

CENTRA SOFTWARE INC
Form 10-K
March 16, 2005
Table of Contents

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10 K

For annual and transition reports pursuant to sections 13 or 15(d) of the
Securities Exchange Act of 1934

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR
THE FISCAL YEAR ENDED DECEMBER 31, 2004

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE
TRANSITION PERIOD FROM TO

Commission File Number: 000 27861

Centra Software, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

04 3268918
(I.R.S. Employer
Identification No.)

430 Bedford Street, Lexington, MA 02420

(Address of Principal Executive Offices)

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(781) 861 7000

(Issuer's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$0.001 par value

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2.) Yes No

The aggregate market value of voting stock held by non-affiliates of the registrant was approximately \$57,164,000 as of June 30, 2004 based on the last sale price of the Common Stock as reported on the NASDAQ National Market for that date (\$2.25 per share.) There were 27,701,766 shares of the registrant's Common Stock issued and outstanding on March 1, 2005.

Table of Contents**TABLE OF CONTENTS**

	Page No.
PART I	
Item 1. <u>Business</u>	4
Item 2. <u>Properties</u>	17
Item 3. <u>Legal Proceedings</u>	18
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	19
PART II	
Item 5. <u>Market for Registrant's Common Equity and Related Stockholder Matters</u>	20
Item 6. <u>Selected Consolidated Financial Data</u>	21
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 7A. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	44
Item 8. <u>Consolidated Financial Statements and Supplementary Data</u>	45
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosures</u>	45
Item 9A. <u>Controls and Procedures</u>	46
Item 9B. <u>Other Information</u>	47
PART III	
Item 10. <u>Directors and Executive Officers of the Registrant</u>	48
Item 11. <u>Executive Compensation</u>	51
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	54
Item 13. <u>Certain Relationships and Related Transactions</u>	56
Item 14. <u>Principal Accountant Fees and Services</u>	56
PART IV	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	58
<u>Signatures</u>	60

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

Certain statements contained in this Annual Report on Form 10-K, including information with respect to our future business plans, objectives, expectations and intentions constitute forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words believe, plan, expect, anticipate, intend, seek, estimate, may, continue, or similar words are intended to identify forward-looking statements. You should read statements that contain these words carefully. They discuss our future expectations, contain projections of our future results of operations or our financial condition or state other forward-looking information, and may involve known and unknown risks over which we have no control. You should not place undue reliance on forward-looking statements. We cannot guarantee any future results, levels of activity, performance or achievements. Moreover, we assume no obligation to update forward-looking statements or update the reasons actual results could differ materially from those anticipated in forward-looking statements, except as required by law. The factors discussed in the sections captioned Business in Item 1 and Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this report, including the sub-section captioned Factors That Could Affect Future Results, identify important factors that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements.

AVAILABLE INFORMATION

Our Internet address is www.centra.com. We make available free of charge through our Web site our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such materials with the Securities and Exchange Commission.

Table of Contents

PART I

ITEM 1. BUSINESS

Centra Software, Inc. was formed as a Delaware corporation in 1995. For financial information about our business, see our consolidated financial statements and the related notes thereto found in Item 8 of this report. Centra[®] and other terms describing our products or services that contain the term Centra are trademarks or registered trademarks of Centra Software, Inc. All other brand or product names referred to throughout this report may be trademarks or registered trademarks of their respective owners.

Company Overview

We provide specialized application software solutions for online business communication, collaboration and learning. Our products and services help organizations automate important business processes by using corporate networks and the Internet to integrate real-time, group-oriented human interactions with online business initiatives. These real-time, group events can range from ad hoc, one-on-one online meetings to highly interactive, structured, collaborative learning sessions to prescheduled Web seminars for larger audiences. They are key elements of business processes that include collaborative learning, enterprise application rollout, online selling and customer acquisition programs.

Our customers use our products and solutions to:

accelerate product introductions;

deliver hands-on training of new software applications;

effect change-management initiatives;

expand training and certification to employees and external channel partners;

facilitate customer interaction and online selling; and

support project management activities.

In addition, we offer consulting, education, content creation and support services that enable our customers to successfully implement, deploy and support our products and solutions throughout their organizations.

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Our products are available as packaged software license applications or through our application service provider, or ASP, service. Based on a common collaboration framework, our products and services support a wide range of convenient business interactions online, including real-time virtual learning, large scale Web conferences and live, interactive Web meetings. Each real-time collaboration interface includes capabilities for Voice-Over-Internet-Protocol, or VoIP, audio, Web-based video, software application sharing, real-time data exchange, facilities for session recording and playback and content management capabilities. These products and services allow organizations to increase the productivity of their members and enhance the effectiveness of knowledge transfer while reducing travel, facilities and telecommunications costs.

In April 2001, we completed the acquisition of MindLever.com, Inc., or MindLever, a privately-held provider of management systems for learning content with standards-based solutions for creating, storing, and delivering live and self-paced learning content in the form of personalized eLearning programs. As a result of this acquisition and through continuing integration efforts, our products and services for live collaboration were expanded to include capabilities and tools for rapid content authoring and for the management of proprietary content, session recordings, and other third-party, standards-compliant content in a centralized, online content repository, providing richer workflow support for business processes.

Table of Contents

Strategic Developments

In April 2004, we began to market and sell a series of specialized solutions, based on best practices gained while working with our customers, that consist of our existing products and services including our proven technology platform, together with an integrated learning content management system, business workflow tools, third-party software integration and professional services. These specialized solutions are designed to enable groups of people to work more efficiently by automating important projects online. The specialized solutions Centra® for Enterprise Application Rollout, Centra® for Sales Effectiveness, Centra® for Collaborative Learning, and Centra® for Customer Acquisition are intended to allow customers to automate and facilitate the planning, execution and evaluation phases of their important business processes.

In June 2004, we introduced the Enterprise Advantage Subscription (EAS) pricing model, a multi-year, flat annual fee, high volume or unlimited use licensing program designed to enable large organizations to meet increasing demand for online collaboration solutions. The EAS model is designed to promote greater use of our products within an organization by providing a fixed annual cost for the unlimited use of our software or ASP service along with maintenance and support and a subscription to our online training classes included as part of a bundled package. This eliminates many of the buying challenges that our customers face when trying to decide on the right number of software licenses or ASP service capacity to purchase, forecast usage, justify up-front capital expenditure, and prevent overage charges for exceeding usage allowances. EAS pricing is primarily based on the end-user population size of the buyer's organization or entity. This new pricing model eliminates the administrative burden of managing a specified number of licenses and provides enterprises with predictable subscription payments; simple, flexible licensing; and greater return on investment. By bundling support services and providing an ASP option, the new model also addresses a purchasing trend toward software as a service for the convenience of a completely outsourced solution.

In October 2004, we entered into an agreement with EMC Documentum, a technology provider of content management solutions, under which we will integrate their Enterprise Content Management platform with our core technology. We anticipate having this integration available in the first half of 2006. However, we can make no assurances that we will be able to do so by then or at all. Accordingly, we make no specific commitment to deliver such future integration.

Our Centra® 7.5 release, referred to as Centra Live, which is anticipated to be available in June 2005, will include a new native Microsoft client architecture that will eliminate our dependence on Microsoft JVM and support clients in both Macintosh and Citrix environments in the future. Centra 7.5 will also include video enhancements, expanded audio options, enhanced tools for interactivity, and enhanced reporting capabilities and services. In addition to the Centra 7.5 release, we are developing add-on modules for our specialized solution, Centra for Enterprise Application Rollout, to provide users with moment-of-need support by integrating with an Electronic Performance Support System and a help desk communication software application that will better enable users to access support and provide more rapid escalation for support.

We intend to release both Centra 7.5 and the add-on modules in June 2005, but we can make no assurances that we will be able to do so by then or at all. Accordingly, we make no specific commitment to deliver such future release or add-on modules.

As of December 31, 2004, we had sold our products and services to more than 1,400 customer organizations. Our customer base spans multiple industry segments, including financial services, pharmaceutical, government, manufacturing, higher education and telecommunications.

Industry Background

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Today's business environment has become more challenging for large and small organizations regardless of their industry or market sector. Corporations, government agencies and universities are feeling pressure from many directions, including globalization, shrinking margins, shorter product life cycles and customer expectation

Table of Contents

for innovation, improved service delivery and speed to market. Companies and organizations are utilizing the ubiquity and capabilities of the Internet to accelerate critical business processes, improve productivity, create revenue-generating opportunities, leverage employee knowledge and expertise, and lower operating costs. To achieve these goals, organizations are implementing collaborative technologies that can provide more value than generic Web-conferencing tools, enable them to share and exchange business-critical information with geographically distributed customers, partners, prospects and employees, and help them acquire the skills they need to reach their business goals faster. To be truly effective, however, these technologies must be capable of streamlining entire business processes in departments, such as sales, marketing and training, by facilitating the workflow that occurs before, during, and after online meetings, events or classes. These technologies must support the numerous ways in which people collaborate, learn and manage the knowledge assets of an organization, including:

one-to-one customer and sales interactions, such as problem resolution, mentoring, and remote product demonstrations;

one-to-many seminar and presentation events, such as large-scale marketing events, and executive broadcasts;

many-to-many learning and interactive teamwork sessions, such as virtual instructor-led classes, university extension programs, and remote team projects; and

individual, on-demand learning activities, such as personalized learning tracks that blend documents, Web-based content, archived recordings and scheduled live online classes.

Many generic Internet-based communication tools, including chat rooms, instant messaging, Web meetings, Web conferences and screen sharing software, address only ad-hoc and discrete collaboration tasks and are not integrated with a common user interface, back-end management system, or existing operating databases or enterprise applications. Therefore, they are difficult to adopt as a permanent collaboration solution for repeatable business applications. In addition, these products do not support the broad range of user and content management capabilities required by businesses for truly effective real-time collaboration workflow.

To maximize return on software infrastructure investments for collaboration, companies require a solution that can integrate voice communication, video, content sharing and group interaction with existing business tools and software applications. In addition, a complete solution must support a broad range of live, self-service, and recorded group interactions in a variety of business contexts, supported by a common collaboration framework. The solution must allow customers, partners and employees to interact from any location, regardless of whether they are on a corporate network or on a low bandwidth dial-up connection, use VoIP or a standard teleconferencing bridge and provide anytime, anywhere access to knowledge and information by blending live online interaction with self-paced content and recordings. A complete solution for online Web event marketing must also support processes for registration and recruitment, lead source tracking, recorded event management, and attendance follow up. Finally, underneath these important process-oriented features and functionality, a complete online business communications and collaboration solution must have a reliable user management system environment that can grow to support and integrate with a company's other electronic systems, such as e-commerce systems, enterprise computer systems, enterprise operating platforms and databases, other enterprise software applications, and emerging Web technologies.

The Centra Solution

We make secure, scalable, standards-based application software for online business communication, collaboration and learning. Our products are designed to enable effective, Web-based interaction and knowledge sharing among customers, partners and employees in a variety of business contexts. Our application software enables groups of people to quickly assemble, converse, interact, share content and work together in real-time over intranets, extranets and the Internet. In 2004, we combined our industry-leading application software

Table of Contents

platform, Centra 7, with third-party integration and professional services to introduce our specialized solutions: Centra for Enterprise Application Rollout, Centra for Sales Effectiveness, Centra for Collaborative Learning and Centra for Customer Acquisition. Centra 7 is an integrated real-time enterprise multimedia collaboration and knowledge delivery application that was created to support deeper integration with operational business activities: before, during, and after an on-line session. Centra 7's capabilities include features for administering participants, managing in-session content, scheduling and recording online sessions and accessing recorded collaboration sessions after the event for on-demand learning or corporate compliance. Centra 7 was also designed to meet increasing enterprise requirements for scalability, performance, security and reliability through an enhanced server architecture that supports load balancing, fail-over, and recoverability and that supports creation of multiple domains that segregate content and user lists within an enterprise, if so desired by the customer.

Strategy

Our objective is to improve our leadership position in the collaborative learning market segment of application software, services and solutions for online business communications and collaboration. We intend to leverage that leadership to increase the use of our products throughout the enterprise and in other segments of the collaboration market. We intend to focus our sales and marketing efforts on selling to Global 5000 companies, government and higher education institutions. To achieve these objectives, we are pursuing the following strategies (although we can give no assurance that these strategies will be successful or that we will be able to achieve profitability as a result of them see Factors That Could Affect Future Results We may not successfully execute our strategic plan, in Item 7):

Further improve our core technology.

We intend to continue to support and expand our core technology platform including integration of our products with major enterprise applications, desktop email, messaging, and calendaring tools. In October of 2004, we entered into an agreement with EMC Documentum to deliver solutions that integrate our core technology with the EMC Documentum Enterprise Content Management platform. Our Centra 7.5 release, Centra Live, expected to be available in June 2005, will include a new native Microsoft client architecture that will eliminate our dependence on Microsoft JVM and support clients in both Macintosh and Citrix environments in the future. Centra 7.5 will also include video enhancements, expanded audio options, enhanced tools for interactivity, and enhanced reporting capabilities and services. In the future, we intend to add enhanced telephony integration to our core platform. We believe these product development initiatives are in line with the evolving requirements of organizations seeking to find solutions that enable distributed groups of people to work more efficiently and effectively through the online automation of important business processes. While we intend to release Centra 7.5 in June 2005 with the enhanced capabilities of our core technology as mentioned above and to release the integration with the EMC Documentum Enterprise Content Management platform in the first half of 2006, we can make no assurances that we will be able to do so by then for either of them, both of them or at all. Accordingly, we make no specific commitment to deliver such future releases.

Develop add-on modules for our specialized solutions.

We plan to develop add-on modules for our specialized solutions Centra for Enterprise Application Rollout, Centra for Sales Effectiveness, Centra for Collaborative Learning, and Centra for Customer Acquisition that broaden the capabilities and value of these solutions. We believe that if we develop additional functionality and forge technology partnerships with other leading companies that can add value to our solutions, we will be able to increase our competitive advantage by providing an end-to-end solution that combines collaborative workflows with important business processes. Initially, we are focusing on add-on modules for the Centra for Enterprise Application Rollout specialized solution. The add-on modules will include an Electronic Performance Support System and integration of help desk communication software that will better enable users to access support and provide more rapid escalation for support.

Table of Contents

While we intend to release, in June 2005, the add-on modules to the Centra for Enterprise Application Rollout specialized solution, mentioned above, we can make no assurance that we will be able to do so by then or at all, and we make no specific commitment to deliver such add-on modules.

Improve and promote our extensive professional and customer services.

We believe that a company's decision to purchase our products is based, in part, on our ability to provide a high level of customer service, integration assistance, content creation services, implementation assistance and technical support. To the extent that demand increases for our products, we plan to continue to invest in and enhance our customer service capabilities, including state-of-the-art training and education for our products, and professional consulting services, using the best practice methodologies for enterprise deployment and integration.

Offer innovative and flexible pricing options to customers.

In June 2004, we introduced the Enterprise Advantage Subscription (EAS) pricing model, a multi-year, flat annual fee, high volume or unlimited use licensing program designed to enable large organizations to meet increasing demand for online collaboration solutions. The EAS model is designed to promote greater use of our products within an organization by providing a fixed annual cost for the unlimited use of our software or ASP service along with maintenance and support and a subscription to our online training classes included as part of a bundled package. This eliminates many of the buying challenges that our customers face when trying to decide on the right number of software licenses or ASP service capacity to purchase, forecast usage, justify up-front capital expenditure, and prevent overage charges for exceeding usage allowances. EAS pricing is primarily based on the end-user population size of the buyer's organization or entity. This new pricing model eliminates the administrative burden of managing a specified number of licenses and provides enterprises with predictable subscription payments; simple, flexible licensing; and greater return on investment. By bundling support services and providing an ASP option, the new model also addresses a purchasing trend toward software as a service for the convenience of a completely outsourced solution.

Create category awareness by leveraging existing customer usage.

We intend to establish ourselves as a leading provider of specialized solutions for online business communication, collaboration and learning by continuing to: 1) leverage our existing brand recognition in the collaborative learning segment of this marketplace, 2) promote our solutions and services to targeted new customers and 3) work with industry analysts to define the opportunity and leadership criteria for specialized online business communication, collaboration and learning solutions market. We believe that the online business communications and collaboration solutions market is, as yet, comparatively unrecognized by industry analysts and business media but that it is starting to attract increasing attention. Through our efforts to define and provide solutions for this market, we believe we can enhance our position as a leader in this market.

Leverage our direct field sales force to expand penetration in existing accounts and acquire new enterprise accounts.

An element of our sales strategy is to leverage our leadership position in the collaborative learning market segment to increase penetration of other collaboration market segments and to broaden usage of our products throughout the enterprise. We intend to focus on selling specialized solutions to large business accounts, instead of selling only stand-alone collaboration or learning products to departments and smaller groups within the organization. Our goal is to have these large business accounts select Centra as the standard, or one of the standards, for their entire company's online business communication and collaboration needs. To that end, in 2004 we realigned our direct field sales representative territories to geographic areas with the highest concentration of these target customers. We also undertook to retrain our field sales force, hiring and training sales staff to sell to a new target customer class of senior information technology officers and other corporate executives of Global 5000 companies, government agencies and

Table of Contents

higher education institutions. We intend to leverage the time and resources invested in training the direct field sales force and making the transition from our previous sales strategy toward selling specialized solutions at the enterprise level. In 2005, we anticipate an increase in enterprise-level specialized solution sales as our direct sales force executes this strategy. We can give no assurance, however, that this strategy will prove to be successful. See **Factors That Could Affect Future Results** We may not successfully execute our strategic plan in Item 7.

Evaluate strategic alternatives.

We plan to continue to evaluate strategic opportunities that complement our strategy. These opportunities may include agreements with companies or technologies that broaden our market opportunity and enable us to expand into adjacent areas or companies that can leverage our current solutions to extend Centra's position in our current markets.

Products

Our products provide multiple functions, including ad-hoc and self-service interactive online meetings, structured virtual classes and large-scale Web seminars, and include a robust, integrated content management component. They provide access to users through firewalls and proxy servers, and deliver both half and full-duplex VoIP audio, live multi-point video, fully interactive application sharing and record and playback capabilities. They are designed to function over low-bandwidth network connections through a standard browser interface that is consistent for all products and easy to use through a small, downloadable client. Based upon a technological foundation employing Internet standards and Microsoft platform technologies, our products can be deployed on a single Microsoft Windows 2000 or 2003 server, and are designed to operate without any special hardware or network technologies. Our enterprise-class software products are designed to scale, as a customer's usage requires, by adding additional servers or Internet protocol (IP) multicasting capabilities. We offer flexible deployment options, including on-premises software deployed behind a company firewall, a secure full-service ASP, an outsourced server hosting service, and the option to start with our ASP service and migrate to deploying the software on-premises, behind-the-firewall as needs change.

Centra 7, our enterprise-class application software, addresses a wide range of requirements for enterprise adoption of real-time collaboration solutions and is available in nine languages (English, French, German, Italian, Spanish, Danish, Japanese, simplified Chinese and traditional Chinese). Centra 7 includes integration with desktops for increased ease of use, and enhanced integration with departmental business processes through business application integration, and a system architecture that supports information technology (IT) integration, security, scalability, and reliability requirements for enterprise-wide deployment.

Centra 7 enables organizations to streamline business processes through online collaboration and learning. It consists of the following products:

Centra 7 for Virtual Classes. Centra 7 for Virtual Classes is designed for virtual classrooms and highly interactive teamwork. Its real-time collaboration features include full-duplex VoIP audio, integrated Web-based video, application sharing with mark-up, breakout rooms, whiteboards, slide mark-up, Web touring, text chat, real-time feedback, quizzes, surveys, graded assessments, and record and playback capabilities. Management capabilities include scheduling classes, enrolling students, and reporting student learning activity and assessment results, and passing information to leading Learning Management Systems.

Centra 7 for Web Seminars. Centra 7 for Web Seminars is designed for large-scale Web events, such as online seminars and corporate communications. Integrated capabilities for both VoIP and traditional teleconferencing audio provide customers with the choice that best suits their audience, infrastructure, and budget. Additional in-session features include streaming video, application sharing, record and playback, and

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system administration capabilities optimized for managing large groups of attendees. The Company's pre- and post-event management functionality includes lead source tracking, online registration and reminders, post-event follow up and supports overall automation and efficiency of the Web event process.

Table of Contents

Centra 7 for Self-Service Meetings. Centra 7 for Self-Service Meetings provides an easy-to-use virtual meeting facility where users can schedule, organize and run their own Web meetings with co-workers, customers, suppliers, partners, and prospects. Using Centra for Self-Service Meetings, individuals can hold online business meetings with others inside or outside their corporate network, using a personal meeting room for spontaneous meetings, or using Microsoft Outlook to organize a meeting for a later date and time. In-session features include Microsoft PowerPoint content import, VoIP audio, Web-based video, application sharing, real-time file transfer, and record and playback capabilities. Post-meeting features include an automated email summary.

Centra Knowledge Center. Centra Knowledge Center is designed to provide on-demand or assigned access to a wide variety of learning resources and corporate information assets stored in a centralized, standards-based, online content library. Its capabilities include content search and management, personalized learning tracks, learning program administration, skills tracking and assessment, and progress and performance reporting. Working with Centra 7 live products, Centra Knowledge Center delivers blended learning or a mix of self-paced and real-time activity to corporate enterprises for more effective on-the-job learning and knowledge transfer.

Specialized Solutions

Based on best practices gained while working with our customers, we began to market and sell four specialized solutions in 2004. These specialized solutions consist of our core products listed above, together with business workflow tools, third-party software integration and professional services. They are:

Centra for Enterprise Application Rollout. This specialized solution is designed to save organizations substantial expense by shortening application rollout cycles and lowering travel, facilities and telecommunication costs associated with traditional rollout methods. This solution enables customers to engage their users during the design phase, conduct project team meetings online, communicate executive support and project updates, rollout personalized training to thousands of employees through a combination of self-service and live online learning, and automate the gathering and reporting of the progress of the rollout and effectiveness metrics. In addition, we are currently developing add-on modules for this solution to provide users with moment-of-need support by integrating with an Electronic Performance Support System (EPSS) and a help desk communication software application (expected to be available in June 2005.) An EPSS offers one place where an employee can instantly find all of the information related to a particular process, procedure or business rule that is needed to perform their job.

Centra for Sales Effectiveness. This specialized solution is designed to assist sales forces and channel partners in the pursuit of sales opportunities through greater personnel productivity and marketing intelligence. This solution enables users to marshal corporate knowledge and resources along the steps in a sales cycle. It also enables organizations to accelerate field readiness when launching new products or responding to competitive actions, deliver product and sales methodology training, assess and track sales rep product knowledge and competency, conduct online sales presentations and meetings, provide individualized coaching sessions, launch products, and establish continuity by creating a channel knowledge center and measuring channel partner effectiveness.

Centra for Collaborative Learning. This specialized solution is designed as a complete eLearning delivery solution for ongoing individual development and accelerated knowledge transfer. Our Collaborative Learning solution provides capabilities that capture, share and manage information and skills in a variety of formats to meet the requirements of specific learners or job tasks. It enables customers to gain knowledge of new products and services and solve critical collaboration requirements around corporate eLearning programs, corporate universities, new employee orientation, customer training, soft skills training, executive education and HR benefits and policy updates.

Table of Contents

Centra for Customer Acquisition. Our customer acquisition specialized solution automates online meeting events, extends marketing messages to prospective buyers and captures sales leads. This solution delivers Webinars and eConferences, facilitates online product launches, announcements and demos, and broadcasts events and cost-effective online user conferences.

We are developing add-on modules that provide additional capabilities to the Centra for Enterprise Application Rollout specialized solution expected to be delivered in June 2005. In the future, we plan to develop and introduce new add-on modules for our other specialized solutions . However, we can give no assurance as to the functionality of these additional capabilities or their delivery date. Also, we can give no assurance, that this approach to marketing and selling our products will be successful. See Factors That Could Affect Future Results We may not successfully execute our strategic plan, in Item 7.

Professional Services and Support

Our global professional services organization provides comprehensive customer assistance programs, including consulting, education and training, content services, Web event services and maintenance and support services to aid our customers in optimizing the use and experience of our products. In addition, our professional services organization provides guidance and support to help customers solve their business problems and achieve their productivity improvement objectives with online collaboration and learning.

Consulting. We offer a wide range of consulting services to our customers to facilitate the efficient and cost-effective use of our products and services. Our consulting team is trained to align the value of our products with customer functional, learning and development, and information technology performance measures. Our proven deployment methodology provides a roadmap to help customers become productive quickly. Based on the unique needs of an organization, we offer custom development projects including business process analysis, customized system configuration, content migration, best practice audits and ongoing change management. Our consulting organization is also responsible for assisting customers with the installation and deployment of our products and offers extended services such as on-site training.

Education and Training. We provide education programs and courses to assist presenters, content developers, event managers, systems administrators, help-desk support professionals, implementation specialists and other professionals in the use of our products and services. Online and on-site courses and workshops led by expert instructors provide knowledge and skills to successfully deploy, use and maintain our products and services. These courses focus on the technical aspects of our products as well as business issues and processes related to collaborative learning, content creation and management, Web marketing and online business collaboration. Additional offerings include professional certification programs.

Content Services. We offer a range of content creation services where our instructional designers and content specialists design and develop presentations, courseware and proprietary content based on new or existing training content. In addition, we offer feedback and best practices on how to design and deliver content to increase the effectiveness of online sessions.

Web Event Services. We offer complete Web event services for the start-to-finish management of Web seminars including presenter training, practice sessions, custom Web registration pages, email management, in-session event moderators, event recordings and attendance reporting.

Maintenance and Support. Our standard maintenance and support agreement gives customers access to error corrections or bug fixes and rights to unspecified upgrades and enhancements on a when-and-if available basis as well as related technical support. Our technical support

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organization helps resolve technical inquiries, is available by telephone, email and fax or, if necessary, on-site at a customer's premises and provides various levels of technical support and documentation for our customers. We also offer Premium Support for an additional fee, which provides customers with higher levels of support, additional software tools, and expanded education services.

Hosting and ASP Services. We offer our entire product line accessible through a variety of secure, outsourced application services and hosting options. These options are designed to accommodate the needs

Table of Contents

of buyers that may require the flexibility of an outsourced service or who lack the information technology infrastructure and resources to deploy real-time collaboration solutions on-site. We use a third-party Internet service provider, or ISP, to provide the telecommunications, data center and ongoing monitoring of our hosting and ASP services, and we offer these services on a global basis.

Sales and Marketing

Distribution

We sell our products and services through a direct sales force and through indirect channel partners, including value-added resellers and integrated technology solution vendors. As of December 31, 2004, our sales and marketing organization consisted of 65 sales and marketing professionals located in North America, Europe and Australia. Our direct field sales force now focuses primarily on selling our enterprise products and solutions to Global 5000 companies, universities and colleges, government agencies, and other large organizations. We utilize direct field sales teams consisting of both sales and technical professionals who work directly with potential customers to provide proposals, demonstrations and presentations designed to meet the specific needs of each customer. Our inside sales organization teams with our direct field sales representatives and focuses on smaller opportunities within the Global 5000. Our telesales organization sells all of our products and services to small- and medium-sized organizations.

Augmenting the efforts of our direct sales force, our products and services are sold indirectly through relationships with value-added resellers. As of December 31, 2004, we had relationships with resellers in North America, Europe, the Middle East, Africa, Japan, China, Korea, Singapore, India and Brazil making our products and services available in major markets worldwide. Our reseller partners focus on selling packaged software and ASP services and target department-level purchasers in both the enterprise and the small- and medium-sized business markets. We intend to increase the size of our direct field sales force as necessary and to authorize additional resellers to sell our products and services both domestically and in select international markets.

Revenues from sales outside of the United States were \$6,888,000, \$8,361,000 and \$7,367,000 or 21%, 19% and 19% of total revenues, for 2002, 2003 and 2004, respectively. Since 1999, we have continuously invested in resources and in infrastructure necessary to maintain or expand our global operations, including the formation and staffing of our international operations in Europe, Australia, Asia and Canada. We expect to continue to invest in our international operations as we expand our international indirect channels and our ASP service operations abroad to increase worldwide market share. While weak global economic conditions for enterprise software continued to constrain our international revenues in 2002, 2003 and 2004, we anticipate that, because of our on-going investments in this area, revenues derived from outside the United States will increase in absolute dollars in the future. We can give no assurance, however, that these investments will prove successful or help us increase revenues from outside the United States. See Factors That Could Affect Future Results, in Item 7.

To complement our specialized solutions, extend our reach within the online business communications, collaboration and learning market and facilitate more rapid integration with third-party products and services for online business communications and collaboration, we have identified, recruited and supported a strategic ecosystem of business relationships. In the collaborative learning market segment, we have partnered with leading content developers, professional service firms, learning technology providers and online training companies. These relationships have included partners such as Saba, Sum Total, Plateau, Thing, Deloitte Consulting, and IBM Global Services, and are aimed at increasing market awareness of our products and helping us generate sales leads. These formal and informal relationships are intended to provide additional marketing resources, awareness and account access. We can give no assurance, however, that these relationships will continue or that they will produce the expected results. See Factors That Could Affect Future Results, in item 7.

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In addition to activities aimed at advancing awareness and reach of our brand, we entered into an agreement with EMC Documentum, a provider of content management solutions, in which we have agreed to integrate their

Table of Contents

Enterprise Content Management platform with our core technology platform. This agreement was entered into in October 2004, and is not expected to result in any significant revenues until after product integration is complete and joint selling activities begin in 2006. We plan to pursue other arrangements with other technology solution providers in complementary application areas such as portals, document management and customer relationship management. Also, we plan to enter into other strategic technology agreements to provide additional functionality to our products and services. We can give no assurance, however, that this will prove successful or help us increase revenues. See Factors That Could Affect Future Results, in Item 7.

Pricing

Our products and services are divided into four major categories for pricing purposes:

licenses for our software products;

maintenance and support services related to those licenses;

consulting, training and education services for assistance with integration and implementation; and

hosting and ASP service offerings.

We license our software under a variety of pricing models including perpetual named-user licenses, perpetual concurrent-user licenses and time-limited or subscription-based licenses. Customers that license our enterprise application software typically purchase renewable maintenance and support contracts that provide telephone support, error corrections or bug fixes and rights to unspecified upgrades and enhancements on a when-and-if available basis over a stated term, usually a 12-month period. Maintenance is priced as a percentage of the license fees. We also offer consulting, training and education services to our customers, primarily on a time-and-materials basis, but also, with respect to education services, on a course subscription or per-course basis. In addition, we offer hosting services for customers under hosting agreements, with terms typically ranging from 6-12 months, to outsource the administration and infrastructure necessary to operate our enterprise application software. Hosting fees include a monthly service fee in addition to license fees for the software. We offer all of our packaged software products as an ASP service as well, with a variety of terms, including annual, semi-annual, quarterly, monthly or hourly on a per event or actual usage basis to facilitate a low-entry price point for easy adoption. Prices for a complete system vary based upon the number of system users and servers, and the level of use.

In June 2004, we introduced the Enterprise Advantage Subscription (EAS) pricing model, a multi-year, flat annual fee, high volume or unlimited use licensing program designed to enable large organizations to meet increasing demand for online collaboration solutions. The EAS model is designed to promote greater use of our products within an organization by providing a fixed annual cost for the unlimited use of our software or ASP service along with maintenance and support and a subscription to our online training classes included as part of a bundled package. This eliminates many of the buying challenges that our customers face when trying to decide on the right number of software licenses or ASP service capacity to purchase, forecast usage, justify up-front capital expenditure, and prevent overage charges for exceeding usage allowances. EAS pricing is primarily based on the end-user population size of the buyer's organization or entity. This new pricing model eliminates the administrative burden of managing a specified number of licenses and provides enterprises with predictable subscription payments; simple, flexible licensing; and greater return on investment. By bundling support services and providing an ASP option, the new model also addresses a purchasing trend toward software as a service for the convenience of a completely outsourced solution.

Marketing

We focus our marketing efforts on developing and executing targeted marketing programs featuring our specialized solutions. We address the specific needs and challenges of the vertical markets and geographic areas that we serve and highlight customer success stories. We also focus on generating specific interest among business executives considering enterprise-level online business communication, collaboration and learning

Table of Contents

solutions as well as individual and departmental users. We engage in a broad range of marketing activities, including advertising, sponsoring seminars for prospective customers, exhibiting at targeted conferences for the technology community and using direct mail and email to increase awareness of our products and generate leads. We maintain an active public relations program through which we issue press releases that highlight major customer additions, strategic partnerships, new product releases and customer success stories. We develop relationships with industry analysts and promote coverage of the Company in the trade and business press. We devote resources to our Web site to provide product and company information as well as customer profiles. We continue to enhance our Web site with features, including online presentations, seminar content and customer application success stories. Our product marketing programs are aimed at informing customers of the capabilities and benefits of our products and increasing the demand for such products across major industry segments. Our marketing organization works closely with our customers and direct sales organization to manage the lead process and to capture, organize and prioritize customer feedback to help guide our product development efforts.

Customers

As of December 31, 2004, we had sold our products to more than 1,400 distinct customer organizations worldwide, across many industry sectors, which in the aggregate represents millions of end-users both inside and outside of their respective organizations. New customers added in 2004 include Royal Bank of Canada, TES Franchising, the University of California Medical School, Department of Education in Australia, Samsung, the U.S. Department of Energy, the University of Florida, BiSys, Hughes Supply, Mitsubishi Trust, NationsRent, Rockwell Automation, Food Lion, Morgan Stanley, the U.S. Marine Corps and the University of Kentucky.

We operate within a single business segment. Our total revenues from customers in the years ended December 31, 2002, 2003 and 2004 were \$33.4 million, \$43.0 million and \$38.1 million, respectively. No single customer, including direct end-users or resellers, accounted for more than 10% of our total revenues during the years ended December 31, 2002, 2003 or 2004. See footnote 1(o) to our consolidated financial statements for a discussion of our financial information by geographic segment.

Competition

The market for Web conferencing and business collaboration is competitive, evolving and subject to rapid change because of market consolidation. We have focused on becoming the leading provider of value-added specialized applications that address specific and important business activities such as enterprise application deployment, sales effectiveness, collaborative learning and customer acquisition. We expect that the intensity of our competition will increase in the future as our competitors try to differentiate themselves from other Web conferencing providers. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any of which could seriously harm our business. We believe that our ability to compete depends on many factors both within and beyond our control, including:

our ability to deliver high-value, specialized applications that differentiate our products from generic Web conferencing tools;

the performance, reliability, ease of use and features of our products as compared to those of our competitors;

our ability to secure and maintain key strategic relationships with other software vendors, system integrators, value-added resellers and technology providers;

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our ability to expand and enhance our sales operations and partner channels around the world;

the timing and market acceptance of new products and solutions and enhancements and add-ons to existing products and solutions developed by us and our competitors; and

our ability to provide a high level of customer service, integration assistance, content creation services, implementation assistance, education and training and technical support.

Table of Contents

Our competitors vary in size and in the scope and breadth of the products and services offered. They include suppliers addressing sub-segments of our overall target market with products and services for virtual classrooms, Web conferences, Web meetings, content management and creation, and related offerings. Our primary competitors include WebEx, Microsoft, Interwise, the Lotus division of IBM and Macromedia. We believe that our principal competitive advantages in the market for online business communications and collaboration include:

focusing on high-value specialized applications that provide greater functionality than generic Web conferencing tools;

delivering our products in many ways; deployed at a customer's premises or on its network as a packaged software application, or delivered by us as an ASP or hosted service utilizing our network;

offering our products with an open application program interface, so that they can be integrated with various software applications, operating platforms and software tools;

creating a significant base of reference customers that could choose to expand their deployments of our products into other areas or departments of their companies;

using our fully integrated multi-point VoIP audio, saving costs over traditional audio conferencing services typically used with online collaboration tools; and

offering flexible pricing, including through our new Enterprise Advantage Subscription pricing model.

Unlike competitors that sell basic Web conferencing or collaboration tools, we focus on specific business problems, enabling organizations to more effectively and cost-efficiently roll out new IT enterprise applications, prepare their sales force to be more productive, and assist and improve corporate training programs. Today, our specialized solutions include core software, workflow capabilities that automate business processes, professional services and third-party integrations. In the future, we plan to develop add-on modules that will provide additional capabilities to these specialized solutions. Also, we believe that not all of our competitors typically offer as wide a variety of deployment options (on premises for highest security, ASP, or hosted services) or as broad an integration with other software assets (desktops, enterprise applications, learning management systems, databases, user directories, etc.) as we do. Finally, we believe that not all of our competitors provide an integrated knowledge portal for delivery of corporate content and blended learning programs, accelerating knowledge transfer and building skills. In addition to the companies named above, there are a number of other real-time collaboration software and service companies that compete with parts of or all of our real-time enterprise offerings, such as Raindance, Cisco, HorizonLive and Genesys. We believe that we are able to compete favorably against these companies because they provide products or services that are less complete than ours.

Some of our competitors have longer operating histories, and greater financial, technical, marketing and other resources than we do. In addition, many of our competitors have well-established relationships with our current and potential customers. In the past, we have lost potential customers to competitors for various reasons, including lower prices and other incentives not matched by us. In addition, current and potential competitors have established, and may in the future establish, cooperative selling relationships among themselves or with third parties. They may also expand their offerings through the acquisition of and/or merger with other current or potential competitors, increase the distribution of their products to the marketplace and increase the ability of their products to address customer needs. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

Finally, our market is relatively new and is changing rapidly. We may not be able to maintain our competitive position against current and potential competitors, especially those with significantly greater financial, marketing, service, technical and other resources. See [Factors That Could Affect Future Results](#). We face significant competition from other technology companies and we may not be able to compete effectively, in

Item 7.

15

Table of Contents

Product Development

The market for online business communications and collaboration products is characterized by rapid technological change, evolving customer requirements, frequent new product introductions and enhancements, and emerging industry standards. We devote significant time and resources to analyzing and responding to changes in the industry, such as changes in operating systems, application software, security standards, and networking software that might have an impact on evolving customer requirements.

Our online business communications and collaboration products and services must compete on the basis of reliability, scalability, interoperability, security, ease of use and flexibility of administration. We have made, and expect to continue to make, a substantial investment in research and development to enhance our products, and solutions based thereon, stay abreast of advances in collaboration technology, network infrastructure and user administration, and respond to evolving customer needs. In the years ended December 31, 2002, 2003, and 2004, we spent approximately \$12.1 million, \$11.5 million and \$10.0 million, respectively, on product development or 36%, 27% and 26%, respectively, of total revenues. In addition, to facilitate the development and expedite the time to market of new enhancements and add-on modules to our core platform and specialized solutions, we incorporate third-party software when available and can be licensed under acceptable terms.

We believe our future success depends largely on our ability to enhance and broaden our existing product lines to meet the evolving needs of the market. There can be no assurance that we will be able to respond effectively to technological changes or new industry standards or developments. Our operating results and business could be adversely affected if we were to incur significant delays or be unsuccessful in developing new products or enhancing our existing products, or if any such enhancements or new products do not gain market acceptance. Since add-on modules for our new solutions integrate licensed technology from third-parties, we are at risk if these companies' products do not perform adequately, if these companies go out of business, or if they discontinue their licensing relationships with us. See **Factors That Could Affect Future Results**. The success of our strategy depends on our ability to license and integrate third-party technology to enhance our products in Item 7. In addition, a number of factors may cause variations in our future operating results, including the timing of our product introductions and enhancements or those of our competitors, market acceptance of new products, or the delay of customer orders for existing products because of anticipation of the availability of new products. We believe that our ability to attract, as needed, and to retain a technically skilled development team is also critical to our future success.

Proprietary Rights

Our success and ability to compete are dependent, to a significant degree, on our ability to develop and maintain the proprietary aspects of our technology and operate without infringing the proprietary rights of others. We regard certain aspects of our products and documentation as proprietary and we rely on a combination of patent, trademark, trade secret and copyright laws and licenses and contractual restrictions to protect our proprietary rights. These legal protections afford only limited protection for our technology. We seek to protect our source code for our software, documentation and other written materials under trade secret and copyright laws. We license our software pursuant to license agreements that restrict use of the software by our customers. Finally, we seek to limit disclosure of our intellectual property by requiring employees, consultants and customers with access to our proprietary information to execute confidentiality agreements with us and by restricting access to our source code. We believe, however, that in the market for online business communications and collaboration products, solutions and services, factors such as the technological and creative skills of our personnel and our ability to develop new products and enhancements to existing products and solutions are more important than the various legal protections of our technology to establishing and maintaining a technology leadership position.

We have filed a patent application with the United States Patent and Trademark Office for two inventions embodied in the software products that we have developed and that may be useful in the field of real-time enterprise collaboration. There can be no assurance, though, that this application will result in an issued patent.

Table of Contents

Our products are generally licensed to end-users on a right-to-use basis pursuant to a license that restricts the use of our products to the customer's internal business purposes. We also rely on click wrap licenses, which include a notice informing the end-user that, by downloading the product, the end-user agrees to be bound by the license agreement displayed on the customer's computer screen. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult and, while we are unable to determine the extent to which piracy of our software exists, it can be expected to be a persistent problem. In addition, the laws of many countries do not protect our proprietary rights to as great an extent as do the laws of the United States. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity. Any such litigation could be costly and divert resources and could have a material adverse effect on our business, operating results and financial condition; even if we prevailed in such litigation. We can give no assurance that our means of protecting our proprietary rights will be adequate, or that our competitors will not independently develop similar technology. Any failure by us to protect our intellectual property could have a material adverse effect on our business, operating results and financial condition.

There can be no assurance that other parties will not claim that our current or future products infringe their intellectual property rights. We expect that developers of enterprise applications will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and as the functionality of products in different segments of the software industry increasingly overlaps. Any such claims, with or without merit, could be time consuming to defend, result in costly litigation, divert management's attention and resources, cause product shipment delays or require us to enter into terms marginally acceptable to us. A successful infringement claim against us, and our failure or inability to license the infringed rights or develop license technology with comparable functionality, could have a material adverse effect on our business, financial condition and operating results. In August 2003, a complaint was filed against us in federal court in the District of Colorado on a claim that we infringed the plaintiff's patent rights. We have filed an answer to the complaint denying all of the allegations. See Item 3, Legal Proceedings.

We integrate third-party software into our products. This third-party software may not continue to be available on commercially reasonable terms. We believe, however, there are alternative sources for such technology. If we are unable to maintain licenses to the third-party software included in our products, distribution of our products could be delayed until equivalent software could be developed or licensed and integrated into our products. This delay could materially adversely affect our business, operating results and financial condition.

Employees

As of December 31, 2004, we employed a total of 208 full-time employees, including 65 in product development, 65 in sales and marketing, 53 in services and support and 25 in general and administration. As of December 31, 2004, a total of 192 employees were located in the United States and 16 were located outside of the United States. None of our employees are represented by a collective bargaining agreement, nor have we experienced any work stoppages. We consider our relations with our employees to be good. Our future success will depend in part on our ability to attract, retain, and motivate highly qualified technical and management personnel for whom competition is intense.

ITEM 2. PROPERTIES

Our current headquarters consist of a leased office suite located at 430 Bedford Street in Lexington, Massachusetts. We occupy approximately 49,000 square feet of space at that location under a lease that expires in June 2008. In addition, we lease approximately 30,000 square feet of space in Morrisville, North Carolina under a lease that expires in May 2005. In 2004, we closed the Morrisville facility as part of our restructuring including the consolidation of development activities to our Lexington, Massachusetts facility. We also lease approximately 5,000 square feet of space in Duluth, Georgia as a technical support facility under a lease that

Table of Contents

expires in January 2007 and approximately 3,600 square feet in Maidenhead, England as headquarters for our Europe, Middle East and Africa field operations under a lease that expires in November 2008. These facilities are expected to meet our needs through at least December 31, 2005.

To support our field sales and consulting staff, we also lease office space domestically in the metropolitan areas of Atlanta, Chicago, Los Angeles and San Francisco, and, internationally, in Sydney, Australia and Toronto, Canada. Each of these offices is generally leased under an agreement with a term of 12 months or less.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we have been, and expect to continue to be, subject to legal proceedings and claims in the ordinary course of our business. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Except for the lawsuits identified below in this section, we are not presently a party to any legal proceedings, the adverse outcome of which, in management's opinion, would have a material adverse effect on our results of operations or financial position.

Securities Class Action Lawsuit

We, and certain of our officers and directors and the managing underwriters of our initial public offering were named as defendants in an action filed in the United States District Court for the Southern District of New York. The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve us on or about March 18, 2002. The original complaint has been superseded by an amended complaint filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, which is being coordinated with an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92, is purportedly brought on behalf of the class of persons who purchased our common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The complaint alleges that, in connection with our initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the after-market at pre-determined prices. The complaint asserts that our registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against us and the named individuals. We joined in motions with the underwriter defendants to dismiss the above-reference action on July 3 and July 15, 2002, respectively. On October 9, 2002, the plaintiffs dismissed, without prejudice, the claims against our officers and directors in the above-referenced action. On February 19, 2003, the court issued an order denying the motion to dismiss as to the other defendants and us. On June 7, 2003, the plaintiffs announced a proposed settlement with all issuers, including us. On June 25, 2004, the plaintiffs filed a motion with the United States District Court for the Southern District of New York requesting preliminary approval of the settlement. The court has given preliminary approval of the settlement. We plan to participate in this settlement, which has been negotiated, and will be fully funded directly to the plaintiffs, by our insurers. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred.

EdiSync Patent Claim

On August 19, 2003, a complaint was filed against us and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and

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interest, costs and expenses associated with the litigation. We filed an answer to the complaint denying all of the allegations. No amount has been accrued related to this matter and legal costs incurred in the defense of the

Table of Contents

matter are being expensed as incurred. We filed a request for re-examination of the patents at issue with the U.S. Patent and Trademark Office as our patent counsel is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the District Court has approved the parties' motion to stay the court proceedings during the re-examination proceedings. We believe that we have meritorious defenses and we intend to vigorously defend this action.

Employment Claim

On September 3, 2004, a former employee filed a complaint with the Massachusetts Superior Court (civil action no. 04-3479) against us and two of our executive officers alleging wrongful termination and discrimination on the basis of age, race and gender in connection with the employee's employment with us and subsequent termination. The complaint seeks remedies including damages in an unspecified amount. We have filed a motion to dismiss certain of the claims in the complaint as well as an answer to the complaint, which we believe is without merit. We intend to vigorously defend this action.

Software Indemnifications

We enter into standard indemnification agreements in our ordinary course of business. Pursuant to these agreements, we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally our business partners or customers, in connection with any patent, copyright or other intellectual property infringement claim by any third party with respect to our products. The term of these indemnification agreements is generally perpetual. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We have never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. Accordingly, we have no liabilities recorded for these agreements as of December 31, 2004.

We warrant that our software products will perform in all material respects in accordance with our standard published specifications in effect at the time of delivery of the licensed products to the customer for 90 days. Additionally, we warrant that our maintenance services will be performed consistent with generally accepted industry standards through completion of the agreed upon services. If necessary, we would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history, however, we have never incurred any significant expenses under our product or service warranties. Accordingly, we have no liabilities recorded for these agreements as of December 31, 2004.

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

No matter was submitted to a vote of security holders during the quarter ended December 31, 2004.

Table of Contents**PART II****ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS**

Our common stock is traded on the Nasdaq National Market under the symbol CTRA. The following table sets forth, for the periods indicated, the range of high and low prices per share of our common stock as reported on the Nasdaq National Market during each of the quarters indicated.

	Price Range of Common Stock	
	High	Low
2003 Year:		
First Quarter ended March 31, 2003	\$ 1.56	\$ 0.93
Second Quarter ended June 30, 2003	\$ 3.36	\$ 1.28
Third Quarter ended September 30, 2003	\$ 4.21	\$ 2.43
Fourth Quarter ended December 31, 2003	\$ 4.48	\$ 2.70
	High	Low
2004 Year:		
First Quarter ended March 31, 2004	\$ 5.75	\$ 3.06
Second Quarter ended June 30, 2004	\$ 4.00	\$ 1.66
Third Quarter ended September 30, 2004	\$ 2.25	\$ 1.41
Fourth Quarter ended December 31, 2004	\$ 2.75	\$ 1.33

As of February 28, 2005, there were approximately 192 holders of record of our common stock. This number does not include stockholders for whom shares are held in a nominee or street name of which we believe there are a substantial number.

We have never declared or paid cash dividends on our common stock. We currently intend to retain earnings, if any, for use in our business and do not anticipate paying any cash dividends in the foreseeable future.

Table of Contents**ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

The selected consolidated financial data set forth below should be read in conjunction with our consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 in this report. The historical results are not necessarily indicative of the operating results to be expected in the future.

	Year Ended December 31,				
	2000	2001(1)	2002	2003	2004
	(In Thousands, Except Per Share Data)				
Consolidated Statements of Operations Data:					
Revenues:					
License	\$ 18,697	\$ 28,815	\$ 15,967	\$ 20,342	\$ 11,650
Software services	408	2,716	5,478	8,235	10,338
Maintenance and professional services	3,868	7,586	11,955	14,464	16,076
Total revenues	22,973	39,117	33,400	43,041	38,064
Cost of revenues:					
License	314	505	434	581	277
Amortization of acquired developed technology		467	700	700	233
Software services	241	2,216	2,286	2,320	2,386
Maintenance and professional services	3,164	4,360	4,119	4,218	4,549
Total cost of revenues	3,719	7,548	7,539	7,819	7,445
Gross profit	19,254	31,569	25,861	35,222	30,619
Operating expenses:					
Sales and marketing	22,964	25,872	20,975	22,146	22,496
Product development	8,642	12,675	12,113	11,513	10,029
General and administrative	5,316	7,731	8,121	9,736	8,630
Acquired in-process research and development		2,200			
Amortization of goodwill		783			
Amortization of other intangible assets		66			
Impairment of goodwill			5,885		
Merger transaction costs			1,238		
Restructuring charges			439		788
Total operating expenses	36,922	49,327	48,771	43,395	41,943
Operating loss	(17,668)	(17,758)	(22,910)	(8,173)	(11,324)
Other income, net	3,810	1,076	440	262	219
Net loss	(13,858)	(16,682)	(22,470)	(7,911)	(11,105)
Accretion of discount on preferred stock	649				
Net loss attributable to common stockholders	\$ (14,507)	\$ (16,682)	\$ (22,470)	\$ (7,911)	\$ (11,105)
Basic and diluted net loss per common share	\$ (0.67)	\$ (0.68)	\$ (0.88)	\$ (0.30)	\$ (0.41)

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Weighted average common shares outstanding, basic and diluted	21,781	24,449	25,601	26,502	27,367
Pro forma basic and diluted net loss per common share(2)	\$ (0.64)				
Pro forma weighted average common shares outstanding, basic and diluted(2)	22,608				

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- 1) Includes the impact of the acquisition of MindLever from the date of acquisition in April 2001.
 - 2) Pro forma basic and diluted net loss per common share includes accretion of \$649 based on the assumption that the full amount of the discount is expensed at conversion.

Table of Contents

	December 31,				
	2000	2001	2002	2003	2004
(In Thousands)					
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	\$ 65,187	\$ 48,183	\$ 38,244	\$ 28,888	\$ 25,135
Working capital	59,927	42,188	28,127	16,549	12,604
Long-term investments				5,888	743
Goodwill and other intangible assets, net		6,955	933	233	
Total assets	75,064	70,977	51,424	46,028	37,228
Term loans, net of current maturities	1,894	2,631	2,027	553	1,012
Total stockholders' equity	61,874	51,347	30,490	24,325	14,191

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with "Selected Consolidated Financial Data" appearing in Item 6 of this report and our consolidated financial statements and notes thereto appearing under Item 8 of this report. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements, as described under "Special Note Regarding Forward-Looking Information" above Item 1 of this report and in the discussion under the heading "Factors That Could Affect Future Results" in this Item 7.

Overview

We provide specialized application software solutions and services for online business communication, collaboration and learning. Our products and services help organizations automate important business processes by integrating real-time, group-oriented human interactions with online business initiatives, all delivered over corporate networks and the Internet. Our customers can use our products and solutions to accelerate product introductions, deliver hands-on training of new software applications, effect change-management initiatives, expand training and certification to employees and external channel partners, facilitate customer interaction and online selling and support project management activities. In addition, we offer consulting, education, content creation and support services that enable our customers to successfully implement, deploy and support our products and solutions throughout their organizations.

An overview of our products and services, our geographical markets, our strategic intent as well as the challenges inherent in achieving our operational and financial goals, is outlined in Item 1 "Business" of this report.

Our objective is to improve our leadership position in the collaborative learning market segment of application software solutions and services for online business communications, collaboration and learning. We intend to leverage our leadership position to increase the use of our products throughout the enterprise and in other segments of the collaborative learning market. Also, we intend to focus our sales and marketing efforts on selling to the Global 5000 companies, government agencies and higher education institutions. To achieve these objectives, we are pursuing the following strategies (although we can give no assurance that these strategies will be successful or that we will be able to achieve profitability as a result of them - see "Factors That Could Affect Future Results," in this Item 7):

Further improve our core technology;

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Develop add-on modules for our specialized solutions;

Improve and promote our extensive professional and customer services;

Table of Contents

Offer innovative and flexible pricing options to customers;

Create category awareness by leveraging existing customer usage;

Leverage our direct field sales force to expand penetration in existing accounts and acquire new enterprise accounts; and

Evaluate strategic alternatives.

The market for specialized application software solutions and services for online business communication, collaboration and learning is both evolving and subject to rapid technological change. Additionally, the purchasing behavior of our customers is influenced, in large part, by the macroeconomic environment as well as their corporate financial condition. These factors combined or in isolation present formidable challenges in the marketplace as we cannot predict the timing or magnitude of such external situations. Our goals of achieving revenue growth and establishing a market leading position are dependent upon various factors including: 1) delivery of new add-on modules for our specialized solutions; 2) macroeconomic conditions, 3) corporate IT needs and spending capacity, 4) successful packaging and presentation of our products, 5) efficient and effective execution of our sales, pricing and licensing strategies and 6) competitive entrants and marketplace actions. (For a more comprehensive analysis of risk factors, see [Factors That Could Affect Future Results](#) below).

On April 30, 2001, we acquired MindLever.com, Inc., a North Carolina corporation and a provider of management systems for learning content, for \$2.9 million in cash and 509,745 shares of common stock valued at approximately \$3.8 million, plus acquisition costs of approximately \$512,000, for a total purchase price of approximately \$7.2 million. When we acquired MindLever, we recorded a goodwill asset on our balance sheet in the amount of \$5.9 million. During the quarter ended December 31, 2002, however, we recorded an impairment charge of \$5.9 million to write down the remaining goodwill to its implied fair value of zero.

Our revenues are classified into three main categories: license, software services and maintenance and professional services. License revenue is generated from the sale of packaged software applications on either a perpetual or term basis. Software services revenue is comprised of revenues from our ASP service sold on a subscription or per-use basis and from hosted services. Maintenance and professional services revenue includes revenue from maintenance and support contracts and from consulting and education services.

Our cost of license revenues includes royalties due to third parties for technology included in our products as well as the cost of product documentation, media used to deliver our products, and fulfillment. Amortization of acquired developed technology represents the amortization, over a three-year period, of the valuation of the developed technology and know-how acquired in connection with our April 2001 acquisition of MindLever. Our cost of software service revenues includes 1) salaries and related expenses for our hosted and ASP services organizations, 2) an overhead allocation consisting primarily of that portion of our facilities, communications and depreciation expenses that is attributable to providing these services, and 3) direct costs related to our hosted and ASP service offerings. Our cost of professional services and maintenance revenues includes 1) salaries and related expenses for our consulting, education and technical support services organizations and 2) an overhead allocation consisting primarily of that portion of our facilities, communications and depreciation expenses that is attributable to providing these services.

Our operating expenses are classified into the following six general categories: sales and marketing, product development, general and administrative, impairment of goodwill, merger transaction costs and restructuring charges.

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Sales and marketing expenses consist primarily of salaries, benefits and other related costs for sales and marketing personnel, costs associated with marketing programs, including trade shows, user group meetings, seminars and advertising, public relations activities, new product launches and compensation charges for issuance of stock options.

Table of Contents

Product development expenses consist primarily of employee salaries, benefits and other related costs for engineering, product management, quality assurance and documentation personnel, fees for outside consultants and other related costs associated with the development of new products and the enhancement of existing products, costs associated with quality assurance, testing and documentation, third-party product localization costs and compensation charges for issuance of stock options.

General and administrative expenses consist primarily of salaries, benefits and other related costs for executive, financial, administrative and information systems and technology personnel as well as costs for auditing and accounting, legal, investor relations, liability insurance and other expenses associated with being a public company, including increased costs resulting from compliance with the Sarbanes-Oxley Act of 2002 and compensation charges for issuance of stock options.

Impairment of goodwill represents the write down of the remaining goodwill related to the MindLever transaction to its implied fair value of zero.

Merger transaction costs represent legal and investment advisor costs that were incurred related to the proposed merger between Centra and SmartForce PLC. The proposed merger was terminated as of April 2, 2002.

Restructuring charges represent charges incurred related to a reduction in our workforce in April 2002, June 2004 and September 2004 and the closing of our North Carolina product development facility in 2004.

In the development of new products and enhancements of existing products, the technological feasibility of the software is not established until substantially all product development is complete. Historically, our software development costs eligible for capitalization have been insignificant and all costs related to internal product development have been expensed as incurred.

Compensation charges for issuance of stock options represents the amortization, over the vesting period, of the difference between the exercise price of options granted to employees in 1999 and 2000 and the deemed fair market value of these options at the time they were granted for financial reporting purposes. The charges are allocated by expense category based on the actual compensation charge for each employee and the expense category that their salary costs are charged to. In addition, a compensation charge for the issuance of stock options in the third quarter of 2003 of approximately \$300,000 for the acceleration of vesting and extension of the time period to exercise certain options under the terms of a severance agreement with our former president and chief operating officer was incurred and charged to general and administrative expenses in the period.

We have experienced substantial losses in each fiscal period since our inception. As of December 31, 2004, we had an accumulated deficit of \$99.2 million. These losses and our accumulated deficit have resulted from the significant costs incurred in the development, marketing, sale and delivery of our products and services, including the establishment of our hosted and ASP services infrastructure, which have been only partially offset by our revenues to date. Although we have reduced our operating expenses in 2004 over 2003 by reducing the number of employees, consolidating development facilities, entering into a new lower cost operating lease for our headquarters office facility and other cost reduction measures, we may not be able to continue to decrease our expenses, increase our revenues or attain profitability and, if we do achieve profitability, we may not be able to sustain profitability for any future periods. We plan for our operations to become profitable during 2005. To accomplish this goal we will need to generate a significant increase in revenues in 2005 over 2004 and reduce our operating expenses in 2005 below 2004 levels. We believe that period-to-period comparisons of our historical operating results may not be meaningful, and you should not rely upon them as an indication of our future financial performance. See **Factors That Could Affect Future Results** in this Item 7.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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The preparation of our 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

Table of Contents

date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition, accounts receivable valuation and reserves, the valuation of intangible assets and goodwill and accounting for income taxes. 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 value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Note 1 to the consolidated financial statements included in this report contains a discussion of our significant accounting policies. Management believes that the following critical accounting policies most significantly affect the portrayal of our financial condition and require management's most difficult and subjective judgments:

Revenue Recognition

The recognition of revenue is a key component of our results of operations and the time at which revenue is recognized determines the timing of certain costs and expenses, such as royalties and referral fees. In measuring revenues, we follow the specific guidelines of the Securities and Exchange Commission Staff Accounting Bulletin No. 104 (SAB 104) *Revenue Recognition in Financial Statements*, American Institute of Certified Public Accountants Statement of Position (SOP) No. 97-2 *Software Revenue Recognition*, and SOP No. 98-9, *Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions*, and related authoritative literature.

We derive our revenues from the sale of software licenses, ASP and hosting services, maintenance (post-contract support) and professional services. Maintenance includes telephone support, error correction or bug fixes and rights to upgrades and enhancements on a when-and-if available basis. We execute contracts that govern the terms and conditions of each software license, each ASP and hosting agreement, each maintenance and support arrangement and other professional services arrangements. These contracts may be elements in a multiple-element arrangement. Revenue under multiple-element arrangements, which may include several different software products and services sold together, is allocated to each element based on the residual method in accordance with SOP No. 98-9. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Management analyzes various factors, including a review of specific transactions, historical experience, creditworthiness of customers and current market and economic conditions. Changes in judgments based upon these factors could impact the timing and amount of revenue and cost recognized and thus affect our results of operations and financial condition.

We generally license our software products on a perpetual basis. We apply the provisions of SOP No. 97-2, as amended by SOP No. 98-9, to all transactions involving the sale of software products. We recognize revenue from the sale of software licenses when persuasive evidence of an arrangement exists, the product has been delivered, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. This policy is applicable to all direct sales to end-users. License sales to distributors or to value-added resellers are recognized when an end-user customer has been identified and all other revenue recognition criteria above have been met. License sales to U.S. government agencies through teaming arrangements with third-party partners are recognized when a signed order from the partner and evidence of a purchase order from the government agency to the partner is received and all other revenue recognition criteria above have been met. We do not offer a right of return on our products.

For all sales, except those to U.S. government agencies as described above, we use a signed master license or service agreement, a signed sales order or contract amendment and/or a binding purchase order as evidence of an arrangement. For arrangements with multiple elements (i.e., the sale of a product license along with the sale of maintenance and support, training and consulting to be delivered later), we allocate revenue to each component

Table of Contents

of the arrangement using the residual value method. Under the residual value method, revenue is recognized in a multiple element arrangement in which vendor-specific objective evidence (VSOE) of fair value exists for all of the undelivered elements in the arrangement, but does not exist for one or more of the delivered elements in the arrangement. We defer revenue from the arrangement equivalent to the fair value of the undelivered elements and recognize the remaining amount from the total arrangement fee at the time of the shipment or at the time the last element for which VSOE does not exist has been completed, assuming all other revenue recognition criteria have been met. The VSOE of fair values for the ongoing maintenance and support obligations, professional services, training and other products sold by us are based upon prices realized when these services are sold separately.

We also sell our suite of products and services bundled together under a multi-year subscription term for broader use by our customers within their organizations. In June 2004, we introduced our Enterprise Advantage Subscription (EAS) pricing model and began to offer it in the third quarter of 2004. The EAS is a bundled package of products and services for an annual fee based on a multi-year purchase commitment of two to three years. The annual fee, which is typically paid at the beginning of each year, provides for unlimited use of the specified software products within a specific department, division or entity of a corporation or for use by the entire enterprise. The suite of products and services may include a term license for the software products, ASP or hosting services, maintenance and support, consulting and training. We recognize revenue from these multi-year subscriptions either ratably on a straight line basis over the entire length of the subscription term or over each annual payment term. For classification purposes in the statement of operations, we allocate revenue to each of the license, software services, maintenance and professional services revenue categories based on their relative fair values supported by VSOE if available or a reasonable estimate of fair value made by management based on the average discount offered on products or services when sold separately. Our customers may choose to purchase the enterprise-wide subscription without a term license for the software and instead utilize our ASP service over the term of the agreement. We recognize revenue for ASP enterprise-wide subscriptions ratably over the subscription term according to SAB 104. Revenue is allocated for classification purposes to software services and professional services based on their relative fair values supported by verifiable objective evidence.

At the time of a sales transaction, we assess whether the fee from the sale is fixed or determinable based on the payment terms associated with it. Billings to customers are generally due within 30 to 90 days. However, in certain circumstances, we have offered extended payment terms greater than 90 days but less than 365 days to certain customers for which license revenue is recognized upon shipment. These customers are well capitalized and typically have entered into license arrangements with us previously. We believe that we have sufficient history of collecting all amounts within the stated terms under these types of arrangements to conclude that the fee is fixed or determinable at the time the product is delivered. In addition, we assess whether collection is probable based on the creditworthiness of the customer. Initial creditworthiness is assessed through Dun & Bradstreet, similar credit rating agencies or the customer's SEC filings. Creditworthiness for transactions to existing customers is assessed through a review of their prior payment history. We do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we will defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon the receipt of payment.

Revenues from start-up fees associated with our ASP service are recognized over the estimated life of the ASP relationship. Revenues related to ASP services are recognized ratably on a straight-line basis over the period that the ASP services are provided, or on an as-used basis if defined in the contract. In certain ASP contracts, the amount of usage is purchased in advance in blocks of time, either minutes or hours, with a defined period in which they must be used. As the blocks of time are used, revenue is recognized. Any unused blocks of time are recorded as revenue in the period that the contractual right for use has expired. Revenues for hosting services are recognized ratably on a straight-line basis over the term that the hosting services are provided. Also, in instances where we host a customer's purchased software on our server and network, we provide the customer a copy of the licensed software in addition to one that is kept on our server and recognize the license revenue for the purchased software in accordance with our revenue recognition policy for licensed software as discussed above

Table of Contents

and in accordance with Emerging Issues Task Force (EITF) No. 00-3, *Application of SOP 97-2 to Arrangements that Include the Rights to Use Software Stored on Another Entity's Hardware*.

Revenues from maintenance and support services are recognized ratably on a straight-line basis over the term that the maintenance service is provided. Revenues from consulting and education services are recognized either as the services are performed, ratably over a subscription period or upon completing a project milestone if defined in the agreement. Consulting and education services, including implementation, are not considered essential to the functionality of our products as these services do not alter the product capabilities, do not require specialized skills and may be performed by the customer or other vendors.

We record as deferred revenues any billed amounts due from customers in excess of revenues recognized. Deferred revenues consist principally of maintenance and support, subscriptions, ASP and hosting services, consulting and education services and term license fees.

Accounts Receivable Valuation and Reserves

We maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance for uncollectible amounts is based primarily on a specific analysis of accounts in the receivable portfolio and on our history of write-offs of accounts receivable. While we believe the allowance to be adequate, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required and bad debt expense would increase by a like amount. Each reporting period we adjust the reserve based on our review of current receivables and our history of write offs. In addition to the allowance for uncollectible amounts, we also provide an allowance for sales returns based on historical return rates. If we were to experience return rates exceeding those provided for, an additional allowance for sales returns would be required, and our total revenues would be reduced by a like amount. Historically, very few of our returns and uncollectible receivables have been significant or have had a material impact on our financial position or results of operations.

Valuation of Intangible Assets and Goodwill

Effective January 1, 2002, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. Under SFAS No. 142, instead of amortizing goodwill and certain other indefinite lived assets over time, we carry the asset on our balance sheet at its stated value and test it for impairment. The test is performed both annually and on an interim basis if an event or circumstance indicates that it is more likely than not that an impairment loss has been incurred. If it is determined that the carrying amount of goodwill exceeds its implied fair value, then a loss to the extent of the impairment must be recorded. Because such impairment losses can occur irregularly and in varying amounts, our operating results may be subject to volatility from time to time if we have goodwill and other non-amortizing assets on our balance sheet. We did not have any goodwill on our balance sheet as of December 31, 2004.

When we acquired MindLever in April 2001, we allocated approximately \$5.9 million of the purchase price of approximately \$7.2 million to goodwill. This amount represented management's estimate of the excess of the purchase price over fair value of the identifiable tangible and intangible net assets that we acquired in the transaction. We also allocated approximately \$2.1 million of the MindLever purchase price to developed technology and \$300,000 to assembled workforce. These amounts were being amortized over a period of three years. In December 2002, we conducted our first annual impairment test of the goodwill under SFAS No. 142. To measure the value of the goodwill, we used a combination of our market value and the net present value of the cash flows that we estimated our assets would produce over their useful lives. We determined that the value of the goodwill was zero. Accordingly, we recorded an impairment charge of \$5.9 million, representing the entire carrying amount of goodwill, in the fourth quarter of 2002.

Table of Contents**Accounting for Income Taxes**

The preparation of our consolidated financial statements requires us to estimate our income taxes in each of the jurisdictions in which we operate, including those outside the United States, which may be subject to certain risks that ordinarily would not be expected in the United States. The income tax accounting process requires us to estimate our actual current exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in the recognition of deferred tax assets and liabilities. We must then record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against deferred tax assets. We have recorded a net deferred tax asset of \$34.2 million as of December 31, 2004, primarily consisting of certain net operating losses and tax credits carried forward before they expire. We have booked a valuation allowance in the full amount of this asset, \$34.2 million, as of December 31, 2004, due to uncertainty about our ability to utilize any of our deferred tax assets. The valuation allowance is based on our estimates of taxable income by the jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to adjust our valuation allowance, which could materially impact our financial position and results of operations.

Results of Operations

The following table sets forth operating data expressed as percentages of total revenues for each period indicated.

	Year Ended December 31,		
	2002	2003	2004
Consolidated Statements of Operations Data:			
Revenues:			
License	48%	47%	31%
Software services	16	19	27
Maintenance and professional services	36	34	42
	—	—	—
Total revenues	100	100	100
	—	—	—
Cost of revenues:			
License	1	1	1
Amortization of acquired developed technology	2	2	1
Software services	7	5	6
Maintenance and professional services	12	10	12
	—	—	—
Total cost of revenues	22	18	20
	—	—	—
Gross margin	78	82	80
	—	—	—
Operating expenses:			

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Sales and marketing	63	51	59
Product development	36	27	26
General and administrative	24	23	23
Impairment of goodwill	18		
Merger transaction costs	4		
Restructuring and severance charges	1		2
	<u> </u>	<u> </u>	<u> </u>
Total operating expenses	146	101	110
	<u> </u>	<u> </u>	<u> </u>
Operating loss	(68)	(19)	(30)
Other income, net	1	1	1
	<u> </u>	<u> </u>	<u> </u>
Net loss	(67)%	(18)%	(29)%
	<u> </u>	<u> </u>	<u> </u>

Table of Contents*Comparison of 2004 and 2003**Revenues (\$ In Millions)*

	2004		2003		\$ Change 2003 to 2004	% Change 2003 to 2004
	\$	% of Total Revenues	\$	% of Total Revenues		
License	\$ 11.7	31%	\$ 20.3	47%	\$ (8.6)	(42)%
Software services	10.3	27%	8.2	19%	2.1	26%
Maintenance and professional services	16.1	42%	14.5	34%	1.6	11%
Total revenues	\$ 38.1	100%	\$ 43.0	100%	\$ (4.9)	(11)%

Total revenues decreased by \$4.9 million, or 11%, to \$38.1 million for 2004, from \$43.0 million for 2003. The decrease was attributable to a significant decline in software license revenues, partially offset by the continued growth in revenues from our ASP service and maintenance contracts. We believe that revenues will grow in 2005 in the range of 10% to 20% based on the impact of our new sales strategy to focus on selling specialized solutions, both at the executive level and in new departments and divisions within our existing strategic accounts, sales of our new add-on modules for the Centra for Enterprise Application Rollout specialized solution (planned to be released in June 2005) and increased revenues generated from utilizing our new EAS pricing model for a full year. We expect license revenues to represent a greater portion of the increase in overall revenues for 2005 as we generally recognize the majority of license revenues up front, upon shipment of the licenses to the customer, compared with software services and maintenance support revenues, which are generally recognized over time. See Strategy in Item 1.

- Software license revenues decreased by \$8.6 million, or 42%, to \$11.7 million for 2004, from \$20.3 million for 2003. The decrease over the prior year was attributed to the change in our sales strategy in 2004 to target sales of specialized solutions at the enterprise level and the transition of our field sales force through either retraining our existing field sales representatives or replacing and hiring new field sales representatives to support this new sales strategy. This transition had a negative and disruptive impact on the ability of our field sales force to complete sales during 2004. In addition, to a lesser extent, the decline in software revenues reflects the impact on license revenue from the introduction in 2004 of our EAS multi-year term license pricing model, which we believe customers chose in lieu of perpetual license sales, thereby, resulting in revenue from these sales to be deferred and amortized over the term instead of recognized up front upon shipment. In the future, we expect software license revenues to grow, reflecting the efforts to increase the average license transaction size by transitioning our field sales force toward penetrating larger accounts with specialized solutions across the enterprise and leveraging our EAS pricing model. Software license revenues represented 31% of total revenues for 2004 and 47% of total revenues for 2003.
- Software services revenue, which includes revenue from our ASP and hosting services, increased by \$2.1 million, or 26%, to \$10.3 million in 2004 from \$8.2 million in 2003. The increase in software services revenues was due to an increase in ASP revenues, which represented 91% of total software services revenues in 2004 from 88% in 2003, resulting from the growth in ASP subscription orders both in 2003 and 2004, increased usage volume under ASP usage-based pricing contracts, and an increase in expired blocks of time on certain prepaid usage-based contracts. We expect that a portion of our existing license customers will add ASP services over time to facilitate reaching their external constituents, such as prospects, customers and channel partners, over the Internet, in a secure environment without breaching the customer's behind-the-firewall-network. Should this occur, our ASP revenues will grow. In addition, for new buyers who may require the flexibility of an outsourced service or who lack the information technology infrastructure and resources to deploy real-time collaboration solutions on-site, our ASP or hosted services offerings will be preferred. Software services revenues represented 27% of total revenues for 2004 and 19% of total revenues for 2003.

Table of Contents

- Maintenance and professional services revenues, which includes revenue from our maintenance, consulting and education services, increased by \$1.6 million, or 11%, to \$16.1 million for 2004, from \$14.5 million for 2003. The majority of the increase was attributable to the growth in both the total number and dollar value of renewals of annual maintenance and support contracts. To a lesser extent, the increase was also due to an increase in professional services revenues resulting from improved productivity rates of our consulting and education personnel and higher billing rates, revenue recognized on expired consulting days and reimbursable travel costs. We expect total maintenance and professional services revenues to continue to increase in future periods as our installed base of license users grows and new maintenance contracts are added or the value increased as the result of new and additional license sales. The rate of the increase may vary from period to period, depending upon the value of new maintenance contracts added and the billable productivity rates of our consulting and education personnel. Any increase may be offset by non-renewals of existing maintenance contracts. Maintenance and professional services revenues represented 42% of total revenues for 2004 and 34% of total revenues for 2003.

Cost of license revenues. Cost of license revenues decreased by \$304,000, or 52%, to \$277,000 for 2004, from \$581,000 for 2003. The decrease was attributable to lower variable royalty fees and fulfillment costs resulting from a lower volume of license revenue in 2004 and lower fixed royalty costs resulting from completion of obligations. Since a significant portion of our license costs represent royalties that we pay to third parties on a per unit rate of product sold, primarily on server units, we expect that cost of license revenues will vary in the future based upon the unit volume of products sold. In addition, we expect cost of license revenues to increase to the extent that we use new third-party technologies in future releases of our products and solutions and license the technology on a royalty basis. Cost of license revenues was 2% and 3% of license revenues for 2004 and 2003, respectively.

Amortization of acquired developed technology. In connection with our acquisition of MindLever in April 2001, we allocated approximately \$2.1 million to acquired developed technology, which was being amortized over a three-year estimated useful life. Amortization of acquired developed technology was \$233,000 for 2004 representing a decline of \$467,000 from an amortization charge of \$700,000 for 2003. At December 31, 2004, the acquired developed technology asset is fully amortized and no further amortization costs associated with it will be incurred.

Cost of software services revenue. Cost of software services revenues increased slightly by \$66,000, or 3%, to \$2.4 million for 2004, from \$2.3 million for 2003, due to increased customer call volume for our ASP service as the result of both a higher number of ASP users and increased usage of the ASP service by existing ASP customers. Cost of software services revenue was 23% of software services revenue for 2004 and 28% of software services revenue for 2003. This decline in costs as a percentage of software services revenue reflects the increase in ASP revenue in 2004 combined with a proportionally lower amount of additional ASP service costs as the result of increased utilization of the existing capacity of our ASP services. We anticipate that the cost of software services revenues will increase in absolute dollars to the extent that we must expand the capacity of our ASP service to meet increased demand.

Cost of maintenance and professional services revenue. Cost of maintenance and professional services revenue increased by \$331,000, or 8%, to \$4.5 million for 2004, from \$4.2 million for 2003. This increase was primarily related to consulting and education services, including outside consulting costs to support various global services engagements and an increase in reimbursable travel costs. Cost of maintenance and professional services revenues were 28% of maintenance and professional services revenue for 2004 and 29% of maintenance and professional services revenue for 2003 reflecting the growth in higher margin maintenance services as compared to consulting and education services, which have a lower margin. We believe that the cost of maintenance and professional services revenue will increase in absolute dollars but decline as a percentage of revenues to the extent that we continue to acquire new customers, new service engagements or sell additional licenses and generate associated maintenance and professional services revenues.

Table of Contents

Sales and marketing expenses. Sales and marketing expenses increased by \$350,000, or 2%, to \$22.5 million for 2004, from \$22.1 million for 2003. The increase resulted from an increase in advertising programs to support our new sales strategy, particularly the introduction of specialized solutions in 2004, as well as an increase in marketing support provided to our partners in the Asia Pacific region. These increases were partially offset by a reduction in various other marketing programs as we shifted our focus towards advertising; a decrease in the amount of professional services charged to sales for supporting sales activities; a reduction in severance expense due to the departure of our senior vice president of sales in 2003; and decreases in consulting costs, stock compensation charges, bad debt expense and the cost of our annual user conference. Sales and marketing expenses were 59% of total revenues for 2004 and 51% of total revenues for 2003. In 2005, we expect that sales and marketing expenses will decrease in both absolute dollars and as a percent of total revenues as we leverage the investments made in advertising in 2004.

Product development expenses. Product development expenses decreased by \$1.5 million, or 13%, to \$10.0 million for 2004, from \$11.5 million for 2003. The decrease was primarily attributed to lower personnel and facility expenses as a result of closing our development facility in North Carolina and the subsequent reduction in headcount-related expenses thereto, and, to a lesser extent, the decrease in overhead costs allocated to product development resulting from the reduction in rent related to the lease renewal in 2004 of our corporate office facility in Lexington, Massachusetts. Product development expenses were 26% of total revenues for 2004 and 27% of total revenues for 2003. We expect product development expenses in 2005 to decrease in both absolute dollars and as a percentage of revenue reflecting the impact for a full year of cost savings from the closing of our development facility and related headcount reductions and the lease renewal of our corporate office in 2004.

General and administrative expenses. General and administrative expenses decreased by \$1.1 million, or 11%, to \$8.6 million for 2004, from \$9.7 million for 2003. The decrease was primarily related to stock compensation charges incurred in 2003 related to the retirement of our former president and chief operating officer, a reduction in executive salaries, bonuses and severance as a result of this retirement as well as the departure of our founder and chief strategy officer in 2004, and decreases in depreciation charges, recruiting fees and overhead costs. Partially offsetting the decline in general and administrative expenses were increases in audit and consulting fees to comply with Section 404 of the Sarbanes-Oxley Act of 2002. General and administrative expenses were 23% of total revenues for both 2004 and 2003. We expect general and administrative expenses to decline in 2005 in both absolute dollars and as a percentage of revenues reflecting the cost savings for a full year from the departure of our founder and chief strategy officer and from other expenditure reductions initiated during 2004.

Restructuring charges. In June 2004, we closed our product development facility located in Morrisville, North Carolina and implemented an 18% reduction in our workforce. As a result, we incurred restructuring charges in 2004 of \$788,000 consisting of facility closing costs, severance payments, health benefits and outplacement services. The accrued and unpaid amount of these charges at December 31, 2004 was \$85,000, which we expect to pay out through May 2005.

Interest income. Interest income decreased by \$27,000 to \$364,000 for 2004, from \$391,000 for 2003. Interest income consists of interest on our cash, cash equivalents and short- and long-term investments. The decrease was attributable to declines in the average balances of cash, cash equivalents and short- and long-term investments in 2004.

Interest expense. Interest expense decreased by \$44,000 to \$87,000 for 2004, from \$131,000 for 2003. The decrease was attributed to a decline in the average balance outstanding on our term loans as the result of principal payments made on these loans during the year.

Other income or expense, net. Other income or expense, net, changed by \$60,000 to reflect a net expense of \$58,000 for 2004 from a net income of \$2,000 for 2003, related to changes in net foreign exchange gains and losses.

Table of Contents*Comparison of 2003 and 2002**Revenues (\$ In Millions)*

	2003		2002		\$ Change 2002 to 2003	% Change 2002 to 2003
	\$	% of Total Revenues	\$	% of Total Revenues		
License	\$ 20.3	47%	\$ 16.0	48%	\$ 4.3	27%
Software services	8.2	19%	5.5	16%	2.7	49%
Maintenance and professional services	14.5	34%	11.9	36%	2.6	22%
Total revenues	\$ 43.0	100%	\$ 33.4	100%	\$ 9.6	29%

Total revenues increased by \$9.6 million, or 29%, to \$43.0 million for 2003, from \$33.4 million for 2002. The increase in revenue was driven primarily by an increase in license sales and was further impacted by growth in both software services and professional services and maintenance support.

- Software license revenues increased by \$4.3 million, or 27%, to \$20.3 million for 2003, from \$16.0 million for 2002. The increase over 2002 was due to the growth in the number of total license transactions for both new and existing customers. The average transaction size declined for new customers reflecting a more conservative buying pattern with lower initial investments to start. The average transaction value for existing customers increased. However, if we excluded the transaction in the third quarter of 2003 with the U.S. Army for \$1.6 million in licenses, the average transaction value for existing customers would have been flat with the prior year. The average transaction value for existing accounts is higher than the average transaction value for new accounts in 2003 compared with 2002 in which the average transactions values were relatively the same. Software license revenues represented 47% of total revenues for 2003 and 48% of total revenues for 2002.
- Software services revenue increased by \$2.7 million, or 49%, to \$8.2 million in 2003 from \$5.5 million in 2002. The increase in software services revenue was primarily due to an increase in ASP revenues, which represented 88% of total software services revenues in 2003, resulting from the growth of our ASP orders in both 2002 and 2003. The increase in ASP orders was attributed to higher volume in new ASP accounts and continued high renewal rates for our ASP services. Software services revenues represented 19% of total revenues for 2003 and 16% of total revenues for 2002.
- Maintenance and professional services revenues increased by \$2.6 million, or 22%, to \$14.5 million for 2003, from \$11.9 million for 2002. The increase was primarily due to an increase in both the total number and dollar value of renewals of annual maintenance and support contracts, from the sales of new maintenance and support contracts associated with sales of licenses, and, to a lesser extent, from professional services revenues. Maintenance and professional services revenues represented 34% of total revenues for 2003 and 36% of total revenues for 2002.

Cost of license revenues. Cost of license revenues increased by \$147,000, or 34%, to \$581,000 for 2003, from \$434,000 for 2002. The increase was attributable to higher royalty fees and fulfillment costs resulting from a higher volume of license revenues in 2003. Cost of license revenues was 3% of license revenues for both 2003 and 2002.

Amortization of acquired developed technology. In connection with our acquisition of MindLever in April 2001, we allocated approximately \$2.1 million to acquired developed technology, which was being amortized over a three-year estimated useful life. Amortization of acquired developed technology was \$700,000 for 2003 and 2002.

Cost of software services revenue. Cost of software services revenue increased by \$34,000, or 1%, to \$2.3 million for 2003 due to an increase in the use of technical support services resulting from the growth in the

Table of Contents

number of ASP service customers added in 2003. Cost of software services revenue was 28% of software services revenue for 2003 and 42% of software services revenue for 2002. This decline in costs as a percentage of software services revenue reflects the increase in software services revenue in 2003 combined with a proportionally lower amount of additional ASP service costs reflecting the increased capacity of our ASP services as the result of our product release in June 2003.

Cost of maintenance and professional services revenue. Cost of maintenance and professional services revenue increased by \$99,000, or 2%, to \$4.2 million for 2003, from \$4.1 million for 2002. This increase was attributed to higher compensation expenses related to higher salaries. Cost of maintenance and professional services revenue was 29% of maintenance and professional services revenue for 2003 and 34% of maintenance and professional services revenue for 2002 reflecting the growth in higher margin maintenance services as compared to consulting and education services, which have a lower margin.

Sales and marketing expenses. Sales and marketing expenses increased by \$1.1 million, or 6%, to \$22.1 million for 2003, from \$21.0 million for 2002. The increase resulted from an increase in severance expense related to the departure of various sales and marketing management personnel as well as an increase in sales commissions and bonuses due to a higher amount of orders received in 2003. These increases were partially offset by a reduction in bad debt expense due to the impact of a large write-off taken in the prior year and, to a lesser extent, a reduction in marketing programs, including advertising and tradeshows. Sales and marketing expenses were 51% of total revenues for 2003 and 63% of total revenues for 2002.

Product development expenses. Product development expenses decreased by \$600,000, or 5%, to \$11.5 million for 2003, from \$12.1 million for 2002. The decrease resulted from a small decline in the average engineering headcount for 2003; a decrease in outside translation costs as certain translation activities were either not required for recent product releases or were completed in-house in 2003 and a reduction in depreciation expense as various capital assets became fully depreciated in 2003 and are still in service. Product development expenses were 27% of total revenues for 2003 and 36% of total revenues for 2002.

General and administrative expenses. General and administrative expenses increased by \$1.6 million, or 20%, to \$9.7 million for 2003, from \$8.1 million for 2002. The increase was primarily due to an increase in stock compensation charges related to the 2003 departure of our former president and chief executive officer, increased recruiting costs attributed to the hiring of our new president and chief executive officer, as well as increases in salaries and bonuses and incremental fees for consulting, legal and audit to comply with the regulations under the Sarbanes-Oxley Act of 2002. General and administrative expenses were 23% of total revenues for 2003 and 24% of total revenues for 2002.

Impairment charges. Under SFAS No. 142, goodwill is not amortized but is reviewed at least annually for impairment. See *Critical Accounting Policies and Estimates* above. In 2002, we recorded an impairment charge of \$5.9 million related to goodwill associated with our April 2001 acquisition of MindLever. This charge amounted to a write-off of the entire amount of the goodwill asset associated with the MindLever acquisition, and materially affected our results of operations for that year. During 2003, we did not carry any goodwill asset on our books.

Merger transaction costs. In 2002, we recorded a charge of \$1.2 million for costs incurred related to the proposed merger with SmartForce PLC. The costs consisted primarily of advisory, legal and retainer fees. We did not incur any such costs in 2003.

Restructuring charges. In April 2002, in light of changing market dynamics and economic factors, we reduced our workforce by approximately 10% or 30 positions, primarily in the product development group, and in our domestic and international sales and services departments. As a result of the restructuring, we recorded a charge in 2002 of \$439,000 for the associated severance payments, benefits and outplacement services provided

Table of Contents

to the employees affected by this restructuring. The entire amount of this restructuring charge was paid in 2002 and no further charges related to this restructuring were incurred in 2003.

Interest income. Interest income decreased by \$359,000 to \$391,000 for 2003, from \$750,000 for 2002. The decrease was primarily attributable to declines in both the total average balances of, and average interest rates for, cash, cash equivalents and short- and long-term investments in 2003.

Interest expense. Interest expense decreased by \$54,000 to \$131,000 for 2003, from \$185,000 for 2002. The decrease was primarily attributable to a decline in the average balance outstanding on our term loans as the result of principal payments made on these loans during the year.

Other income or expense, net. Other expense decreased by \$127,000 to \$2,000 of other income for 2003, from other expense of \$125,000 for 2002, as a result of changes in net foreign exchange gains and losses.

Quarterly Results of Operations

The following table presents our unaudited quarterly results of operations for 2003 and 2004. You should read the following table in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this report. We have prepared this unaudited information on a basis consistent with the audited consolidated financial statements contained in this report and it includes all adjustments, consisting of normal recurring adjustments, that we consider necessary for a fair presentation of our financial position and operating results for the quarters presented. You should not draw any conclusions about our future results from the results of operations for any quarter.

	Quarter Ended,							
	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004
(In Thousands, Unaudited)								
Consolidated Statements of Operations Data:								
Revenues:								
License	\$ 4,365	\$ 4,613	\$ 5,447	\$ 5,917	\$ 2,531	\$ 2,612	\$ 2,829	\$ 3,678
Software services	1,843	2,093	2,113	2,186	2,371	2,630	2,670	2,667
Maintenance and professional services	3,475	3,686	3,549	3,754	3,734	4,015	4,202	4,125
Total revenues	9,683	10,392	11,109	11,857	8,636	9,257	9,701	10,470
Cost of revenues:								
License	140	133	153	155	77	54	63	83
Amortization of acquired developed technology	175	175	175	175	175	58		
Software services	581	560	590	589	636	593	555	602
Maintenance and professional services	1,031	1,084	1,055	1,048	976	1,060	1,208	1,305
Total cost of revenues	1,927	1,952	1,973	1,967	1,864	1,765	1,826	1,990
Gross profit	7,756	8,440	9,136	9,890	6,772	7,492	7,875	8,480

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Operating expenses:								
Sales and marketing	5,457	5,488	5,213	5,988	5,155	6,897	4,763	5,681
Product development	2,954	2,999	2,811	2,749	2,759	2,817	2,313	2,140
General and administrative	2,346	2,236	2,911	2,243	1,978	2,162	2,443	2,047
Restructuring charges						547	241	
Total operating expenses	10,757	10,723	10,935	10,980	9,892	12,423	9,760	9,868
Operating loss	(3,001)	(2,283)	(1,799)	(1,090)	(3,120)	(4,931)	(1,885)	(1,388)
Other income, net	82	76	53	51	(18)	92	78	67
Net loss	\$ (2,919)	\$ (2,207)	\$ (1,746)	\$ (1,039)	\$ (3,138)	\$ (4,839)	\$ (1,807)	\$ (1,321)

Table of Contents**Liquidity and Capital Resources:**

	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(amounts expressed in thousands)		
Cash and cash equivalents	\$ 25,891	\$ 13,357	\$ 11,779
Short-term investments	12,353	15,531	13,356
Long-term investments		5,888	743
	<u>\$ 38,244</u>	<u>\$ 34,776</u>	<u>\$ 25,878</u>
Working capital	\$ 28,127	\$ 16,549	\$ 12,604
Days sales outstanding	69	59	68
Cash used in operating activities	\$ (9,348)	\$ (2,255)	\$ (8,461)
Cash provided by (used in) investing activities	9,101	(9,756)	6,059
Cash provided by (used in) financing activities	675	(730)	794

As of December 31, 2004, we had cash and cash equivalents of \$11.8 million and short- and long-term investments of \$14.1 million, a decrease of \$1.6 million of cash and cash equivalents from \$13.4 million at December 31, 2003, and a decrease of \$7.3 million of short- and long-term investments from \$21.4 million as of December 31, 2003. The combined decrease of \$8.9 million for cash, cash equivalents and short- and long-term investments resulted primarily from cash used to fund operating activities of \$8.5 million and purchases of fixed assets of \$1.2 million, partially offset by \$1.0 million in proceeds from the issuance of shares in connection with the employee stock purchase plan and the exercise of stock options. Our working capital, defined as our current assets less our current liabilities, as of December 31, 2004 was \$12.6 million, compared to \$16.5 million as of December 31, 2003.

Cash used in operating activities of \$8.4 million for 2004 was primarily the result of a net loss of \$11.1 million, a decrease in accrued expenses of \$600,000 and an increase in prepaid expenses and other current assets of \$336,000, partially offset by an increase in deferred revenue of \$1.9 million and non-cash charges for depreciation and amortization of \$1.6 million. For 2003, our operating activities resulted in net cash outflows of \$2.3 million due to a net loss of \$7.9 million and an increase in accounts receivable of \$923,000, partially offset by non-cash charges for depreciation and amortization of \$2.8 million and other non-cash charges, including stock-based compensation and an increase in the provision for bad debts in the aggregate of \$774,000, an increase in deferred revenue of \$2.2 million and a decrease in prepaid expenses and other current assets of \$562,000.

Cash provided by investing activities of \$6.1 million for 2004 consisted of maturities of short- and long-term investments of \$49.6 million, partially offset by purchases of short- and long-term investments of \$42.3 million, the purchase of \$1.2 million of property and equipment, primarily computer equipment, for support of current operations and an increase in restricted cash of \$200,000. For 2003, our investing activities had resulted in net cash outflows of \$9.8 million resulting from purchases of short- and long-term investments of \$56.6 million and the purchase of \$822,000 of property and equipment, primarily computer equipment, for support of current operations, partially offset by maturities of short-term investments of \$47.5 million and a decrease in restricted cash of \$100,000.

Cash provided by financing activities for 2004 of \$794,000 resulted from drawings of \$1.6 million under our equipment line of credit and \$1.0 million in proceeds from the issuance of shares in connection with our employee stock purchase plan and the exercise of stock options, partially offset by \$1.8 million in principal payments on term loans under our equipment line of credit. For 2003, our financing activities resulted in net cash outflows of \$730,000, related to \$2.0 million in principal payments on term loans under our equipment line of credit, partially offset by \$1.0 million in proceeds from the issuance of shares in connection with our employee stock purchase plan and the exercise of stock options and \$255,000 from drawings under our equipment line of credit.

Table of Contents

Days sales outstanding, or DSO (calculated as net accounts receivable divided by revenue per day for the previous 90 days), at December 31, 2004 was 68 days, an increase of 9 days compared to DSO of 59 days at December 31, 2003. This increase resulted from 1) an increase of \$2.0 million in deferred revenue during the fourth quarter of 2004 as compared to the same quarter of the prior year (reflecting growth in ASP sales and maintenance renewals) and 2) a higher percentage of sales in December 2004 compared with December 2003. Any increase or decrease in our accounts receivable balance will affect our cash flow from operations and liquidity. Our accounts receivable and DSO may increase due to changes in factors such as the timing of when sales are invoiced and the length of our customers' payment cycle. We also record deferred ASP and hosted services, maintenance and professional services billings as accounts receivable, and thus the timing of these billings can affect the DSO calculation as the receivable may be recorded in the current period with the associated revenue recorded over future periods resulting in an increase in the DSO for the current period. Historically, international customers and resellers pay at a slower rate than domestic customers and customers sold to directly. An increase in revenue generated from international customers and resellers may increase our DSO and accounts receivable balance. To the extent that our accounts receivable balance increases, we may incur increased bad debt expense and will be subject to greater general credit risks.

At December 31, 2004, \$2.1 million in term loans under our current amended equipment line of credit was outstanding as compared to \$2.3 million outstanding at December 31, 2003. Of the total outstanding \$1.3 million and \$241,000 are payable in monthly principal payments of approximately \$38,000 and \$7,000 plus interest maturing in September and December 2007, respectively. Interest is payable monthly based on the prime rate (5.25% at December 31, 2004) plus 0.5%. The remaining outstanding amount of \$553,000 represents three separate loan advances, and is payable in fixed monthly payments of principal and interest of \$35,000, \$9,000 and \$8,000 maturing at different times through June 2006. Interest was calculated at prime plus 0.5% at the initiation of each of the loan advances, or 5.25%, 4.75% and 4.75%, respectively. The current amended equipment line of credit requires Centra to maintain a minimum balance of cash, cash equivalents and investments of \$10 million and hold all of the Company's cash, cash equivalents and investments in operating, deposit and investment accounts at the bank. At December 31, 2004, approximately \$877,000 remained available for borrowings under the current line of credit, which may be drawn until September 2005. All borrowings are secured by substantially all of Centra's assets. At December 31, 2004, the Company was in compliance with the covenants under the equipment line of credit.

Capital expenditures totaled \$1.2 million for 2004 and \$822,000 for 2003. Our capital expenditures consisted of purchases of assets to manage our internal operations and our ASP service, including computer hardware and software, office furniture and equipment and leasehold improvements. Purchases of computer equipment represent the largest component of our capital expenditures. We expect capital expenditures in 2005 to remain consistent with 2004 levels. Since inception, we have generally funded capital expenditures either through the use of working capital or with equipment bank loans.

As of December 31, 2004, our primary financial commitments consisted of obligations outstanding under long-term debt, operating leases and other contractual obligations, including severance and royalty payments discussed elsewhere herein.

These commitments expire at various times through 2009. Long-term debt represents the portion of principal payments to be made under our equipment line of credit facility that extends greater than one year. Operating leases shown below are primarily for facility costs for the Company's corporate headquarters, our product development facility in North Carolina and worldwide sales offices. Other contractual obligations primarily consist of minimum royalty fees payable by the Company in connection with software royalty agreements and certain costs for the use of facilities at third-party Internet Service Providers for our hosted and ASP service offerings.

Table of Contents

<u>Years Ended December 31,</u>	<u>Long-Term Debt</u>	<u>Operating Leases</u>	<u>Other Contractual Obligations</u>	<u>Total</u>
	(Amounts in Thousands)			
Less than 1 Year	\$ 1,049	\$ 1,469	\$ 1,533	\$ 4,051
1-3 Years	1,012	3,307	1,017	5,336
4 Years			105	105
Total	\$ 2,061	\$ 4,776	\$ 2,655	\$ 9,492

Under the terms of our standard software license contracts, we indemnify our customers for the potential liability associated with the infringement of other parties' technology based upon our software products. There is a possibility that we could be found liable to our customers in the event that there is infringement occurring. On August 19, 2003, a complaint was filed against Centra and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. The Company believes it has meritorious defenses and intends to vigorously defend this action. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred. The Company filed a request for re-examination of the patents at issue with the U.S. Patent and Trademark Office as patent counsel to the Company is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the District Court has approved the parties' motion to stay the court proceedings during the re-examination proceedings. The Company believes that it has meritorious defenses and the Company intends to vigorously defend this action. We have not accrued any amounts for the replacement or refund of any software products sold or any indemnification costs related to the EdiSync claim or any infringement through December 31, 2004. See Item 3, Legal Proceedings.

As of December 31, 2004, we had net operating loss carryforwards of \$57.7 million and research and development credit carryforwards of \$3.5 million. The net operating loss and credit carryforwards expire at various dates, beginning in 2004 through 2024, if not used. Under the provisions of the Internal Revenue Code, substantial changes in our ownership may limit the amount of net operating loss carryforwards that could be utilized annually in the future to offset taxable income. A valuation allowance has been established in our consolidated financial statements for the full amount of our net deferred tax assets to reflect the uncertainty of our ability to use available tax loss and tax credit carryforwards and other deferred tax assets.

Over the past two years, in response to business challenges and economic conditions, we have made considerable efforts to reduce our operating expenses through constrained spending and reductions in workforce. This has resulted in a decrease in our cash used in operations; however, as of December 31, 2004, we still use more cash to operate our business than we generate in revenues. As discussed above, we anticipate that our overall operating expenses in 2005 will decline as compared to 2004. We anticipate that such operating expenses, along with capital expenditures, will constitute the most significant use of our cash resources. If we have the opportunity, we may also use cash resources to fund acquisitions or investments in complementary businesses, technologies, products or services. We believe that our existing cash, cash equivalents and short-term and long-term investments, which totaled \$25.9 million at December 31, 2004, will be sufficient to meet our anticipated cash requirements for operating expenses, capital expenditures and any strategic efforts for at least the next 12 months. However, thereafter we may need to raise additional funds to support our operations, particularly if our strategic sales and marketing efforts do not produce the desired results. We might also need to seek additional financing if we were to identify a strategic opportunity that required more cash than we had available at such time. If we did seek to raise additional funds, though, we may not be able to obtain them on terms that are favorable or acceptable to us. See Factors That Could Affect Future Results We may require additional funds in this Item 7.

Table of Contents

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (Revised 2004) (FAS 123R), *Share-Based Payment*, which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. It requires fair value valuations be used for share-based payments to employees that in the past have been accounted for by us under the intrinsic method of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employee*. This Statement is effective beginning the first interim or annual reporting period that begins after June 15, 2005. FAS 123R allows for three methods of accounting upon adoption; modified prospective application, modified retrospective application for all periods presented or modified retrospective application only for the period presented in the current fiscal year. The modified prospective application allows for the recording of share-based payment expenses in the current period only and requires pro forma disclosures of prior periods for comparability. The modified retrospective application requires the restatement of prior periods in the current fiscal year or all periods presented as if FAS 123R was effective in those years and the recording of share-based payments expenses in the current period. We have not determined which method will be applied upon adoption. We have not determined the effect adoption of FAS 123R will have on the Company's financial statements. However, the pro forma disclosure under *Stock-Based Compensation* in Note 1 to the consolidated financial statements approximates what would have been the impact of applying FAS 123R to the historical periods presented.

In December 2004, the FASB issued SFAS No. 153 (FAS 153), *Exchange of Nonmonetary Assets an amendment of APB Opinion No. 29*, which amends Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. FAS 153 defines a nonmonetary exchange as having commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005 and shall be applied prospectively. We have adopted FAS 153 effective January 1, 2005 and have determined that its adoption will not have a material effect on our financial position or financial statements.

Factors That Could Affect Future Results

As defined under the safe harbor provisions of The Private Securities Litigation Reform Act of 1995, some of the matters discussed in this report contain forward-looking statements, including but not limited to statements about the beliefs and expectations of management regarding our future performance, strategic initiatives, ability to achieve and maintain a leadership position in real-time conferencing and collaboration, demand for our software services and management's goals and objectives regarding future results of operations and sales strategy. These statements reflect management's beliefs and expectations as of the date of this report, and involve risk and uncertainties that may cause actual results, events and performance to differ materially. These risk factors include, but are not limited to: risks associated with our ability to successfully execute our strategic plan, the effects of our recent cost-cutting measures on our results of operations and sales strategy, product demand for and market acceptance of our current and future products, our ability to achieve profitability, our ability to execute our marketing, sales and distribution initiatives, the impact of competitive products and pricing, the effects of changes in the senior management team, system failures that disrupt our hosted and ASP services, the effect of economic conditions generally on the market for IT spending and for our products, the results of our future research and development activities, reliance on third-party technology, technological difficulties and/or other factors outside our control. If any of the events described below were to actually occur, then our business, financial condition or results of operations could be seriously harmed and the trading price of our common stock could decline. There is no assurance that we will be able to implement our operating plans as anticipated or achieve projected revenue and earnings goals.

Important factors that could cause our actual results to differ from the forward-looking statements described above include, but are not limited to, the factors outlined below.

Table of Contents

We may not successfully execute our strategic plan.

Our strategic initiatives include enhancing our solutions, improving our services, and continuing to develop and beginning to sell add-on modules for our specialized solutions. We also intend to continue to evaluate the evolving market for specialized application software solutions and services for online business communication, collaboration and learning and assess any strategic alternatives that we identify. We can give no assurance as to whether and when we will successfully implement our new strategy of developing and selling specialized solutions. If we are not successful in achieving our strategic objectives, then our liquidity and working capital will be materially diminished and the value of our stockholders' investments could decline significantly.

Our cost cutting efforts could impede our ability to successfully execute our sales strategy

We believe to successfully transition to our new sales strategy of selling specialized application software and services for online business communication, collaboration and learning, we will need to develop new channel partnerships, enhance our relationships with existing customers, expand international operations, implement new initiatives that improve sales execution and consistency and attract new customers with targeted messaging, print advertising, public relations efforts and lead generation marketing programs. When we adopted this new sales strategy, we intended to increase our sales and marketing expenditures significantly. However, during the quarter ended June 30, 2004, we concluded that it would take longer than we previously thought before we begin to see significant annual revenue growth as a result of our efforts. Therefore, we decided to scale back our planned increases in sales and marketing expenses until such time that our new add-on modules for our specialized solutions are available and begin to achieve market acceptance, and we implemented other initiatives aimed at reducing our costs. These cost-cutting efforts included closing our development facility in North Carolina and reducing our worldwide workforce by 18%. While we believe that our cost cutting decisions, including our delay in increasing sales and marketing expenses, to be sound, they could impede our ability to successfully execute our sales strategy.

We have incurred substantial losses in the past and may not achieve profitability in the future.

We incurred net losses of \$22.5 million in 2002, \$7.9 million in 2003 and \$11.1 million in 2004 and we had an accumulated deficit of \$99.2 million at December 31, 2004. We cannot predict when we will become profitable, if at all, and if we do, we may not remain profitable for any substantial period of time. If we fail to achieve and maintain profitability, then our investors' expectations may not be met and the market price of our common stock may fall.

Our future success depends to a significant degree on our senior management team and our ability to retain key employees.

Since June 2003, we have effected a number of significant changes to our senior management team, including: the arrival of our president and chief executive officer, Paul Gudonis, in July 2003, the departure of our founder and chief strategy officer, Leon Navickas in September 2004; the departure of our chief financial officer, Stephen Johnson, effective May 2005, and the departure of and hiring of senior sales, marketing and professional services executives in 2003 and 2004. Our future success will depend in part on our ability to carry out the transition in senior management and to integrate the new people and positions into our operations, as well as on the efforts of our other senior managers. Changes in our management team, the inability of our executive officers and key employees to work effectively as a team or the inability to retain key employees could have a material adverse effect on our business, operating results and financial condition.

The success of our strategy depends on our ability to license and integrate third-party technology to enhance our products.

Our ability to enhance and deliver our specialized solutions and the add-on modules to them is dependent upon our ability to license, under commercially reasonable terms, third-party software that enhances, enables or provides additional functionality for them. If we are not able to successfully license third-party software to

Table of Contents

incorporate into our products, we may not be able to timely deliver more robust versions of our specialized solutions. In addition, the third-party software that we intend to license may or may not continue to be available on commercially reasonable terms or with acceptable levels of support or functionality, or at all. Failure to obtain or maintain these license arrangements, failure of the third-party vendors to provide updates, modifications or future versions of their software or defects and errors in, or infringement claims against those third-party products could delay or impair our ability to develop and sell our products and execute against our strategic plan.

Delays in sales could cause significant variability in our revenues and operating results for any particular period.

We generally need to educate potential customers regarding the benefits of our real-time conferencing, collaboration and learning products and services before they will commit to the purchase of our products. Our sales cycle varies depending on the size and type of customer contemplating a purchase, the complexity of the customer's purchasing process and whether we have conducted business with the customer in the past. Both new and existing customers frequently need to obtain approvals from multiple decision makers within their organization prior to making purchase decisions. We expect that the sales cycle will continue to be characterized by these features as we move towards selling broader enterprise-based solutions and larger, multi-year contracts.

We face significant competition from other technology companies and we may not be able to compete effectively.

The markets for real-time conferencing, collaboration and learning products and services are highly competitive. We expect that our competition in this market will intensify in the future, which will likely result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business. Competitors vary in size and in the scope and breadth of the products and services offered. We encounter competition with respect to different aspects of our online business communication, collaboration and learning solutions from a variety of software and services vendors. In addition, larger companies with more resources than we have could enter our market and either reduce our sales or require us to lower our prices, or both.

Some of our competitors have longer operating histories, significantly greater financial, technical, marketing and other resources than we do. Some have significantly greater name recognition and a larger installed base of customers. In addition, many of our competitors have well-established relationships with our current and potential customers. In the past, we have lost potential customers to competitors for various reasons, including lower prices and other incentives not matched by us. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address customer needs. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

We may lose customers or incur losses if we experience system failures that significantly disrupt the availability and quality of our hosted and ASP services.

While our products can be deployed at a customer's premises or on its network as a packaged software application, we also deliver our products as an ASP or hosted service utilizing our network. Our hosted services and ASP services depend on the efficient and continued operation of our internal and outsourced computer and communications hardware and software systems and our ability to avoid and mitigate any interruptions in service or reduced capacity. Some of our communications hardware and software is hosted at third-party facilities. These third-party providers are vulnerable to business and economic uncertainties as well as damage or interruption from human error, telecommunications failures, computer viruses, sabotage, and intentional acts of vandalism, all of which may affect their ability to continue to provide services. Interruptions in service or performance problems, for whatever reason, could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones. In addition, any significant interruption in our service could result in

Table of Contents

losses to our customers. Although we attempt contractually to disclaim liability for any such losses, a court might not enforce a limitation on our liability, which could expose us to financial loss.

We may require additional funds.

We expect that our current cash, cash equivalents and short-term investments will be adequate to provide us with sufficient working capital for at least the next 12 months. However, our current plans and projections may prove to be inaccurate or our expected cash flow may prove to be insufficient to fund our operations because of difficulties in executing our sales and marketing strategy, demand for our new products, delays in developing new products and improvements, unanticipated expenses or other unforeseen difficulties. Therefore, we may need to raise additional capital to continue to fund our operations, particularly if our strategic sales and marketing efforts do not produce the desired results. We might also need to seek additional financing if we were to identify a strategic opportunity or desirable technology to acquire that required more cash than we had available at the time.

Our ability to obtain any additional financing that may be needed will depend on a number of factors, including market conditions, our operating performance and investor interest, particularly in software companies providing online business communication, collaboration and learning solutions. These factors may make the timing, amount, terms and conditions of any financing unattractive. They may also result in our incurring additional indebtedness or accepting stockholder dilution. If adequate funds are not available or are not available on acceptable terms, we may have to forego strategic acquisitions or investments, defer our product development activities, or delay our continued rollout of new products and product versions. Any of these actions may seriously harm our business and operating results.

If we identify and report material weaknesses in our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our common stock.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission adopted rules requiring public companies to include in their annual reports on Form 10-K a report of management on our internal control over financial reporting, including managements assessment of the effectiveness of the company s internal control over financial reporting as of the company s year end. In addition, the accounting firm auditing a public company s financial statements must also attest to and report on management s assessment of the effectiveness of the company s internal control over financial reporting as well as the operating effectiveness of the company s internal controls. Our independent accountants have provided a report on managements assessment of internal controls for financial reporting and their audit of our internal controls and financial reporting in which they expressed an opinion that we maintained in all material respects effective internal controls and financial reporting as of December 31, 2004. However, if in future periods it is determined that our internal controls are not designed or operating effectively as required by Section 404 or our accounting firm 1) disclaims an opinion as it relates to management s assessment of the effectiveness of its internal controls; 2) issues a qualified opinion on the effectiveness of the company s internal controls or 3) renders an adverse opinion due to material weaknesses in our internal controls, then investors may lose confidence in the reliability of our financial statements, which could cause the market price of our common stock to decline.

Future regulations could be enacted that either directly restrict our business or indirectly impact our business by limiting the growth of Internet-based business and services.

As commercial use of the Internet increases, federal, state and foreign agencies could enact laws or adopt regulations covering issues such as user privacy, content, taxation of products and services, encryption, network and information security, and the convergence of telephone and

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other traditional communication services with Internet communications such as Voice-Over-Internet-Protocol. If enacted, such laws or regulations could limit

Table of Contents

the market for our products and services. Any inconsistencies between state, federal and non-U.S. laws and regulations could affect distribution of our products and/or increase our costs. Such legislation or regulation could also dampen the growth in Web usage and decrease its acceptance as a medium of communications and commerce.

Our future success will depend on our ability to respond effectively to technological changes and new industry standards and developments in new versions of our products.

As with any software technology, we expect that the demand and product specifications continue to change and therefore our future success will depend in large part on our ability to stay current with any technology shifts and meet the evolving needs of the market by timely introduction of new products or product releases. In the past, we have experienced delays in the introduction of new products. In addition, our product enhancements must meet the requirements of our current and prospective customers and must achieve significant market acceptance. We could also incur substantial costs if we need to modify our products, services or information technology infrastructure to adapt to these changes, standards and developments.

We face business risks relating to our international operations.

Our success is focused on sales to multinational corporations, which requires us to have international operations and incur risks associated with those operations. In addition to our North American operations, we have established sales, marketing and service operations in Europe and Australia and we sell through distributors and resellers in a number of countries around the world. We cannot be sure that our international operations will be successful. Our international operations require resources and management attention beyond those required for our domestic operations and subject us to additional regulatory, economic and political risks, including:

longer payment cycles and problems in collecting accounts receivable;

adverse changes in trade and tax regulations;

the absence or significant lack of legal protection for intellectual property rights;

the adoption of data privacy or other laws or regulations that restrict or regulate the use of our products or the Internet;