

EGAIN COMMUNICATIONS CORP
Form 10-Q
February 16, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2009

OR

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

For the transition period from _____ to _____

Commission File No. 0-30260

eGAIN COMMUNICATIONS CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

94043
(Zip Code)

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

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

Class	Outstanding at December 31, 2009
Common Stock \$0.001 par value	22,178,589

Table of Contents

eGAIN COMMUNICATIONS CORPORATION

TABLE OF CONTENTS

	Page
PART I. <u>FINANCIAL INFORMATION</u>	1
Item 1. <u>Financial Statements (unaudited)</u>	1
<u>Condensed Consolidated Balance Sheets at December 31, 2009 and June 30, 2009</u>	1
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended December 31, 2009 and 2008</u>	2
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended December 31, 2009 and 2008</u>	3
<u>Notes to Condensed Consolidated Financial Statements</u>	4
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	25
Item 4T. <u>Controls and Procedures</u>	25
PART II. <u>OTHER INFORMATION</u>	26
Item 1. <u>Legal Proceedings</u>	26
Item 1A. <u>Risk Factors</u>	26
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	27
Item 6. <u>Exhibits</u>	27
<u>Signatures</u>	28

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

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

	December 31, 2009	June 30, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,970	\$ 7,511
Restricted cash	13	13
Accounts receivable, net	4,688	4,308
Prepaid and other current assets	437	538
Total current assets	11,108	12,370
Property and equipment, net	968	995
Goodwill	4,880	4,880
Other assets	398	391
Total assets	\$ 17,354	\$ 18,636
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	\$ 801	\$ 979
Accrued compensation	1,787	2,429
Accrued liabilities	1,662	2,141
Deferred revenue	6,118	5,398
Capital lease obligation	177	181
Bank borrowings	125	3,125
Total current liabilities	10,670	14,253
Deferred revenue, net of current portion	223	133
Capital lease obligation, net of current portion	99	187
Related party notes payable	8,199	7,697
Bank borrowings, net of current portion	52	115
Other long term liabilities	338	344
Total liabilities	19,581	22,729
Commitments and Contingencies (Notes 10 and 12)		
Stockholders' deficit:		
Common stock	22	22
Additional paid-in capital	323,644	323,550
Notes receivable from stockholders	(78)	(76)
Accumulated other comprehensive loss	(580)	(506)
Accumulated deficit	(325,235)	(327,083)

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Total stockholders' deficit	(2,227)	(4,093)
Total liabilities and stockholders' deficit	\$ 17,354	\$ 18,636

See accompanying notes

Table of Contents**eGAIN COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share data)****(unaudited)**

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Revenue:				
License	\$ 2,516	\$ 3,529	\$ 4,470	\$ 5,128
Recurring services	4,292	3,637	8,276	7,748
Professional services	1,504	2,423	3,541	4,852
Total revenue	8,312	9,589	16,287	17,728
Cost of license	83	19	151	38
Cost of recurring services	1,129	1,078	2,281	2,204
Cost of professional services	1,336	1,501	2,631	3,216
Gross profit	5,764	6,991	11,224	12,270
Operating costs and expenses:				
Research and development	1,285	1,400	2,455	2,925
Sales and marketing	2,350	2,851	4,784	5,633
General and administrative	731	873	1,517	1,920
Total operating costs and expenses	4,366	5,124	8,756	10,478
Income from operations	1,398	1,867	2,468	1,792
Interest expense, net	(279)	(335)	(556)	(820)
Other income, net	36	341	30	365
Income before income taxes	1,155	1,873	1,942	1,337
Benefit / (provision) for income taxes	(94)	96	(94)	110
Net income	\$ 1,061	\$ 1,969	\$ 1,848	\$ 1,447
Per Share information:				
Basic net income per common share	\$ 0.05	\$ 0.09	\$ 0.08	\$ 0.08
Diluted net income per common share	\$ 0.04	\$ 0.09	\$ 0.08	\$ 0.08
Weighted average shares used in computing basic net income per common share	22,205	22,213	22,209	19,035
Weighted average shares used in computing diluted net income per common share	24,232	22,213	22,444	19,035

See accompanying notes

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

	Six Months Ended December 31,	
	2009	2008
Cash flows from operating activities:		
Net income	\$ 1,848	\$ 1,447
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	301	409
Loss on disposal of fixed assets		7
Stock-based compensation	132	172
Provisions for doubtful accounts and sales returns	(17)	163
Amortization of debt issuance costs	42	
Accrued interest and amortization of discount on related party notes payable	502	700
Changes in operating assets and liabilities:		
Accounts receivable	(433)	(4,032)
Prepaid and other current assets	56	263
Other assets	6	(37)
Accounts payable	(168)	(541)
Accrued compensation	(624)	859
Accrued liabilities	(465)	24
Deferred revenue	916	728
Other long term liabilities	(1)	(36)
Net cash provided by operating activities	2,095	126
Cash flows from investing activities:		
Purchases of property and equipment	(277)	(234)
Proceeds from sales of fixed assets		14
Net cash used in investing activities	(277)	(220)
Cash flows from financing activities:		
Payments on borrowings	(3,062)	(55)
Payments on capital lease	(87)	
Payments to repurchase stock	(44)	
Proceeds from borrowings		63
Net proceeds from issuance of common stock	5	
Net cash provided by (used in) financing activities	(3,188)	8
Effect of change in exchange rates on cash and cash equivalents	(171)	101
Net increase (decrease) in cash and cash equivalents	(1,541)	15
Cash and cash equivalents at beginning of period	7,511	3,790

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Cash and cash equivalents at end of period	\$ 5,970	\$ 3,805
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Supplemental cash flow disclosures:

Cash paid for interest	\$ 16	\$ 142
Cash paid for taxes	\$ 94	\$

See accompanying notes

Table of Contents**eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Note 1. Organization, Nature of Business, Basis of Presentation and Liquidity**

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

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

Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP), have been condensed or omitted pursuant to such rules and regulations. In our opinion, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our financial position, results of operations and cash flows for the periods presented. These financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2009, included in our Annual Report on Form 10-K. The condensed consolidated balance sheet at June 30, 2009 has been derived from audited financial statements as of that date but does not include all the information and footnotes required by GAAP for complete financial statements. The results of our operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending June 30, 2010. We have evaluated material subsequent events requiring recognition or disclosure through February 12, 2010 the date of issuance of our consolidated financial statements and there were none.

Reclassification

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

For the three months ended December 31, 2008, to conform to the fiscal 2010 classifications, we reclassified \$3.6 million to recurring services revenue and \$2.4 million to professional services revenue from the support and services revenue of \$6.1 million. In addition, we reclassified \$1.1 million to cost of recurring services and \$1.5 million to cost of professional services from the cost of support and services of \$2.6 million.

For the six months ended December 31, 2008, to conform to the fiscal 2010 classifications, we reclassified \$7.7 million to recurring services revenue and \$4.9 million to professional services revenue from the support and services revenue of \$12.6 million. In addition, we reclassified \$2.2 million to cost of recurring services and \$3.2 million to cost of professional services from the cost of support and services of \$5.4 million. The table below summarizes the information (in thousands).

	Three months ended December 31, 2008		Six months ended December 31, 2008	
	Reported fiscal year 2010	Reported fiscal year 2009	Reported fiscal year 2010	Reported fiscal year 2009
Recurring services revenue	\$ 3,637	\$	\$ 7,748	\$
Professional services revenue	2,423		4,852	
Support and services revenue		6,060		12,600
Total revenue reclassification	\$ 6,060	\$ 6,060	\$ 12,600	\$ 12,600

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Cost of recurring services	\$ 1,078	\$	\$ 2,204	\$
Cost of professional services	1,501		3,216	
Cost of support and services		2,579		5,420
Total cost of revenue reclassification	\$ 2,579	\$	2,579	\$ 5,420
			\$ 5,420	\$ 5,420

Table of Contents

eGAIN COMMUNICATIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Change in Estimate

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

Note 2. Software Revenue Recognition

Revenue Recognition

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

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

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

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

Table of Contents

eGAIN COMMUNICATIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

License Revenue

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

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

We periodically sell to resellers. License sales to resellers as a percentage of total revenue was approximately 5% and 21% for the three months ended December 31, 2009 and 2008, respectively. License sales to resellers as a percentage of total revenue was approximately 6% and 20% for the six months ended December 31, 2009 and 2008, respectively. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller's plans to sell the software, the reseller's financial status, our past experience with the particular reseller and whether there are any return provisions, price protection or other allowances. Historically sales to resellers have not included any return provisions, price protections, or other allowances.

Hosting Services Revenue

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

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

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

Maintenance and Support Revenue

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

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

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

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

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

Note 3. Stock-Based Compensation

The stock-based compensation expense in our condensed consolidated statement of operations for the three months ended December 31, 2009 and 2008 was \$77,000 and \$89,000, respectively, and for the six months ended December 31, 2009 and 2008 was \$132,000 and \$172,000, respectively.

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

	Three months ended December 31,		Six months ended December 31,	
	2009	2008	2009	2008
Cost of professional and recurring services	\$ 11	\$ 7	\$ 19	\$ 15
Research and development	23	11	40	25
Sales and marketing	16	6	28	15
General and administrative	27	65	45	117
Total stock-based compensation expense	\$ 77	\$ 89	\$ 132	\$ 172

We utilized the Black-Scholes valuation model for estimating the fair value of the stock-based compensation of options granted. All shares of our common stock issued pursuant to our stock option plans are only issued out of an authorized reserve of shares of common stock which were previously registered on Form S-8. Options granted during the three months ended December 31, 2009 and 2008, were 21,000 and 54,000, with a weighted-average fair value of \$0.70 and \$0.30, respectively. Options granted during the six months ended December 31, 2009 and 2008 were 936,200 and 84,000, with a weighted-average fair value of \$0.52 and \$0.37, respectively, using the following assumptions:

	Three months ended December 31,		Six months ended December 31,	
	2009	2008	2009	2008
Dividend yield				
Expected volatility	80%	80%	80%	80%
Average risk-free interest rate	2.64%	2.41%	2.79%	2.72%

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Expected life (in years)

6.25

6.25

6.25

6.25

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

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

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

Total compensation cost of all options granted but not yet vested as of December 31, 2009 was \$279,000, which is expected to be recognized over the weighted average period of 1.70 years. There were 8,416 options exercised for the three and six months ended December 31, 2009 and there were no options exercised for the three and six months ended December 31, 2008.

Note 4. Net Income Per Common Share

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

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

	Three months ended December 31,		Six months ended December 31	
	2009	2008	2009	2008
Net income applicable to common stockholders	\$ 1,061	\$ 1,969	\$ 1,848	\$ 1,447
Basic net income per common share	\$ 0.05	\$ 0.09	\$ 0.08	\$ 0.08
Weighted-average common shares used in computing basic net income per common share	22,205	22,213	22,209	19,035
Effect of dilutive options and warrants	2,027		235	
Weighted-average common shares used in computing diluted net income per common share	24,232	22,213	22,444	19,035
Diluted net income per common share	\$ 0.04	\$ 0.09	\$ 0.08	\$ 0.08

Outstanding options and warrants to purchase 2,986,967 and 4,239,989 shares of common stock for the three months ended December 31, 2009 and 2008, respectively, and 4,778,763 and 4,239,714 for the six months ended December 31, 2009 and 2008, respectively, were not included in the computation of diluted net income per common share due to their anti-dilutive effect. Such securities could have a dilutive effect in future periods.

Note 5. Comprehensive Income

We report comprehensive income and its components in accordance with ASC Topic 220, *Comprehensive Income*. Under the accounting standards comprehensive income includes all changes in equity during a period except those resulting from investments by or distributions to owners. The comprehensive income was \$975,000 and \$1.8 million for the three and six months ended December 31, 2009, respectively, as compared to a comprehensive income of \$1.9 million and \$1.4 million for the comparable year-ago periods. Accumulated other comprehensive income/(loss) presented in the accompanying consolidated balance sheets at December 31, 2009 consists solely of accumulated foreign currency translation adjustments.

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The table below summarizes the comprehensive income (unaudited, in thousands):

	Three months ended		Six months ended	
	December 31,		December 31,	
	2009	2008	2009	2008
Net income	\$ 1,061	\$ 1,969	\$ 1,848	\$ 1,447
Foreign currency translation adjustments	(86)	(100)	(74)	(55)
Comprehensive income	\$ 975	\$ 1,869	\$ 1,774	\$ 1,392

Table of Contents**eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6. Segment Information**

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Total Revenue:				
North America	\$ 3,893	\$ 3,726	\$ 8,039	\$ 7,867
Europe	4,372	5,812	8,168	9,739
Asia Pacific	47	51	80	122
	\$ 8,312	\$ 9,589	\$ 16,287	\$ 17,728
Operating Income/ (Loss):				
North America	\$ 346	\$ (62)	\$ 1,091	\$ 107
Europe	1,631	2,644	2,609	3,240
Asia Pacific*	(579)	(715)	(1,232)	(1,555)
	\$ 1,398	\$ 1,867	\$ 2,468	\$ 1,792

* Includes costs associated with corporate support.

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

	Three Months Ended December 31,	
	2009	2008
North America	\$ 7,095	\$ 4,011
Europe	4,568	6,298
Asia Pacific	811	826
	\$ 12,474	\$ 11,135

The following table provides revenue information for the three and six months ended December 31, 2009 and 2008, respectively, (unaudited, in thousands):

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	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Revenue :				
License	\$ 2,516	\$ 3,529	\$ 4,470	\$ 5,128
Recurring services	4,292	3,637	8,276	7,748
Professional services	1,504	2,423	3,541	4,852
	\$ 8,312	\$ 9,589	\$ 16,287	\$ 17,728

For the three months ended December 31, 2009, there were two customers that accounted for 14% and 15% of total revenue respectively, and there were two customers that accounted for 21% and 11% of total revenue respectively, in the comparable year-ago quarter. For the six months ended December 31, 2009, there was one customer that accounted for 16% of total revenue and there was one customer that accounted for 11% of total revenue for the same period last year.

Table of Contents**eGAIN COMMUNICATIONS CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 7. Related Party Notes Payable**

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

On October 31, 2003, we entered into an amendment to the 2002 Agreement with Mr. Roy, pursuant to which he loaned to us an additional \$2.0 million, evidenced by a subordinated secured promissory note, the 2003 Note, and received additional warrants to purchase up to 128,766 shares at \$3.88 per share. These warrants expired in October 2008. In connection with this additional loan we recorded \$1.8 million in related party notes payable and \$195,000 of discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the five year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of three years, an expected stock price volatility of 75%, a risk free interest rate of 2.25%, and a dividend yield of 0%. These notes were amended and restated on June 29, 2007 and on September 24, 2008.

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

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

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

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0%. In addition, we recorded the \$3.1 million gain on the Note Conversion as a deemed contribution to capital since the lenders are related parties. The principal and interest due on the loans as of December 31, 2009 was \$8.2 million, and warrants to purchase 1,525,515 shares of common stock issued were vested and outstanding.

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

On June 27, 2008, we entered into a Loan and Security Agreement (the Bridge Bank Credit Facility) with Bridge Bank, N. A., as may be amended from time to time (Bridge Bank). Our obligations under the Bridge Bank Credit Facility are secured by a lien on our assets including intellectual property. Holders of certain outstanding secured promissory notes have subordinated their security interests to those of the Bridge Bank pursuant to a Subordination Agreement dated as of June 24, 2008. The Bridge Bank Credit Facility provides for the advance of up to the lesser of \$3.0 million under a revolving line of credit, or the sum of (i) 80% of certain qualified receivables, (ii) 75% of cash on deposit with Bridge Bank, (iii) the lesser of \$1.5 million or 60% of eligible unbilled license and hosting contracts, less (iv) the amount of any outstanding obligations to Bridge Bank. The revolving credit line has a maturity date of June 24, 2010 and bears interest at a rate of prime plus 0.5% per annum, provided that we maintain an average monthly cash balance of \$1 million (the Required Balance), or the rate will be increased to a rate of prime plus 1%. As of December 31, 2009 there was no outstanding balance under the Bridge Bank Credit Facility. The Bridge Bank Credit Facility also provides up to \$300,000 to pay off existing obligations to another bank (the Bridge Bank Term Loan) and is payable in thirty six equal monthly payments of principal and interest. As of December 31, 2009, the amount outstanding under the Bridge Bank Term Loan Line was \$142,000 with an interest rate of 4.75%. In addition, the Bridge Bank Credit Facility allows for an advance of up to \$300,000 to be used to finance equipment purchases (the Bridge Bank Equipment Line) which must be repaid in 30 equal monthly payments of principal and interest, commencing on the tenth day of the first month following the date the advance is made, and continuing for each succeeding month. Terms for both the Bridge Bank Term Loan and the Bridge Bank Equipment Line include: (i) interest that accrues from the date of each advance at a rate of prime plus 1% per annum, provided that we maintain the Required Balance, or the rate will be increased to a rate of prime plus 1.5% (ii) once repaid, amounts cannot be re-borrowed and (iii) a maturity date of June 24, 2011. As of December 31, 2009, the balance under the Bridge Bank Equipment Line was \$35,000, and the interest rate was 4.75%. There are financial covenants under this Bridge Bank Credit Facility that requires us to meet certain revenue performance and net loss excluding non-cash charges requirements. If we fail to comply with our covenants under the Bridge Bank Credit Facility, Bridge Bank can declare any outstanding amounts immediately due and payable and cease advancing money or extending credit to us. As of December 31, 2009, we were compliant with these financial covenants. In connection with the credit facility Bridge Bank received warrants to purchase 73,889 shares of our common stock at an exercise price equal to \$0.90 per share. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of three years, an expected stock price volatility of 80%, a risk free interest rate of 3.14%, and a dividend yield of 0%. The warrants are revalued each quarter and the fair value of \$0.59 at December 31, 2009 was calculated using the market price of \$1.04. The increase of fair value of \$12,000 was included within other income. The warrants contain a put option right that could be exercised by Bridge Bank upon the expiration date of June 24, 2011, or the early termination of the loan, a change in control, a sale of substantially all our equity ownership or an uncured event of default.

The following table summarizes debt maturities for the next five years and thereafter on an aggregate basis at December 31, 2009.

	Bank Borrowings
December 31, 2010	\$ 125
December 31, 2011	52
December 31, 2012	
December 31, 2013	
December 31, 2014	
Thereafter	
Total Bank Borrowings	\$ 177

Note 9. Income Taxes

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

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

Table of Contents

eGAIN COMMUNICATIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Commitments

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

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

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

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

Note 11. New Accounting Pronouncements

In October 2009, the FASB issued new accounting guidance for certain revenue arrangements that include software elements. The guidance focuses on determining which arrangements are within the scope of the software revenue guidance in Topic 985 and which are not; excluding tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality from its scope. This update is effective for fiscal years beginning on or after June 15, 2010; however, early adoption is permitted for revenue arrangements entered into or materially modified. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.

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

In January 2010, the FASB issued Accounting Standards Update No. 2010-06 (ASU 2010-06), *Fair Value Measurement and Disclosures* which amends ASC Topic 820, adding new requirements for disclosures for levels 1 and 2, separate disclosures and purchases, sales, issuances, and settlements relating to Level 3 measurements and clarification of existing fair value disclosures. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to provide Level 3 activity of purchases, sales, issuances, and

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settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010 (our fiscal year 2011); early adoption is permitted. We are currently evaluating the impact of adopting ASU 2010-06 on our consolidated financial statements.

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

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

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

Note 13. Fair Value Measurement.

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

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

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

Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets.
 Level 2 instrument valuations are obtained from readily-available pricing sources for comparable instruments.
 Level 3 instrument valuations are obtained without observable market value and require a high level of judgment to determine the fair value.
 The following table summarizes our financial assets and liabilities measured at Level 1 fair value on a recurring basis as of December 31, 2009 (unaudited, in thousands):

	Balance as of December 31, 2009	Quoted Prices Active Markets of Identical Assets (Level 1)
Assets:		
Cash equivalents	\$ 3,231	\$ 3,231
Liabilities		
	\$	\$

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

Note 14. Share Repurchase Program

On September 14, 2009, we announced that our board of directors has approved a repurchase program under which it may begin purchasing up to 1,000,000 shares of its common stock. The duration of the repurchase program is open-ended. Under the program, we could purchase shares of common stock from time to time through the open market and privately negotiated transactions at prices deemed appropriate by management. The repurchase will be funded by cash on hand. As of December 31, 2009, we had repurchased and retired 43,050 shares at an average price of \$1.03 per share.

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

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

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

Overview

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

Critical Accounting Policies and Estimates

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

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

Table of Contents**Results of Operations**

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

	Three Months Ended		Six Months Ended	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
Revenue:				
License	30%	37%	27%	29%
Recurring services	52%	38%	51%	44%
Professional services	18%	25%	22%	27%
Total revenue	100%	100%	100%	100%
Cost of license	1%	0%	1%	0%
Cost of recurring services	14%	11%	14%	13%
Cost of professional services	16%	16%	16%	18%
Gross profit	69%	73%	69%	69%
Operating costs and expenses:				
Research and development	15%	15%	15%	16%
Sales and marketing	28%	30%	30%	32%
General and administrative	9%	9%	9%	11%
Total operating costs and expenses	52%	54%	54%	59%
Income from operations	17%	19%	15%	10%

Revenue

Total revenue decreased 13% to \$8.3 million in the quarter ended December 31, 2009 from \$9.6 million in the quarter ended December 31, 2008. New hosting transactions increased 111% for the quarter ending December 31, 2009 compared to the comparable year-ago quarter. During the three months ended December 31, 2009, there were two customers that accounted for 14% and 15% of total revenue, respectively, and there were two customers that accounted for 21% and 11% of total revenue, respectively, in the comparable year-ago quarter. Total revenue for the six months ended December 31, 2009 decreased 8% to \$16.3 million, compared to \$17.7 million in the same period last year. New hosting transactions increased 45% for the six months ending December 31, 2009 compared to the same period last year. During the six months ended December 31, 2009, there was one customer that accounted for 16% of total revenue and there was one customer that accounted for 11% of total revenue in the same period last year. To measure the impact of foreign exchange rate fluctuation, we recalculate current period results using the comparable prior period exchange rate. The impact of the foreign exchange fluctuation between the U.S. dollar and European currencies resulted in an increase of \$354,000 in total revenue for the three months ended December 31, 2009 as compared to the comparable year-ago quarter. The impact of the foreign exchange fluctuation on the total revenue for the six months ended December 31, 2009 was minimal as compared to the same period last year.

There is general unpredictability of the length of our current sales cycles, the timing of revenue recognition on more complex license transactions and seasonal buying patterns. This unpredictability has increased in the last two years due to the global economic slowdown and the increased volatility of the value of the U.K. pound and Euro in relation to the U.S. dollar. Also, because we offer a hybrid delivery model, the mix of new hosting and license business in a quarter could also have an impact on our revenue in a particular quarter. We are continuing to see the mix of license and hosting business fluctuates from quarter to quarter. The value of new hosting transactions, as a percentage of combined new hosting and license business excluding the Cisco OEM agreement was 43% for the quarter ended December 31, 2009, compared to 16% for the comparable year-ago quarter. The value of new hosting transactions, as a percentage of combined new hosting and license business excluding the Cisco OEM agreement was 53% for the six months ended December 31, 2009, compared to 31% for the same period last year. For license transactions, the license revenue amount is generally recognized in the quarter which delivery and acceptance of our software takes place whereas, for hosting transactions, hosting revenue is recognized ratably over the term of the hosting contract, which is typically one to two years. As a result, our total revenue may increase or decrease in future quarters as a result of the timing and mix of license and hosting transactions.

Table of Contents*License Revenue*

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2009	2008	Change	%	2009	2008	Change	%
Revenue:								
License	\$ 2,516	\$ 3,529	\$ (1,013)	(29)%	\$ 4,470	\$ 5,128	\$ (658)	(13)%
Percentage of total revenue	30%	37%			27%	29%		

License revenue decreased 29% to \$2.5 million in the quarter ended December 31, 2009 from \$3.5 million in the comparable year-ago quarter. License revenue in the quarter was positively impacted by \$280,000 due to the strengthening of the European currencies in which certain licenses were denominated against the U.S. dollar. The license revenue for the quarter included one large transaction of \$800,000 compared to a total of \$3.3 million from three large transactions in the comparable year-ago quarter. License revenue represented 30% and 37% of total revenue for the quarters ended December 31, 2009 and 2008, respectively.

License revenue decreased 13% to \$4.5 million for the six months ended December 31, 2009 from \$5.1 million in the same period last year. License revenue for the six months ended December 31, 2009 was positively impacted by \$299,000 due to the strengthening of the Euro in which certain licenses were denominated against the U.S. dollar. License revenue represented 24% and 29% of total revenue for the six months ended December 31, 2009 and 2008, respectively.

Given the general unpredictability of the length of current sales cycles, the mix between hosting and license business, the uncertainty in the global economy and the recent volatility of the value of the U.K. pound and Euro in relation to the U.S. dollar, license revenue may increase or decrease in future periods but we anticipate total license revenue to increase in fiscal year 2010.

Recurring Services Revenue

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2009	2008	Change	%	2009	2008	Change	%
Revenue:								
Hosting services	\$ 1,977	\$ 1,616	\$ 361	22%	\$ 3,656	\$ 3,236	\$ 420	13%
Maintenance and support services	2,315	2,021	294	15%	4,620	4,512	108	2%
Total recurring services	\$ 4,292	\$ 3,637	\$ 655	18%	\$ 8,276	\$ 7,748	\$ 528	7%
Percentage of total revenue	52%	38%			51%	44%		

Recurring services revenue includes hosting and software maintenance and support services. Software maintenance and support services consist of technical support and software upgrades and enhancements. Recurring services revenue increased 18% to \$4.3 million in the quarter ended December 31, 2009 from \$3.6 million for the comparable year-ago quarter. Recurring services revenue represented 52% and 38% of total revenue for the quarters ended December 31, 2009 and 2008, respectively. Recurring services revenue increased 7% to \$8.3 million in the six months ended December 31, 2009 from \$7.7 million for the same period last year. Recurring services revenue represented 51% and 44% of total revenue for the six months ended December 31, 2009 and 2008, respectively.

Hosting revenue increased 22% to \$2.0 million in the quarter ended December 31, 2009 from the comparable year-ago quarter. The impact from the foreign currency fluctuations on hosting revenue was minimal for the quarter ended December 31 2009. The increase was primarily due to two new hosting contracts totaling approximately \$2.5 million entered into in the last two fiscal quarters which began generating hosting revenue in fiscal year 2010.

Hosting revenue increased 13% to \$3.7 million in the six months ended December 31, 2009 from the same period last year. Hosting revenue was negatively impacted by \$112,000 due to the weakening of the British pound against the U.S. dollar. The increase was primarily due to the increased size of new hosting contracts with larger enterprises. Excluding the impact from any further foreign currency fluctuations, we expect hosting revenue to increase in future periods based upon current renewal rates for existing hosted customers, the new hosting agreements entered into in recent quarters that we expect to start generating hosting revenue in future quarters and the increased interest we are seeing for our hosting or on demand services from our target customers.

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Maintenance and support services revenue increased 15% to \$2.3 million in the quarter ended December 31, 2009 from \$2.0 million in the comparable year-ago quarter. The impact from the foreign currency fluctuations on maintenance and support service revenue was minimal for the quarter ended December 31, 2009. The increase in maintenance and support service revenue was primarily due to the improved renewal rates for existing support customers and increased license revenue over the last few quarters.

Table of Contents

Maintenance and support services revenue increased 2% to \$4.6 million in the six months ended December 31, 2009 from the same period last year. Maintenance and support services revenue was negatively impacted by \$149,000 due to the weakening of the British pound against the U.S. dollar. The increase in maintenance and support services revenue was primarily due to the improved renewal rates for existing support customers and increased license revenue. Excluding the impact from any future foreign currency fluctuations, we expect maintenance and support revenue to increase in future periods based upon the current renewal rates for existing maintenance and support customers and the projected levels of new license sales.

Professional Services Revenue

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2009	2008	Change	%	2009	2008	Change	%
Revenue:								
Professional services	\$ 1,504	\$ 2,423	\$ (919)	(38)%	\$ 3,541	\$ 4,852	\$ (1,311)	(27)%
Percentage of total revenue	18%	25%			22%	27%		

Professional services revenue decreased 38% to \$1.5 million in the quarter ended December 31, 2009 from \$2.4 million in the comparable year-ago quarter. The impact from the foreign currency fluctuations on professional service revenue was minimal for the quarter ended December 31, 2009. The decrease was primarily due to a decrease in professional services revenue from the Cisco OEM agreement. There was no additional revenue recorded for the profit margin from the Cisco OEM agreement in the quarter ended December 31, 2009 compared to \$480,000 in the comparable year-ago quarter. Professional services revenue represented 18% and 25% of total revenue for the quarters ended December 31, 2009 and 2008, respectively.

Professional services revenue decreased 27% to \$3.5 million in the six months ended December 31, 2009 from \$4.9 million in the same period last year. Professional services revenue was negatively impacted by \$64,000 due to the weakening of the British pound against the U.S. dollar. The decrease for the six months ended December 31, 2009 was primarily due to a decrease in professional services revenue from the Cisco OEM agreement. In the quarter ended September 30, 2009, we signed an amendment to the Cisco OEM agreement, with an effective date of July 27, 2009. Based upon certain changes, including pricing for support, we no longer estimate the minimum profit and record the associated revenue as professional services for the Cisco OEM agreement from the effective date of the amendment. Instead, we will begin to record royalties earned under the Cisco OEM agreement as license revenue. In the quarter ended September 30, 2009, but prior to the effective date of the amendment we increased the minimum margin to 48%. As a result, we recorded a revenue increase of \$420,000 and an increase to our net income by \$0.02 per share for the six months ended December 31, 2009 compared to a revenue increase of \$1.2 million and an increase to our net income by \$0.01 per share for the same period last year.

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

Cost of Revenue

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2009	2008	Change	%	2009	2008	Change	%
Cost of Revenue								