization of capitalized software development costs. Royalty expenses can vary depending upon the mix of products sold within the period. The capitalized software development costs pertain to a banking product that was completed and available for general release in August 2005. Annual amortization expense associated with this product is $0.9 million. Amortization of these costs is expected through 2008. The following table sets forth our cost of license revenues for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

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	Years Ended September 30,			
	2006	2005	Change	%
Cost of license revenue	$ 1,690	$ 1,079	$ 611	57%
Percentage of total revenue	2%	1%		

Cost of license revenues increased $0.6 million, or 57%, to $1.7 million for the year ended September 30, 2006 compared to $1.1 million for the year ended September 30, 2005. This increase is primarily related to the fiscal year 2006 including a full year of amortization related to the banking product versus the prior year which included only 1.5 months of amortization. These costs resulted in license gross margins of approximately 96% and 97% for the years ended September 30, 2006 and 2005, respectively.

Service. Cost of service revenues consists primarily of personnel, third party consulting, facility and travel costs incurred to provide consulting implementation and integration, consulting customization, training, PCS support services. The following table sets forth our cost of service revenues for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	2005	Change	%
Cost of service revenue	$ 30,566	$ 30,155	$ 411	1%
Percentage of total revenue	31%	36%		

Cost of service revenues increased $0.4 million, or 1%, to $30.6 million for the year ended September 30, 2006 compared to $30.2 million for the year ended September 30, 2005. This increase in costs is primarily due to increases in personnel related costs of $0.7 million related to an increase in headcount, facility and information technology costs of $0.6 million, third party support and maintenance costs of $0.3 million offset by a decrease in third party consulting costs of $1.5 million. These costs resulted in service gross margins of approximately 46% and 42% for the years ended September 30, 2006 and 2005, respectively.

Amortization of Intangible Assets (included in Cost of Revenues). Amortization of intangible assets cost consists primarily of the amortization of amounts paid for developed technologies, customer lists and trade-names resulting from business acquisitions. The following table sets forth our costs associated with amortization of intangible assets for the years months ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	2005	Change	%
Amortization of intangible assets	$ 1,211	$ 1,068	$ 143	13%
Percentage of total revenue	1%	2%		

Amortization of intangible assets was $1.2 million for the year ended September 30, 2006 compared to $1.1 million for the year ended September 30, 2005. The amortization expense in the year ended September 30, 2006 is solely related to $6.1 million of intangible assets associated with the acquisition of KiQ in December 2004. The amortization for 2005 includes a partial year of KiQ related amortization. We expect to continue to amortize these assets through December 2009.

Operating Expenses

Sales and Marketing. Sales and marketing expenses is composed primarily of costs associated with selling, promoting and advertising our products, product demonstrations and customer sales calls. These costs consist primarily of

employee salaries, commissions and bonuses, benefits, facilities, travel expenses and promotional and advertising expenses. The following table sets forth our sales and marketing expenses in terms of absolute dollars for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	**2005**	**Change**	**%**
Sales and marketing costs	$ 33,616	$ 29,561	$ 4,055	14%
Percentage of total revenue	34%	36%		

Sales and marketing expenses increased $4.0 million, or 14%, to $33.6 million for the year ended September 30, 2006 compared to $29.6 million for the year ended September 30, 2005. The $4.0 million increase in these expenses was mainly attributable to an increase of $2.7 million in personnel related expenses, $1.0 million in sales events, and $0.3 million increase in legal contract and personnel costs.

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Research and Development. Research and development expenses is composed primarily of costs associated with the development of new products, enhancements of existing products and quality assurance activities. These costs consist primarily of employee salaries and benefits, facilities, the cost of software and development tools and equipment and consulting costs, including costs for offshore consultants. The following table sets forth our research and development expenses in terms of absolute dollars for years ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	**2005**	**Change**	**%**
Research and development costs	$ 25,858	$ 20,272	$ 5,586	28%
Percentage of total revenue	27%	24%		

Research and development expenses increased $5.6 million, or 27%, to $25.9 million for the year ended September 30, 2006 compared to $20.3 million for the year ended September 30, 2005. This increase was driven by two large co-development projects; one in North America and one in the United Kingdom. The United Kingdom project was completed in September 2006 and the North America project was completed in the second half of 2007. This $5.6 million increase in costs was primarily composed of $6.6 million in consulting expenses related to our outsourcing of technical support and certain sustaining engineering functions and $0.4 million in travel costs which were offset by decreases of $1.1 million in personnel costs and $0.3 million in information technology costs.

General and Administrative. General and administrative expenses is composed primarily of costs associated with our executive and administrative personnel (e.g. the CEO, human resources, legal and finance personnel). These costs consist primarily of employee salaries, bonuses, stock compensation expense, benefits, facilities, consulting costs, including costs for Sarbanes-Oxley Act of 2002 (SOX) consultants and the recently concluded stock option review. The following table sets forth our general and administrative expenses in terms of absolute dollars for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	**2005**	**Change**	**%**
General and administrative costs	$ 20,445	$ 18,549	$ 1,896	10%
Percentage of total revenue	21%	22%		

General and administrative expenses increased $1.9 million, or 10%, to $20.4 million for the year ended September 30, 2006 compared to $18.5 million for the year ended September 30, 2005. The increase in costs is primarily due to increases of $3.4 million for personnel costs, $0.7 million for severance costs associated with two senior executives, offset by a reduction of $2.3 million in professional services for consultants. The increase in personnel costs and decrease in professional services was driven by the replacement of accounting consultants with permanent employees. The decrease in professional services was also due to a decrease in SOX consulting fees of $2.7 million which was offset by stock option review professional fees of $1.2 million during the year. We did not experience the same level of decrease in SOX costs in 2007 that we did in 2006. The costs associated with the stock option review continued in the first half of 2007.

Amortization of Intangible Assets (included in Operating Expenses). There was no amortization of intangible assets included in operating costs for 2006. All intangible assets attributable to operating expenses were fully amortized in 2005. Amortization of intangible assets included in operating expenses was $0.1 million for the year ended September 30, 2005. These intangible assets were the result of the Prime Response acquisition in March 2001.

Purchased in-process Research and Development. In-process research and development expense represents acquired technology that, on the date of acquisition, had not achieved technological feasibility and did not have an alternative future use, based on the state of development. Because the product under development may not achieve commercial viability, the amount of acquired in-process research and development was immediately expensed. The nature of the efforts required to develop the purchased in-process research and development into a commercially viable product principally relate to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its designed specifications, including functions, features and technical performance requirements. There was no purchased in-process research and development expense for the year ended September 30, 2006. For the year ended September 30, 2005, we recorded an expense of $1.9 million related to acquired in-process technology attributable to the acquisition of KiQ.

Restructuring Expenses. In July 2005, we announced a reduction in workforce and incurred a one-time cash expense of approximately $1.1 million in the year ended September 30, 2005. Please refer to Note 6 to the Consolidated Financial Statements for further discussion.

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Stock-based Compensation (included in Individual Operating Expense and Cost of Revenue Categories). The following table sets forth our stock-based compensation expense in terms of absolute dollars and functional breakdown for the years ended September 30, 2006 and 2005 (in thousands):

	Years Ended September 30,	
	2006 (under SFAS 123®)	**2005 (under SFAS 123/APB 25)**
Stock-based compensation expense:		
Cost of revenues	$ 248	$ 690
Sales and marketing	2,327	986
Research and development	332	843
General and administrative	1,788	512
Total stock-based compensation expense	$ 4,695	$ 3,031

For the year ended September 30, 2006, the aggregate stock-based compensation cost included in cost of revenues and in operating expenses was $4.7 million which is a combination of $2.7 million related to stock options and $2.0 million associated with restricted stock awards. Included in the restricted stock award compensation expense of $2.0 million is $1.2 million associated with the amortization of restricted stock awards attributable to the KiQ acquisition in December 2004. Amortization of deferred stock-based compensation attributable to the acquisition of KiQ was expensed through June 2007.

For the year ended September 30, 2005, the aggregate stock-based compensation cost included in cost of revenues and in operating expenses was $3.0 million which was a combination of a $0.4 million benefit related to stock options and $3.4 million expense associated with restricted stock awards. Included in the restricted stock award compensation expense of $3.4 million is $2.7 million associated with the amortization of restricted stock awards attributable to the KIQ acquisition.

Interest Income, Net. Interest income, net, consists primarily of interest income generated from our cash and cash equivalents, offset by interest expense incurred in connection with our capital leases and letters of credit. The following table sets forth our interest income, net, in terms of absolute dollars for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	**2005**	**Change**	**%**
Interest income, net	$ 1,120	$ 755	$ 365	48%
Percentage of total revenue	1%	1%		

Interest income, net, increased to approximately $1.1 million for the year ended September 30, 2006 from $0.8 million for the year ended September 30, 2005. This increase is primarily due to improved interest rates related to interest-bearing cash and cash equivalents accounts and a higher average cash balance during 2006 versus 2005.

Other Income (Expense), Net. These gains and losses are primarily associated with foreign currency transaction gains or losses and the re-measurement of our short-term intercompany balances between the U.S. and our foreign

denominated subsidiaries. The following table sets forth our other income (expense), net in terms of absolute dollars for the years ended September 30, 2006 and 2005 (in thousands, except percentages):

	Years Ended September 30,			
	2006	**2005**	**Change**	**%**
Other income (expense), net	$ (627)	$ (103)	$ (524)	(509)%
Percentage of total revenue	—%	—%		

Other expense was $0.6 million for the year ended September 30, 2006 as compared to $0.1 million for the same period in the prior year. The change is primarily attributable to currency exchange gains and losses recognized during the years ended September 30, 2006 and 2005. These gains and losses are primarily associated with our U.S. Dollar account balances held in Europe and the U.S. Dollar's fluctuations in value against the Euro and U.K. Pound Sterling.

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Provision for Income Taxes. Our provisions for income taxes were $0.6 million and $0.4 million for the years ended September 30, 2006 and 2005, respectively. The provisions were attributable to taxes on earnings from our foreign subsidiaries and certain state income taxes.

Our deferred tax assets primarily consist of net operating loss carryforwards, nondeductible allowances and research and development tax credits. We have recorded a valuation allowance for the full amount of our net deferred tax assets, as the future realization of the tax benefit is not considered by management to be more-likely-than-not.

Liquidity and Capital Resources

Prior to the year ended September 30, 2007, we have not been profitable and we have financed any shortfall from our operating activities through the issuance of our common stock. Currently, in addition to generating profit for the year, we have generated $38.9 million cash from operations for the year ended September 30, 2007. It is anticipated that we will continue to generate cash from operations or financing activities in excess of the cash requirements in the near term.

Our cash, cash equivalents, restricted cash are principally held in operating accounts, money market accounts, commercial paper and certificates of deposit and our marketable securities are invested in corporate bonds and commercial paper. The balances of these accounts totaled $90.5 million and $45.8 million at September 30, 2007 and 2006, respectively, an increase of $44.7 million, or 98%.

Operating Activities

Cash provided by operating activities was $38.9 million during the year ended September 30, 2007, which consisted primarily of our net income of $6.0 million adjusted for non-cash items (depreciation, amortization, non-cash stock-based compensation expense, provision for doubtful accounts, loss on disposal of assets and other non-cash charges) aggregating approximately $7.8 million and the net cash inflow effect from changes in assets and liabilities of approximately $25.1 million. This net cash inflow effect from changes in assets and liabilities was primarily related to changes in deferred revenue of $36.6 million offset by changes in accounts receivable of $11.8 million The increase in deferred revenue is the result of sales transactions that were completed during the year ended September 30, 2007 for which revenue will not be recognized until subsequent periods.

Cash provided by operating activities was $3.2 million during the year ended September 30, 2006, which consisted primarily of our net loss of $16.0 million adjusted for non-cash items (depreciation, amortization, non-cash stock-based compensation expense, provision for doubtful accounts, loss on disposal of assets and other non-cash charges) aggregating approximately $8.2 million and the net cash inflow effect from changes in assets and liabilities of approximately $11.0 million. This net cash inflow was primarily caused by an increase in liability balances for accrued expenses and other liabilities of $6.1 million, accounts payable of $3.0 million and deferred revenue of $2.8 million offset by cash outflows related to an increase in prepaid expenses of $1.0 million. The increase in accrued expenses, other liabilities and accounts payable is primarily due to the timing of when the payments were made for these liabilities. The increase in deferred revenue was primarily due to an increase in deferred license revenue for the year.

Cash used in operating activities was $9.0 million during the year ended September 30, 2005, which consisted primarily of our net loss of $19.9 million adjusted for non-cash items (primarily the write off of in-process research and development costs associated with the KiQ acquisition, depreciation, amortization, non-cash stock-based compensation expense and other non-cash charges) aggregating approximately $7.9 million and the net cash inflow effect from changes in assets and liabilities of approximately $3.1 million. This net cash inflow was primarily caused

by an increase in revenue and the collection of accounts receivable, offset by the payment of accounts payable and accrued expenses, and additions to prepaid expenses and other assets. The increase in deferred revenue is primarily attributable to two significant license agreements signed in the three month period ended June 30, 2005. These agreements were accounted for under the percentage of completion method of accounting.

Investing Activities

Cash used in investing activities during the year ended September 30, 2007 was $14.9 million. The cash was used primarily for the purchase of $18.0 million of marketable securities, the purchase of $2.8 million of property and equipment, and the capitalization of $0.3 million of software development costs associated with the porting an existing product to a new platform. This use of cash was offset by $6.0 million of proceeds from the maturity of marketable securities and the release of $0.2 million of restricted cash during the period. The majority of the property and equipment purchased was associated with the closure of the old European headquarters office and the opening of the new smaller European headquarters office during the period. The remainder of the property and equipment purchases was primarily computer equipment use in for day-to-day operations.

Cash used in investing activities during the year ended September 30, 2006 was less than $0.1 million. The cash used primarily related to the purchase of $1.7 million of property and equipment and the capitalization of $0.3 million of software development costs associated with the porting an existing product to a new platform. This use of cash was offset by the release of $1.9 million of restricted cash during the period.

Cash used in investing activities during the year ended September 30, 2005 was $8.8 million. This use of cash primarily related to the $9.8 million in funds used to acquire KiQ, $2.2 million in funds used to complete development of an acquired banking product offset by the $4.0 million in net proceeds from the sale of marketable securities. Property and equipment purchases also consumed $0.7 million of cash during the period.

Financing Activities

Financing activities were a source of cash in the amounts of $6.2 million, $2.0 million, and $1.0 million for the year ended September 30, 2007, 2006 and 2005, respectively.

For the year ended September 30, 2007, the amount relates to $6.2 million in proceeds from stock option exercises and $0.1 million from excess tax benefits from stock based compensation, offset by payments of $0.1 million on capital lease obligations. We paid off the remainder of the capital lease obligations during the year ended September 30, 2007.

For the year ended September 30, 2006, the amount relates to $2.2 million in proceeds from stock option exercises, offset by payments of $0.2 million on capital lease obligations.

For the year ended September 30, 2005, the amount relates to $1.2 million in proceeds from stock option exercises, offset by payments of $0.2 million on capital lease obligations. During the year ended September 30, 2005, we suspended our Employee Stock Purchase Plan, or ESPP. Historically, proceeds to us from the ESPP have been significant. The ESPP is not expected to be reinstated and, accordingly, we do not anticipate that we will receive proceeds from the ESPP in the near term.

Revolving Line of Credit

The Company’s revolving line of credit with Comerica Bank was amended and restated on March 8, 2006 and was extended to March 7, 2008. The terms of the agreement include a $5.0 million line of credit and require us to maintain (i) at least a $5.0 million cash balance in Comerica Bank accounts, (ii) a minimum quick ratio of 2 to 1, (iii) a liquidity ratio of at least 1 to 1 at all times, and (iv) subordinate any debt issuances subsequent to the effective date of the agreement, and certain other covenants. All assets of the Company have been pledged as collateral on the credit facility. Due to the Company’s failing to timely file its periodic reports on Form 10-K for the year ended September 30, 2006 and on Form 10-Q for the quarter ended June 30, 2006, the line of credit agreement was amended in August 2006, November 2006, and December 2006 to extend the deadline related to the filing of its periodic reports to February 20, 2007. As of February 14, 2007, the Company became current with its SEC regulatory filings and has remained current for filings thereafter.

The revolving line of credit contains a provision for a sub-limit of up to $5.0 million for issuances of standby commercial letters of credit. As of September 30, 2007, we had utilized $0.3 million of the standby commercial letters of credit limit of which $0.3 million serves as collateral for computer equipment leases for Ness (see Note 9 to the Consolidated Financial Statements). The revolving line of credit also contains a provision for a sub-limit of up to $3.0 million for issuances of foreign exchange forward contracts. As of September 30, 2007, we had not entered into any

foreign exchange forward contracts. Pursuant to the amendment in March 2006, we are required to secure the standby commercial letters of credit and foreign exchange forward contracts through March 7, 2008. If these have not been secured to Comerica Bank's satisfaction, our cash and cash equivalent balances held by Comerica Bank automatically secure such obligations to the extent of the then continuing or outstanding and undrawn letters of credit or foreign exchange contracts.

Borrowings under the revolving line of credit bear interest at the lending bank's prime rate. Except for the standby commercial letters of credit, as of September 30, 2007, there was no outstanding balance on the revolving line of credit. Advances are available on a non-formula basis up to $5.0 million.

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Contractual Obligations

We entered into an agreement with Ness Technologies Inc., Ness Global Services, Inc. and Ness Technologies India, Ltd. (collectively, "Ness"), effective December 15, 2003, pursuant to which Ness provides our customers with technical product support through a worldwide help desk facility, a sustaining engineering function that serves as the interface between technical product support and our internal engineering organization, product testing services and product development services (collectively, the "Services"). The agreement had an initial term of three years and was extended for two additional year terms. Under the terms of the agreement, we pay for services rendered on a monthly fee basis, including the requirement to reimburse Ness for approved out-of-pocket expenses. The agreement may be terminated for convenience by the Company, subject to the payment of a termination fee. In 2004, 2005, 2006 and 2007 we further expanded its agreement with Ness whereby Ness is providing certain additional technical and consulting services. The additional agreements can be cancelled at the option of the Company without the payment of a termination fee. The remaining minimum purchase commitment under these agreements, if Chordiant was to cancel the contracts, was approximately $0.7 million at September 30, 2007. In addition to service agreements, we also guaranteed certain equipment lease obligations of Ness (see Note 8 to the Consolidated Financial Statements). Ness may procure equipment to be used in performance of the Services, either through leasing arrangements or direct cash purchases, for which we are obligated under the agreement to reimburse them. In connection with the procurement of equipment, Ness has entered into a 36 month equipment lease agreement with IBM India and, in connection with the lease agreement we have an outstanding standby letter of credit in the amount of $0.3 million in guarantee of Ness' financial commitments under the lease. Over the term of the lease, our obligation to reimburse Ness is approximately equal to the amount of the guarantee.

During the three months ended March 31, 2007, the Company paid the final payments on its remaining capital lease obligations. Operating lease payments in the table below include approximately $4.9 million for two facility operating lease commitments that are included in restructuring expenses. One of the leases is located in Boston, Massachusetts and the other is located in the United Kingdom. As of September 30, 2007, the Company has $0.9 million in sublease income contractually committed for future periods relating to the Boston, Massachusetts facility classified as an operating lease. See Note 6 to the Consolidated Financial Statements for further discussion.

In November 2007, we expect to negotiate a break clause in the in the United Kingdom facility lease allowing for an early termination of the respective facility which will release the Company of any future rent liabilities subsequent to January 2008. The scheduled lease payments shown in the table below reflect a payment of $2.5 million in fiscal year 2008 associated with the anticipated early termination of the United Kingdom lease.

We have asset retirement obligations, associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 30, 2007, the Company estimated that gross expected cash flows of approximately $0.3 million will be required to fulfill these obligations

We have no material commitments for capital expenditures and do not anticipate capital expenditures to fluctuate significantly from historic levels.

The following table presents certain payments due under contractual obligations as of September 30, 2007(in thousands):

	Payments due by period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 years

Operating lease obligations	13,580	5,772	4,779	2,472	557
Asset retirement obligations	346	—	—	346	—
Total	13,926	5,772	4,779	2,818	557

We believe that the effects of our strategic actions implemented to improve revenue as well as to control costs will be adequate to generate sufficient cash flows from operations, which, when combined with existing cash balances, we anticipate will be sufficient to meet our working capital and operating resource expenditure requirements for the near term. If the global economy weakens, a decline could occur.

We anticipate that operating expenses will continue to be a material use of our cash resources. We may continue to utilize cash resources to fund acquisitions or investments in other businesses, technologies or product lines. In the long-term, we may require additional funds to support our working capital and operating expense requirements or for other purposes, and may seek to raise these additional funds through public or private debt or equity financings. There can be no assurance that this additional financing will be available, or if available, will be on reasonable terms. Failure to generate sufficient revenues or to control spending could adversely affect our ability to achieve our business objectives.

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Indemnification

As permitted under Delaware law, we have agreements whereby we have indemnified our officers, directors and certain employees for certain events or occurrences while the employee, officer or director is, or was serving, at our 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 we could be required to make under these indemnification agreements is unlimited; however, we have a Director and Officer insurance policy that limits our exposure and may enable us to recover a portion of any future amounts paid. Future payments may be required to defend current and former directors in the derivative class action lawsuits described in Note 10 to the Consolidated Financial Statements. As a result of our insurance policy coverage, we believe the estimated fair value of these indemnification agreements is minimal. Accordingly, we have no liabilities recorded for these agreements as of September 30, 2007.

We have entered into standard indemnification agreements in our ordinary course of business. Pursuant to these agreements, we agreed to indemnify, defend, hold harmless, and to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally our business partners or customers, in connection with any patent, copyright or other intellectual property infringement claim by any third party with respect to our products. The term of these indemnification agreements is generally perpetual after execution of the agreement. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We have not incurred significant costs to defend lawsuits or settle claims related to these indemnification agreements. We believe the estimated fair value of these agreements is minimal. Accordingly, we have no liabilities recorded for these agreements as of September 30, 2007.

We have entered into arrangements with our business partners, whereby the business partners agree to provide services as subcontractors for its implementations. We may, at its discretion and in the ordinary course of business, subcontract the performance of any of our services. Accordingly, we have entered into standard indemnification agreements with our customers, whereby we indemnify them for other acts, such as personal property damage by our subcontractors. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have general and umbrella insurance policies that may enable us to recover a portion of any amounts paid. We have not incurred significant costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, we believe the estimated fair value of these agreements is minimal. Accordingly, we have no liabilities recorded for these agreements as of September 30, 2007.

When, as part of an acquisition, we acquire all of the stock or all of the assets and liabilities of a company, we may assume the liability for certain events or occurrences that took place prior to the date of acquisition. The maximum potential amount of future payments, if any, we could be required to make for such obligations is undeterminable at this time. Accordingly, we have no amounts recorded for these contingent liabilities as of September 30, 2007.

We warrant that our software products will perform in all material respects in accordance with our standard published specifications and documentation in effect at the time of delivery of the licensed products to the customer for a specified period of time. Additionally, we warrant that our maintenance and consulting services will be performed consistent with generally accepted industry standards. If necessary, we would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history, however, we have not incurred significant expense under our product or services warranties to date. As a result, we believe the estimated fair value on these warranties is minimal. Accordingly, we have no amounts recorded for these contingent liabilities as of September 30, 2007.

Off Balance Sheet Arrangements

None.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the impact of interest rate changes and foreign currency fluctuations.

The following table presents the amounts of restricted cash and marketable securities that are subject to interest rate risk by year of expected maturity and average interest rates as of September 30, 2007 (in thousands):

	September 30, 2007	Fair Value	Average Interest Rates
Restricted cash in short-term investments	$ 311	$ 311	2.8%
Marketable securities	12,159	12,159	5.0%
Total restricted cash and marketable securities	$ 12,470	$ 12,470	4.9%

The following table presents the amounts of restricted cash that are subject to interest rate risk by year of expected maturity and average interest rates as of September 30, 2006 (in thousands):

	September 30, 2006	Fair Value	Average Interest Rates
Restricted cash in short-term investments	$ 519	$ 519	1.9%
Total restricted cash in short-term investments	$ 519	$ 519	

Interest Rate Risk. Our exposure to market rate risk for changes in interest rates relates primarily to money market accounts, commercial paper, short-term certificates of deposit and marketable securities. We invest our excess cash in money market accounts, commercial paper, certificates-of-deposit, and marketable securities with maturities of less than one year. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell our fixed rate securities which have declined in market value due to changes in interest rates.

To provide a meaningful assessment of the interest rate risk associated with the Company's total restricted cash and marketable securities, the Company performed a sensitivity analysis to determine the hypothetical impact of a decrease in interest rate of 100 basis points. Assuming consistent investment levels as of September 30, 2007, interest income would decline by $0.1 million. Assuming consistent investment levels as of September 30, 2006, interest income would have declined by less than $0.1 million.

Foreign Currency Risk. International revenues accounted for approximately 47% of total revenues for the year ended September 30, 2007, compared to 38% of total revenues for the year ended September 30, 2006. International revenues increased $21.3 million or 57% compared to the prior year. The growth in our international operations has increased our exposure to foreign currency fluctuations. Revenues and related expense generated from our international subsidiaries are generally denominated in the functional currencies of the local countries. Primary currencies include the United Kingdom Pound Sterling, the Euro and the Canadian Dollar. The Statement of Operations is translated into United States Dollars at the average exchange rates in each applicable period. To the extent the United States Dollar strengthens against foreign currencies, the translation of these foreign currencies

denominated transactions results in reduced revenues, operating expense, and net income for our international operations. Similarly, our revenues, operating expenses, and net income will increase for our international operations, if the United States Dollar weakens against foreign currencies. Using the average foreign currency exchange rates from 2007, our international revenues for 2007 would have been lower than we reported by approximately $0.1 million and our international income from operations would have not been materially different. Using the average foreign currency exchange rates from 2006, our international revenues for 2007 would have been lower than we reported by approximately $4.9 million and our international income from operations would have been lower than we reported by $0.8 million.

We are also exposed to foreign exchange rate fluctuations as we convert the financial statements of our foreign subsidiaries and our investments in equity interests into United States dollars in consolidation. If there is a change in foreign currency exchange rates, the conversion of the foreign subsidiaries' financial statements into United States dollars will lead to a translation gain or loss which is recorded as a component of accumulated other comprehensive income which is a component of stockholders' equity. In addition, we have certain assets and liabilities that are denominated in currencies other than the relevant entity's functional currency. Changes in the functional currency value of these assets and liabilities create fluctuations that will lead to a transaction gain or loss. For the fiscal years ended September 30, 2007, 2006 and 2005, we recorded net foreign currency transaction gains and (losses), realized and unrealized, of approximately $0.6 million, ($0.5 million), and $0.1 million, respectively, which were recorded in Other income (expense), net, in the Consolidated Statements of Operations.

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ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements

Chordiant Software, Inc. and Subsidiaries: Consolidated Financial Statements for the Years Ended September 30, 2007, 2006 and 2005.

Consolidated Financial Statements:

Report of Independent Registered Public Accounting Firm	50
Consolidated Balance Sheets as of September 30, 2007 and 2006	51
Consolidated Statements of Operations for the years ended September 30, 2007, 2006, and 2005	52
Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the years ended September 30, 2007, 2006, and 2005	53
Consolidated Statements of Cash Flows for the years ended September 30, 2007, 2006, and 2005	54
Notes to Consolidated Financial Statements	55

Financial Statement Schedule:

Schedule II—Valuation and Qualifying Accounts for the years ended September 30, 2007, 2006, and 2005	85

All other schedules are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or Notes thereto.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Chordiant Software, Inc.
Cupertino, California

We have audited the accompanying consolidated balance sheets of Chordiant Software, Inc. (the "Company") as of September 30, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended September 30, 2007. We have also audited the financial statement schedule listed in the accompanying index. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Chordiant Software, Inc. at September 30, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2007**,** in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Chordiant Software, Inc.'s internal control over financial reporting as of September 30, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated November 15, 2007 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

San Jose, California
November 15, 2007

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CHORDIANT SOFTWARE, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	September 30, 2007	September 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 77,987	$ 45,278
Marketable securities	12,159	—
Restricted cash	46	185
Accounts receivable, net, including nil and $142 due from related parties at September 30, 2007 and 2006, respectively	27,381	19,025
Prepaid expenses and other current assets	5,306	5,210
Total current assets	122,879	69,698
Restricted cash	265	334
Property and equipment, net	3,638	2,630
Goodwill	32,044	32,044
Intangible assets, net	2,725	3,937
Other assets	3,264	2,860
Total assets	$ 164,815	$ 111,503
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, including nil and $132 due to related parties at September 30, 2007 and 2006, respectively	$ 8,080	$ 7,665
Accrued expenses	13,804	15,706
Deferred revenue, including related party balances of $116 and $112 at September 30, 2007 and 2006, respectively	44,548	23,909
Current portion of capital lease obligations	—	95
Total current liabilities	66,432	47,375
Deferred revenue—long-term	23,434	5,596
Restructuring costs, net of current portion	942	1,239
Other long-term liabilities	646	68
Total liabilities	91,454	54,278
Commitments and contingencies (Notes 6, 8, 9, and 10)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 51,000 shares authorized; none issued and outstanding at September 30, 2007 and 2006	—	—
Common stock, $0.001 par value; 120,000 shares authorized; 33,221 and 32,030 shares issued and outstanding at September 30, 2007 and 2006, respectively	33	32
Additional paid-in capital	295,650	286,440
Accumulated deficit	(226,915)	(232,943)
Accumulated other comprehensive income	4,593	3,696

Total stockholders' equity		73,361		57,225
Total liabilities and stockholders' equity	$	164,815	$	111,503

The accompanying notes are an integral part of these consolidated financial statements.

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CHORDIANT SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Years Ended September 30,		
	2007	**2006**	**2005**
Revenues:			
License, including related party items aggregating nil, nil, and $5,612, for years ended September 30, 2007, 2006, and 2005, respectively	$ 54,052	$ 40,514	$ 31,678
Service, including related party items aggregating $252, $663, and $2,443, for years ended September 30, 2007, 2006, and 2005, respectively	70,495	57,022	52,047
Total revenues	124,547	97,536	83,725
Cost of revenues:			
License	1,813	1,690	1,079
Service, including related party items aggregating $72, $669, and nil, for the years ended September 30, 2007, 2006, and 2005, respectively	30,329	30,566	30,155
Amortization of intangible assets	1,211	1,211	1,068
Total cost of revenues	33,353	33,467	32,302
Gross profit	91,194	64,069	51,423
Operating expenses:			
Sales and marketing	32,597	33,616	29,561
Research and development	27,546	25,858	20,272
General and administrative	19,898	20,445	18,549
Amortization of intangible assets	—	—	117
Restructuring expense	6,543	—	1,052
Purchased in-process research and development	—	—	1,940
Total operating expenses	86,584	79,919	71,491
Income (loss) from operations	4,610	(15,850)	(20,068)
Interest income, net	2,198	1,120	755
Other income (expense), net	822	(627)	(103)
Income (loss) before income taxes	7,630	(15,357)	(19,416)
Provision for income taxes	1,602	644	449
Net income (loss)	$ 6,028	$ (16,001)	$ (19,865)
Net income (loss) per share:			
Basic	$ 0.19	$ (0.51)	$ (0.67)
Diluted	$ 0.18	$ (0.51)	$ (0.67)
Weighted average shares used in computing net income (loss) per share:			
Basic	32,425	31,073	29,780
Diluted	33,261	31,073	29,780

The accompanying notes are an integral part of these consolidated financial statements.

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CHORDIANT SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
(in thousands)

	Common Stock					Accumulated Other	
	Shares	Amount	Additional Paid-in Capital	Deferred Stock-Based Compensation	Accumulated Deficit	Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at September 30, 2004	**29,014**	**$ 29**	**$ 270,571**	**$ (700)**	**$ (197,077)**	**$ 3,089**	**$ 75,912**
Net loss	—	—	—	—	(19,865)	—	(19,865)
Foreign currency translation loss	—	—	—	—	—	(605)	(605)
Comprehensive loss	—	—	—	—	—	—	(20,470)
Exercise of stock options	498	—	1,512	—	—	—	1,512
Stock-based compensation-stock options related to acquisitions	—	—	—	2,729	—	—	2,729
Stock-based compensation-stock options	—	—	—	(348)	—	—	(348)
Stock-based compensation-restricted stock	—	—	—	650	—	—	650
Cancellation of restricted stock	(38)	—	(221)	221	—	—	—
Unearned compensation on variable options	—	—	(411)	411	—	—	—
Issuance of restricted stock	180	—	952	(952)	—	—	—
Issuance of common stock, net of offering costs, and restricted stock related to acquisitions	1,741	2	9,305	(4,123)	—	—	5,184
Warrants issued to customer	—	—	(12)	—	—	—	(12)
Balance at September 30, 2005	**31,395**	**31**	**281,696**	**(2,112)**	**(216,942)**	**2,484**	**65,157**
Net loss	—	—	—	—	(16,001)	—	(16,001)
Foreign currency translation gain	—	—	—	—	—	1,212	1,212
Comprehensive loss	—	—	—	—	—	—	(14,789)
Exercise of stock options and warrants	513	1	2,025	—	—	—	2,026
Stock-based compensation-stock	—	—	756	—	—	—	756

options related to acquisitions							
Stock-based compensation-stock options	—	—	3,475	—	—	—	3,475
Stock-based compensation-restricted stock	—	—	463	—	—	—	463
Cancellation of restricted stock	(8)	—	—	—	—	—	—
Issuance of restricted stock	130	—	—	—	—	—	—
Issuance of common stock, net of offering costs, and restricted stock related to acquisitions	—	—	137	—	—	—	137
Reclassification of deferred compensation due to adoption of SFAS 123R	—	—	(2,112)	2,112	—	—	—
Balance at September 30, 2006	**32,030**	**32**	**286,440**	**—**	**(232,943)**	**3,696**	**57,225**
Net income	—	—	—	—	6,028	—	6,028
Unrealized gain/loss on marketable securities, net	—	—	—	—	—	(2)	(2)
Foreign currency translation gain	—	—	—	—	—	899	899
Comprehensive income	—	—	—	—	—	—	6,925
Exercise of stock options	1,328	1	6,113	—	—	—	6,114
Cancellation of restricted stock	(137)	—	—	—	—	—	—
Stock-based compensation-stock options	—	—	2,870	—	—	—	2,870
Stock-based compensation-restricted stock	—	—	150	—	—	—	150
Tax benefit from stock options	—	—	77	—	—	—	77
Balance at September 30, 2007	**33,221**	**$ 33**	**$ 295,650**	**$ —**	**$ (226,915)**	**$ 4,593**	**$ 73,361**

The accompanying notes are an integral part of these consolidated financial statements.

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CHORDIANT SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended September 30, 2007	2006	2005
Cash flows from operating activities:			
Net income (loss)	$ 6,028	$ (16,001)	$ (19,865)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,611	1,238	1,382
Purchased in-process research and development	—	—	1,940
Amortization of intangibles and capitalized software	2,133	2,111	1,335
Non-cash stock-based compensation expense	3,020	4,695	3,031
Excess tax benefits from stock-based compensation	(77)	—	—
Provision (reversal) for doubtful accounts	82	(9)	103
Warrants issued to customers	—	—	(12)
Loss on disposal of assets	673	40	27
Accretion of discounts on investments	(131)	—	—
Other non-cash charges	445	140	29
Changes in assets and liabilities:			
Accounts receivable	(11,825)	292	1,479
Prepaid expenses and other current assets	(59)	(1,028)	(988)
Other assets	2,585	(136)	250
Accounts payable	238	3,004	(3,893)
Accrued expenses, other long term liabilities and restructuring	(2,383)	6,106	743
Deferred revenue	36,573	2,793	5,489
Net cash provided by (used in) operating activities	38,913	3,245	(8,950)
Cash flows from investing activities:			
Property and equipment purchases	(2,809)	(1,694)	(726)
Capitalized product development costs	(257)	(250)	(2,226)
Proceeds from disposal of property and equipment	—	11	—
Cash used for acquisitions, net	—	—	(9,800)
Proceeds from release of restricted cash	215	1,893	(12)
Purchases of marketable securities and short term investments	(18,028)	—	(100)
Proceeds from maturities of short term investments	6,000	—	4,100
Net cash used in investing activities	(14,879)	(40)	(8,764)
Cash flows from financing activities:			
Proceeds from exercise of stock options	6,191	2,250	1,210
Payment on capital leases	(96)	(213)	(199)
Excess tax benefits from stock-based compensation	77	—	—
Net cash provided by financing activities	6,172	2,037	1,011
Effect of exchange rate changes	2,503	1,490	(499)
Net increase (decrease) in cash and cash equivalents	32,709	6,732	(17,202)
Cash and cash equivalents at beginning of the year	45,278	38,546	55,748

Cash and cash equivalents at end of the year	$	77,987	$	45,278	$	38,546
Supplemental cash flow information:						
Cash paid for interest	$	3	$	17	$	29
Cash paid for taxes	$	1,669	$	360	$	478

Supplemental non-cash investing and financing activities: