STELLENT INC
Form 10-Q
November 08, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2006

OR

o 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 0-19817.

STELLENT, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

MINNESOTA (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**41-1652566** (I.R.S. EMPLOYER IDENTIFICATION NO.)
7500 FLYING CLOUD DRIVE, SUITE 500, EDEN PRAIRIE, MINNESOTA (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	**55344-3736** (ZIP CODE)

(952) 903-2000

(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

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. xYes o No

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

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. Common Stock, $.01 par value 29,999,426 shares as of November 3, 2006.

STELLENT, INC

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STELLENT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

(UNAUDITED)

	September 30, 2006	March 31, 2006
ASSETS		
Current assets		
Cash and equivalents	$ 33,864	$ 34,741
Short-term marketable securities	28,212	29,900
Trade accounts receivable, net	33,928	31,320
Prepaid royalties, current portion	1,458	941
Prepaid expenses and other current assets	4,862	4,512
Total current assets	102,324	101,414
Long-term marketable securities	8,296	17,112
Property and equipment, net	7,288	7,822
Prepaid royalties, net of current portion	602	923
Goodwill	87,652	74,409
Other acquired intangible assets, net	5,209	4,003
Other	964	866
	$ 212,335	$ 206,549
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 2,664	$ 3,072
Deferred revenues, current portion	20,517	20,143
Commissions payable	3,045	3,839
Accrued expenses and other	7,136	7,442
Current portions of obligation under capital leases	189	473
Total current liabilities	33,551	34,969
Deferred revenue, net of current portion	876	1,079
Deferred rent, net of current portion	1,157	1,264
Obligations under capital leases, net of current portions	185	281
Total liabilities	35,769	37,593
Shareholders equity		
Common stock	299	294
Additional paid-in capital	259,862	254,381
Unearned compensation		(123)
Accumulated deficit	(84,144)	(85,793)
Accumulated other comprehensive income	549	197
Total shareholders equity	176,566	168,956
	$ 212,335	$ 206,549

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

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STELLENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

(UNAUDITED)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Revenues				
Product licenses	$ 14,491	$ 13,321	$ 28,844	$ 27,049
Services	8,527	6,938	16,206	12,098
Post-contract support	10,710	9,888	21,020	19,561
Total revenues	33,728	30,147	66,070	58,708
Cost of revenues				
Product licenses	783	815	1,611	1,975
Services	7,368	6,484	14,271	11,509
Post-contract support	1,813	1,956	3,538	3,806
Amortization of capitalized software from acquisitions	339	443	646	859
Total cost of revenues	10,303	9,698	20,066	18,149
Gross profit	23,425	20,449	46,004	40,559
Operating expenses				
Sales and marketing	13,063	11,712	25,421	23,148
General and administrative	3,753	2,812	6,949	5,982
Research and development	5,832	4,895	11,350	9,551
Amortization of acquired intangible assets and unearned compensation	116	210	209	374
Restructuring charges		648		665
Total operating expenses	22,764	20,277	43,929	39,720
Income from operations	661	172	2,075	839
Other:				
Interest income, net	741	478	1,490	893
Net income before income taxes	1,402	650	3,565	1,732
Provision for income taxes	69	93	132	93
Net income	$ 1,333	$ 557	$ 3,433	$ 1,639
Net income per common share:				
Basic	$ 0.04	$ 0.02	$ 0.12	$ 0.06
Diluted	$ 0.04	$ 0.02	$ 0.11	$ 0.06
Weighted average shares outstanding:				
Basic	29,844	28,101	29,626	27,815
Diluted	31,006	29,264	31,093	28,848

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

STELLENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(UNAUDITED)

	Six Months Ended September 30, 2006	2005
Operating activities:		
Net income	$ 3,433	$ 1,639
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation and amortization	1,792	1,206
Amortization of acquired intangible assets and other	855	1,256
Lease incentives		1,043
Employee stock-based compensation	2,382	
Changes in operating assets and liabilities, net of amounts acquired:		
Trade accounts receivable, net	(1,983)	857
Prepaid expenses and other current assets, prepaid royalties and other assets	(199)	85
Accounts payable	(547)	(2,493)
Accrued liabilities	(1,332)	1,814
Deferred revenue	(468)	(1,044)
Accrued commissions	(794)	152
Net cash flows provided by operating activities	3,139	4,515
Investing activities:		
Maturities of marketable securities, net	10,504	(520)
Business acquisitions, net of cash acquired	(13,607)	(5,439)
Purchases of property and equipment	(1,142)	(3,488)
Purchases of intangibles	(134)	
Net cash flows used in investing activities	(4,379)	(9,447)
Financing activities:		
Proceeds from stock options	3,227	1,902
Proceeds from issuance of stock under the Employee Stock Purchase Plan		480
Payments under capital leases	(380)	(188)
Cash dividend paid	(1,782)	
Net cash flows provided by financing activities	1,065	2,194
Effect of exchange rate changes on cash and equivalents	(702)	(623)
Net decrease in cash	(877)	(3,361)
Cash and equivalents at beginning of the period	34,741	49,113
Cash and equivalents at end of the period	$ 33,864	$ 45,752
Supplemental disclosure of cash flows information:		
Cash paid for interest	$ 20	$
Non-cash investing and financing activities:		
Common stock issued in business acquisitions	$	$ 2,008
Dividends earned on unvested deferred share units	2	
Business acquisition hold-back	200	
Purchase of equipment through capital leases		567

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

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for Quarterly Reports on Form 10-Q and instructions for Article 10 of Regulation S-X. In the opinion of management, all adjustments, consisting only of normal recurring adjustments (except for the adjustments used to record the acquisition of BitForm, Inc. (BitForm) and SealedMedia Limited, (SealedMedia) disclosed in Note 3), have been recorded as necessary to present fairly the consolidated financial position, results of operations and cash flow of Stellent, Inc. (the Company) for the periods presented. These consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements included in the Company s fiscal year 2006 Annual Report on Form 10-K. The consolidated results of operations for the three and six month periods ended September 30, 2006 and 2005 are not necessarily indicative of the results that may be expected for any future period. References to fiscal years 2007 and 2006 represent the twelve months ended March 31, 2007 and 2006, respectively.

The condensed consolidated balance sheet at March 31, 2006 has been derived from audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Such disclosures are contained in the Company s Annual Report on Form 10-K.

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

Revenue Recognition

Revenue consists principally of software license, support, consulting and training fees. The Company recognizes revenue in accordance with Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-9*, Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions*, and Securities and Exchange Commission Staff Accounting Bulletin 104, *Revenue Recognition*.

Product license revenue is recognized under SOP 97-2 when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable and supported and the arrangement does not require services that are essential to the functionality of the software.

Persuasive Evidence of an Arrangement Exists The Company determines that persuasive evidence of an arrangement exists with respect to a customer under, (i) a signature license agreement, which is signed by both the customer and the Company or, (ii) a purchase order, quote or binding letter-of-intent received from and signed by the customer, in which case the customer has either previously executed a signature license agreement with us or will receive a shrink-wrap license agreement with the software. The Company does not offer product return rights to end users or resellers.

Delivery has Occurred The Company s software may be either physically or electronically delivered to the customer. The Company determines that delivery has occurred upon shipment of the software pursuant to the billing terms of the arrangement or when the software is made available to the customer through electronic delivery. Customer acceptance generally occurs at delivery.

The Fee is Fixed or Determinable If at the outset of the customer arrangement, the Company determines that the arrangement fee is not fixed or determinable, revenue is typically recognized when the arrangement fee becomes due and payable. Fees due under an arrangement are generally deemed fixed and determinable if they are payable within twelve months.

Collectibility is Probable and Supported The Company determines whether collectibility is probable and supported on a case-by-case basis. The Company may generate a high percentage of our license revenue from our current customer base, for which there is a history of successful collection. The Company assesses the probability of collection from new customers based upon the number of years the customer has been in business and a credit review process, which evaluates the customer s financial position and ultimately its ability to pay. If the Company is unable to determine from the outset of an arrangement that collectibility is probable based upon the Company s review process, revenue is recognized as payments are received.

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STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

With regard to software arrangements involving multiple elements, the Company allocates revenue to each element based on the relative fair value of each element. The Company s determination of fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence (VSOE). The Company limits its assessment of VSOE for each element to the price charged when the same element is sold separately. The Company has analyzed all of the elements included in its multiple-element arrangements and has determined that it has sufficient VSOE to allocate revenue to consulting services and post-contract customer support (PCS) components of its license arrangements. The Company sells its consulting services separately, and has established VSOE on this basis. VSOE for PCS is determined based upon the customer s annual renewal rates for these elements. Accordingly, assuming all other revenue recognition criteria are met, revenue from perpetual licenses is recognized upon delivery using the residual method in accordance with SOP 98-9, and revenue from PCS is recognized ratably over their respective terms, typically one year.

The Company s direct customers typically enter into perpetual license arrangements. The Company s OEM group generally enters into term-based license arrangements with its customers, the term of which generally exceeds one year in length. The Company recognizes revenue from time-based licenses at the time the license arrangement is signed, assuming all other revenue recognition criteria are met, if the term of the time-based license arrangement is greater than twelve months. If the term of the time-based license arrangement is twelve months or less, the Company recognizes revenue ratably over the term of the license arrangement.

Services revenue consists of fees from consulting services, PCS and out-of-pocket expenses reimbursed by the Company. Consulting services include needs assessment, software integration, security analysis, application development and training. The Company bills consulting services fees either on a time and materials basis or on a fixed-price schedule. In general, the Company s consulting services are not essential to the functionality of the software. The Company s software products are fully functional upon delivery and implementation and generally do not require any significant modification or alteration for customer use. Customers purchase the Company s consulting services to facilitate the adoption of its technology and may dedicate personnel to participate in the services being performed, but they may also decide to use their own resources or appoint other professional service organizations to provide these services. Software products are billed separately from professional services. The Company recognizes revenue from consulting services as services are performed. The Company s customers typically purchase PCS annually, and the Company prices PCS based on either a percentage of the product license fee or product list price, as applicable. Customers purchasing PCS receive product upgrades, Web-based technical support and telephone hot-line support. Unspecified product upgrades are not provided without the purchase of PCS. The Company typically has not granted upgrade rights in its license agreements. Specified undelivered elements are allocated a relative fair value amount within a license agreement and the revenue allocated for these elements are deferred until delivery occurs.

Customer advances and billed amounts due from customers in excess of revenue recognized are recorded as deferred revenue.

Cost of Revenues

The Company expenses all manufacturing, packaging and distribution costs associated with product license revenue as cost of revenues. The Company expenses all technical support service costs associated with service revenues as a cost of revenues. The Company also expenses amortization of capitalized software from acquisition as cost of revenues. The Company reports out-of-pocket expenses reimbursed by customers as revenue and the corresponding expenses incurred as costs of revenues.

Cash, Cash Equivalents, Marketable Securities

Cash and Cash Equivalents: The Company considers all short-term, highly liquid investments that are readily convertible into known amounts of cash and have original maturities of three months or less to be cash equivalents.

Marketable Securities: Investments in debt securities with a remaining maturity of one year or less at the date of purchase are classified as short-term marketable securities. Investments are held in debt securities of the United States government and with corporations that have the highest possible credit rating. Investments in debt securities with a remaining maturity of greater than one year are classified as long-term marketable securities. These investments are classified as held to maturity and recorded at amortized cost as the Company has the ability and positive intent to hold to maturity.

Warranties

The Company generally warrants its software products for a period of 30 to 90 days from the date of delivery and estimates probable product warranty costs at the time revenue is recognized. The Company exercises judgment in determining its accrued warranty liability. Factors that may affect the warranty liability include historical and anticipated rates of warranty claims, material

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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usage, and service delivery costs. Warranty costs incurred have not been material.

Indemnification Obligations

The Company generally undertakes intellectual property indemnification obligations in its software products or services agreements with customers. Typically these obligations provide that the Company will indemnify, defend and hold the customers harmless against claims by third parties that its software products or services infringe upon the copyrights, trademarks, patents or trade secret rights of such third parties. No such material claim has been made by any third party with regard to the Company s software products or services.

Comprehensive Income

Other comprehensive income consist of gains or losses that under the accounting principles generally accepted in the United States of America are recorded as an element of shareholders equity and are excluded from operations. The following table represents comprehensive income for the six months ended September 30, 2006 and 2005:

	Six Months Ended September 30, 2006	**2005**
Net income	$ 3,433	$ 1,639
Other comprehensive income:		
Foreign currency translation adjustments	352	(623)
Comprehensive income	$ 3,785	$ 1,016

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Goodwill and Other Acquired Intangible Asset

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets,* effective April 1, 2002 and, as a result, ceased to amortize goodwill at that time. The changes in the carrying amount of goodwill for the six months ended September 30, 2006 was as follows:

	2006
Balance as of April 1,	$ 74,409
Acquisition of BitForm	976
Acquisition of SealedMedia	10,792
Earn-out related to the acquisition of e-Onehundred Group	1,473
Foreign translation adjustment	2
Balance as of September 30,	$ 87,652

Other acquired intangible assets by major intangible asset class at September 30, 2006 were as follows:

	Acquired Value	Amortization Period in Years
Core technology	$ 4,210	3
Customer base	3,493	3 to 10
Patents	800	3
Trademarks	288	10 to 20
	$ 8,791	6.34 weighted average years

The other intangibles have no significant residual values. There are no other intangible assets which are not subject to amortization. Gross carrying amounts and accumulated amortization of the other acquired intangibles were as follows for each major intangible asset class:

STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	As of September 30, 2006 Gross Carrying Amount	Accumulated Amortization	Net Balances
Core technology	$ 4,210	$ (2,785)	$ 1,425
Customer base	3,493	(769)	2,724
Patents	800	(14)	786
Trademarks	288	(14)	274
	$ 8,791	$ (3,582)	$ 5,209

Amortization expense for other acquired intangible assets for the six months ended September 30, 2006 and 2005 was $855 and $1,020, respectively.

Estimated amortization expense for other acquired intangible assets is as follows for the years ending March 31:

2007 (remaining six months)	$ 952
2008	954
2009	620
2010	581
2011	581
Thereafter	1,521
	$ 5,209

The preceding expected amortization expense is an estimate. Actual amortization expense may differ from estimates due to additional intangible asset acquisitions, impairment of intangible assets, accelerated amortization of intangible assets and other events.

New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides related guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this standard.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No, 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors considered, is material. SAB 108 is effective for fiscal years ending on or after November 15, 2006, with early application encouraged. The Company does not believe that SAB 108 will have a material impact on its Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. Under SFAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity s own data. Fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of this standard.

Note 2. Basic and Diluted Net Income Per Common Share

Basic net income per share is computed using the weighted average number of shares outstanding of common stock. Diluted net income per share is computed using the weighted average number of shares of common stock and common equivalent shares outstanding during the period. Common equivalent shares consist of stock options and deferred share units, which were excluded from the computation if their effect is anti-dilutive. The components of basic and diluted net income per share computations were as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2006	2005	2006	2005
Net income as reported	$ 1,333	$ 557	$ 3,433	$ 1,639
Weighted average shares outstanding:				
Basic	29,844	28,101	29,626	27,815
Dilution associated with employee stock option and deferred share units	1,162	1,163	1,467	1,033
Diluted	31,006	29,264	31,093	28,848
Net income per share as reported:				
Basic	$ 0.04	$ 0.02	$ 0.12	$ 0.06
Diluted	$ 0.04	$ 0.02	$ 0.11	$ 0.06
Anti-dilutive stock options excluded from above calculation	1,314	2,124	1,195	2,302

STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

Note 3. Mergers and Acquisitions

On July 31, 2006, the Company acquired all of the outstanding shares of capital stock of SealedMedia Limited, a privately held provider of enterprise digital rights management solutions primarily located in the United Kingdom, for $10,000 in cash. The Company incurred approximately $361 in professional fees and other costs directly associated with the acquisition. The Company is also required to make potential earn-out payments up to $5,000 based upon revenue performance through June 30, 2007.

A restructuring plan was adopted as a result of the acquisition. The acquisition restructuring charge relates to severance costs for terminated employees of $161 and facility closing costs of $696 primarily related to lease obligations. As of September 30, 2006, approximately $15 and $493 were unpaid related to severance and facility costs, respectively. Under the purchase method of accounting, the total estimated consideration as shown in the table below is allocated to SealedMedia s tangible and intangible assets and liabilities based on their estimated fair values as of the date of completion of the SealedMedia acquisition. The excess of the purchase price over the net tangible and identifiable intangible assets (core technology, customer base, patents and trademarks, which will be amortized over a 3 to 20 year period) has been recorded as goodwill. The estimated consideration is allocated as follows:

Cash		$ 10,000
Direct transaction costs		361
Total purchase price		$ 10,361
Assets and liabilities acquired / assumed		
Cash and cash equivalents	$ 172	
Accounts receivable, net	128	
Prepaid expenses and other current assets	318	
Property and equipment, net	90	
Accounts payable	(182)	
Accrued liabilities	(1,714)	
Deferred revenue	(883)	
Net liabilities assumed		(2,071)
Goodwill		10,792
Intangible assets:		
Core technology	520	
Customer base	250	
Patents	800	
Trademarks	70	
Total intangible assets acquired		1,640
Total		10,361

A final determination of fair values may differ materially from the preliminary estimates and will include management s final valuation of the fair values of assets acquired and liabilities assumed. This final valuation will be based on the actual net tangible assets of SealedMedia that exist as of the date of the completion of the SealedMedia acquisition. The final valuation may change the allocations of purchase price, which could affect the fair value assigned to the assets and liabilities and could result in a change to the unaudited pro forma condensed combined financial statements data. Among the factors that could affect the preliminary fair value estimates are changes in the amounts allocated to core technology and other intangible assets, changes in the net realizable value of assets, and changes in accrued liability, accounts payable and deferred revenue balances.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisition of SealedMedia had occurred as of April 1, 2005:

STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	Six months ended September 30, 2006	2005
Net revenues	$ 1,658	$ 1,693
Net income (loss)	$ (2,067)	$ (2,316)
Net income (loss) per share:		
Basic	$ (0.07)	$ (0.08)
Diluted	$ (0.07)	$ (0.08)
Weighted average shares outstanding:		
Basic	29,626	27,815
Diluted	31,093	28,848

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisition occurred as of April 1, 2005, nor are they necessarily indicative of the results that may occur in the future.

On June 29, 2006, the Company acquired all of the outstanding capital stock of BitForm, a privately held provider of software cleansing technologies, for $1,200 in cash. The Company also incurred approximately $26 in professional fees and other costs directly associated with this acquisition. The purchase price was allocated to goodwill for approximately $946 and $280 was allocated to other acquired intangible assets (core technology, which will be amortized over a five year period). The Company is also required to make potential earn-out payments up to $1,300 based upon revenue performance over a one-year period from the date of the acquisition. Additional pro forma disclosures required under SFAS No. 141 related to this acquisition were not considered material.

Note 4. Equity-based Compensation

On April 1, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all equity-based payment awards made to employees and directors, including employee stock options and deferred share units (DSUs), to be based on estimated fair values. SFAS 123(R) supersedes the Company s previous accounting under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* for periods beginning April 1, 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of April 1, 2006. The Company s condensed consolidated financial statements as of and for the three and six months ended September 30, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company s condensed consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Equity-based compensation expense recognized under SFAS 123(R) for the three and six months ended September 30, 2006 was $1,263 and $2,382, respectively. Equity-based compensation expense for the three and six months ended September 30, 2005 was $119 and $213, respectively, which related to additional compensation expense to employee stock options. On a SFAS No. 123, *Accounting for Stock-Based Compensation* pro forma basis, equity-based compensation expense was $1,658 and $3,686 for the three and six months ended September 30, 2005, respectively. The following table illustrates how equity-based compensation was allocated to the Consolidated Statement of Operations as well as the effect on net income and net income per share of all equity-based compensation recognized under SFAS 123(R) during the three and six months ended September 30, 2006:

	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006
Cost of revenue	$ 194	$ 323
Sales and marketing	607	1,191
General and administrative	159	282
Research and development	303	586

Equity-based compensation before income taxes	1,263		2,382	
Income tax provision				
Total equity-based compensation after income taxes	$	1,263	$	2,382
Impact on basic earning per share	$	0.04	$	0.08
Impact on diluted earnings per share	$	0.04	$	0.08
Weighted average shares outstanding:				
Basic	29,844		29,626	
Diluted	31,006		31,093	

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STELLENT, INC.

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(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

The following table illustrates the effect on net income and net income (loss) per share as if the Company had applied the fair value recognition provisions of SFAS 123 to equity-based compensation during the three and six months ended September 30, 2005:

	Three Months Ended September 30, 2005	Six Months Ended September 30, 2005
Net income as reported	$ 557	$ 1,639
Add: Stock-based compensation included in net income as reported	119	213
Less: Total stock-based employee compensation expense determined under fair value based method for all awards	(1,658)	(3,686)
Net income (loss) pro forma	$ (982)	$ (1,834)
Weighted average shares outstanding:		
Basic	28,101	27,815
Diluted	29,264	28,848
Net income per share as reported:		
Basic	$ 0.02	$ 0.06
Diluted	$ 0.02	$ 0.06
Net income (loss) per share pro forma:		
Basic and diluted	$ (0.03)	$ (0.07)

SFAS 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The Company uses the Black-Scholes option-pricing model, which requires the input of significant assumptions including an estimate of the average period of time employees will retain vested stock options before exercising them, the estimated volatility of the Company s common stock price over the expected term and the number of options that will ultimately be forfeited before completing vesting requirements. Changes in the assumptions can materially affect the estimate of fair value of equity-based compensation and, consequently, the related expense recognized. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite vesting period in the Company s Consolidated Statement of Operations. Prior to the adoption of SFAS 123(R), the Company accounted for equity-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under SFAS 123. Under the intrinsic value method, equity-based compensation expense is recognized in the Company s Consolidated Statement of Operations when the exercise price of the Company s stock options granted to employees and directors exceeds the fair market value of the underlying stock at the date of grant.

Stock Options

Equity-based compensation expense recognized in the Company s Consolidated Statement of Operations for the three and six months ended September 30, 2006 included compensation expense for equity-based payment awards granted on or prior to March 31, 2006, but not yet vested as of that date. The compensation expense for these awards is based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, which was in effect on and prior to March 31, 2006. Compensation expense for the equity-based payment awards granted subsequent to March 31, 2006 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Because equity-based compensation expense recognized in the Consolidated Statement of Operations for the three and six months ended September 30, 2006 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. In the Company s pro forma information required under SFAS 123 for the periods prior to April 1, 2006, the Company accounted for forfeitures as they occurred.

The aggregate intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the option) exercised during the three and six months ended September 30, 2006 was $1,203 and $1,878, respectively. Cash received from the exercise of stock options for the three and six months ended September 30, 2006 was $1,830 and $3,227, respectively. The Company did not recognize a tax benefit from awards exercised for the three and six months ended September 30, 2006, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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The aggregate intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the option) exercised during the three and six months ended September 30, 2005 was $1,070 and $1,661, respectively. Cash received from the exercise of stock options for the three and six months ended September 30, 2005 was $1,760 and $2,382, respectively. The Company did not recognize a tax benefit from awards exercised for the three and six months ended September 30, 2005, respectively.

As of September 30, 2006, there was $7,361 of unrecognized compensation expense related to stock options that is expected to be recognized over a weighted-average period of 1.97 years.

The following table summarizes stock option activity for the six months ended September 30, 2006:

	Shares Underlying Options	Weighted-Average Exercise Price Per Share	Weighted-Average Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding as of March 31, 2006	5,773	$ 9.76		
Granted	1,334	$ 9.87		
Exercised	(472)	$ 6.84		
Forfeited/cancelled/expired	(236)	$ 8.35		
Total options outstanding as of September 30, 2006	6,399	$ 10.05	6.1	$ 17,883
Options exercisable as of September 30, 2006	3,722	$ 11.06	4.5	$ 11,899

For purposes of calculating the fair value of options under SFAS 123(R), the weighted average fair value of options granted during the three and six months ended September 30, 2006 was $3.43 and $3.47 per option, respectively. For purposes of calculating the fair value of options under FAS 123, the weighted average fair value of options granted during the three and six months ended September 30, 2005 was $3.30 and $3.17 per option, respectively. The weighted average fair values for the Plans and the non-plan options were based on the fair values on the dates of grant. The fair values for the Plans and the non-plan employee options were calculated using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2006	2005	2006	2005
Risk free interest yields	5.1 %	4.0 %	5.1 %	3.8 %
Dividend yield	1.1 %		1.1 %	
Volatility factor of expected market price of Company s stock	46 %	58 %	58 %	58 %
Weighted average expected life of options (years)	3.3	3.0	3.3	3.0

The risk-free interest rate assumption is based upon the interpolation of various U.S. Treasury STRIPS rates for a like term instrument at the date of option grant. The dividend yield is based on the Company s estimated annual dividend divided by the stock price on the dividend date. The volatility assumption is based on the historical daily price data of the Company s stock over a period equal to the expected life of the options. Management evaluated whether there were factors during that period which were unusual and which would distort the volatility figure if used to estimate future volatility and concluded that there were no such factors. The expected life of employee stock options represents the weighted-average period that the stock options are expected to remain outstanding. It is based upon an analysis of the historical behavior of options holders during the period from April 1995 to March 31, 2006. Management believes historical data is representative of future exercise behavior. As equity-based compensation expense recognized in the consolidated statement of operations pursuant to SFAS 123(R) is based on awards ultimately expected to vest, expense for grants beginning upon adoption of SFAS 123(R) on April 1, 2006 will be 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 significantly from those estimates. In the Company s pro forma information required under SFAS 123 for the periods prior to April 1, 2006, the Company accounted for forfeitures as they occurred.

STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

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Deferred Share Units

The Company granted nonvested shares of common stock (deferred share units or DSUs) to certain directors and employees under the Company s 2005 Equity Incentive Plan. The accounting for DSUs is based on the vesting schedule for the shares. If the vesting schedule is based only on the passage of time and continued employment (time-based), the award is expensed from the grant date to the expected vesting date based on the number of shares expected to vest and the stock price on the date of grant. The Company recognizes expense on a straight-line basis for the time-based awards. If the vesting is based on performance criteria (performance-based) that could cause the awards to vest over varying periods of time, or to not vest at all, the award is expensed from the grant date to the expected vesting date at the stock price at the date of grant using a graded vesting approach for those awards that the Company determines are probable of vesting. During the three and six months ended September 30, 2006, the Company granted both time-based and performance-based deferred share units that vest over periods ranging from three to five years. The fair value of the DSUs was determined by using the closing market price for the Company s stock on the date of grant for each DSUs. Under the agreements covering DSUs, the number of shares of common stock to be issued for unvested DSUs is increased for dividends paid by the Company while the unvested DSUs is outstanding. The unvested DSUs covered by a particular award are multiplied by the per share value of the dividend. The product of that calculation is divided by the closing market price for the Company s stock on the date the dividend is paid. The number of shares of common stock covered by the award is increased by the resulting amount. During the three and six months ended September 30, 2006, the number of unvested DSUs outstanding was increased slightly due to the $0.03 per share dividend paid by the Company. Equity-based compensation expense related to DSUs for the three and six months ending September 30, 2006 was $1 and $2, respectively. There was no equity-based compensation expense related to DSUs for the three and six months ending September 30, 2005.

A summary of the Company s DSUs activity, for the six months ended September 30, 2006:

	Units	Weighted-Average Exercise Price Per Unit
Outstanding as of March 31, 2006		$
Granted	63	11.94
Exercised	(3)	12.08
Forfeited	(8)	11.95
Outstanding as of September 30, 2006	52	$ 11.93

As of September 30, 2006, there was $519 of unrecognized compensation expense related to DSUs that is expected to be recognized over a weighted-average period of 2.7 years.

Note 5. Contingencies

The Company is subject to various claims and litigation in the ordinary course of its business, including employment matters and intellectual property claims. Management does not believe the outcome of any current legal matters will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Note 6. Restructuring Charges

The Company initiated four restructuring plans during fiscal year 2003 in an effort to better align its expenses and revenues in light of economic conditions at the time. The Company adopted SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, effective January 1, 2003 and has accounted for restructuring charges initiated after December 31, 2002 under its provisions. At September 30, 2006, there were no remaining obligations to be paid in connection with the restructuring plans initiated during fiscal year 2003. In connection with the integration of Optika and with the Company s plans to continue to reduce costs and improve operating efficiencies, the Company adopted two restructuring plans during fiscal 2005. At September 30, 2006, approximately $130 remained to be paid in connection with these initiatives.

During the second quarter of fiscal year 2006, the Company adopted a restructuring plan to reorganize its international sales operations and consolidate certain general and administrative activities. The initial charge of $508 was recognized during the second quarter of fiscal year 2006, which included the costs for pay and benefits related to the involuntary termination of 8 employees of approximately $321 with the remaining $187 related to the closure of the Company s Brazilian facility. In the third quarter and fourth quarter of fiscal year 2006 a change of estimate was recorded which resulted in $67 and $28, respectively, of additional expense related to this restructuring plan. The second restructuring plan resulted in a charge of $513 which was recorded during the fourth

STELLENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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quarter of fiscal year 2006. The expense recognized included costs for pay and benefits of approximately $470 that were related to the involuntary termination of 20 employees and the remaining $43 related to other exit costs necessary to the elimination of our digital asset management group as the technology has been fully integrated into our other software products. At September 30, 2006 approximately $42 remained to be paid in connection with this charge.

Employee termination benefit costs of $166 will be paid out through January 2007 and the other exit costs totaling $6 will be paid out through January 2007.

Selected information regarding the restructuring charges and related accrued liabilities by restructuring plan is as follows:

	Second Quarter 03	First Quarter 05		Fourth Quarter 05		Second Quarter 06		Fourth Quarter 06		
	Other Exit Costs	**Employee Termination Benefits**	**Other Exit Costs**	**Employee Termination Benefits**	**Other Exit Costs**	**Employee Termination Benefits**	**Other Exit Costs**	**Employee Termination Benefits**	**Other Exit Costs**	**Total**
Balance at April 1, 2003	$ 304	$	$	$	$	$	$	$	$	$ 304
Expense										
Payments	(65)									(65)
Change in estimate	360									360
Balance at June 30, 2003	599									599
Payments	(43)									(43)
Balance at September 30, 2003	556									556
Payments	(43)									(43)
Balance at December 31, 2003	513									513
Payments	(49)									(49)
Change in estimate										
Balance at March 31, 2004	464									464
Expense		1,866	595							2,461
Payments	(48)	(306)								(354)
Balance at June 30, 2004	416	1,560	595							2,571
Payments	(33)	(794)	(81)							(908)
Balance at September 30, 2004	383	766	514							1,663
Payments	(51)	(391)	(81)							(523)
Balance at December 31, 2004	332	375	433							1,140
Expense				990	114					1,104
Payments	(51)	(36)	(87)	(348)	(7)					(529)
Change in estimate		32								32
Balance at March 31, 2005	281	371	346	642	107					1,747

Payments	(87)	(91)	(87)	(265)	(142)					(672)
Change in estimate	(57)			27	47					17
Balance at June 30, 2005	137	280	259	404	12					1,092
Expense						321	187			508
Payments	(79)		(91)	(216)	(12)	(160)	(43)			(601)
Change in estimate			140							140
Balance at September 30, 2005	58	280	308	188		161	144			1,139
Payments	(42)	(9)	(91)	(63)		(113)	(81)			(399)
Change in estimate						67				67
Balance at December 31, 2005	16	271	217	125		115	63			807
Expense								470	43	513
Payments			(91)	(69)		(115)	(34)	(257)	(11)	(577)
Change in estimate		(150)				28				(122)
Balance at March 31, 2006	$ 16	$ 121	$ 126	$ 56	$	$ 28	$ 29	$ 213	$ 32	$ 621
Payments	(4)		(90)	(51)		(18)	(22)	(124)	(32)	(341)
Balance at June 30, 2006	$ 12	$ 121	$ 36	$ 5	$	$ 10	$ 7	$ 89	$	$ 280
Payments	(12)	(2)	(30)			(10)	(7)	(47)		(108)
Balance at September 30, 2006	$	$ 119	$ 6	$ 5	$	$	$	$ 42	$	$ 172

STELLENT, INC.

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Note 7. Subsequent Event

On November 2, 2006, the Company entered into an Agreement and Plan of Merger with Oracle Systems Corporation (Oracle), and a wholly owned subsidiary of Oracle, providing for the merger of that subsidiary with and into our company. Following consummation of the merger, the Company would be a wholly owned subsidiary of Oracle. Under the terms of the merger agreement, the Oracle subsidiary has agreed to make a cash tender offer for all outstanding shares of our common stock at $13.50 per share. As soon as practicable following the completion of the offer, the Oracle subsidiary has agreed to effect the merger described above. Upon the consummation of the merger, each share of our common stock not purchased in the offer would be converted into the right to receive $13.50 per share in cash. The consummation of each of the tender offer and the merger is subject to certain customary conditions, including regulatory approval.

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

FORWARD-LOOKING STATEMENTS

This Form 10-Q for the period ended September 30, 2006 contains certain forward-looking statements within the meaning of the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Such forward-looking statements are based on the beliefs of our management as well as on assumptions made by, and information currently available to, us at the time such statements were made. When used in this Form 10-Q, the words approximate, anticipate, believe, estimate, expect, intend and similar expressions, as they relate us, are intended to identify such forward-looking statements. Although we believe these statements are reasonable, readers of this Form 10-Q should be aware that actual results could differ materially from those projected by such forward-looking statements as a result of the risk factors listed below. Readers of this Form 10-Q should consider carefully the factors listed below, as well as the other information and data contained in this Form 10-Q. We caution the reader, however, that such list may not be exhaustive and that those or other factors, many of which are outside of our control, could have a material adverse effect on us and our results of operations. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth hereunder. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

OVERVIEW

In 1997, we launched one of the first software product suites on the market that was fully developed and created expressly for Web-based content and document management. At the time, content management today considered a critical component of an organization s communication and information technology (IT) infrastructure was an emerging technology used to help companies easily and quickly share information with employees, partners, customers and prospects using the World Wide Web.

Currently, our suite of software solutions help customers worldwide solve business problems related to efficiently creating, managing, sharing and archiving critical information.

We help our customers optimize the use of our software products by providing them with value-based consulting services related to their content management needs. We also provide our customers with a range of product support programs that allow them to select maintenance and support services that are appropriate for their business.

PRODUCTS AND SERVICES

Stellent s products and services consist of content management, filtering and conversion software products; electronic content management consulting services; and post-contract software maintenance and support.

Licenses of Content Management, Filtering and Conversion Software

Universal Content Management is Stellent s primary software product, consisting of a unified architecture and product which power multiple applications. These applications help organizations manage their business information such as records, legal documents such as contracts, business documents, presentations, Web content and graphics via the Web, from the time its created to the time its archived or disposed of, so employees, customers, partners and investors can more easily find, access and re-use that information. With Stellent software, customers can increase employee productivity, reduce expenses and improve company-wide collaboration and communication.

Our Universal Content Management software addresses the key elements of content management document management and imaging, Web content management, digital asset management, records and retention management, and collaboration from a unified architecture, enabling customers to fully leverage their content management investment across the organization. We believe our tightly integrated products allow companies to implement content management-based applications using fewer products and consulting services than other content management offerings, which can lead to a lower total cost of ownership.

Both technical and non-technical users find using the Stellent system easy. Users can submit, or contribute, business content such as a word processing document, spreadsheet, CAD file or image to the Stellent system, and the Stellent technology automatically converts the file to a format that can be viewed on a Web site without needing the software application that created the file. This automatic conversion capability enables even non-technical users to easily publish information to a site, such as an employee portal or partner extranet, so the information can be shared with other users.

Our Universal Content Management software is comprised primarily of Stellent Content Server a data repository that provides a core set of content services to help ensure users can access only the most current information as appropriate to their role or permissions the following five key content management application modules:

- *Web Content Management:* Enables organizations to create web content, and manage and publish Web sites.

- *Document Management and Imaging:* Provides Web-based management, collaboration and access to business information created in common office software applications or created as paper documents which are then converted into electronic images.

- *Digital Asset Management:* Enables digital assets such as photos, graphics, audio clips and video clips to be searched, accessed, viewed, managed, distributed and re-purposed via the Web.

- *Records and Retention Management:* Provides a Web-based method for managing business records and creating rules such as expiration, archiving and deletion regarding how long content needs to be retained and what actions to take regarding the content.

- *Collaboration Management:* Enables the creation of a project or team space for sharing documents, schedules and discussions among a team via the Web.

Stellent also offers end-user and OEM customers the content filtering and conversion components of its Universal Content Management software. These technologies make information created in more than 390 common office software applications more accessible to the business users who need it. Since business information is often difficult to access without the native software application in which it was created, Stellent s technologies convert files into any one of 11 common output formats, empowering users to locate and view information without needing the software application that created the file. Other technology companies embed these technologies in their own solutions to enable them to extract text and metadata and provide a high-fidelity view of file contents.

Services

Our services group is focused on delivering value-based content management solutions to our customers. Our services professionals employ a combination of business analysis, enterprise architecture, application analysis, installation, configuration, development and integration skills with experience-based project methodology and management knowledge to facilitate the rollout of content management solutions at all levels of a customer s organization. Available on a worldwide basis, we act as a business partner to our customers by providing a broad spectrum of services including:

- Technical architecture analysis and needs assessment, such as software, security and metadata analysis

- Solutions development and deployment strategies

- Software installation and configuration

- Custom application development

- Third party product integration

- Project management

- Knowledge transfer

These services can be offered in conjunction with our software products to new customers, or on a stand alone basis to our existing customers to assist them in driving additional content management solutions across their enterprises. These services are sold in conjunction with our *software products and are offered for fees, the amount of which depends on the nature and scope of the project.*

Post-Contract Customer Support

We offer several post-contract customer support programs that allow customers to select the offering(s) that best satisfies their maintenance and support requirements. From the initial installation and configuration of Stellent to the point of application deployment, our post-contract customer support resources offer customer service through quick response time, trouble-shooting and the delivery of complete and comprehensive technical solutions. Customers may access product support resources on a worldwide basis for assistance during the customer s normal business hours. Additional support offerings are available which supplement the customer s post-contract customer support requirements.

Post-contract customer support offerings are renewable on an annual basis and are typically priced as a percentage of the product license fees or percentage of product list price.

RESULTS OF OPERATIONS

THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

REVENUES

	Three Months Ended September 30, 2006	2005	Change	Six Months Ended September 30, 2006	2005	Change
	(in thousands, except for percentages)					
Product licenses	$ 14,491	$ 13,321	9 %	$ 28,844	$ 27,049	7 %
Services	8,527	6,938	23 %	16,206	12,098	34 %
Post-contract support	10,710	9,888	8 %	21,020	19,561	7 %
Total	$ 33,728	$ 30,147	12 %	$ 66,070	$ 58,708	13 %
As a percentage of total revenues:						
Product licenses	43 %	44 %		44 %	46 %	
Services	25 %	23 %		24 %	21 %	
Post-contract support	32 %	33 %		32 %	33 %	

Revenues totaled $33.7 million and $66.1 million for the second quarter and first half of fiscal year 2007, respectively, compared to $30.1 million and $58.7 million for the second quarter and first half of fiscal year 2006, respectively. Total revenues for the second quarter and first half of fiscal year 2007 were up $3.6 million and $7.4 million, or 12% and 13%, respectively, from the second quarter and first half of fiscal year 2006. The overall increase in revenues was due primarily to the significant amount of growth in our consulting services revenue for the second quarter and the first half of fiscal year 2007, when compared to the same prior year periods. The services revenue growth continues to be concentrated primarily within our international operations as we continue to experience a strong demand from our customers to assist them in implementing and deploying our software products across their enterprise. We also experienced an increased demand for our universal content management technology, resulting in a $1.3 million increase in end-user product license revenue during the second quarter of fiscal year 2007, when compared to the same period in the prior year. Our license sales to our OEM customers for the first half of fiscal year 2007 was up approximately $1.8 million, when compared to first half of fiscal year 2006, as a result of an increase demand for our filtering and conversion technology. Our post-contract support revenue continues to increase and accounted for $0.8 million of the increase for the second quarter of fiscal year 2007 as our installed base continues to expand. The remaining increase for the second quarter of fiscal year 2007, when compared to the same period in the prior year was attributed to our acquisition of SealedMedia. The additional increase in our post-contract support for the first half of 2007, when compared to the first half of fiscal year 2006 relates to the organic growth of our install base.

Product Licenses

Revenues generated from product licenses totaled $14.5 million and $28.9 million for the second quarter and first half of fiscal year 2007, respectively, increases of $1.2 million and an increase of $1.8 million, or 9% and 7%, respectively, from $13.3 million and $27.0 million in the second quarter and first half of fiscal year 2006, respectively. The increase in product license revenues for the second quarter of fiscal year 2007, when compared to the same period in the prior year can be attributed to increased demand for our universal content management software products to our end users, specifically internationally, where our license sales had increased approximately $2.7 million, partially offsetting this increase was a decline in our domestic Sarbanes/Oxley Solution and Universal Content Management license orders from the US federal government. The increase in license revenue for the first half of fiscal year 2007, when compared to the first half of fiscal year 2006 can be attributed to an increased demand for our filtering and conversion technology to our OEM customers.

Services

Revenues for services, consisting of consulting services, training and billable expenses, totaled $8.5 million and $16.2 million for the second quarter and first half of fiscal year 2007, respectively, increases of $1.6 million and $4.1 million, or 23% and 34%, respectively, from $6.9 million and $12.1 million in the second quarter and first half of fiscal year 2006, respectively. The increase in revenues for services was due to an increased number of service engagements associated with the increase in universal content management product license revenue, specifically internationally, where our services revenues were up $1.9 million and $3.4 million for the second quarter and first half of fiscal year 2007, when compared to the same periods in the prior year. Our consulting services revenue for implementing our compliance software has decreased $0.6 million during the first half of fiscal year 2007, when compared to the same period in the prior year as a result of lower domestic sales of our Sarbanes / Oxley Solutions software product.

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Customers use our consulting services to facilitate the adoption or our software or supplement their internal information technology staff in software implementation projects. Our consulting service revenue relates almost exclusively to end-user customers, as our OEM customer embed our software in their own software and they in turn perform the consulting services to their own end-user customers. Revenues related to consulting services work can increase as a result of a larger install base of products with end-user customers. A decline in product license revenues to end-users customers may result in fewer consulting services engagements.

Post-Contract Support

Revenues for post-contract support for the second quarter and first half of fiscal year 2007 totaled $10.7 million and $21.0 million, respectively, increases of $0.8 million and $1.5 million, or 8% and 7%, respectively, from $9.9 million and $19.6 million in the second quarter and first half of fiscal year 2006, respectively. Approximately $0.2 million of the increase in the second quarter of fiscal year 2007, when compared to the same period in the prior year can be attributed to revenue generated from the install base of SealedMedia. The remaining increase in revenues for the second quarter and first half of 2007, when compared to the same periods in the prior year for our post-contract support was due to supporting a larger customer installed base of software products

As we license our products, whether on a perpetual basis to our end-user customers, or on a term basis to OEM customers, our installed base of software products increases. Since the rate of annual renewals of post-contract customer support services on our software products has remained high, our post-contract customer support revenues grow because we have a larger installed base of products. Since post-contract customer support contracts are generally sold with each license transaction, a decline in license revenues may also result in a decline in post-contract customer support revenues. However, since post-contract customer support revenues are recognized over the duration of the support contract, the impact would lag behind a decline in license revenues.

COST OF REVENUES AND GROSS PROFIT

Cost of Revenues   General

	Three Months Ended September 30,			Six Months Ended September 30,		
	2006	**2005**	**Change**	**2006**	**2005**	**Change**
	(in thousands, except for percentages)					
Cost of product licenses	$ 783	$ 815	(4)%	$ 1,611	$ 1,975	(18)%
Cost of amortization of capitalized software from acquisitions	339	443	(23)%	646	859	(25)%
Cost of services	7,368	6,484	14 %	14,271	11,509	24 %
Cost of post-contract support	1,813	1,956	(7)%	3,538	3,806	(7)%
Total cost of revenues	$ 10,303	$ 9,698	6 %	$ 20,066	$ 18,149	11 %
Gross profit	$ 23,425	$ 20,449	15 %	$ 46,004	$ 40,559	13 %
As a percentage of total revenue:						
Cost of product licenses	2 %	3 %		2 %	3 %	
Cost of amortization of capitalized software from acquisitions	1 %	1 %		1 %	2 %	
Cost of services	22 %	22 %		22 %	20 %	
Cost of post-contract support	6 %	6 %		5 %	6 %	
Total cost of revenues	31 %	32 %		30 %	31 %	
Gross margin	69 %	68 %		70 %	69 %	

Total cost of revenues increased by $0.6 million and $1.9 million, or 6% and 11%, respectively, to $10.3 million and $20.1 million for the second quarter and first half of fiscal 2007 when compared to the same periods in fiscal year 2006. Total cost of revenues as a percentage of total revenues was 31% and 30% for the second quarter and first half of fiscal year 2007, compared to 32% and 31% for the same periods in fiscal year 2006. Overall gross profit increased by $3.0 million and $5.4 million, or 15% and 13%, to $23.4 million and $46.0 million for the second quarter and first half of fiscal year 2007, respectively, when compared to the second quarter

and first half of fiscal year 2006. Total gross profit as a percentage of total revenues was 69% and 70% for the second quarter and first half of fiscal year 2007, compared to 68% and 69% for the same periods in fiscal year 2006. Our overall gross profit percentage was slightly higher in the second quarter and first half of fiscal year 2007, when compared to the same periods a year ago as a result of an improvement in our gross margin percentages for our product and services. The increase in absolute gross product dollars was attributable to the increase in product license, services and post-contract support revenues described above. Our overall gross profit was impacted during the second quarter and first half of fiscal year 2007 by approximately $0.2 million and $0.3 million, respectively, as a result of the adoption of SFAS 123(R) during the first quarter of fiscal year 2007.

Cost of Revenues Product Licenses

	Three Months Ended September 30,			Six Months Ended September 30,		
	2006	2005	Change	2006	2005	Change
	(in thousands, except for percentages)					
Cost of product licenses	$ 783	$ 815	(4)%	$ 1,611	$ 1,975	(18)%
Cost of amortization of capitalized software from acquisitions	339	443	(23)%	646	859	(25)%
Total cost of product licenses	$ 1,122	$ 1,258	(11)%	$ 2,257	$ 2,834	(20)%
Gross profit product licenses	$ 13,369	$ 12,063	11 %	$ 26,587	$ 24,215	10 %
As a percentage of product license revenue:						
Cost of product licenses	6 %	6 %		6 %	7 %	
Cost of amortization of capitalized software from acquisitions	2 %	3 %		2 %	3 %	
Total cost of product license revenues	8 %	9 %		8 %	10 %	
Product license gross margin	92 %	91 %		92 %	90 %	

Cost of revenues for product licenses. Cost of product licenses includes expenses incurred to manufacture, package and distribute our software products and related documentation, as well as costs of licensing third-party software embedded in or sold in conjunction with our software products. Cost of revenues for product licenses in the second quarter and first half of fiscal year 2007 totaled $1.1 million and $2.3 million, respectively, a decrease of $0.2 million and $0.5 million, from $1.3 million and $2.8 million in the second quarter and first half of fiscal year 2006. Gross profit as a percentage of revenues for product licenses was up to 92% for both the second quarter and first half of fiscal year 2007, compared to 91% and 90% for the same periods in fiscal year 2006. The decrease in cost of revenues for product licenses was due to lower third-party software royalty costs associated with technology incorporated into our end-user software products during the second quarter of fiscal year 2007, when compared to the same period a year ago. Also contributing to the overall decrease in our cost of product license during the first half of fiscal year 2007, when compared to the same period in the prior year was the result of higher levels of sales to our OEM customers, which carry a higher gross margin percentage than sales to our end-user customers. Sales to our OEM customers were approximately $1.8 million higher in the first half of fiscal year 2007, when compared to the same period in the prior year.

Amortization of Capitalized Software from Acquisitions. Cost of product license revenues related to amortization of capitalized software from acquisitions was approximately $0.3 million and $0.6 million for the second quarter and first half of fiscal year 2007 compared to $0.4 million and $0.9 million for the second quarter and first half of fiscal year 2006. The cost of revenues for amortization of capitalized software from acquisitions was attributable to the amortization of capitalized software obtained in the acquisition of certain assets Active IQ, Ancept, Optika, the e-Onehundred Group, BitForm and SealedMedia, in March 2003, August 2003, May 2004, June 2005, June 2006 and July 2006, respectively. The slight decrease in cost of revenues related to amortization of capitalized software from fiscal 2007 compared to fiscal 2006 was attributable to the completion of amortization of capitalized software during fiscal year 2006 related to the Active IQ and Ancept acquisitions. This was partially offset by amortization expense recognized in connection with our acquisition of BitForm starting in July 2006 and SealedMedia in August of 2006. We acquired technology from the companies listed above for incorporation into our end-users and OEM products in order to maintain competitive functionality.

Cost of Revenues Services

	Three Months Ended September 30, 2006	2005	Change	Six Months Ended September 30, 2006	2005	Change
	(in thousands, except for percentages)					
Services cost of revenue	$ 7,368	$ 6,484	14 %	$ 14,271	$ 11,509	24 %
Gross profit services	$ 1,159	$ 454	155 %	$ 1,935	$ 589	229 %
As a percentage of respective revenue:						
Cost of services	86 %	93 %		88 %	95 %	
Gross profit	14 %	7 %		12 %	5 %	

Cost of services revenues, consisting of personnel, billable and unbilled travel expenses and other operating expense, increased by $0.9 million and $2.8 million, or 14% and 24%, to $7.4 million and $14.3 million for the second quarter and first half of fiscal year 2007, when compared to the same period in the prior year. Gross profit as a percentage of revenues for services improved to 14% and 12% for the second quarter and first half of fiscal year 2007, compared to gross margin percentages of 7% and 5% for the same periods in fiscal year 2006. The overall increase in cost of services relates to personnel and outside contractors needed to generate the additional $1.6 million and $4.1 million of services revenue in the second quarter and first half of fiscal year 2007, when compared to the periods a year ago. The overall increase in our gross profit margin on services was due to high levels of consulting and training revenue, along with higher utilization of our employees and increased bill rates. We have made significant changes in our services organization over the past twelve months, resulting in increased efficiencies and cost reductions, which also have contributed to the overall improvement in our services gross margin percentage. We have also continued to add consultants within our services group which has allowed us to source a larger number of engagement through internal resources versus outside contractors resulting continued improvement in our gross margin percentage in fiscal year 2007, when compared to the prior fiscal year. We recognized approximately $0.2 million and $0.3 million of compensation expense during the second quarter and first half of fiscal year 2007, respectively, as a result of our adoption of SFAS 123(R).

Since our support and service revenues have lower gross margins than our license revenues, our overall gross margins will typically decline if our support and service revenues increase as a percent of total revenues. Our cost of support and service revenues as a percentage of support and service revenues may vary from period to period, depending in part on whether the services are performed by our in-house staff, subcontractors or third-party system integrators. If our customers perform more services activities in-house or increase the use of third-party systems integrators, our support and service revenues and cost of support and service revenues realized on a per-customer basis may decline and result in lower gross margins.

Cost of Revenues Post-Contract Support

	Three Months Ended September 30, 2006	2005	Change	Six Months Ended September 30, 2006	2005	Change
	(in thousands, except for percentages)					
Post-contract support cost of revenue	$ 1,813	$ 1,956	(7)%	$ 3,538	$ 3,806	(7)%
Gross profit post-contract support	$ 8,897	$ 7,932	12 %	$ 17,482	$ 15,755	11 %
As a percentage of respective revenue:						
Post-contract support	17 %	20 %		17 %	19 %	
Gross profit	83 %	80 %		83 %	81 %	

Cost of post-contract support services, consisting of personnel and other operating expenses, decreased by $0.1 million and $0.3 million, or 7%, to $1.8 million and $3.5 million for the second quarter and first half of fiscal year 2007, when compared to the same periods in fiscal year 2006. Gross profit as a percentage of post-contract support increased to 83% for both the second quarter and first half of fiscal year 2007 from 80% and 81% for the second quarter and first half of fiscal year 2006. The increase in the gross profit dollars was due to a growing installed base of software products. The overall increase in gross margin percentage was due to lower levels of personnel costs within our support organization during the second quarter and first half of fiscal year 2007, when compared to the same periods a year ago.

Since our post-contract support revenues have lower gross margins than our license revenues, our overall gross margins will typically decline if our post-contract support revenues increase as a percent of total revenues. Our cost of post-contract support as a percentage of post-contract support revenues may vary from period to period, depending in part on whether we are able to sell post-contract support on new product license revenue and also if our annual renewal rates with our existing customers continues to remain high. Any significant change in our annual renewal rates could result in a decline in our gross profit margins.

OPERATING EXPENSES

Sales and Marketing

	Three Months Ended September 30,			**Six Months Ended September 30,**		
	2006	**2005**	**Change**	**2006**	**2005**	**Change**
	(in thousands, except for percentages)					
Sales and marketing	$ 13,063	$ 11,712	12 %	$ 25,421	$ 23,148	10 %
Percentage of total revenues	39 %	39 %		38 %	39 %	

Sales and marketing expenses consist of salaries, commissions, benefits and related costs for sales and marketing personnel, travel and marketing programs, including customer conferences, promotional materials, trade shows and advertising. Sales and marketing expenses were $13.1 million and $25.4 million for the second quarter and first half of fiscal year 2007, an increase of $1.4 million and $2.3 million, or 12% and 10%, when compared to the same periods in fiscal year 2006. As a percentage of total revenues, sales and marketing expenses were 39% and 38% for the second quarter and first half of fiscal year 2007, compared to 39% for both the second quarter and first half of fiscal year 2006. The increase in sales and marketing costs in the second quarter of fiscal year 2007, when compared to the same period a year ago was due to our adoption of SFAS 123(R) in which we recorded approximately $0.6 million of compensation expense, where none was recorded in the same period in the prior year. We also incurred integration costs in connection with our acquisition of BitForm and SealedMedia which totaled approximately $0.5 million during the second quarter of fiscal year 2007. The remaining increase in sales and marketing costs for the second quarter of fiscal year 2007, when compared to the same period in the prior year was due to additional variable compensation costs associated with the additional revenue generated. The increase in sales and marketing costs for the first half of fiscal year 2007, when compared to the same period in the prior year was due to the previously noted integration charge of $0.5 million, along with our adoption of SFAS 123(R) under which we had recorded $1.2 million of compensation expense year-to-date in fiscal 2007 versus none in the prior year. The remaining increase can be attributed to the variable compensation costs associated with the higher levels of revenue. Partially offsetting these increased expenses was a $0.4 million reduction in expenses during the first half of fiscal year 2007, when compared to the same period a year ago related to severance costs associated with the departure of our Executive Vice President of Field Operations during the first quarter of fiscal year 2006. The overall decrease in sales and marketing as a percentage of revenue is primarily due to a larger revenue base, achieving improved productivity from our sales personnel and the sales restructuring actions taken during fiscal 2006.

General and Administrative

	Three Months Ended September 30,			**Six Months Ended September 30,**		
	2006	**2005**	**Change**	**2006**	**2005**	**Change**
	(in thousands, except for percentages)					
General and administrative	$ 3,753	$ 2,812	33 %	$ 6,949	$ 5,982	16 %
Percentage of total revenues	11 %	9 %		11 %	10 %	

General and administrative expenses consist of salaries and related costs for general corporate functions, including finance, accounting, human resources, legal and information technology, as well as insurance, professional fees and bad debt expense. For the second quarter and first half of fiscal year 2007, general and administrative expenses were $3.8 million and $6.9 million, an increase of $1.0 million and $0.9 million, or 33% and 16%, from $2.8 million and $6.0 million for the second quarter and first half of fiscal year 2006. The increase in general and administrative expenses during the second quarter of fiscal year 2007, when compared to the

same period a year ago was primarily due to $0.4 million of additional bad debt expense, $0.3 million of personnel costs and approximately $0.2 million of stock compensation expense related to our adoption of SFAS 123(R) in fiscal year 2007. We also incurred approximately $0.1 million of costs associated with the integration of BitForm and SealedMedia. The increase for the first half of fiscal year 2007, when compared to the same period in the prior year was again due to approximately $0.5 million of additional contract labor and personnel costs, $0.3 million of additional bad debt expense, $0.3 million of stock compensation expense and $0.1 million of integration costs mentioned above. These increases were partially offset by $0.2 million reduction in professional fees associated with our compliance with the Sarbanes-Oxley Act of 2002.

Research and Development

	Three Months Ended September 30,			Six Months Ended September 30,		
	2006	**2005**	**Change**	**2006**	**2005**	**Change**
	(in thousands, except for percentages)					
Research and development	$ 5,832	$ 4,895	19 %	$ 11,350	$ 9,551	19 %
Percentage of total revenues	17 %	16 %		17 %	16 %	

Research and development expenses consist of salaries and benefits, third-party contractors, facilities and related overhead costs associated with our product development and quality assurance activities. For the second quarter and first half of fiscal year 2007, research and development expenses totaled $5.8 million and $11.4 million, compared to $4.9 million and $9.6 million for the second quarter and first half of fiscal year 2006. Our research and development efforts continue to be focused on enhancing our many products. The increase in research and development during the second quarter of fiscal year 2007, when compared to the same period a year ago was due to $0.6 million of additional personnel costs primarily associated with the employees acquired through our acquisition of both BitForm and SealedMedia. Also, we recorded stock compensation expense of $0.3 million during the second quarter of fiscal year 2007, as a result of adopting SFAS 123(R) in fiscal year 2007 versus none in the same period a year ago. The increase when comparing the first half of fiscal year 2007 to the first half of fiscal year 2006 was due to $1.1 million of additional personnel costs, of which approximately $0.4 million can be attributed to employees acquired through our acquisition of BitForm and SealedMedia. We also recognized approximately $0.6 million of stock compensation expense during the first half of fiscal year 2007 versus none in the same period in the prior year.

Amortization of Acquired Intangible Assets and Other

	Three Months Ended September 30,			Six Months Ended September 30,		
	2006	**2005**	**Change**	**2006**	**2005**	**Change**
	(in thousands, except for percentages)					
Amortization of acquired intangible assets and other	$ 116	$ 210	(45)%	$ 209	$ 374	(44)%
Percentage of total revenues	%	1 %		%	1 %	

During the second quarter and first half of fiscal year 2007, amortization of acquired intangible assets consisted of amortization expense associated with the amount of the purchase price allocated to Optika s, e-Onehundred Group s, BitForm s and SealedMedia s customer base, patents and trademarks acquired in the acquisitions of the respective entities. During the second quarter and first half of fiscal year 2005, amortization of acquired intangible assets and other, also included stock compensation expense related to the unvested stock options acquired in the acquisition of Optika.

Other Income (Expense)

	Three Months Ended September 30,			Six Months Ended September 30,		
	2006	**2005**	**Change**	**2006**	**2005**	**Change**
	(in thousands, except for percentages)					
Interest income	$ 741	$ 478	55 %	$ 1,490	$ 893	67 %
Percentage of total revenues	2 %	2 %		2 %	2 %	

For the second quarter and first half of fiscal year 2007, interest income, net $0.7 million and $1.5 million, an increase of $0.2 million and $0.6 million, or 55% and 67%, from $0.5 million and $0.9 million for the second quarter and first half of fiscal year 2006. The increase in interest income, net was mainly due to higher interest rates on cash, cash equivalents, and marketable securities of approximately $0.2 million in the second quarter of fiscal year 2007 when compared to the same period in fiscal year 2006. In the first half of fiscal year 2007, when compared to the same periods in fiscal year 2006, interest income, net increased approximately $0.4 million due to higher interest rates on cash, cash equivalents, and marketable securities and approximately $0.2 million due to an increase in the average balance of invested funds.

Income Taxes

	Three Months Ended September 30,			Six Months Ended September 30,		
	2006	2005	Change	2006	2005	Change
	(in thousands, except for percentages)					
Provision for income taxes	$ 69	$ 93	(26)%	$ 132	$ 93	42 %
Percentage of total revenues	%	%		%	%	

During the second quarter and first half of fiscal year 2007 our provision for income tax totaled approximately $0.1 million for both periods versus $0.1 million when compared to the same periods in the prior year. Our tax provision primarily related to the Alternative Minimum Tax and FAS 109 *Accounting for Income Taxes*.

Net Operating Loss Carryforwards

As of September 30, 2006, we had net operating loss carryforwards of approximately $160 million. The net operating loss carryforwards will expire at various dates beginning in 2010, if not utilized. The Tax Reform Act of 1986 imposes substantial restrictions on the utilization of net operating losses and tax credits in the event of an ownership change of a corporation. Our ability to utilize net operating loss carryforwards on an annual basis will be limited as a result of ownership changes in connection with the sale of equity securities. We have provided a valuation allowance against the entire amount of the deferred tax asset as of September 30, 2006 because of uncertainty regarding its full realization. Our accounting for deferred taxes involves the evaluation of a number of factors concerning the realizability of our deferred tax assets. In concluding that a valuation allowance was required, management considered such factors as our history of operating losses, potential future losses and the nature of our deferred tax assets.

Liquidity and Capital Resources

We have funded our operations and satisfied our capital expenditure requirements primarily through revolving working capital term loans from banking institutions, private placements and public offerings of securities.

To date, we have invested our capital expenditures in property and equipment, consisting largely of computer hardware and software. Capital expenditures for the six months ended September 30, 2006 were $1.1 million. We have also entered into capital and operating leases for facilities and equipment. We expect that our capital expenditures will increase as our employee base grows.

As of September 30, 2006, we had $70.4 million in cash and marketable securities and $68.8 million in working capital. We currently believe that our cash and cash equivalents on hand will be sufficient to meet our working capital requirements for the foreseeable future, particularly through March 31, 2007. On a longer term basis, we may require additional funds to support our working capital requirements or for other purposes and may seek to raise such additional funds through public or private equity financings or from other sources. We cannot be certain that additional financing will be available on terms favorable to us, or on any terms, or that any additional financing will not be dilutive.

Cash, cash equivalents and marketable securities decreased $11.4 million, or approximately 14% or $70.4 million as of September 30, 2006 from $81.8 million at March 31, 2006. The decrease was primarily due to cash paid for our acquisition of BitForm and SealedMedia, which together totaled approximately $12.1 million, $1.5 million of additional consideration paid to the former shareholders of E-100 and $1.8 million in dividends to our shareholders. We also incurred $1.1 million in capital expenditures during the first six months of fiscal year 2007. These amounts were offset by the $6.3 million of positive cash flow generated from operations during the six months ended September 30, 2006 and the proceeds of stock options exercises.

Our sources and uses of cash were as follows (in thousands):

	Six Months Ended September30,	
	2006	2005
Cash provided by operating activities	$ 3,139	$ 4,515
Cash used in investing activities	(4,379)	(9,447)
Cash provided by financing activities	1,065	2,194

Operating Activities. Net cash provided by operating activities of $3.1 million in the six months ended September 30, 2006 resulted primarily from net income of $3.4 million. After excluding the effects of non-cash expenses, including employee stock-based compensation of $2.4 million, depreciation and amortization of $1.8 million, and amortization of intangible assets of $0.9 million, the adjusted cash provided before the effect of changes in working capital components was $8.5 million. Cash used in operations included a $2.0 million increase in accounts receivable, a decrease in deferred revenue of $0.5 million, an increase in prepaid expenses and other current assets of $0.2 million and an overall decrease in accounts payable and accrued expenses including commissions of $0.5 million and $2.1 million, respectively.

A number of non-cash items were charged to expense and reduced our net income for the six months ended September 30, 2006 and 2005, respectively. These items include employee stock-based compensation, depreciation and amortization of property and equipment and intangible assets. The extent to which these non-cash items increase or decrease in amount and increase or decrease our future operating results will have no corresponding impact on our operating cash flows.

Our primary source of operating cash flow is the collection of accounts receivable from our customers, offset by payments to our employees, vendors and service providers. We measure the effectiveness of our collection efforts by an analysis of average accounts receivable days outstanding (days outstanding). Days outstanding were 89 days and 92 days for the six months ended September 30, 2006 and 2005, respectively. Collections of accounts receivable and related days outstanding will fluctuate in future periods due to the timing and amount of our future revenues, payment terms on customer contracts and the effectiveness of our collection efforts.

Our operating cash flows will also be impacted in the future based on the timing of payments to our vendors. We endeavor to pay our vendors and service providers in accordance with invoice terms and conditions. The timing of cash payments in future periods will be impacted by the nature of vendor arrangements and management s assessment of our cash inflows.

Investing Activities. Net cash used in investing activities was $4.4 million for the six months ended September 30, 2006. This resulted from cash used in the acquisition of SealedMedia and BitForm, which totaled $12.1 million. We also paid the former shareholders of E-100 $1.5 million in additional consideration pursuant to the earn-out provisions of the agreement under which we acquired e-Onehundred. We also purchased $1.1 million of capital expenditures during the first six months of fiscal year 2007. Offsetting these cash outflows was $10.5 million of net maturities of our marketable securities during the first six months of fiscal year 2007.

Generally, our investment portfolio is classified as held to maturity. Our investments objectives are to preserve principal and provide liquidity, while at the same time maximizing yields without significantly increasing risk. We generally hold investments in commercial paper, corporate bonds and United States government agency securities to maturity.

We anticipate that we will continue to purchase property and equipment necessary in the normal course of our business. The amount and timing of these purchases and the related cash outflows in future periods is difficult to predict and is dependent on a number of factors including the hiring of employees, the rate of change of computer hardware and software used in our business and our business outlook.

Financing Activities. Net cash provided by financing activities of $1.1 million in the six months ended September 30, 2006 included approximately $3.2 million in net proceeds from the issuance of common stock related to the exercise of employee stock options, offset by the $1.8 million cash dividend paid to shareholders and $0.4 million of payments under capital leases during the first half of fiscal year 2007.

Our cash flows from financing activities are the result of cash receipts from the issuance of common stock. We receive cash from the exercise of common stock options. While we expect to continue to receive these proceeds in future periods, the timing and amount of such proceeds is difficult to predict and is contingent on a number of factors including the price of our common stock, the number of employees participating in our stock option plans and general market conditions. Our Board of Directors approved a $0.03 per common share dividend during the first and second quarter of fiscal year 2007. In accordance with our merger agreement with Oracle and wholly owned subsidiary of Oracle, our Board of Directors has suspended further dividends on our common stock pending the consummation of the transactions contemplated by the merger agreement.

New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides related guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this standard.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No, 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors considered, is material. SAB 108 is effective for fiscal years ending on or after November 15, 2006, with early application encouraged. The Company does not believe that SAB 108 will have a material impact on our Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. Under SFAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity s own data. Fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of this standard.

Financial Risk Management

As a global concern, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our consolidated financial results. Our primary exposures relate to non-United States dollar-denominated revenues and operating expenses in Europe, Asia Pacific, Australia and Canada. At the present time, the exposure is not significant. We do not anticipate significant currency gains or losses in the near term.

Critical Accounting Policies and Estimates

In preparing our condensed consolidated financial statements, we make estimates, assumptions and judgments that can have a significant impact on our revenues, loss from operations and net loss, as well as on the value of certain assets and liabilities on our consolidated balance sheet. We believe that there are several accounting policies that are critical to an understanding of our historical and future performance, as these policies affect the reported amounts of revenues, expenses and significant estimates and judgments applied by management. While there are a number of accounting policies, methods and estimates affecting our consolidated financial statements, areas that are particularly significant include:

- revenue recognition;
- allowance for doubtful accounts;
- accrual for restructuring and excess facilities costs;

accounting for income taxes; and

valuation and evaluating impairment of long-lived assets, intangible assets and goodwill.

Revenue Recognition

We currently derive all of our revenues from licenses of software products and related services. We recognize revenue in accordance with SOP 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, Modification of SOP 97-2, *Software Revenue Recognition with Respect to Certain Transactions*, and Securities and Exchange Commission Staff Accounting Bulletin 104, *Revenue Recognition*.

Product license revenue is recognized under SOP 97-2 when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable and supported and the arrangement does not require services that are essential to the functionality of the software.

Persuasive Evidence of an Arrangement Exists We determine that persuasive evidence of an arrangement exists with respect to a customer under, (i) a signature license agreement, which is signed by both the customer and us, or, (ii) a purchase order, quote or binding letter-of-intent received from and signed by the customer, in which case the customer has either previously executed a signature license agreement with us or will receive a shrink-wrap license agreement with the software. We do not offer product return rights to end users or resellers.

Delivery has Occurred Our software may be either physically or electronically delivered to the customer. We determine that delivery has occurred upon shipment of the software pursuant to the billing terms of the arrangement or when the software is made available to the customer through electronic delivery. Customer acceptance generally occurs at delivery.

The Fee is Fixed or Determinable If at the outset of the customer arrangement, we determine that the arrangement fee is not fixed or determinable, revenue is typically recognized when the arrangement fee becomes due and payable. Fees due under an arrangement are generally deemed fixed and determinable if they are payable within twelve months.

Collectibility is Probable and Supported We determine whether collectibility is probable and supported on a case-by-case basis. We may generate a high percentage of our license revenue from our current customer base, for which there is a history of successful collection. We assess the probability of collection from new customers based upon the number of years the customer has been in business and a credit review process, which evaluates the customer s financial position and ultimately its ability to pay. If we are unable to determine from the outset of an arrangement that collectibility is probable based upon our review process, revenue is recognized as payments are received.

With regard to software arrangements involving multiple elements, we allocate revenue to each element based on the relative fair value of each element. Our determination of fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence (VSOE). We limit our assessment of VSOE for each element to the price charged when the same element is sold separately. We have analyzed all of the elements included in our multiple-element arrangements and have determined that we have sufficient VSOE to allocate revenue to consulting services and post-contract customer support components of our license arrangements. Generally, we sell our consulting services separately, and have established VSOE on this basis. VSOE for post-contract customer support (PCS) is determined based upon the customer s annual renewal rates for these elements. Accordingly, assuming all other revenue recognition criteria are met, revenue from perpetual licenses is recognized upon delivery using the residual method in accordance with SOP 98-9, and revenue from PCS is recognized ratably over their respective terms, typically one year.

Our direct customers typically enter into perpetual license arrangements. Our Content Components Division generally enters into term-based license arrangements with its customers, the term of which generally exceeds one year in length. We recognize revenue from time-based licenses at the time the license arrangement is signed, assuming all other revenue recognition criteria are met, if the term of the time-based license arrangement is greater than twelve months. If the term of the time-based license arrangement is twelve months or less, we recognize revenue ratably over the term of the license arrangement.

Services revenue consists of fees from consulting services and PCS. Consulting services include needs assessment, software integration, security analysis, application development, training and billable expenses. We bill consulting services fees either on a time and materials basis or on a fixed-price schedule. In general, our consulting services are not essential to the functionality of the software. Our software products are fully functional upon delivery and implementation and generally do not require any significant modification or alteration for customer use. Customers purchase our consulting services to facilitate the adoption of our technology and may dedicate personnel to participate in the services being performed, but they may also decide to use their own resources or appoint other professional service organizations to provide these services. Software products are billed separately from professional services. We recognize revenue from consulting services as services are performed. Our customers typically purchase PCS annually, and we price PCS based on a percentage of the product license fee or a percentage of product list price. Customers purchasing PCS receive product upgrades, Web-based technical support and telephone hot-line support. Unspecified product upgrades are typically not provided without the purchase of PCS. We typically have not granted specific upgrade rights in our license agreements. Specified undelivered elements are allocated a relative fair value amount within a license agreement and the revenue allocated for these elements are deferred until delivery occurs.

Customer advances and billed amounts due from customers in excess of revenue recognized are recorded as deferred revenue.

We follow very specific and detailed guidelines, discussed above, in determining revenues; however, certain judgments and estimates are made and used to determine revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue recognized for any period if different conditions were to prevail. For example, in determining whether

collection is probable, we assess our customers ability and intent to pay. Our actual experience with respect to collections could differ from our initial assessment if, for instance, unforeseen declines in the overall economy occur and negatively impact our customers financial condition.

Accounts Receivable and Allowance for Doubtful Accounts

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of assets and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Specifically, we make estimates as to the overall collectibility of accounts receivable and provide an allowance for amounts deemed to be uncollectible. Management specifically analyzes its accounts receivable and establishes a reserve based on factors that include historical bad debt experience, customer credit-worthiness, and current economic trends.

Restructuring and Excess Facilities Accrual

Due to cyclical economic patterns and associated reductions in information technology spending, we have implemented a series of restructuring and facility consolidation plans to improve our operating performance. We also implemented restructuring plans during fiscal year 2006 related to the integration of our acquisition of Optika. Restructuring and facilities consolidation costs consist of expenses associated with workforce reductions and consolidation of excess facilities.

Workforce Reductions

In connection with our restructuring plans, we accrue for severance payments and other related termination benefits provided to employees in connection with involuntary staff reductions. We accrue for these benefits in the period when benefits are communicated to the terminated employees. Typically, terminated employees are not required to provide continued service to receive termination benefits. If continued service is required, then the severance liability is accrued over the required service period. In general, we use a formula based on a combination of the number of years of service and the employee s position within our company to calculate the termination benefits to be provided to affected employees. At September 30, 2006, approximately $0.2 million was accrued for future severance and termination benefits payments that is payable through January 2007.

Excess Facilities

In connection with our restructuring and facility consolidation plans, we perform evaluations of our then-current facilities requirements and identify facilities that are in excess of our then-current and estimated future needs. When a facility is identified as excess and we have ceased use of the facility, we accrue the fair value of the lease obligations. In determining fair value, we consider expected sublease income over the remainder of the lease term and related exit costs, if any. To determine the estimated sublease income, we receive appraisals from real estate brokers to aid in our estimate. In addition, during our evaluation of our facilities requirements, we also identify operating equipment and leasehold improvements that may have suffered a reduction in their economic useful lives. Most of our excess facilities are being marketed for sublease and are currently unoccupied. Accordingly, our estimate of excess facilities could differ from actual results and such differences could result in additional charges that could materially affect our consolidated financial position and results of operations. We reassess our excess facilities liability each quarterly fiscal period based on current real estate market conditions.

Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax liability in each of the jurisdictions in which we do business. This process involves estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We must then assess the likelihood that these deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not more likely than not or unknown, we must establish a valuation allowance.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. At September 30, 2006, we have recorded a full valuation allowance of $73.1 million against our deferred tax assets, due to uncertainties related to our ability to utilize our deferred tax assets, consisting principally of certain net operating losses carried forward. The valuation allowance is based on our estimates of taxable income by jurisdiction and the period over which our deferred tax assets will be recoverable. The Company had U.S. net operating loss (NOL) carryforwards of approximately $126.0 million and foreign net operating losses of approximately $36.0 million at

September 30, 2006. The NOL carryforwards begin to expire in 2010. These NOL carryforwards are subject to annual utilization limitations due to prior ownership changes.

Realization of the NOL carryforwards and other deferred tax temporary differences are contingent on future taxable earnings. The deferred tax asset was reviewed for expected utilization using a more likely than not approach as required by SFAS No. 109, *Accounting for Income Taxes*, by assessing the available positive and negative evidence surrounding its recoverability.

We will continue to assess and evaluate strategies that will enable the deferred tax asset, or portion thereof, to be utilized, and will reduce the valuation allowance appropriately at such time when it is determined that the more likely than not approach is satisfied.

Valuation and Evaluation of Impairment of Long-lived Assets

We account for long-lived assets in accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* This Statement requires that long-lived and intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Based on our review no impairment of long-lived assets has occurred through September 30, 2006.

Valuation and Evaluation of Goodwill and Other Acquired Intangible Assets

On April 1, 2002, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets.* SFAS No. 142 requires that goodwill no longer be amortized and that goodwill be tested annually for impairment or more frequently if events and circumstances warrant. We are required to perform an impairment review of goodwill 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 unit to its carrying value, including goodwill. If the reporting unit s carrying value, including goodwill, exceeds the unit s fair value, we move on to Step 2. If the 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 its 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 have determined that we have two reporting units. We performed and completed our required annual impairment testing on January 1, 2006. Upon completing our internal review, we determined that the carrying value of our recorded goodwill as of this date had not been impaired and no impairment charge was recorded.

We are also required to assess goodwill for impairment on an interim basis when indicators exist that goodwill may be impaired based on the factors mentioned above. For example, if our market capitalization declines below our net book value or we suffer a sustained decline in our stock price, we will assess whether our goodwill has been impaired. A significant impairment could result in additional charges and could have a material adverse impact on our consolidated financial condition and operating results. No circumstances occurred during the first nine months of calendar year 2006 that would have required us to assess goodwill for impairment on an interim basis.

Valuation and Evaluation of Equity-based Compensation

Effective April 1, 2006, we adopted the fair value recognition provisions of SFAS 123(R), using the modified prospective transition method, and therefore have not restated prior periods results. Under this method, we recognize compensation expense for all equity-based payments granted on or after April 1, 2006 and prior to but not yet vested as of April 1, 2006, in accordance with SFAS 123(R). Under the fair value recognition provisions of SFAS 123(R), we recognize equity-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line basis over the requisite service period of the award. Prior to SFAS 123(R) adoption, we accounted for equity-based payments under Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and accordingly recognized equity-based compensation if the exercise price of the stock options was less than the fair market value of the common stock on the date of grant.

Determining the appropriate fair value model and calculating the fair value of equity-based payment awards require the input of subjective assumptions, including the expected life of the equity-based payment awards and stock price volatility. The assumptions used in calculating the fair value of equity-based payment awards represent management s best estimates, which involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our equity-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the equity-based compensation expense could be significantly different from what we have recorded in the current period. See Note 4 to the Condensed Consolidated Financial Statements for a further discussion on equity-based compensation.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our interest income on cash, cash equivalents and marketable securities is affected by changes in interest rates in the United States. Changes in these rates have a significant effect on our interest income. Over the past year, interest rates earned on invested funds have increased by approximately 200 basis points. We believe that there may be future exposure to interest rate market risk.

Our investments are held primarily in commercial paper, which is affected by equity price market risk and other factors. We do not anticipate that exposure to these risks will have a material impact on us, due to the nature of our investments.

We have no history of, and do not anticipate in the future, investing in derivative financial instruments. Many transactions with international customers are entered into in U.S. dollars, precluding the need for foreign currency hedges. Any transactions that are currently entered into in foreign currency are not deemed material to the financial statements. Thus, the exposure to market risk is not material.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, our management conducted an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on this evaluation, the officers concluded that our company s disclosure controls and procedures were effective to ensure that information required to be disclosed by our company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) Changes in Internal Control Over Financial Reporting

Our management, with the participation of our chief executive officer and chief financial officer, performed an evaluation as to whether any change in the internal controls over financial reporting (as defined in Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934) occurred during the period covered by this report. Based on that evaluation, the chief executive officer and chief financial officer concluded that no change occurred in the internal controls over financial reporting during the period covered by this report that materially affected or were reasonably likely to materially affect, the internal controls over financial reporting.

Management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors or fraud. An internal control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all internal control systems, no evaluation of controls can provide absolute assurance that all control issues, errors and instances of fraud, if any, within our company have been detected.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, we are subject to various claims and litigation, including employment matters and intellectual property claims. Management does not believe the outcome of any current legal matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

The risks and uncertainties described below are not the only risks we face. These risks include those that we consider to be significant at this time to investment decisions regarding our common stock. There may be risks that you, in particular, view differently than we do, and there are other risks and uncertainties that we do not presently know of or that we currently deem immaterial, but that may, in fact, harm our business in the future. If any of these events occur, they could have a material adverse effect on our business, results of operations and financial condition could be seriously harmed, and the trading price of our common stock could decline.

You should consider carefully the following factors, in addition to other information in this Quarterly Report on Form 10-Q, in evaluating our company and business.

RECENT ANNOUNCEMENTS REGARDING OUR ANTICIPATED ACQUISITION COULD CAUSE A DECLINE IN THE SALES OF OUR PRODUCTS, AS WELL AS CAUSE THE RESULTS OF OUR OPERATIONS TO SUFFER. OUR BUSINESS AND STOCK PRICE MAY ALSO SUFFER PRIOR TO COMPLETION OF, OR IF WE DO NOT COMPLETE, A PROPOSED TRANSACTION.

On November 2, 2006, we entered into an Agreement and Plan of Merger with Oracle, and a wholly owned subsidiary of Oracle, providing for the merger of that subsidiary with and into our company. Following consummation of the merger, we would be a wholly owned subsidiary of Oracle. Under the terms of the merger agreement, the Oracle subsidiary has agreed to make a cash tender offer for all outstanding shares of our common stock at $13.50 per share. As soon as practicable following the completion of the offer, the Oracle subsidiary has agreed to effect the merger described above. Upon the consummation of the merger, each share of our common stock not purchased in the offer would be converted into the right to receive $13.50 per share in cash. The consummation of each of the tender offer and the merger is subject to certain customary conditions, including regulatory approval. We expect the transactions to close in the third or fourth quarter of fiscal 2007.

If the transaction is not completed, we could be subject to a number of factors that may adversely affect our business, results of operations and stock price, including:

our day-to-day operations may be disrupted due to the substantial time and effort our management must devote to the transaction;

the market price of our common stock may decline to the extent that the current market price of such shares reflects a market assumption that a transaction will be completed;

we must pay various costs related to the transaction, such as our legal, investment advisor and accounting fees; and

if our board of directors determines to seek another merger or business combination, we may not be able to find a partner willing to enter into a transaction with more favorable terms and conditions than that agreed to by Oracle.

The announcement of proposed transactions and related uncertainty concerning our future may make it more difficult for us to sell our products, which could have an adverse effect on our revenues.

Third parties with whom we currently have relationships may terminate or otherwise reduce the scope of their relationship with us in anticipation or as a result of the proposed transactions. Moreover, the pace of our installations and maintenance renewals may decline as customers await closure of a transaction. Speculation regarding the likelihood of the closing of a transaction could increase the volatility of the price of our common stock.

BECAUSE OUR INFRASTRUCTURE COSTS ARE GENERALLY FIXED AND THE TIMING OF OUR REVENUES FROM QUARTER TO QUARTER IS HIGHLY VARIABLE, OUR FUTURE PERFORMANCE IS DIFFICULT TO PREDICT, MAKING AN INVESTMENT IN OUR COMMON STOCK SUBJECT TO HIGH VOLATILITY.

While our products and services are not seasonal, our revenues and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. If our quarterly revenues or operating results fall below the expectations of investors or securities analysts, the price of our common stock could fall substantially. A large part of our sales typically occurs in the last month of a quarter, frequently in the last week or even the last days of the quarter. If these sales were delayed from one quarter to the next for any reason, our operating results could fluctuate dramatically. In addition, our sales cycles may vary, making the timing of sales difficult to predict. Furthermore, our infrastructure costs are generally fixed. As a result, modest fluctuations in revenues between quarters may cause large fluctuations in operating results. These factors all tend to make the timing of revenues unpredictable and may lead to high period-to-period fluctuations in operating results.

Our quarterly revenues and operating results may fluctuate for several additional reasons, many of which are outside of our control, including the following:

- demand for our products and services;
- the timing of new product introductions and sales of our products and services;
- unexpected delays in introducing new products and services;
- increased expenses, whether related to sales and marketing, research and development, administration or services;
- changes in the rapidly evolving market for Web content management solutions;
- the mix of revenues from product licenses and services, as well as the mix of products licensed;
- the mix of services provided and whether services are provided by our staff or third-party contractors;
- the mix of domestic and international sales;
- costs related to possible acquisitions of technology or businesses;
- general economic conditions; and
- public announcements by our competitors.

WE HAVE A HISTORY OF MAKING ACQUISITIONS, INCLUDING LARGE STRATEGIC ACQUISITIONS, AND FUTURE POTENTIAL ACQUISITIONS MAY BE DIFFICULT TO COMPLETE OR TO INTEGRATE AND MAY DIVERT MANAGEMENT S ATTENTION AND CAUSE OUR OPERATING RESULTS TO SUFFER.

We acquired BitForm on June 29, 2006 and SealedMedia on July 31, 2006. If we are not able to successfully integrate there businesses into our existing business and operations, our operating results may suffer. We may seek to acquire or invest in businesses, products or technologies that are complementary to our business. If we identify an appropriate acquisition opportunity, we may be unable to negotiate favorable terms for that acquisition, successfully finance the acquisition or integrate the new business or products into our existing business and operations. In addition, the negotiation of potential acquisitions and the integration of acquired businesses or products may divert management time and resources from our existing business and operations. To finance acquisitions, we may use a substantial portion of our available cash or we may issue additional securities, which would cause dilution to our shareholders.

WE MAY NOT BE PROFITABLE IN THE FUTURE, WHICH WOULD CAUSE OUR FINANCIAL POSITION TO SUFFER AND MAY CAUSE THE MARKET PRICE OF OUR STOCK TO FALL.

Our revenues may not grow in future periods and we may not sustain profitability. If we do not sustain profitability, our financial position will suffer and the market price of our stock may fall. Our ability to sustain profitable operations depends upon many factors beyond our direct control. These factors include, but are not limited to:

- the demand for our products;
- our ability to quickly introduce new products;

- the level of product and price competition;
- our ability to control costs; and
- general economic conditions.

THE INTENSE COMPETITION IN OUR INDUSTRY FROM RECENT AND EXPECTED INDUSTRY CONSOLIDATION MAY REDUCE OUR FUTURE SALES AND PROFITS.

The market for our products is highly competitive and is likely to become more competitive from recent and expected industry consolidation. We may not be able to compete successfully in our chosen marketplace, which may have a material adverse effect on our business, operating results and financial condition. Additional competition may cause pricing pressure, reduced sales and margins, or prevent our products from gaining and sustaining market acceptance. Many of our current and potential competitors have greater name recognition, access to larger customer bases, and substantially more resources than we have. Competitors with greater resources than ours may be able to respond more quickly than we can to new opportunities, changing technology, product standards or customer requirements.

WE DEPEND ON THE CONTINUED SERVICE OF OUR KEY PERSONNEL; IF WE LOSE THE SERVICES OF OUR KEY PERSONNEL OUR ABILITY TO EXECUTE OUR OPERATING PLAN, AND OUR OPERATING RESULTS, MAY SUFFER.

We are a small company and depend greatly on the knowledge and experience of our senior management team and other key personnel. If we lose any of these key personnel, our business, operating results and financial condition could be materially adversely affected. Our success will depend in part on our ability to attract and retain additional personnel with the highly specialized expertise necessary to generate revenue and to engineer, design and support our products and services. Like other software companies, we face intense competition for qualified personnel. We may not be able to attract or retain such personnel. Our pending transaction with Oracle may result in employee attrition.

WE HAVE RELIED AND EXPECT TO CONTINUE TO RELY ON SALES OF OUR CONTENT MANAGEMENT SOFTWARE, FOR OUR REVENUES; IF OUR CONTENT MANAGEMENT SOFTWARE DOES NOT GAIN AND MAINTAIN CUSTOMER ACCEPTANCE, OUR REVENUES AND OPERATING RESULTS MAY SUFFER.

We currently derive all of our revenues from product licenses and services associated with our suite of content management and viewing software products. The market for these products is new and rapidly evolving. We cannot be certain that a viable market for our products will continue or that it will be sustainable. If we do not increase employee productivity and revenues related to our existing products or generate revenues from new products and services, our business, operating results and financial condition may be materially adversely affected. We will continue to depend on revenues related to new and enhanced versions of our software products for the foreseeable future. Our success will largely depend on our ability to increase sales from existing products and generate sales from product enhancements and new products. We cannot be certain that we will be successful in upgrading and marketing our existing products or that we will be successful in developing and marketing new products and services. The market for our products is highly competitive and is subject to rapid technological change. Technological advances could make our products less attractive to customers and adversely affect our business. In addition, complex software product development involves certain inherent risks, including risks that errors may be found in a product enhancement or new product after its release, even after extensive testing, and the risk that discovered errors may not be corrected in a timely manner.

IF WE CANNOT COST-EFFECTIVELY PROTECT OUR INTELLECTUAL PROPERTY, WHICH CONSISTS PRIMARILY OF OUR PROPRIETARY SOFTWARE PRODUCTS, OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION MAY SUFFER.

If we are unable to protect our intellectual property, or incur significant expense in doing so, our business, operating results and financial condition may be materially adversely affected. Any steps we take to protect our intellectual property may be inadequate, time consuming and expensive. Without significant patent or copyright protection, we may be vulnerable to competitors who develop functionally equivalent products. We may also be subject to claims that our current products infringe on the intellectual property rights of others. Any such claim may have a material adverse effect on our business, operating results and financial condition.

We anticipate that software product developers will be increasingly subject to infringement claims due to growth in the number of products and competitors in our industry, and the overlap in functionality of products in different industries. Any infringement claim, regardless of its merit, could be time-consuming, expensive to defend, or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements may not be available on commercially favorable terms, or at all.

We rely on trade secret protection, confidentiality procedures and contractual provisions to protect our proprietary information. Despite our attempts to protect our confidential and proprietary information, others may gain access to this information. Alternatively, other companies may independently develop substantially equivalent information.

OUR PRODUCTS MAY NOT BE COMPATIBLE WITH COMMERCIAL WEB BROWSERS AND OPERATING SYSTEMS, WHICH MAY LIMIT OUR ABILITY TO GENERATE REVENUES FROM OUR PRODUCTS.

Our products utilize interfaces that are compatible with commercial Web browsers. In addition, our Stellent Content Management System is a server-based system written in Java that functions in both Windows NT and UNIX environments. We must continually

modify our products to conform to commercial Web browsers and operating systems. If our products were to become incompatible with commercial Web browsers and operating systems, our business would be harmed. In addition, uncertainty related to the timing and nature of product introductions or modifications by vendors of Web browsers and operating systems may have a material adverse effect on our business, operating results and financial condition.

WE COULD BE SUBJECT TO PRODUCT LIABILITY CLAIMS IF OUR SOFTWARE PRODUCTS DAMAGE CUSTOMER S DATA, FAIL TO MAINTAIN ACCESS SECURITY OR OTHERWISE FAIL TO PERFORM TO SPECIFICATIONS, WHICH COULD HARM OUR OPERATING RESULTS AND FINANCIAL POSITION AND REDUCE THE VALUE OF AN INVESTMENT IN OUR COMMON STOCK.

If software errors or design defects in our products cause damage to customers data and our agreements do not protect us from related product liability claims, our business, operating results and financial condition may be materially adversely affected. In addition, we could be subject to product liability claims if our security features fail to prevent unauthorized third parties from entering our customers intranet, extranet or Internet Websites. Our software products are complex and sophisticated and may contain design defects or software errors that are difficult to detect and correct. Errors, bugs or viruses spread by third parties may result in the loss of market acceptance or the loss of customer data. Our agreements with customers that attempt to limit our exposure to product liability claims may not be enforceable in certain jurisdictions where we operate.

FUTURE REGULATION OF THE INTERNET COULD BE ADOPTED THAT WOULD RESTRICT OUR BUSINESS, WHICH MAY LIMIT OUR ABILITY TO GENERATE REVENUES FROM OUR PRODUCTS.

Federal, state or foreign agencies may adopt new legislation or regulations governing the use and quality of Web content. We cannot predict if or how any future laws or regulations would impact our business and operations. Even though these laws and regulations may not apply to our business directly, they could indirectly harm us to the extent that they impact our customers and potential customers.

WE HAVE BEEN NAMED A DEFENDANT IN SECURITIES CLASS-ACTION LAWSUITS AND WE MAY IN THE FUTURE BE NAMED IN ADDITIONAL LITIGATION, WHICH MAY RESULT IN SUBSTANTIAL COSTS AND DIVERT MANAGEMENT S ATTENTION AND RESOURCES.

Stellent and certain of our current and former officers and directors were named as co-defendants in a shareholder class-action lawsuit that was settled during fiscal year 2006. Also, certain current and former officers and directors were named in a derivative lawsuit that followed the completion of a special litigation committee process in which the plaintiff, on behalf of the Company, alleged that the board breached its fiduciary duties by allowing certain circumstances to exist that gave rise to the shareholder lawsuit described above. A special litigation committee has recommended that the Company not pursue an action against the Board and/or the Company s officers. The Company moved to dismiss the action. While the motion to dismiss was pending the Company s insurance carriers, because of the ongoing expense of litigation and the role the plaintiff s counsel played in the special litigation committee process, agreed to settle the pending derivative lawsuit for a payment of $0.3 million. The settlement received final court approval in the second quarter of fiscal 2007. The settlement was paid entirely from proceeds of an insurance policy.

Securities class-action litigation has often been brought against companies following periods of volatility in the price of their securities. This risk is greater for technology companies, which have experienced greater-than-average stock price volatility in recent years and, as a result, have been subject to, on average, a greater number of securities class-action claims than companies in other industries. We may in the future again be the target of this kind of litigation, and such litigation could also result in substantial costs and divert management s attention and resources.

THE MARKET PRICE OF OUR COMMON STOCK COULD FLUCTUATE SIGNIFICANTLY DUE TO VARIATIONS IN OUR OPERATING RESULTS, CHANGES IN THE SOFTWARE INDUSTRY AND OTHER FACTORS.

The market price of our common stock has fluctuated significantly in the past and may do so in the future. The market price of our common stock may be affected by each of the following factors, many of which are outside of our control:

- variations in quarterly operating results;
- changes in estimates by securities analysts;
- changes in market valuations of companies in our industry;
- announcements of significant events, such as major sales;

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- acquisitions of businesses or losses of major customers; and
- sales of our equity securities.

WE CAN ISSUE SHARES OF PREFERRED STOCK WITHOUT SHAREHOLDER APPROVAL, WHICH COULD ADVERSELY AFFECT THE RIGHTS OF COMMON SHAREHOLDERS.

Our articles of incorporation permit us to establish the rights, privileges, preferences and restrictions, including voting rights, of unissued shares of our capital stock and to issue such shares without approval from our shareholders. The rights of holders of our common stock may suffer as a result of the rights granted to holders of preferred stock that may be issued in the future. In addition, we could issue preferred stock to prevent a change in control of our company, depriving shareholders of an opportunity to sell their stock at a price in excess of the prevailing market price.

OUR SHAREHOLDER RIGHTS PLAN AND CERTAIN PROVISIONS OF MINNESOTA LAW MAY MAKE A TAKEOVER OF STELLENT DIFFICULT, DEPRIVING SHAREHOLDERS OF OPPORTUNITIES TO SELL SHARES AT ABOVE-MARKET PRICES.

Our shareholder rights plan and certain provisions of Minnesota law may have the effect of discouraging attempts to acquire Stellent without the approval of our board of directors. Consequently, our shareholders may lose opportunities to sell their stock for a price in excess of the prevailing market price.

ACCOUNTING FOR STOCK-BASED COMPENSATION USING THE FAIR VALUE METHOD, WILL SIGNIFICANTLY INCREASE OUR COMPENSATION EXPENSE IN FISCAL 2007 COMPARED TO FISCAL 2006.

In December 2004, Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment,* known as Statement 123(R). Statement 123(R) supersedes APB Opinion No. 25. Under APB Opinion No. 25, no compensation expense is recognized for employee stock option grants if the exercise price of the Company s stock option grants is at or above the fair market value of the underlying stock on the date of grant. SFAS No. 123(R) requires the determination of the fair value of the share-based compensation at the grant date and the recognition of the related expense over the period in which the share-based compensation vests, which will increase our compensation expense significantly. We adopted SFAS No. 123(R) effective April 1, 2006. As part of this adoption, we began expensing options effective April 1, 2006. Based on the current amount of outstanding stock options that will vest on or after April 1, 2006, we anticipate recognizing approximately $4.5 million of compensation expense during fiscal year 2007. This amount will fluctuate depending on future stock options granted to or forfeited by employees and directors.

NEW LEGISLATION IS LIKELY TO IMPACT OUR FUTURE CONSOLIDATED FINANCIAL POSITION AND RESULTS OF OPERATIONS.

Recently, there have been significant regulatory changes, including the Sarbanes-Oxley Act of 2002, which will continue to have an impact on our future consolidated financial position and results of operations. The Sarbanes-Oxley Act of 2002 and other rule changes and proposed legislative initiatives which following several highly publicized corporate accounting and corporate governance failures, have increased general and administrative costs. Additional regulatory changes may increase our costs further. Further, the impact of these changes may increase costs incurred by our customers and prospects, which could result in delays or cancellations in spending on enterprise content management software and services like those that we provide. Such delays and cancellations could have a material adverse impact on our consolidated statement of operations and financial condition.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

On August 1, 2006 the Company held its Annual Meeting of the Shareholders to consider a vote upon the following proposals. The tabulation of the votes, in favor, against, and abstaining with regard to the proposals is set forth below.

	PROPOSAL	AFFIRMATIVE VOTES	NEGATIVE VOTES	ABSTAIN VOTES	BROKER NON-VOTES
1.	Election of Directors:				
	Robert F. Olson	24,214,131	1,329,651		
	Philip E. Soran	25,147,465	396,317		
	Kenneth H. Holec	25,147,565	396,217		
	Raymond A. Tucker	25,127,565	416,217		
	William B. Binch	25,126,569	417,213		
	Alan B. Menkes	24,745,448	798,334		
2.	Ratification of the appointment of Grant Thornton LLP as independent auditors for the Company for fiscal year ended March 31, 2007.	25,162,136	4,062	377,163	

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

FILE	DESCRIPTION	REFERENCE
2.1	Agreement and Plan of Merger, dated as of November 2, 2006, by and among Stellent, Inc., Oracle Systems Corporation, and Star Acquisition Corp.*	Incorporated by reference to Exhibit 2.1 of the Registrant s Form 8-K/A filed November 6, 2006
2.2	Tender and Support Agreement, dated as of November 2, 2006, by and among Oracle Systems Corporation, Star Acquisition Corp., and the individuals listed on Annex I thereto*	Incorporated by reference to Exhibit 2.2 of the Registrant s Form 8-K/A filed November 6, 2006
3.1	Amended and Restated Articles of Incorporation	Incorporated by reference to Exhibit 3.1 of the Registrant s Form 8-K dated August 29, 2001
3.2	Bylaws	Incorporated by reference to Exhibit 4.2 of the Registrant s Registration Statement on Form S-8, File No. 333-75828
31.1	Certification by Robert F. Olson, Chairman of the Board, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Electronic Transmission
31.2	Certification by Darin P. McAreavey, Executive Vice President, Chief Financial Officer, Secretary and Treasurer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Electronic Transmission
32.1	Certification by Robert F. Olson, Chairman of the Board, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Electronic Transmission
32.2	Certification by Darin P. McAreavey, Executive Vice President, Chief Financial Officer, Secretary and Treasurer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Electronic Transmission

* Excludes schedules, exhibits and certain annexes, which the registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request.

SIGNATURES

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

	STELLENT, INC.	
	(Registrant)	
Date: November 8, 2006	By:	/s/ Robert F. Olson
	Robert F. Olson, Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)	
Date: November 8, 2006	By:	/s/ Darin P. McAreavey
	Darin P. McAreavey Executive Vice President, Chief Financial Officer, Secretary and Treasurer (Principal Financial and Accounting Officer)	

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