

EGAIN COMMUNICATIONS CORP

Form 10-Q

May 17, 2010

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-30260

**eGAIN COMMUNICATIONS CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**77-0466366**  
(I.R.S. Employer  
Identification No.)

**345 E. Middlefield, Mountain View, CA**  
(Address of principal executive offices)

**94043**  
(Zip Code)

**(650) 230-7500**  
(Registrant's telephone number, including area code)

**N/A**  
(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: Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes  No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                          | Outstanding at March 31, 2010 |
|--------------------------------|-------------------------------|
| Common Stock \$0.001 par value | 22,149,999                    |



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**eGAIN COMMUNICATIONS CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, unaudited)

|  | March 31,<br>2010 | June 30,<br>2009 |
|--|-------------------|------------------|
| <b>ASSETS</b>                                    |                   |                  |
| Current assets:                                  |                   |                  |
| Cash and cash equivalents                        | \$ 7,587          | \$ 7,511         |
| Restricted cash                                  | 13                | 13               |
| Accounts receivable, net                         | 2,735             | 4,308            |
| Prepaid and other current assets                 | 325               | 538              |
| <b>Total current assets</b>                      | <b>10,660</b>     | <b>12,370</b>    |
| Property and equipment, net                      | 955               | 995              |
| Goodwill   | 4,880             | 4,880            |
| Other assets                                     | 462               | 391              |
| <b>Total assets</b>                              | <b>\$ 16,957</b>  | <b>\$ 18,636</b> |
| <b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>      |                   |                  |
| Current liabilities:                             |                   |                  |
| Accounts payable                                 | \$ 786            | \$ 979           |
| Accrued compensation                             | 1,432             | 2,429            |
| Accrued liabilities                              | 1,831             | 2,141            |
| Deferred revenue                                 | 6,040             | 5,398            |
| Capital lease obligation                         | 166               | 181              |
| Bank borrowings                                  | 125               | 3,125            |
| <b>Total current liabilities</b>                 | <b>10,380</b>     | <b>14,253</b>    |
| Deferred revenue, net of current portion         | 224               | 133              |
| Capital lease obligation, net of current portion | 63                | 187              |
| Related party notes payable                      | 8,459             | 7,697            |
| Bank borrowings, net of current portion          | 21                | 115              |
| Other long term liabilities                      | 304               | 344              |
| <b>Total liabilities</b>                         | <b>19,451</b>     | <b>22,729</b>    |
| Commitments and Contingencies (Notes 10 and 12)  |                   |                  |
| Stockholders' deficit:                           |                   |                  |
| Common stock                                     | 22                | 22               |
| Additional paid-in capital                       | 323,666           | 323,550          |
| Notes receivable from stockholders               | (78)              | (76)             |
| Accumulated other comprehensive loss             | (551)             | (506)            |
| Accumulated deficit                              | (325,553)         | (327,083)        |

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|   |           |           |
|---|-----------|-----------|
| Total stockholders' deficit                 | (2,494)   | (4,093)   |
| Total liabilities and stockholders' deficit | \$ 16,957 | \$ 18,636 |

**See accompanying notes**

**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

(unaudited)

|   | Three Months Ended<br>March 31, |                 | Nine Months Ended<br>March 31, |                 |
|---|---------------------------------|-----------------|--------------------------------|-----------------|
|   | 2010                            | 2009            | 2010                           | 2009            |
| <b>Revenue:</b>   |                                 |                 |                                |                 |
| License   | \$ 1,407                        | \$ 463          | \$ 5,877                       | \$ 5,591        |
| Recurring services  | 4,248                           | 3,708           | 12,524                         | 11,456          |
| Professional services   | 1,288                           | 2,410           | 4,829                          | 7,262           |
| <b>Total revenue</b>  | <b>6,943</b>                    | <b>6,581</b>    | <b>23,230</b>                  | <b>24,309</b>   |
| Cost of license   | 1                               | 16              | 152                            | 54              |
| Cost of recurring services  | 1,104                           | 1,035           | 3,385                          | 3,239           |
| Cost of professional services   | 1,225                           | 1,405           | 3,857                          | 4,621           |
| <b>Gross profit</b>   | <b>4,613</b>                    | <b>4,125</b>    | <b>15,836</b>                  | <b>16,395</b>   |
| <b>Operating costs and expenses:</b>  |                                 |                 |                                |                 |
| Research and development  | 1,402                           | 1,378           | 3,857                          | 4,303           |
| Sales and marketing   | 2,461                           | 2,101           | 7,245                          | 7,734           |
| General and administrative  | 755                             | 616             | 2,272                          | 2,536           |
| <b>Total operating costs and expenses</b>   | <b>4,618</b>                    | <b>4,095</b>    | <b>13,374</b>                  | <b>14,573</b>   |
| Income / (loss) from operations   | (5)                             | 30              | 2,462                          | 1,822           |
| Interest expense, net   | (282)                           | (318)           | (837)                          | (1,138)         |
| Other income / (expense) , net  | (5)                             | 130             | 25                             | 495             |
| Income / (loss) before income taxes   | (292)                           | (158)           | 1,650                          | 1,179           |
| Benefit / (provision) for income taxes  | (26)                            | (38)            | (120)                          | 72              |
| <b>Net income / (loss)</b>  | <b>\$ (318)</b>                 | <b>\$ (196)</b> | <b>\$ 1,530</b>                | <b>\$ 1,251</b> |
| <b>Per Share information:</b>   |                                 |                 |                                |                 |
| Basic net income / (loss) per common share  | \$ (0.01)                       | \$ (0.01)       | \$ 0.07                        | \$ 0.06         |
| Diluted net income / (loss) per common share  | \$ (0.01)                       | \$ (0.01)       | \$ 0.07                        | \$ 0.06         |
| Weighted average shares used in computing basic net income / (loss) per common share  | 22,162                          | 22,213          | 22,194                         | 20,079          |
| Weighted average shares used in computing diluted net income/ (loss) per common share | 22,162                          | 22,213          | 22,513                         | 20,080          |

See accompanying notes





**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

|   | <b>Nine Months Ended<br/>March 31,</b> |             |
|---|--|-------------|
|   | <b>2010</b>                            | <b>2009</b> |
| <b>Cash flows from operating activities:</b>                                      |  |             |
| Net income  | \$ 1,530                               | \$ 1,251    |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |             |
| Depreciation  | 475                                    | 561         |
| Loss on disposal of property and equipment  |  | 60          |
| Stock-based compensation  | 191                                    | 222         |
| Provisions for doubtful accounts and sales returns                                | (38)                                   | 67          |
| Amortization of debt issuance costs   | 63                                     |             |
| Accrued interest and amortization of discount on related party notes payable      | 762                                    | 963         |
| Changes in operating assets and liabilities:                                      |  |             |
| Accounts receivable   | 1,416                                  | (2,148)     |
| Prepaid and other current assets  | 141                                    | 170         |
| Other assets  | (42)                                   | (103)       |
| Accounts payable  | (173)                                  | (543)       |
| Accrued compensation  | (952)                                  | 225         |
| Accrued liabilities   | (251)                                  | 178         |
| Deferred revenue  | 1,027                                  | 988         |
| Other long term liabilities   | (71)                                   | 97          |
| Net cash provided by operating activities   | 4,078                                  | 1,988       |
| <b>Cash flows from investing activities:</b>                                      |  |             |
| Purchases of property and equipment   | (445)                                  | (278)       |
| Proceeds from sales of property and equipment                                     |  | 14          |
| Net cash used in investing activities   | (445)                                  | (264)       |
| <b>Cash flows from financing activities:</b>                                      |  |             |
| Payments on borrowings  | (3,093)                                | (83)        |
| Payments on capital lease   | (131)                                  |             |
| Payments to repurchase stock  | (86)                                   |             |
| Proceeds from borrowings  |  | 63          |
| Net proceeds from issuance of common stock  | 10                                     |             |
| Net cash used in financing activities   | (3,300)                                | (20)        |
| Effect of change in exchange rates on cash and cash equivalents                   | (257)                                  | 19          |
| Net increase in cash and cash equivalents   | 76                                     | 1,723       |
| Cash and cash equivalents at beginning of period                                  | 7,511                                  | 3,790       |

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|  |          |          |
|--|----------|----------|
| Cash and cash equivalents at end of period | \$ 7,587 | \$ 5,513 |
|--|----------|----------|

**Supplemental cash flow disclosures:**

|                        |        |        |
|------------------------|--------|--------|
| Cash paid for interest | \$ 21  | \$ 196 |
| Cash paid for taxes    | \$ 120 | \$ 38  |

See accompanying notes

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**eGAIN COMMUNICATIONS CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**Note 1. Organization, Nature of Business, Basis of Presentation and Liquidity**

We are a leading provider of customer service and contact center software, used by global enterprises and fast-growing businesses. Trusted by prominent enterprises and growing mid-sized companies worldwide, eGain's award-winning software has been helping organizations achieve and sustain customer service excellence for more than a decade.

We have prepared the condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission and included the accounts of our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles ( GAAP ), have been condensed or omitted pursuant to such rules and regulations although we believe that the disclosures made are adequate to make the information not misleading. In our opinion, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our financial position, results of operations and cash flows for the periods presented. These financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2009, included in our Annual Report on Form 10-K. The condensed consolidated balance sheet at June 30, 2009 has been derived from audited financial statements as of that date but does not include all the information and footnotes required by GAAP for complete financial statements. The results of our operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending June 30, 2010. We have evaluated material subsequent events requiring recognition or disclosure, and there were none.

***Reclassification***

Historically we have reported revenue derived from two sources: 1) license fees and 2) support and services, which were comprised of hosting, software maintenance and support, and professional services. Starting the first quarter of fiscal year 2010, we have revised our reported revenue sources to separate support and services into two sources: 1) recurring services, which are comprised of hosting and software maintenance and support, and 2) professional services. The division is appropriate because recurring services contracts are generally long term (one or two years in length) and are typically renewed, whereas professional services contracts generally cover discrete activities such as installation, configuration or training that do not typically renew once the activity is complete.

For the three months ended March 31, 2009, to conform to the fiscal 2010 classifications, we reclassified \$3.7 million to recurring services revenue and \$2.4 million to professional services revenue from the support and services revenue of \$6.1 million. In addition, we reclassified \$1.0 million to cost of recurring services and \$1.4 million to cost of professional services from cost of support and services of \$2.4 million.

For the nine months ended March 31, 2009, to conform to the fiscal 2010 classifications, we reclassified \$11.5 million to recurring services revenue and \$7.3 million to professional services revenue from the support and services revenue of \$18.7 million. In addition, we reclassified \$3.2 million to cost of recurring services and \$4.6 million to cost of professional services from the cost of support and services of \$7.9 million. The table below summarizes the information (in thousands).

**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

|   | Three months ended<br>March 31, 2009   |                                    | Nine months ended<br>March 31, 2009    |                                    |
|---|--|------------------------------------|--|------------------------------------|
|   | As reclassified in fiscal year<br>2010 | As reported in fiscal year<br>2009 | As reclassified in fiscal year<br>2010 | As reported in fiscal year<br>2009 |
| Recurring services revenue                | \$ 3,708                               | \$                                 | \$ 11,456                              | \$                                 |
| Professional services revenue             | 2,410                                  |                                    | 7,262                                  |                                    |
| Support and services revenue              |  | 6,118                              |  | 18,718                             |
| Total revenue reclassification            | \$ 6,118                               | \$ 6,118                           | \$ 18,718                              | \$ 18,718                          |
| Cost of recurring services                | \$ 1,035                               | \$                                 | \$ 3,239                               | \$                                 |
| Cost of professional services             | 1,405                                  |                                    | 4,621                                  |                                    |
| Cost of support and services              |  | 2,440                              |  | 7,860                              |
| Total cost of revenue<br>reclassification | \$ 2,440                               | \$ 2,440                           | \$ 7,860                               | \$ 7,860                           |

***Change in Estimate***

In the quarter ended September 30, 2009, we signed an amendment to the Cisco OEM agreement, with an effective date of July 27, 2009. Based upon certain changes, including pricing for support, we no longer estimate the minimum profit and record the associated revenue as professional services for the Cisco OEM agreement from the effective date of the amendment. Instead, we record royalties earned under the Cisco OEM agreement as license revenue. In the quarter ended September 30, 2009, but prior to the effective date of the amendment, we increased the minimum margin to 48% from 40% in the second half of fiscal 2009 and 25% in the quarter ended September 30, 2008. The changes in minimum margin were a result of increased royalties received from Cisco and an update to the estimate of costs remaining to complete the final milestones per the Cisco OEM agreement. The change in accounting estimate resulted in an increase to our professional services revenue of \$420,000 and an increase to our net income by \$0.02 per share for the three months ended September 30, 2009 compared to a revenue increase of \$700,000 and a corresponding positive impact to our net loss (\$0.05 loss per share) for the comparable year-ago quarter.

**Note 2. Software Revenue Recognition*****Revenue Recognition***

We derive revenue from three sources: license fees, recurring services, and professional services. Recurring services include hosting and software maintenance and support. Maintenance and support consists of technical support and software upgrades and enhancements. Professional services primarily consist of consulting and implementation services and training. Significant management judgments and estimates are made and used to determine the revenue recognized in any accounting period. Material differences may result in changes to the amount and timing of our revenue for any period if different conditions were to prevail.

We apply the provisions of Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) Topic 985, *Software Revenue Recognition*, to all transactions involving the licensing of software products. In the event of a multiple element arrangement for a license transaction, we evaluate the transaction as if each element represents a separate unit of accounting taking into account all factors following the accounting standards. We apply ASC Topic 605, Revenue Recognition for hosting transactions to determine the accounting treatment for multiple elements. We also apply ASC Topic 605, Revenue Recognition for fixed fee arrangements in which we use the percentage of completion method to recognize revenue when reliable estimates are available for the costs and efforts necessary to complete the implementation services. When such estimates are not available, the completed contract method is utilized.

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**eGAIN COMMUNICATIONS CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

When licenses are sold together with system implementation and consulting services, license fees are recognized upon shipment, provided that (i) payment of the license fees is not dependent upon the performance of the consulting and implementation services, (ii) the services are available from other vendors, (iii) the services qualify for separate accounting as we have sufficient experience in providing such services, have the ability to estimate cost of providing such services, and we have vendor specific objective evidence of pricing, and (iv) the services are not essential to the functionality of the software.

We use signed software license and services agreements and order forms as evidence of an arrangement for sales of software, hosting, maintenance and support. We use signed engagement letters to evidence an arrangement for professional services.

***License Revenue***

We recognize license revenue when persuasive evidence of an arrangement exists, the product has been delivered, no significant obligations remain, the fee is fixed or determinable, and collection of the resulting receivable is probable. In software arrangements that include rights to multiple software products and/or services, we use the residual method under which revenue is allocated to the undelivered elements based on vendor specific objective evidence of the fair value of such undelivered elements. The residual amount of revenue is allocated to the delivered elements and recognized as revenue assuming all other criteria for revenue recognition have been met. Such undelivered elements in these arrangements typically consist of software maintenance and support, implementation and consulting services and, in some cases, hosting services.

Software is delivered to customers electronically or on a CD-ROM, and license files are delivered electronically. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. We have standard payment terms included in our contracts. We assess collectability based on a number of factors, including the customer's past payment history and its current creditworthiness. If we determine that collection of a fee is not reasonably assured, we defer the revenue and recognize it at the time collection becomes reasonably assured, which is generally upon receipt of cash payment. If an acceptance period is required, revenue is recognized upon the earlier of customer acceptance or the expiration of the acceptance period.

We periodically sell to resellers. License sales to resellers as a percentage of total revenue was approximately 0% and 1% for the three months ended March 31, 2010 and 2009, respectively. License sales to resellers as a percentage of total revenue was approximately 4% and 15% for the nine months ended March 31, 2010 and 2009, respectively. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller's plans to sell the software, the reseller's financial status, our past experience with the particular reseller and whether there are any return provisions, price protection or other allowances. Historically sales to resellers have not included any return provisions, price protections, or other allowances.

***Hosting Services Revenue***

Revenue derived from our hosted service offerings is included in recurring services revenue. We recognize hosting services revenue ratably over the period of the applicable agreement as services are provided. Hosting agreements typically have an initial term of one or two years and automatically renew unless either party cancels the agreement. The majority of the hosting services customers purchase a combination of our hosting service and professional services. In some cases the customer may also acquire a license for our software.

We evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by ASC Topic 605 using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, (iii) there is objective reliable evidence of the fair value of the undelivered item, and (iv) there is a general right of return. We consider the applicability ASC Topic 985, *Software Revenue*, on a contract-by-contract basis. In hosted term-based agreements, where the customer does not have the contractual right to take possession of the software, the revenue is recognized on a monthly basis over the term of the contract. Invoiced amounts are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. For professional services that we determine do not have stand-alone value to the customer, we recognize the services revenue ratably over the longer of the remaining contractual period or the remaining estimated life of the customer hosting relationship, once hosting has gone live. We currently estimate the life of the customer hosting relationship to be approximately 24 months, based on the average life of all hosting customer relationships.



**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

We consider a software element to exist when we determine that the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty and can feasibly run the software on its own hardware or enter into another arrangement with a third party to host the software. Additionally, we have established vendor specific objective evidence for the hosting and support elements of perpetual license sales, based on the prices charged when sold separately and substantive renewal terms. Accordingly, when a software element exists in a hosting services arrangements, license revenue for the perpetual software license element is determined using the residual method and is recognized upon delivery. Revenue for the hosting and support elements is recognized ratably over the contractual time period. Professional services are recognized as described below under Professional Services Revenue. If evidence of fair value cannot be established for the undelivered elements of an agreement, the entire amount of revenue from the arrangement is recognized ratably over the period that these elements are delivered.

***Maintenance and Support Revenue***

Included in recurring services revenue is revenue derived from maintenance and support. Maintenance and support revenue is recognized ratably over the term of the maintenance contract, which is typically one year. Maintenance and support is renewable by the customer on an annual basis. Maintenance and support rates, including subsequent renewal rates, are typically established based upon a specified percentage of net license fees as set forth in the arrangement.

***Professional Services Revenue***

Included in professional services revenue is revenue derived from system implementation, consulting and training. For license transactions, the majority of our consulting and implementation services and accompanying agreements qualify for separate accounting. We use vendor specific objective evidence of fair value for the services and maintenance to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element. Our consulting and implementation service contracts are bid either on a fixed-fee basis or on a time-and-materials basis. Substantially all of our contracts are on a time-and-materials basis. For time-and-materials contracts, where the services are not essential to the functionality, we recognize revenue as services are performed. If the services are essential to functionality, then both the product license revenue and the service revenue are recognized under the percentage of completion method. For a fixed-fee contract we recognize revenue based upon the costs and efforts to complete the services in accordance with the percentage of completion method, provided we are able to estimate such cost and efforts.

For hosting, consulting and implementation services that do not qualify for separate accounting, we recognize the services revenue ratably over the estimated life of the customer hosting relationship.

Training revenue that meets the criteria to be accounted for separately is recognized when training is provided or, in the case of hosting, when the customer also has access to the hosting services.

**Note 3. Stock-Based Compensation**

The stock-based compensation expense in our condensed consolidated statement of operations for the three months ended March 31, 2010 and 2009 was \$59,000 and \$50,000, respectively, and for the nine months ended March 31, 2010 and 2009 was \$191,000 and \$222,000, respectively.

Below is a summary of stock-based compensation included in the costs and expenses (in thousands):

|   | Three months ended<br>March 31, |      | Nine months ended<br>March 31, |       |
|---|---------------------------------|------|--------------------------------|-------|
|   | 2010                            | 2009 | 2010                           | 2009  |
| Cost of professional and recurring services | \$ 8                            | \$ 7 | \$ 27                          | \$ 22 |
| Research and development                    | 20                              | 13   | 60                             | 38    |

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|  |       |       |        |        |
|--|-------|-------|--------|--------|
| Sales and marketing                    | 11    | 7     | 39     | 22     |
| General and administrative             | 20    | 23    | 65     | 140    |
| Total stock-based compensation expense | \$ 59 | \$ 50 | \$ 191 | \$ 222 |



**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

We utilized the Black-Scholes valuation model for estimating the fair value of the stock-based compensation of options granted. All shares of our common stock issued pursuant to our stock option plans are only issued out of an authorized reserve of shares of common stock which were previously registered on Form S-8. Options to purchase 29,600 and 17,000 shares of common stock were granted during the three months ended March 31, 2010 and 2009, respectively, with a weighted-average fair value of \$0.73 and \$0.34, respectively. Options to purchase 965,800 and 101,000 shares of common stock were granted during the nine months ended March 31, 2010 and 2009, respectively, with a weighted-average fair value of \$0.53 and \$0.36, respectively, using the following assumptions:

|                                 | Three months ended |       | Nine months ended |       |
|---------------------------------|--------------------|-------|-------------------|-------|
|                                 | March 31,          |       | March 31,         |       |
|                                 | 2010               | 2009  | 2010              | 2009  |
| Dividend yield                  |                    |       |                   |       |
| Expected volatility             | 80%                | 80%   | 80%               | 80%   |
| Average risk-free interest rate | 2.79%              | 1.86% | 2.79%             | 2.57% |
| Expected life (in years)        | 6.25               | 6.25  | 6.25              | 6.25  |

The dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. In the three months ended December 31, 2009, we changed from using the simplified method of developing the estimate of the expected life to basing it on the historical exercise behavior of our employees. We have developed sufficient historical exercise behavior in order to develop the estimate of the expected life of our options granted. The change in the estimate had minimal effect on both the expected life and the valuation of the stock options. We determined the appropriate measure of expected volatility by reviewing historic volatility in the share price of our common stock, as adjusted for certain events that management deemed to be non-recurring and non-indicative of future events. The risk-free interest rate is derived from the average U.S. Treasury Strips rate with maturities approximating the expected lives of the awards during the period, which approximate the rate in effect at the time of the grant.

Based on our historical experience of option pre-vesting cancellations, we have assumed an annualized 14% forfeiture rate for our options. We will record additional expense if the actual forfeiture rate is lower than we estimated, and will record a recovery of prior expense if the actual forfeiture is higher than what we estimated.

Total compensation cost of all options granted but not yet vested as of March 31, 2010 was \$235,000, which is expected to be recognized over the weighted average period of 1.60 years. Options exercised for the three and nine months ended March 31, 2010 were 11,768 and 20,184, respectively. There were no options exercised for the three and nine months ended March 31, 2009.

**Note 4. Net Income/ (Loss) Per Common Share**

Basic net income/ (loss) per common share is computed using the weighted-average number of shares of common stock outstanding. In periods where net income is reported, the weighted average number of shares is increased by warrants and options in the money to calculate diluted net income per common share.

The following table sets forth a reconciliation of shares used in calculating basic and diluted earnings per share (in thousands, except per share data):

|  | Three months ended |          | Nine months ended |          |
|--|--------------------|----------|-------------------|----------|
|  | March 31,          |          | March 31,         |          |
|  | 2010               | 2009     | 2010              | 2009     |
| Net income/ (loss) applicable to common stockholders | \$ (318)           | \$ (196) | \$ 1,530          | \$ 1,251 |

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|  |           |           |         |         |
|--|-----------|-----------|---------|---------|
| Basic net income/ (loss) per common share  | \$ (0.01) | \$ (0.01) | \$ 0.07 | \$ 0.06 |
| Weighted-average common shares used in computing basic net income/ (loss) per common share   | 22,162    | 22,213    | 22,194  | 20,079  |
| Effect of dilutive options and warrants  |           |           | 319     | 1       |
| Weighted-average common shares used in computing diluted net income/ (loss) per common share | 22,162    | 22,213    | 22,513  | 20,080  |
| Diluted net income/ (loss) per common share  | \$ (0.01) | \$ (0.01) | \$ 0.07 | \$ 0.06 |

**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

Outstanding options and warrants to purchase 5,005,301 and 4,221,948 shares of common stock for the three months ended March 31, 2010 and 2009, respectively, were not included in the computation of diluted net loss per common share due to their anti-dilutive effect. Such securities could have a dilutive effect in future periods.

Outstanding options and warrants to purchase 4,685,560 and 4,221,287 shares of common stock for the nine months ended March 31, 2010 and 2009, respectively, were not included in the computation of diluted net income per common share due to their exercise price exceeding the average market price of the common stock during the period.

**Note 5. Comprehensive Income/ (Loss)**

We report comprehensive income/ (loss) and its components in accordance with ASC Topic 220, *Comprehensive Income*. Under the accounting standards comprehensive income/ (loss) includes all changes in equity during a period except those resulting from investments by or distributions to owners. Comprehensive loss was \$289,000 for the quarter ended March 31, 2010 as compared to a comprehensive loss of \$240,000 for the comparable year-ago quarter. Comprehensive income was \$1.5 million for the nine months ended March 31, 2010 as compared to a comprehensive income of \$1.2 million for the same period last year. Accumulated other comprehensive income / (loss) presented in the accompanying consolidated balance sheets at March 31, 2010 consists solely of accumulated foreign currency translation adjustments.

The table below summarizes the comprehensive income/ (loss) (in thousands):

|  | Three months ended |                 | Nine months ended |                 |
|--|--------------------|-----------------|-------------------|-----------------|
|  | March 31,<br>2010  | 2009            | March 31,<br>2010 | 2009            |
| Net income/ (loss)                       | \$ (318)           | \$ (196)        | \$ 1,530          | \$ 1,251        |
| Foreign currency translation adjustments | 29                 | (44)            | (45)              | (99)            |
| <b>Comprehensive income/ (loss)</b>      | <b>\$ (289)</b>    | <b>\$ (240)</b> | <b>\$ 1,485</b>   | <b>\$ 1,152</b> |

**Note 6. Segment Information**

We operate in one segment, the development, license, implementation and support of our customer service infrastructure software solutions. Operating segments are identified as components of an enterprise for which discrete financial information is available and regularly reviewed by the Company's chief operating decision-makers in order to make decisions about resources to be allocated to the segment and assess its performance. Our chief operating decision-makers, under ASC Topic 280, *Segment Reporting*, are our executive management team. Our chief operating decision-makers review financial information presented on a consolidated basis, for purposes of making operating decisions and assessing financial performance. Information relating to our geographic areas is as follows (in thousands):

|                       | Three Months Ended |                 | Nine Months Ended |                  |
|-----------------------|--------------------|-----------------|-------------------|------------------|
|                       | March 31,<br>2010  | 2009            | March 31,<br>2010 | 2009             |
| <b>Total Revenue:</b> |                    |                 |                   |                  |
| North America         | \$ 4,120           | \$ 4,268        | \$ 12,159         | \$ 12,135        |
| Europe                | 2,798              | 2,278           | 10,966            | 12,017           |
| Asia Pacific          | 25                 | 35              | 105               | 157              |
|                       | <b>\$ 6,943</b>    | <b>\$ 6,581</b> | <b>\$ 23,230</b>  | <b>\$ 24,309</b> |

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Operating Income/ (Loss):

|               |        |        |          |          |
|---------------|--------|--------|----------|----------|
| North America | \$ 555 | \$ 466 | \$ 1,646 | \$ 573   |
| Europe        | 157    | 146    | 2,765    | 3,386    |
| Asia Pacific* | (717)  | (582)  | (1,949)  | (2,137)  |
|               | \$ (5) | \$ 30  | \$ 2,462 | \$ 1,822 |

\* Includes costs associated with corporate support.

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In addition, identifiable tangible assets corresponding to our geographic areas are as follows (in thousands):

|               | March 31,<br>2010 | June 30,<br>2009 |
|---------------|-------------------|------------------|
| North America | \$ 7,805          | \$ 7,368         |
| Europe        | 3,502             | 5,485            |
| Asia Pacific  | 770               | 903              |
|               | \$ 12,077         | \$ 13,756        |

The following table provides revenue information for the three and nine months ended March 31, 2010 and 2009, respectively, (in thousands):

|                       | Three Months Ended<br>March 31, |          | Nine Months Ended<br>March 31, |           |
|-----------------------|---------------------------------|----------|--------------------------------|-----------|
|                       | 2010                            | 2009     | 2010                           | 2009      |
| <b>Revenue :</b>      |                                 |          |                                |           |
| License               | \$ 1,407                        | \$ 463   | \$ 5,877                       | \$ 5,591  |
| Recurring services    | 4,248                           | 3,708    | 12,524                         | 11,456    |
| Professional services | 1,288                           | 2,410    | 4,829                          | 7,262     |
|                       | \$ 6,943                        | \$ 6,581 | \$ 23,230                      | \$ 24,309 |

For the quarter ended March 31, 2010, there was one customer who accounted for 15% of total revenue as compared to one customer who accounted for 21% of total revenue, in the comparable year-ago quarter. For the nine months ended March 31, 2010, there was one customer who accounted for 16% of total revenue and there were two customers that accounted for 13% and 12% of total revenue, respectively for the same period last year.

**Note 7. Related Party Notes Payable**

On December 24, 2002, we entered into a note and warrant purchase agreement, as amended (the "2002 Agreement"), with Ashutosh Roy, our Chief Executive Officer, pursuant to which Mr. Roy made a loan to us evidenced by a subordinated secured promissory note and received warrants to purchase shares of our common stock in connection with such loan. The five year subordinated secured promissory note bore interest at an effective annual rate of 12%, due and payable upon the term of such note. We had the option to prepay the note at any time subject to the prepayment penalties set forth in such note. On December 31, 2002, Mr. Roy loaned us \$2.0 million under the agreement and received warrants that allow him to purchase up to 236,742 shares of our common stock at an exercise price equal to \$2.11 per share. These warrants expired in December 2005. In connection with this loan, we recorded \$1.83 million in related party notes payable and \$173,000 of discount on the note related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the five year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of three years, an expected stock price volatility of 75%, a risk free interest rate of 2%, and a dividend yield of 0%.

On October 31, 2003, we entered into an amendment to the 2002 Agreement with Mr. Roy, pursuant to which he loaned to us an additional \$2.0 million, evidenced by a subordinated secured promissory note, the 2003 Note, and received additional warrants to purchase up to 128,766 shares at \$3.88 per share. These warrants expired in October 2008. In connection with this additional loan we recorded \$1.8 million in related party notes payable and \$195,000 of discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the five year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method

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with the following assumptions: an expected life of three years, an expected stock price volatility of 75%, a risk free interest rate of 2.25%, and a dividend yield of 0%. These notes were amended and restated on June 29, 2007 and on September 24, 2008.

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**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

On March 31, 2004, we entered into a note and warrant purchase agreement with Mr. Roy, Oak Hill Capital Partners L.P., Oak Hill Capital Management Partners L.P., and FW Investors L.P. (the lenders) pursuant to which the lenders loaned to us \$2.5 million evidenced by a secured promissory note and received warrants to purchase shares of our common stock in connection with such loan. The secured promissory note had a term of five years and bore interest at an effective annual rate of 12% due and payable upon the maturity of such note. The warrants allowed the lenders to purchase up to 312,500 shares at an exercise price of \$2.00 per share. These warrants expired in March 2007. We recorded \$2.3 million in related party notes payable and \$223,000 of discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the five year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of three years, an expected stock price volatility of 75%, a risk free interest rate of 1.93%, and a dividend yield of 0%. These notes were amended and restated on September 24, 2008.

On June 29, 2007, we amended and restated the 2002 and 2003 notes with Mr. Roy and he loaned to us an additional \$2.0 million evidenced by a subordinated secured promissory note, the 2007 Note, and received additional warrants that allowed him to purchase up to 333,333 shares at \$1.20 per share. In connection with this additional loan we recorded \$1.8 million in related party notes payable and \$187,000 discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of three years, an expected stock price volatility of 75%, a risk free interest rate of 4.28%, and a dividend yield of 0%. In addition, the amendment extended the maturity date of the previous notes through March 31, 2009. As of March 31, 2010, warrants to purchase 333,333 shares of common stock were vested and outstanding. These notes were amended and restated on September 24, 2008.

On September 24, 2008, we entered into a Conversion Agreement and Amendment to Subordinated Secured Promissory Notes, as amended, (the Agreement) with the lenders. Immediately prior to the Agreement, the total outstanding indebtedness, including accrued interest, under the prior notes issued to the lenders, including the 2002, 2003 and 2007 Notes, as amended as applicable, equaled \$13.8 million. Pursuant to the Agreement and subject to the terms and conditions contained therein, we and the lenders have (i) converted a portion of the outstanding indebtedness under the prior notes equal to \$6.5 million into shares of our common stock at a price per share equal to \$0.95, or at a fair value of \$3.4 million (the Note Conversion), and (ii) extended the maturity date of the remaining outstanding indebtedness of \$7.3 million to March 31, 2012, as well as the period for which interest shall accrue (the Note Extension). In consideration for the Note Extension, the lenders received warrants to purchase an aggregate of 1,525,515 shares of our common stock at a price per share equal to \$0.95 and as a result, we recorded \$272,000 of discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the three year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of three years, an expected stock price volatility of 80%, a risk free interest rate of 2.26%, and a dividend yield of 0%. In addition, we recorded the \$3.1 million gain on the Note Conversion as a deemed contribution to capital since the lenders are related parties. The principal and interest due on the loans as of March 31, 2010 was \$8.5 million, and warrants to purchase 1,525,515 shares of common stock issued were vested and outstanding.

**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****Note 8. Bank Borrowings**

On June 27, 2008, we entered into a Loan and Security Agreement (the Bridge Bank Credit Facility) with Bridge Bank, N. A., as may be amended from time to time (Bridge Bank). Our obligations under the Bridge Bank Credit Facility are secured by a lien on our assets including intellectual property. Holders of certain outstanding secured promissory notes have subordinated their security interests to those of the Bridge Bank pursuant to a Subordination Agreement dated as of June 24, 2008. The Bridge Bank Credit Facility provides for the advance of up to the lesser of \$3.0 million under a revolving line of credit, or the sum of (i) 80% of certain qualified receivables, (ii) 75% of cash on deposit with Bridge Bank, (iii) the lesser of \$1.5 million or 60% of eligible unbilled license and hosting contracts, less (iv) the amount of any outstanding obligations to Bridge Bank. The revolving credit line has a maturity date of June 24, 2010 and bears interest at a rate of prime plus 0.5% per annum, provided that we maintain an average monthly cash balance of \$1 million (the Required Balance), or the rate will be increased to a rate of prime plus 1%. As of March 31, 2010 there was no outstanding balance under the Bridge Bank Credit Facility. The Bridge Bank Credit Facility also provides up to \$300,000 to pay off existing obligations to another bank (the Bridge Bank Term Loan) and is payable in 36 equal monthly payments of principal and interest. As of March 31, 2010, the amount outstanding under the Bridge Bank Term Loan Line was \$117,000 with an interest rate of 4.75%. In addition, the Bridge Bank Credit Facility allows for an advance of up to \$300,000 to be used to finance equipment purchases (the Bridge Bank Equipment Line) which must be repaid in 30 equal monthly payments of principal and interest, commencing on the tenth day of the first month following the date the advance is made, and continuing for each succeeding month. Terms for both the Bridge Bank Term Loan and the Bridge Bank Equipment Line include: (i) interest that accrues from the date of each advance at a rate of prime plus 1% per annum, provided that we maintain the Required Balance, or the rate will be increased to a rate of prime plus 1.5%, (ii) once repaid, amounts cannot be re-borrowed and (iii) a maturity date of June 24, 2011. As of March 31, 2010, the balance under the Bridge Bank Equipment Line was \$29,000, and the interest rate was 4.75%. There are financial covenants under this Bridge Bank Credit Facility that requires us to meet certain revenue performance and net loss excluding non-cash charges requirements. If we fail to comply with our covenants under the Bridge Bank Credit Facility, Bridge Bank can declare any outstanding amounts immediately due and payable and cease advancing money or extending credit to us. As of March 31, 2010, we were compliant with these financial covenants. In connection with the credit facility, Bridge Bank received warrants to purchase 73,889 shares of our common stock at an exercise price equal to \$0.90 per share. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of three years, an expected stock price volatility of 80%, a risk free interest rate of 3.14%, and a dividend yield of 0%. The warrants are revalued each quarter and the fair value of \$0.50 at March 31, 2010 was calculated using the market price of \$0.92 for one share of our common stock. The decrease of fair value of \$7,000 was included within other expense. The warrants contain a put option right that could be exercised by Bridge Bank upon the expiration date of June 24, 2011, or the early termination of the loan, a change in control, a sale of substantially all our equity ownership or an uncured event of default.

The following table summarizes debt maturities for the next five years and thereafter on an aggregate basis at March 31, 2010.

|                              | <b>Bank Borrowings</b> |
|------------------------------|------------------------|
| March 31, 2011               | \$ 125                 |
| March 31, 2012               | 21                     |
| March 31, 2013               |                        |
| March 31, 2014               |                        |
| March 31, 2015               |                        |
| Thereafter                   |                        |
| <b>Total Bank Borrowings</b> | <b>\$ 146</b>          |

**Note 9. Income Taxes**

Income taxes are accounted for using the liability method. Under this method, deferred tax liabilities and assets are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is recorded to reduce deferred tax assets to an amount where realization is more likely than not.





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**eGAIN COMMUNICATIONS CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

The FASB clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements, and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Additionally, the FASB provides guidance under ASC Topic 740 *Income Taxes* on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Our tax provision consists of foreign and state income taxes.

**Note 10. Commitments**

We generally warrant that the program portion of our software will perform substantially in accordance with certain specifications for a period up to one year from the date of delivery. Our liability for a breach of this warranty is either a return of the license fee or providing a fix, patch, work-around or replacement of the software. During the three months ended December 31, 2009, we changed the warranty period from a 90 day period to a period of up to one year from the date of delivery in response to industry trends. The effect of this change in estimate was insignificant for the three and nine months ended March 31, 2010.

We also provide standard warranties against and indemnification for the potential infringement of third party intellectual property rights to our customers relating to the use of our products, as well as indemnification agreements with certain officers and employees under which we may be required to indemnify such persons for liabilities arising out of their duties to us. The terms of such obligations vary. Generally, the maximum obligation is the amount permitted by law.

Historically, costs related to these warranties have not been significant; however we cannot guarantee that a warranty reserve will not become necessary in the future.

We have also agreed to indemnify our directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person's service as a director or officer, including any action by us, arising out of that person's services as our director or officer or that person's services provided to any other company or enterprise at our request.

**Note 11. New Accounting Pronouncements**

In January 2010, the FASB issued an accounting standards on fair value measurement and disclosures which amends ASC Topic 820, adding new requirements for disclosures for levels 1 and 2, separate disclosures and purchases, sales, issuances, and settlements relating to Level 3 measurements and clarification of existing fair value disclosures. The update is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to provide Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010 (our fiscal year 2011); early adoption is permitted. We have made additional disclosures in footnote 13, as applicable for levels 1 and 2.

In October 2009, the FASB issued new accounting guidance for revenue recognition with multiple deliverable revenue arrangements. The objective of this guidance is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit as well as eliminate the use of residual method for use in allocating contractual consideration and replace it with the relative selling price method. Vendors often provide multiple products or services to their customers. Those deliverables often are provided at different points in time or over different time periods. This update provides amendments to the criteria in Subtopic 605-25 for separating consideration in multiple-deliverable arrangements. The amendments in this update establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor specific objective evidence nor third-party evidence is available. The amendments in this update also will replace the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. Additionally, the new guidance is only applicable to non-software related deliverables sold as part of a multiple deliverable arrangement. In the instance an arrangement includes software deliverables as well as non-software related deliverables, the provisions of Topic 985 would apply to the software deliverables. This update is effective for fiscal years beginning on or after June 15, 2010; however, early adoption is permitted. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.



**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****Note 12. Litigation**

Beginning on October 25, 2001, a number of securities class action complaints were filed against us, and certain of our then officers and directors and underwriters connected with our initial public offering of common stock. The class actions were filed in the U.S. District Court for the Southern District of New York. The complaints alleged generally that the prospectus under which such securities were sold contained false and misleading statements with respect to discounts and excess commissions received by the underwriters as well as allegations of laddering whereby underwriters required their customers to purchase additional shares in the aftermarket in exchange for an allocation of IPO shares. The complaints sought an unspecified amount in damages on behalf of persons who purchased the common stock between September 23, 1999 and December 6, 2000. Similar complaints were filed against 55 underwriters and more than 300 other companies and other individuals. The over 1,000 actions were consolidated into a single action called *In re Initial Public Offering Sec. Litig.* In 2003, we and the other issuer defendants (but not the underwriter defendants) reached an agreement with the plaintiffs to resolve the cases as to our liability and that of our officers and directors. The settlement involved no monetary payment or other consideration by us or our officers and directors and no admission of liability. On August 31, 2005, the Court issued an order preliminarily approving the settlement. On April 24, 2006, the Court held a public hearing on the fairness of the proposed settlement. Meanwhile the consolidated case against the underwriters proceeded. In October 2004, the Court certified a class. On December 5, 2006, however, the United States Court of Appeals for the Second Circuit reversed, holding that the class certified by the District Court could not be certified. *In re Initial Public Offering Sec. Litig.*, 471 F.3d 24 (2d Cir. 2006). The Second Circuit's holding, while directly affecting only the underwriters, raised doubt as to whether the settlement class contemplated by the proposed issuer settlement could be approved. On June 25, 2007, the district court entered a stipulated order terminating the proposed issuer settlement. Thereafter pretrial proceedings resumed. In March 2009, all parties agreed on a new global settlement of the litigation; this settlement included underwriters as well as issuers. Under the settlement, which remains subject to final Court approval, the insurers would pay the full amount of settlement share allocated to us, and we would bear no financial liability. We, as well as the officer and director defendants, who were previously dismissed from the action pursuant to a stipulation, would receive complete dismissals from the case. On June 10, 2009, the Court entered an order granting preliminary approval of the settlement. On September 10, 2009, the Court held a final settlement approval hearing. On October 5, 2009, the Court issued an order finally approving the settlement. Starting on or about October 23, 2009, some would-be objectors to the certification of a settlement class (which occurred as part of the October 5, 2009 order) petitioned the Court for permission to appeal from the order certifying the settlement class, and on October 29 and November 2, 2009, several groups of objectors filed notices of appeal seeking to challenge the Court's approval of the settlement. On November 24, 2009, the Court signed, and on, December 4, 2009, the Court entered final judgment pursuant to the settlement dismissing all claims involving us. If the settlement and final judgment were to be overturned on appeal and litigation were to proceed, we believe that we have meritorious defenses to plaintiffs' claims and intend to defend the action vigorously. We have not accrued any liability in connection with this matter as we do not expect the outcome of this litigation to have a material impact on our financial condition.

With the exception of this matter, we are not a party to any other material pending legal proceedings, nor is our property the subject of any material pending legal proceeding, except routine legal proceedings arising in the ordinary course of our business and incidental to our business, none of which are expected to have a material adverse impact, taken individually or in the aggregate, upon our business, financial position or results of operations. However, even if these claims are not meritorious, the ultimate outcome of any litigation is uncertain, and it could divert management's attention and impact other resources.

**Note 13. Fair Value Measurement.**

The FASB standard on fair value measurement defines fair value, establishes a framework for measuring fair value to measure assets and liabilities, and expands disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the assets or liabilities in an orderly transaction between market participants on the measurement date. Subsequent changes in fair value of these financial assets and liabilities are recognized in earnings or other comprehensive income when they occur. The standard applies whenever other statements require or permit assets or liabilities to be measured at fair value.

**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

GAAP requires a three-tier fair value hierarchy, of which the first two are considered observable and the last unobservable, that is intended to increase the consistency and comparability in fair value measurements and related disclosures. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The fair value hierarchy consists of the following three levels:

Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets.

Level 2 instrument valuations are obtained from readily-available pricing sources for comparable instruments.

Level 3 instrument valuations are obtained without observable market value and require a high level of judgment to determine the fair value.

The following table summarizes our financial assets and liabilities measured at Level 1 fair value on a recurring basis as of March 31, 2010 and June 30, 2009 (unaudited, in thousands):

|                    | Balance as of<br>March 31,<br>2010 | Quoted Prices<br>Active<br>Markets of<br>Identical<br>Assets<br>(Level 1) | Balance as of<br>June 30,<br>2009 | Quoted Prices<br>Active<br>Markets of<br>Identical<br>Assets<br>(Level 1) |
|--------------------|------------------------------------|---|-----------------------------------|---|
| <b>Assets:</b>     |                                    |   |                                   |   |
| Cash equivalents   | \$ 4,734                           | \$ 4,734  | \$ 3,034                          | \$ 3,034  |
| <b>Liabilities</b> |                                    |   |                                   |   |
|                    | \$                                 | \$  | \$                                | \$  |

Investments primarily include money market funds. We use quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing methodology applies to Level 1 investments. As of March 31, 2010 and June 30, 2009, we did not have any material Level 2 or 3 assets or liabilities.

**Note 14. Share Repurchase Program**

On September 14, 2009, we announced that our board of directors approved a repurchase program under which we may purchase up to 1,000,000 shares of our common stock. The duration of the repurchase program is open-ended. Under the program, we purchase shares of common stock from time to time through the open market and privately negotiated transactions at prices deemed appropriate by management. The repurchase will be funded by cash on hand. As of March 31, 2010, we had repurchased and retired 83,408 shares at an average price of \$1.04 per share.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This report on Form 10-Q and the documents incorporated herein by reference contain forward-looking statements that involve risks and uncertainties. These statements may be identified by the use of the words such as anticipates, believes, continue, could, would, estimates, expects, intends, may, might, plans, potential, should, or will and similar expressions or the negative of those terms. The forward-looking statements include, but are not limited to, risks stemming from: our failure to compete successfully in the markets in which we do business; our history of net losses and our ability to sustain profitability; the adequacy of our capital resources and need for additional financing; continued lengthy and delayed sales cycles; the development of our strategic relationships and third party distribution channels; our ability to innovate and respond to rapid technological change and competitive challenges; legal and regulatory uncertainties and other risks related to protection of our intellectual property assets; the operational integrity and maintenance of our systems; the uncertainty of demand for our products; the anticipated customer benefits from our products; the actual mix in new business between hosting and license business when compared with management's projections; the anticipated revenue to us from the Cisco OEM agreement; the ability to increase revenue as a result of the increased investment in sales and marketing; our ability to manage our expenditures and estimate future expense, revenue, and operational requirements; our ability to manage our business plans, strategies and outlooks and any business-related forecasts or projections; risks from our substantial international operations; currency fluctuations and other risks discussed in Risk Factors in this report and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009. Our actual results could differ materially from those discussed in statements relating to our future plans, product releases, objectives, expectations and intentions, and other assumptions underlying or relating to any of these statements. These forward-looking statements represent our estimates and assumptions and speak only as of the date hereof. We expressly disclaim any obligation or understanding to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based unless required by law.*

All references to eGain, the Company, our, we or us mean eGain Communications Corporation and its subsidiaries, except where it is clear from the context that such terms mean only this parent company and excludes subsidiaries.

**Overview**

We are a pioneer in, and a leading provider of, customer service and contact center software that enables companies to build customer interaction hubs. These hubs provide an innovative approach to customer service by reducing customer service costs while enhancing customer experience within and across interaction channels by centralizing interaction history, knowledge management, business rules, analytics, and workflow and application management in one platform. Trusted by prominent enterprises and growing mid-sized companies worldwide, eGain's award winning software has been helping organizations achieve and sustain customer service excellence for more than a decade. We were incorporated in Delaware in September 1997.

**Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition, valuation allowance and accrued liabilities, long-lived assets and stock-based compensation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

There have been no material changes to these estimates for the periods presented in this Quarterly Report on Form 10-Q. For a detailed explanation of the judgments made in these areas, refer to Management's Discussion and Analysis of Financial Condition and Results of Operations within our Annual Report on Form 10-K for the year ended June 30, 2009, which we filed with the Securities and Exchange Commission on September 28, 2009.

**Table of Contents****Results of Operations**

The following table sets forth the results of operations for the periods presented, expressed as a percentage of total revenue:

|   | Three Months Ended<br>March 31, |             | Nine Months Ended<br>March 31, |             |
|---|---------------------------------|-------------|--------------------------------|-------------|
|   | 2010                            | 2009        | 2010                           | 2009        |
| <b>Revenue:</b>                           |                                 |             |                                |             |
| License                                   | 20%                             | 7%          | 25%                            | 23%         |
| Recurring services                        | 61%                             | 56%         | 54%                            | 47%         |
| Professional services                     | 19 %                            | 37%         | 21%                            | 30%         |
| <b>Total revenue</b>                      | <b>100 %</b>                    | <b>100%</b> | <b>100%</b>                    | <b>100%</b> |
| Cost of license                           | 0%                              | 0%          | 1%                             | 0%          |
| Cost of recurring services                | 16 %                            | 16%         | 14 %                           | 13%         |
| Cost of professional services             | 18 %                            | 21%         | 17 %                           | 19%         |
| <b>Gross profit</b>                       | <b>66 %</b>                     | <b>63%</b>  | <b>68 %</b>                    | <b>68%</b>  |
| <b>Operating costs and expenses:</b>      |                                 |             |                                |             |
| Research and development                  | 20%                             | 21%         | 16%                            | 18%         |
| Sales and marketing                       | 35%                             | 32%         | 31%                            | 32%         |
| General and administrative                | 11%                             | 9%          | 10%                            | 10%         |
| <b>Total operating costs and expenses</b> | <b>66%</b>                      | <b>62%</b>  | <b>57%</b>                     | <b>60%</b>  |
| <b>Income/ (loss) from operations</b>     | <b>0%</b>                       | <b>1%</b>   | <b>11%</b>                     | <b>8%</b>   |

**Revenue**

Total revenue increased 6% to \$6.9 million in the quarter ended March 31, 2010 from \$6.6 million in the quarter ended March 31, 2009. New hosting and license business increased 18% for the quarter ending March 31, 2010 compared to the comparable year-ago quarter. For the quarter ended March 31, 2010, there was one customer who accounted for 15% of total revenue as compared to one customer who accounted for 21% of total revenue, in the comparable year-ago quarter. Total revenue for the nine months ended March 31, 2010 decreased 4% to \$23.2 million, compared to \$24.3 million in the same period last year. New hosting and license business decreased 4% for the nine months ending March 31, 2010 compared to the same period last year. During the nine months ended March 31, 2010, there was one customer who accounted for 16% of total revenue and there were two customers that accounted for 13% and 12% of total revenue, respectively in the same period last year. To measure the impact of foreign exchange rate fluctuation, we recalculate current period results using the comparable prior period exchange rate. The impact of the foreign exchange fluctuation between the U.S. dollar and the Euro and British pound resulted in an increase of \$224,000 in total revenue for the three months ended March 31, 2010 as compared to the comparable year-ago quarter. The impact of the foreign exchange fluctuation on the total revenue for the nine months ended March 31, 2010 was minimal as compared to the same period last year.

There is general unpredictability of the length of our current sales cycles, the timing of revenue recognition on more complex license transactions and seasonal buying patterns. This unpredictability has increased in the last two years due to the global economic slowdown and the increased volatility of the value of the British pound and Euro in relation to the U.S. dollar. Also, because we offer a hybrid delivery model, the mix of new hosting and license business in a quarter could also impact our revenue in a particular quarter. We are continuing to see the mix of license and hosting business fluctuate from quarter to quarter. The value of new hosting business, as a percentage of combined new hosting and license business, excluding the Cisco OEM agreement was 46% for the quarter ended March 31, 2010, compared to 65% for the comparable year-ago quarter. The value of new hosting business, as a percentage of combined new hosting and license business, excluding the Cisco OEM agreement was 50% for the nine months ended March 31, 2010, compared to 36% for the same period last year. For license transactions, the license revenue amount is generally recognized in the quarter which delivery and acceptance of our software takes place whereas, for hosting transactions, hosting revenue is recognized ratably over the term of the hosting contract, which is typically one to two years. As a result, our total revenue may increase or decrease in future quarters as a result of the timing and mix of license and hosting transactions.





**Table of Contents***License Revenue*

| (in thousands)              | Three Months Ended |                |        |      | Nine Months Ended |                |        |    |
|-----------------------------|--------------------|----------------|--------|------|-------------------|----------------|--------|----|
|                             | 2010               | March 31, 2009 | Change | %    | 2010              | March 31, 2009 | Change | %  |
| <b>Revenue:</b>             |                    |                |        |      |                   |                |        |    |
| License                     | \$ 1,407           | \$ 463         | \$ 944 | 204% | \$ 5,877          | \$ 5,591       | \$ 286 | 5% |
| Percentage of total revenue | 20%                | 7%             |        |      | 25%               | 23%            |        |    |

License revenue increased 204% to \$1.4 million in the quarter ended March 31, 2010 from \$463,000 in the comparable year-ago quarter. The impact of the foreign exchange fluctuation on the license revenue for the quarter was minimal as compared to the comparable year-ago quarter. The change was due to the increase in the number and the size of license transactions. License revenue represented 20% and 7% of total revenue for the quarters ended March 31, 2010 and 2009, respectively.

License revenue increased 5% to \$5.9 million for the nine months ended March 31, 2010 from \$5.6 million in the same period last year. License revenue for the nine months ended March 31, 2010 was positively impacted by \$131,000 due to the strengthening of the Euro, in which certain licenses were denominated, against the U.S. dollar. License revenue represented 25% and 23% of total revenue for the nine months ended March 31, 2010 and 2009, respectively.

Given the general unpredictability of the length of current sales cycles, the mix between hosting and license business, the uncertainty in the global economy and the recent volatility of the value of the British pound and Euro in relation to the U.S. dollar, license revenue may increase or decrease in future periods.

*Recurring Services Revenue*

| (in thousands)                   | Three Months Ended |                |        |     | Nine Months Ended |                |          |     |
|----------------------------------|--------------------|----------------|--------|-----|-------------------|----------------|----------|-----|
|                                  | 2010               | March 31, 2009 | Change | %   | 2010              | March 31, 2009 | Change   | %   |
| <b>Revenue:</b>                  |                    |                |        |     |                   |                |          |     |
| Hosting services                 | \$ 2,053           | \$ 1,570       | \$ 483 | 31% | \$ 5,708          | \$ 4,806       | \$ 902   | 19% |
| Maintenance and support services | 2,195              | 2,138          | 57     | 3%  | 6,816             | 6,650          | 166      | 2%  |
| Total recurring services         | \$ 4,248           | \$ 3,708       | \$ 540 | 15% | \$ 12,524         | \$ 11,456      | \$ 1,068 | 9%  |
| Percentage of total revenue      | 61%                | 56%            |        |     | 54%               | 47%            |          |     |

Recurring services revenue includes hosting and software maintenance and support services. Software maintenance and support services consist of technical support and software upgrades and enhancements. Recurring services revenue increased 15% to \$4.3 million in the quarter ended March 31, 2010 from \$3.7 million for the comparable year-ago quarter. Recurring services revenue represented 61% and 56% of total revenue for the quarters ended March 31, 2010 and 2009, respectively. Recurring services revenue increased 9% to \$12.5 million in the nine months ended March 31, 2010 from \$11.5 million for the same period last year. Recurring services revenue represented 54% and 47% of total revenue for the nine months ended March 31, 2010 and 2009, respectively.

Hosting revenue increased 31% to \$2.1 million in the quarter ended March 31, 2010 from \$1.6 million in the comparable year-ago quarter. Hosting revenue was positively impacted by \$82,000 due to the strengthening of the British pound against the U.S. dollar in this period. The increase was primarily due to two new hosting contracts totaling approximately \$2.5 million entered into in the first two quarters of fiscal year 2010.

Hosting revenue increased 19% to \$5.7 million in the nine months ended March 31, 2010 from \$4.8 million in the same period last year. Hosting revenue was negatively impacted by \$31,000 due to the weakening of the British pound against the U.S. dollar in this period. The increase was primarily due to the increased size of new hosting contracts with larger enterprises. Excluding the impact from any further foreign currency fluctuations, we expect hosting revenue to increase in future periods based upon current renewal rates for existing hosted customers, the new hosting agreements entered into in recent quarters that we expect to start generating hosting revenue in future quarters and the increased interest we are seeing for our hosting or on demand services from our target customers.



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Maintenance and support services revenue increased 3% to \$2.2 million in the quarter ended March 31, 2010 from \$2.1 million in the comparable year-ago quarter. Maintenance and support revenue was positively impacted by \$94,000 due to the strengthening of the British pound against the U.S. dollar in this period.

Maintenance and support services revenue increased 3% to \$6.8 million in the nine months ended March 31, 2010 from \$6.7 million for the same period last year. Maintenance and support services revenue was negatively impacted by \$70,000 due to the weakening of the British pound against the U.S. dollar in this period. The increase in maintenance and support services revenue was primarily due to the increased license revenue partly due to increased purchases of maintenance and support contracts over the last few quarters. Excluding the impact from any future foreign currency fluctuations, we expect maintenance and support revenue to increase in future periods based upon the current renewal rates for existing maintenance and support customers and the projected levels of new license sales.

*Professional Services Revenue*

| (in thousands)              | Three Months Ended |                   |            |       | Nine Months Ended |                   |            |       |
|-----------------------------|--------------------|-------------------|------------|-------|-------------------|-------------------|------------|-------|
|                             | 2010               | March 31,<br>2009 | Change     | %     | 2010              | March 31,<br>2009 | Change     | %     |
| <b>Revenue:</b>             |                    |                   |            |       |                   |                   |            |       |
| Professional services       | \$ 1,288           | \$ 2,410          | \$ (1,122) | (47)% | \$ 4,829          | \$ 7,262          | \$ (2,433) | (34)% |
| Percentage of total revenue | 19%                | 37%               |            |       | 21%               | 30%               |            |       |

Professional services revenue decreased 47% to \$1.3 million in the quarter ended March 31, 2010 from \$2.4 million in the comparable year-ago quarter. The decrease for the quarter ended March 31, 2010 was primarily due to a decrease in professional services revenue from the Cisco OEM agreement. In the quarter ended September 30, 2009, we signed an amendment to the Cisco OEM agreement, with an effective date of July 27, 2009. Based upon certain changes, including pricing for support, we no longer estimate the minimum profit and record the associated revenue as professional services for the Cisco OEM agreement from the effective date of the amendment. Instead, we record royalties earned under the Cisco OEM agreement as license revenue. As a result, there was no additional profit margin recorded from the Cisco OEM agreement in the quarter ended March 31, 2010 when compared to \$644,000 of profit margin in the comparable year-ago quarter. In addition, the decrease was due in part to our business strategy to migrate more of our professional services work to partners. The impact from the foreign currency fluctuations on professional service revenue was minimal for the quarter ended March 31, 2010. Professional services revenue represented 19% and 37% of total revenue for the quarters ended March 31, 2010 and 2009, respectively.

Professional services revenue decreased 34% to \$4.8 million in the nine months ended March 31, 2010 from \$7.3 million in the same period last year. The decrease for the nine months ended March 31, 2010 was primarily due to a decrease in professional services revenue from the Cisco OEM agreement. As discussed above, we no longer estimate the minimum profit and record the associated revenue as professional services for the Cisco OEM agreement from the effective date of the amendment. As a result, the professional services revenue for the nine months ended March 31, 2010 included a profit margin of \$420,000 from Cisco OEM agreement prior to the effective date of the amendment when compared to a profit margin of \$1.8 million from Cisco OEM agreement for the same period last year. In addition, the decrease was due in part to our business strategy to migrate more of our professional services work to partners. The impact from the foreign currency fluctuations on professional service revenue was minimal for the nine months ended March 31, 2010. Professional services revenue represented 21% and 30% of total revenue for the nine months ended March 31, 2010 and 2009, respectively.

Excluding the impact from any future foreign currency fluctuations, we expect professional services revenue to remain relatively constant or to increase slightly in future periods.

**Table of Contents****Cost of Revenue**

| (in thousands)              | Three Months Ended<br>March 31, |          |          |      | Nine Months Ended<br>March 31, |          |          |      |
|-----------------------------|---------------------------------|----------|----------|------|--------------------------------|----------|----------|------|
|                             | 2010                            | 2009     | Change   | %    | 2010                           | 2009     | Change   | %    |
| <b>Cost of Revenue</b>      |                                 |          |          |      |                                |          |          |      |
| Cost of Revenue             | \$ 2,330                        | \$ 2,456 | \$ (126) | (5)% | \$ 7,394                       | \$ 7,914 | \$ (520) | (7)% |
| Percentage of total revenue | 34%                             | 37%      |          |      | 32%                            | 32%      |          |      |
| Gross Margin                | 66%                             | 63%      |          |      | 68%                            | 68%      |          |      |

Total cost of revenue decreased 5% to \$2.3 million in the quarter ended March 31, 2010 from \$2.5 million in the comparable year-ago quarter. Total cost of revenue represented 34% and 37% of total revenue in the quarter ended March 31, 2010 and 2009, respectively. The decrease was primarily due to (i) a decrease of \$124,000 for the services performed by research and development personnel in connection with the Cisco OEM agreement, (ii) a decrease of \$79,000 in personnel related expenses, and (iii) a decrease in the third-party software royalties of \$63,000, and was partially offset by (a) an increase in international subsidiaries expenses of approximately \$101,000 primarily from the strengthening of the Euro, British pound and Indian rupee against the U.S. dollar, and (b) an increase of \$36,000 in outside consulting expense and hosting related costs. Gross margin for the quarter ended March 31, 2010 was 66% compared to 63% in the comparable year-ago quarter. The increase in gross margin was primarily due to the increase in our total revenue and the decrease in the cost of revenue.

Total cost of revenue decreased 7% to \$7.4 million in the nine months ended March 31, 2010 from \$7.9 million in the same period last year. Total cost of revenue represented 32% of total revenue for both of the nine months ended March 31, 2010 and 2009. The decrease was primarily due to (i) a decrease of \$357,000 for the services performed by research and development personnel in connection with the Cisco OEM agreement, (ii) a decrease of \$141,000 in personnel related expenses, (iii) a decrease in international subsidiaries expenses of approximately \$105,000 primarily from the weakening of the Euro, British pound and Indian rupee against the U.S. dollar, (iv) a decrease in outside consulting expense of \$62,000, and was partially offset (i) by an increase of \$91,000 in third-party software royalties and the (ii) increase of \$73,000 in hosting related costs. Gross margin for the nine months ended March 31, 2010 was 68%, unchanged from the same period last year.

In order to better understand the changes within our cost of revenue and resulting gross margins, we have provided the following discussion of the individual components of our cost of revenue.

**Cost of License**

| (in thousands)                | Three Months Ended<br>March 31, |       |         |       | Nine Months Ended<br>March 31, |       |        |      |
|-------------------------------|---------------------------------|-------|---------|-------|--------------------------------|-------|--------|------|
|                               | 2010                            | 2009  | Change  | %     | 2010                           | 2009  | Change | %    |
| <b>Cost of License</b>        |                                 |       |         |       |                                |       |        |      |
| Cost of License               | \$ 1                            | \$ 16 | \$ (15) | (94)% | \$ 152                         | \$ 54 | \$ 98  | 181% |
| Percentage of license revenue | 0%                              | 3%    |         |       | 3%                             | 1%    |        |      |
| Gross Margin                  | 100%                            | 97%   |         |       | 97%                            | 99%   |        |      |

Cost of license is the cost for third-party software imbedded in our products. Total cost of license decreased by \$15,000 in the quarter ended March 31, 2010 from the comparable year-ago quarter. Total cost of license as a percentage of total license revenue was approximately 0%, a gross margin of approximately 100% in the quarter ended March 31, 2010 as compared to approximately 3%, a gross margin of approximately 97% in the comparable year-ago quarter.

Total cost of license increased by \$98,000 for the nine months ended March 31, 2010 from the same period last year. Total cost of license as a percentage of total license revenue was approximately 3%, a gross margin of approximately 97% for the nine months ended March 31, 2010, as compared to approximately 1%, a gross margin of approximately 99% in the comparable year-ago quarter.

The changes to the cost of license for the three and nine months ended March 31, 2010 in absolute dollars were minimal. We anticipate cost of license to remain relatively constant as a percentage of total license revenues in future periods.

**Table of Contents***Cost of Recurring Services*

| (in thousands)                          | Three Months Ended |                   |        |    | Nine Months Ended |                   |        |    |
|---|--------------------|-------------------|--------|----|-------------------|-------------------|--------|----|
|   | 2010               | March 31,<br>2009 | Change | %  | 2010              | March 31,<br>2009 | Change | %  |
| <b>Cost of recurring services</b>       | \$ 1,104           | \$ 1,035          | \$ 69  | 7% | \$ 3,385          | \$ 3,239          | \$ 146 | 5% |
| Percentage of recurring service revenue | 26%                | 28%               |        |    | 27%               | 28%               |        |    |
| Gross Margin                            | 74%                | 72%               |        |    | 73%               | 72%               |        |    |

Cost of recurring services includes personnel costs for our hosting services and maintenance and support. It also includes depreciation of capital equipment used in our hosted network, cost of support for the third-party software and lease costs paid to remote co-location centers. Total cost of recurring services increased 7% to \$1.1 million in the quarter ended March 31, 2010 from \$1.0 million for the comparable year-ago quarter. The increase primarily consisted of (i) an increase in our international subsidiaries' expenses of approximately \$45,000 primarily from the strengthening of the Euro, British pound, and Indian rupee against the U.S. dollar, (ii) an increase of \$43,000 in personnel and personnel-related expenses, (iii) an increase of \$18,000 in hosting related costs and was partially offset by a decrease in support of third-party software of \$48,000.

Total cost of recurring services increased 5% to \$3.4 million in the nine months ended March 31, 2010 from \$3.2 million in the same period last year. The increase primarily consisted of (i) an increase of \$107,000 in personnel and personnel-related expenses, and (ii) an increase of \$79,000 in hosting related costs, and was partially offset by (i) a decrease in our international subsidiaries' expenses of approximately \$25,000 primarily from the weakening of the Euro and British pound, and Indian rupee against the U.S. dollar, and (ii) a decrease of \$13,000 in outside consulting services and third-party software support. Excluding the impact from any future foreign currency fluctuations, we anticipate cost of recurring services to increase slightly in future periods.

*Cost of Professional Services*

| (in thousands)                             | Three Months Ended |                   |          |       | Nine Months Ended |                   |          |       |
|--|--------------------|-------------------|----------|-------|-------------------|-------------------|----------|-------|
|  | 2010               | March 31,<br>2009 | Change   | %     | 2010              | March 31,<br>2009 | Change   | %     |
| <b>Cost of professional services</b>       | \$ 1,225           | \$ 1,405          | \$ (180) | (13)% | \$ 3,857          | \$ 4,621          | \$ (764) | (17)% |
| Percentage of professional service revenue | 95%                | 58%               |          |       | 80%               | 64%               |          |       |
| Gross Margin                               | 5%                 | 42%               |          |       | 20%               | 36%               |          |       |

Cost of professional services includes personnel costs for consulting services. In addition, we recorded costs associated with the Cisco OEM agreement from the second quarter in fiscal year 2006 through the first quarter of fiscal year 2010. In the quarter ended September 30, 2009, we signed an amendment to this agreement, with an effective date of July 27, 2009. Based upon certain changes, we no longer record the costs associated with the Cisco OEM agreement as cost of professional services from the effective date of the amendment. There was no cost associated with the Cisco OEM agreement for the quarter ended March 31, 2010 compared to \$124,000 for the comparable year-ago quarter. Total cost of professional services decreased 13% to \$1.2 million for the quarter ended March 31, 2010 compared to \$1.4 million in the comparable year-ago quarter. The decrease was primarily due to (i) a decrease of \$124,000 for the services performed by research and development personnel in connection with the Cisco OEM agreement, and (ii) a decrease of \$123,000 in personnel and personnel-related expenses and was partially offset by an increase in our international subsidiaries' expenses of approximately \$56,000 primarily from the strengthening of the Euro, British pound, and Indian rupee against the U.S. dollar. The gross margin for the quarter ended March 31, 2010 was 5% compared to a gross margin of 42% in the comparable year-ago quarter. The decrease in the gross margin included a decrease of \$1.1 million in the total professional services revenue when the cost of professional services remained relatively constant from the comparable year-ago quarter. The decrease in the gross margin was primarily due to the change in how we record the revenue and costs associated with the Cisco OEM agreement as discussed above.

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Total cost of professional services decreased 17% to \$3.9 million for the nine months ended March 31, 2010 compared to \$4.6 million in the same period last year. The decrease was primarily due to (i) a decrease of \$357,000 for the services performed by research and development personnel in connection with the Cisco OEM agreement, (ii) a decrease of \$226,000 in personnel and personnel related expenses, (iii) a decrease of \$97,000 in outside consulting services and other expenses and (iv) a decrease in international subsidiaries' expenses of approximately \$81,000 primarily from the weakening of the Euro, British pound, and Indian rupee against the U.S. dollar. The gross margin for the nine months ended March 31, 2010 was 20% compared to a gross margin of 36% from the same period last year. The decrease in the gross margin included a decrease of \$2.4 million in the total professional services revenue and was partially offset by a decrease of \$764,000 in the total cost of professional services from the same period last year. The decrease in the gross margin was primarily due to the change in how we record the revenue and costs associated with the Cisco OEM agreement as discussed above.

Excluding the impact from any future foreign currency fluctuations, we anticipate cost of professional services to remain relatively constant in absolute dollars in future periods.

**Research and Development**

| (in thousands)                  | Three Months Ended |          |        |    | Nine Months Ended |          |          |       |
|---------------------------------|--------------------|----------|--------|----|-------------------|----------|----------|-------|
|                                 | 2010               | 2009     | Change | %  | 2010              | 2009     | Change   | %     |
| <b>Research and Development</b> | \$ 1,402           | \$ 1,378 | \$ 24  | 2% | \$ 3,857          | \$ 4,303 | \$ (446) | (10)% |
| Percentage of total revenue     | 20%                | 21%      |        |    | 16%               | 18%      |          |       |

Research and development expenses primarily consist of compensation and benefits for our engineering, product management and development and quality assurance personnel, fees for outside consultants and, to a lesser extent, occupancy costs and related overhead. Research and development costs increased 2% to \$1.4 million in the quarter ended March 31, 2010 from the comparable year-ago quarter. The increase was primarily due to (i) the decrease in allocation of the services in connection with the Cisco OEM agreement to cost of professional services that contributed an increase of \$124,000, (ii) an increase in our international subsidiaries' expenses of approximately \$41,000 primarily from the strengthening of the Euro, British pound, and Indian rupee against the U.S. dollar, and (iii) an increase of \$32,000 in outside consulting services and was partially offset by a decrease of \$168,000 in personnel related costs primarily from the decreased headcount in North America. Total research and development expenses as a percentage of total revenue were 20% and 21% for the quarters ended March 31, 2010 and 2009, respectively.

Research and development costs decreased 10% to \$3.9 million for the nine months ended March 31, 2010 from \$4.3 million in the same period last year. The decrease was primarily due to (i) a decrease of \$657,000 in personnel and personnel related costs from the decreased headcount in North America, and (ii) a decrease in outside consulting services of \$168,000, and was partially offset by the decrease in allocation of the services in connection with the Cisco OEM agreement to cost of professional services that contributed an increase of \$357,000. Total research and development expenses as a percentage of total revenue was 16% and 18% for the nine months ended March 31, 2010 and 2009, respectively.

Excluding the impact from any future foreign currency fluctuations, we anticipate research and development expense to remain relatively constant in absolute dollars in future periods.

**Sales and Marketing**

| (in thousands)                   | Three Months Ended |          |        |     | Nine Months Ended |          |          |      |
|----------------------------------|--------------------|----------|--------|-----|-------------------|----------|----------|------|
|                                  | 2010               | 2009     | Change | %   | 2010              | 2009     | Change   | %    |
| <b>Sales</b>                     | \$ 1,986           | \$ 1,678 | \$ 308 | 18% | \$ 5,956          | \$ 6,358 | \$ (402) | (6)% |
| <b>Marketing</b>                 | \$ 475             | \$ 423   | \$ 52  | 12% | \$ 1,289          | \$ 1,376 | \$ (87)  | (6)% |
| <b>Total Sales and Marketing</b> | \$ 2,461           | \$ 2,101 | \$ 360 | 17% | \$ 7,245          | \$ 7,734 | \$ (489) | (6)% |
| Percentage of total revenue      | 35%                | 32%      |        |     | 31%               | 32%      |          |      |

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Sales and marketing expenses primarily consist of compensation and benefits for our sales, marketing and business development personnel, lead generation activities, advertising, trade show and other promotional costs and, to a lesser extent, occupancy costs and related overhead. Sales and marketing expense increased 17% to \$2.5 million in the quarter ended March 31, 2010 from \$2.1 million in the comparable year-ago quarter. Total sales and marketing expenses as a percentage of total revenues were 35% in the quarter ended March 31, 2010 compared to 32% in the comparable year-ago quarter. Sales and marketing expense decreased 6% to \$7.2 million for the nine months ended March 31, 2010 from \$7.7 million in the same period last year. Total sales and marketing expenses as a percentage of total revenues were 31% and 32% for the nine months ended March 31, 2010 and 2009, respectively.

Total sales expenses increased 18% to \$2.0 million in the quarter ended March 31, 2010 from \$1.7 million in the comparable year-ago quarter. The increase for the quarter was primarily due to (i) an increase of \$126,000 in personnel and personnel related expense, (ii) an increase of \$93,000 in outside consulting services due to the increased sales activities in Germany and, (iii) the increase in our international subsidiaries expenses of approximately \$74,000 primarily from the strengthening of the Euro, British pound, and Indian rupee against the U.S. dollar.

Total sales expenses decreased 6% to \$5.9 million for the nine months ended March 31, 2010 from \$6.4 million in the same period last year. The decrease for the nine months was primarily due to (i) a decrease of \$370,000 in sales commission expense, (ii) a decrease of \$149,000 in personnel and personnel related expense related to a reduction in our worldwide sales force, in the first half of fiscal year 2010, and (iii) a decrease in our international subsidiaries expenses of approximately \$51,000 primarily from the weakening of the Euro, British pound, and Indian rupee against the U.S. dollar which was partially offset by an increase of \$139,000 in outside consulting services.

Total marketing expenses increased 12% to \$475,000 in the quarter ended March 31, 2010 from \$423,000 in the comparable year-ago quarter. The increase for the quarter was primarily due to (i) an increase in our international subsidiaries expenses of approximately \$18,000 from the strengthening of the Euro, British pound, and Indian rupee against the U.S. dollar, (ii) an increase of \$15,000 in marketing program expense and (iii) an increase of \$10,000 in personnel and personnel-related expenses.

Total marketing expenses decreased 6% to \$1.3 million for the nine months ended March 31, 2010 from \$1.4 million in the same period last year. The decrease for the nine months was primarily due to a decrease of \$87,000 in marketing program expense.

Excluding the impact from any future foreign currency fluctuations, we anticipate sales and marketing expenses to increase in future periods based upon the recent expansion of our worldwide sales team.

**General and Administrative**

| (in thousands)                    | Three Months Ended |        |        |     | Nine Months Ended |          |          |       |
|-----------------------------------|--------------------|--------|--------|-----|-------------------|----------|----------|-------|
|                                   | 2010               | 2009   | Change | %   | 2010              | 2009     | Change   | %     |
| <b>General and Administrative</b> | \$ 755             | \$ 616 | \$ 139 | 23% | \$ 2,272          | \$ 2,536 | \$ (264) | (10)% |
| Percentage of total revenue       | 11%                | 9%     |        |     | 10%               | 10%      |          |       |

General and administrative expenses primarily consist of compensation and benefits for our finance, human resources, administrative and legal services personnel, fees for outside professional services, provision for doubtful accounts and, to a lesser extent, occupancy costs and related overhead.

Total general and administrative expense increased 23% to \$755,000 in the quarter ended March 31, 2010 from \$616,000 in the comparable year-ago quarter. The increase was primarily due to (i) an increase of \$110,000 in bad debt expense, and (ii) an increase of \$18,000 in personnel and personnel-related expense. Total general and administrative expenses as a percentage of total revenue were 11% and 9% for the quarters ended March 31, 2010 and 2009, respectively.

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Total general and administrative expense decreased 10% to \$2.3 million for the nine months ended March 31, 2010 from \$2.5 million in the same period last year. The decrease was primarily due to (i) a decrease of \$142,000 in outside consulting services, auditing, legal and other expenses, (ii) a decrease of \$75,000 in stock-based compensation expense, (iii) a decrease of \$36,000 in personnel and personnel-related expense, and (iv) a decrease in our international subsidiaries' expenses of approximately \$26,000 primarily from the weakening of the Euro, British pound, and Indian rupee against the U.S. dollar and was partially offset by an increase of \$18,000 in bad debt expense. Total general and administrative expenses as a percentage of total revenue was 10% for the both of the nine months ended March 31, 2010 and 2009.

Excluding the impact from any future foreign currency fluctuations, we anticipate general and administrative expenses to increase slightly in absolute dollars in future periods based upon current revenue expectations.

**Stock-Based Compensation**

| (in thousands)                              | Three Months Ended<br>March 31, |              |             |            | Nine Months Ended<br>March 31, |               |                |              |
|---|---------------------------------|--------------|-------------|------------|--------------------------------|---------------|----------------|--------------|
|   | 2010                            | 2009         | Change      | %          | 2010                           | 2009          | Change         | %            |
| Cost of professional and recurring services | \$ 8                            | \$ 7         | \$ 1        | 14%        | \$ 27                          | \$ 22         | \$ 5           | 23%          |
| Research and development                    | 20                              | 13           | 7           | 54%        | 60                             | 38            | 22             | 58%          |
| Sales and marketing                         | 11                              | 7            | 4           | 57%        | 39                             | 22            | 17             | 77%          |
| General and administrative                  | 20                              | 23           | (3)         | (13)%      | 65                             | 140           | (75)           | (54)%        |
| <b>Total Stock-Based Compensation</b>       | <b>\$ 59</b>                    | <b>\$ 50</b> | <b>\$ 9</b> | <b>18%</b> | <b>\$ 191</b>                  | <b>\$ 222</b> | <b>\$ (31)</b> | <b>(14)%</b> |
| Percentage of total revenue                 | 1%                              | 1%           |             |            | 1%                             | 1%            |                |              |

Stock-based compensation expense includes the amortization of the fair value of share-based payments made to employees, directors and consultants, primarily in the form of stock options (see Note 3 – Stock-Based Compensation). The fair value of stock options granted is recognized as an expense as the underlying stock options vest. The changes for the three and nine months ended March 31, 2010, as compared to same periods last year, were minimal.

**Income/ (Loss) From Operations**

| (in thousands)                  | Three Months Ended<br>March 31, |              |                |               | Nine Months Ended<br>March 31, |                 |               |            |
|---------------------------------|---------------------------------|--------------|----------------|---------------|--------------------------------|-----------------|---------------|------------|
|                                 | 2010                            | 2009         | Change         | %             | 2010                           | 2009            | Change        | %          |
| <b>Operating Income/ (Loss)</b> | <b>\$ (5)</b>                   | <b>\$ 30</b> | <b>\$ (35)</b> | <b>(117)%</b> | <b>\$ 2,462</b>                | <b>\$ 1,822</b> | <b>\$ 640</b> | <b>35%</b> |
| Operating Margin                | 0%                              | 1%           |                |               | 11%                            | 8%              |               |            |

Loss from operations was \$5,000 in the quarter ended March 31, 2010 compared to an operating income of \$30,000 in the comparable year-ago quarter. We recorded an approximate operating break-even in the quarter ended March 31, 2010, compared to a 1% operating margin in the comparable year-ago quarter. The change in the quarter ended March 31, 2010 primarily included an increase in revenue by \$362,000 including the positive impact of approximately \$224,000 from the strengthening of the Euro, British pound against the U.S. dollar and an increase in total costs and operating expenses of \$397,000. The increase in total costs and operating expenses primarily consisted of (i) an increase of approximately \$250,000 in international expenses due to the strengthening of the European and Indian currencies against the U.S. dollar, (ii) an increase of \$152,000 in outside consulting services, auditing, legal and other expenses, and (iii) an increase of \$109,000 in bad debt expense and was partially offset by a decrease in personnel-related costs of \$88,000.



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Operating income was \$2.5 million for the nine months ended March 31, 2010 compared to an operating income of \$1.8 million in the same period last year. We recorded an 11% operating margin in the nine months ended March 31, 2010 compared to an 8% operating margin in the same period last year. The increase of operating income in the nine months ended March 31, 2010 primarily included a decrease in total costs and operating expenses of \$1.7 million partially offset by a decrease in revenue by \$1.1 million. The impact from the fluctuation of foreign currencies against the U.S. dollar on the total revenue was minimal for the nine months ended March 31, 2010. The decrease in total costs and operating expenses primarily consisted of (i) a decrease in personnel-related costs of \$1.3 million from headcount reductions in sales and in research and development, (ii) a decrease of \$230,000 in outside consulting services, auditing, legal and other expenses, (iii) a decrease of approximately \$196,000 in international expenses primarily due to the weakening of the Euro, British pound, and Indian rupee against the U.S. dollar, and (iv) a decrease of \$87,000 in marketing program expense.

### ***Interest Expense, net***

Interest expense decreased 11% to \$282,000 in the quarter ended March 31, 2010 from \$318,000 in the comparable year-ago quarter. Interest expense decreased 26% to \$837,000 in the nine months ended March 31, 2010 from \$1.1 million in the same period last year. The decrease for the three and nine months ended March 31, 2010, was primarily due to the decrease in the related party notes payable balances which resulted from the conversion agreement and amendment to subordinated secured promissory notes entered into on September 24, 2009 as amended. (See Note 7 Related Party Notes Payable). We expect interest expense to increase in future periods.

### ***Other Income and Expense***

We recorded other expense of \$5,000 for the quarter ended March 31, 2010 compared to other income of \$130,000 for the comparable year-ago quarter which included \$192,000 of exchange rate gain on foreign accounts receivable. Other income for the nine months ended March 31, 2010 was \$25,000 compared to other income of \$495,000 in the same period last year which included \$526,000 exchange rate gain on foreign accounts receivable.

### ***Income Tax Benefit and Expense***

There was an income tax expense of \$26,000 for the quarter ended March 31, 2010 compared to an income tax expense of \$38,000 for the comparable year-ago quarter. Income tax expense for the nine months ended March 31, 2010 was \$120,000 compared to the income tax benefit of \$72,000 in the same period last year. The income tax expenses recorded for the three and nine months ended March 31, 2010 was primarily related to our foreign subsidiaries. The income tax benefit for the nine months ended March 31, 2009 was primarily related to the reversal of the income tax provision for our Indian subsidiary.

### ***Liquidity and Capital Resources***

#### ***Overview***

As of March 31, 2010 our cash and cash equivalents were \$7.6 million with a working capital of \$280,000 compared to cash and cash equivalents of \$7.5 million and a negative working capital of \$1.9 million as of June 30, 2009. As of March 31, 2010, our current liabilities included \$6.0 million of current deferred revenue compared to \$5.4 million on June 30, 2009.

Based upon our current operating plan, we believe that existing capital resources will enable us to maintain current and planned operations for at least the next 12 months. From time to time, however, we may consider opportunities for raising additional capital and/or exchanging all or a portion of our existing debt for equity. We can make no assurances that such opportunities will be available to us on economic terms we consider favorable, if at all.

Our expectations as to our future cash flows and our future cash balances are subject to a number of assumptions, including assumptions regarding anticipated increases in our revenue, the mix of new hosting and license business, our ability to retain existing customers and customer purchasing and payment patterns, many of which are beyond our control.

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On June 27, 2008, we entered into a Loan and Security Agreement ( the Bridge Bank Credit Facility ) with Bridge Bank, N. A. ( Bridge Bank ), as may be amended from time to time (See Note 8 Bank Borrowings ). The Bridge Bank Credit Facility provides for the advance of up to the lesser of \$3.0 million under a revolving line of credit, or the sum of (i) 80% of certain qualified receivables, (ii) 75% of cash on deposit with Bridge Bank, (iii) the lesser of \$1.5 million or 60% of eligible unbilled license and hosting contracts, less (iv) the amount of any outstanding obligations to Bridge Bank. In addition, the Bridge Bank Credit Facility allows for borrowings of up to \$300,000 to pay off existing obligations to Silicon Valley Bank and up to \$300,000 to be used to finance equipment purchases. There are financial covenants under this Bridge Bank Credit Facility that requires us to meet certain revenue performance and net loss excluding non-cash charges requirements. If we fail to comply with our covenants under the Bridge Bank Credit Facility, Bridge Bank can declare any outstanding amounts immediately due and payable and cease advancing money or extending credit to us. As of March 31, 2010 we were compliant with these financial covenants and had \$3.0 million available credit under the Bridge Bank Credit Facility.

On September 24, 2008, we entered into a Conversion Agreement and Amendment to Subordinated Secured Promissory Notes, as amended, (the Agreement ) with the lenders. Pursuant to the Agreement, we and the lenders have (i) converted a portion of the outstanding indebtedness under the prior notes equal to \$6.5 million into shares of our common stock, and (ii) extended the maturity date of the remaining outstanding indebtedness to March 31, 2012, as well as the period for which interest shall accrue (the Note Extension ). In consideration for the Note Extension, the lenders received warrants to purchase an aggregate of 1,525,515 shares of our common stock. The principal and interest due on the loans as of March 31, 2010 was \$8.5 million, and warrants to purchase 1,858,848 shares of common stock issued were vested and outstanding (see Note 7 Related Party Notes Payable).

*Cash Flows*

Net cash provided by operating activities was \$4.1 million for the nine months ended March 31, 2010 compared to net cash provided by operating activities of \$2.0 million from the same period last year. Net cash provided by operating activities for the nine months ended March 31, 2010 consisted primarily of a net income of \$1.5 million, plus non-cash expenses related to depreciation of \$475,000, stock-based compensation of \$191,000, accrued interest and amortization of discount on related party notes of \$762,000, amortization of debt issuance costs of \$63,000, and the net change in operating assets and liabilities.

Net cash provided by operating activities for the nine months ended March 31, 2009 consisted primarily of a net income of \$1.3 million offset by depreciation of \$561,000, accrued interest and amortization of discount on related party notes of \$963,000, stock-based compensation of \$222,000, provisions for doubtful accounts and sales returns of \$67,000, loss on the disposal of fixed assets of \$60,000, and the net increase in operating assets and liabilities.

The net change in operating assets and liabilities for the nine months ended March 31, 2010 primarily consisted of the decrease in accounts receivable by \$1.4 million and the decreases in accrued compensation by \$952,000, accrued liabilities by \$251,000 and accounts payable by \$173,000. This was partially offset by the increases of \$1.0 million in deferred revenue. The decrease in accrued compensation was primarily due to the decrease in sales commission. The decrease in accrued liabilities primarily consisted of the decrease in sales tax and the partial payment of audit fees. The increase in deferred revenue was primarily due to the increase in deferred maintenance and support payments received as a large number of our customers have annual maintenance and support renewals that came due in the last two quarters.

The net change in operating assets and liabilities for the nine months ended March 31, 2009 primarily consisted of the increase in accounts receivable by \$2.1 million primarily due to an increase in our business and a decrease of \$543,000 in accounts payable. This was partially offset by the increase in deferred revenue of \$988,000, an increase in accrued compensation of \$225,000, and a decrease in prepaid and other current assets of \$170,000. The increase in accrued compensation was primarily due to the change in the frequency of payment of bonuses to North American employees from three months to six months. The increase in deferred revenue was primarily due to (i) the increase in deferred maintenance and support payments received as a large number of our customers have annual maintenance and support renewals that come due in the quarter and (ii) the increase in deferred consulting revenue associated with our new hosting customer deployments.

Net cash used in investing activities was \$445,000 for the nine months ended March 31, 2010 compared to net cash used in investing activities of \$264,000 for the same period last year. Cash used in investing activities for the nine months ended March 31, 2010 and 2009 was primarily due to the purchase of equipment and software to support the increase in our hosting business and for new employees.

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Net cash used in financing activities was \$3.3 million for the nine months ended March 31, 2010 compared to net cash used in financing activities of \$20,000 for the same period last year. Net cash used in financing activities for the nine months ended March 31, 2010 primarily included a repayment of \$3.1 million of existing bank borrowings, \$131,000 payment on capital leases and \$86,000 on the repurchase of our stock. Net cash used in financing activities for the nine months ended March 31, 2009 was a net of \$63,000 proceeds from new bank borrowings and \$83,000 payment on existing bank borrowings.

### *Commitments*

There was no significant change to our contractual obligations since September 30, 2009.

### *Off-Balance Sheet Arrangements*

As of March 31, 2010, we had no off-balance-sheet arrangements, as defined in Item 303(a)(4) of SEC Regulation S-K, other than operating leases and co-location agreement that were included in our commitment schedule as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009. There was no significant change since June 30, 2009.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We develop products in the United States and India and sell these products internationally. Generally, sales are made in local currency. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Identifiable assets denominated in foreign currency at March 31, 2010 totaled approximately \$4.3 million. We do not currently use derivative instruments to hedge against foreign exchange risk. As such we are exposed to market risk from fluctuations in foreign currency exchange rates, principally from the exchange rate between the U.S dollar and the Euro, British pound and the Indian rupee. During the three months ended March 31, 2010, there was no significant fluctuation in foreign currency exchange rates between U.S. dollar and the Euro and the British pound and the Rupee. If the dollar strengthens in future periods, we may experience an adverse effect on our financial position or results of operations.

### **Item 4T. Controls and Procedures**

(a) ***Evaluation of disclosure controls and procedures.*** We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of March 31, 2010, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

(b) ***Changes in internal controls.*** There were no changes in our internal controls which occurred during the quarter ended March 31, 2010 that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

Beginning on October 25, 2001, a number of securities class action complaints were filed against us, and certain of our then officers and directors and underwriters connected with our initial public offering of common stock. The class actions were filed in the U.S. District Court for the Southern District of New York. The complaints alleged generally that the prospectus under which such securities were sold contained false and misleading statements with respect to discounts and excess commissions received by the underwriters as well as allegations of laddering whereby underwriters required their customers to purchase additional shares in the aftermarket in exchange for an allocation of IPO shares. The complaints sought an unspecified amount in damages on behalf of persons who purchased the common stock between September 23, 1999 and December 6, 2000. Similar complaints were filed against 55 underwriters and more than 300 other companies and other individuals. The over 1,000 actions were consolidated into a single action called *In re Initial Public Offering Sec. Litig.* In 2003, we and the other issuer defendants (but not the underwriter defendants) reached an agreement with the plaintiffs to resolve the cases as to our liability and that of our officers and directors. The settlement involved no monetary payment or other consideration by us or our officers and directors and no admission of liability. On August 31, 2005, the Court issued an order preliminarily approving the settlement. On April 24, 2006, the Court held a public hearing on the fairness of the proposed settlement. Meanwhile the consolidated case against the underwriters proceeded. In October 2004, the Court certified a class. On December 5, 2006, however, the United States Court of Appeals for the Second Circuit reversed, holding that the class certified by the District Court could not be certified. *In re Initial Public Offering Sec. Litig.*, 471 F.3d 24 (2d Cir. 2006). The Second Circuit's holding, while directly affecting only the underwriters, raised doubt as to whether the settlement class contemplated by the proposed issuer settlement could be approved. On June 25, 2007, the district court entered a stipulated order terminating the proposed issuer settlement. Thereafter pretrial proceedings resumed. In March 2009, all parties agreed on a new global settlement of the litigation; this settlement included underwriters as well as issuers. Under the settlement, which remains subject to final Court approval, the insurers would pay the full amount of settlement share allocated to us, and we would bear no financial liability. We, as well as the officer and director defendants, who were previously dismissed from the action pursuant to a stipulation, would receive complete dismissals from the case. On June 10, 2009, the Court entered an order granting preliminary approval of the settlement. On September 10, 2009, the Court held a final settlement approval hearing. On October 5, 2009, the Court issued an order finally approving the settlement. Starting on or about October 23, 2009, some would-be objectors to the certification of a settlement class (which occurred as part of the October 5, 2009 order) petitioned the Court for permission to appeal from the order certifying the settlement class, and on October 29 and November 2, 2009, several groups of objectors filed notices of appeal seeking to challenge the Court's approval of the settlement. On November 24, 2009, the Court signed, and on December 4, 2009, the Court entered final judgment pursuant to the settlement dismissing all claims involving us. If the settlement and final judgment were to be overturned on appeal and litigation were to proceed, we believe that we have meritorious defenses to plaintiffs' claims and intend to defend the action vigorously. We have not accrued any liability in connection with this matter as we do not expect the outcome of this litigation to have a material impact on our financial condition.

With the exception of this matter, we are not a party to any other material pending legal proceedings, nor is our property the subject of any material pending legal proceeding, except routine legal proceedings arising in the ordinary course of our business and incidental to our business, none of which are expected to have a material adverse impact, taken individually or in the aggregate, upon our business, financial position or results of operations. However, even if these claims are not meritorious, the ultimate outcome of any litigation is uncertain, and it could divert management's attention and impact other resources.

**Item 1A. Risk Factors**

In addition to other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing eGain. Additional risks and uncertainties not currently known to us or that we currently deem to be insignificant also may materially adversely affect our business, financial condition and/or operating results.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On September 14, 2009, we announced that our Board of Directors has approved a stock repurchase program under which we may purchase up to 1,000,000 shares of our common stock. The duration of the repurchase program is open-ended. Under the program, we can purchase shares of common stock from time to time through the open market and privately negotiated transactions at prices deemed appropriate by our management. The repurchases will be funded by cash on hand and the duration of the repurchase program is open-ended.

The following table provides information on such purchases during the third fiscal quarter ended March 31, 2010:

| <b>Period</b>         | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Program</b> | <b>Maximum Number of Shares that may yet be Purchased Under the Program</b> |
|-----------------------|---|-------------------------------------|---|---|
| Jan.01- Jan. 31, 2010 | 10,783                                  | \$ 1.05                             | 10,783  | 946,167   |
| Feb.01- Feb.28, 2010  | 10,975                                  | \$ 1.03                             | 10,975  | 935,192   |
| Mar.01- Mar. 31, 2010 | 18,600                                  | \$ 1.06                             | 18,600  | 916,592   |
| <b>Total</b>          | <b>40,358</b>                           | <b>\$ 1.05</b>                      | <b>40,358</b>   | <b>916,592</b>  |

**Item 6. Exhibits****Exhibits**

| <b>No.</b> | <b>Description of Exhibits</b>  |
|------------|---|
| 31.1       | Rule 13a-15(e)/15d-15(e) Certification of Chief Executive Officer.  |
| 31.2       | Rule 13a-15(e)/15d-15(e) Certification of Chief Financial Officer.  |
| 32.1       | Certification pursuant to 18.U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 of Ashutosh Roy, Chief Executive Officer.* |
| 32.2       | Certification pursuant to 18.U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 of Eric Smit, Chief Financial Officer.*    |

\* The material contained in this exhibit is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after date hereof and irrespective of any general incorporation language contained in such filing.

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**SIGNATURES**

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

Dated: May 14, 2010

eGAIN COMMUNICATIONS CORPORATION

By

/s/ ERIC N. SMIT  
**Eric N. Smit**  
**Chief Financial Officer**  
**(Duly Authorized Officer and**

**Principal Financial and Accounting Officer)**

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**EXHIBIT INDEX**

- 31.1 Rule 13a-15(e)/15d-15(e) Certification of Chief Executive Officer.
- 31.2 Rule 13a-15(e)/15d-15(e) Certification of Chief Financial Officer.
- 32.1 Certification pursuant to 18.U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 of Ashutosh Roy, Chief Executive Officer.\*
- 32.2 Certification pursuant to 18.U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 of Eric Smit, Chief Financial Officer.\*

\* The material contained in this exhibit is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after date hereof and irrespective of any general incorporation language contained in such filing.