RAINING DATA CORP
Form 10KSB
July 24, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

(Mark one)

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

For the fiscal year ended March 31, 2006

or

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

For the transition period from to .

Commission file number 0-16449

RAINING DATA CORPORATION

(Name of Small Business Issuer in Its Charter)

Delaware	**94-3046892**
(State of Incorporation)	(I.R.S. Employer ID. No.)
25A Technology Drive, Irvine, California	**92618**
(Address of Principal Executive Offices)	(Zip Code)

(949) 442-4400
(Issuer s Telephone Number, Including Area Code)

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
None	N/A

Securities registered under Section 12(g) of the Exchange Act:
Common Stock, $0.10 par value

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 o No x

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. x

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

The Registrant s revenues for the fiscal year ended March 31, 2006 were $20.3 million.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was $25,549,055 on May 31, 2006 based on the closing sale price of such stock on that date.

As of May 31, 2006, the Registrant had 20,644,976 shares of its common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

Transitional Small Business Disclosure Format (check one): Yes o No x

RAINING DATA CORPORATION

FISCAL YEAR 2006 FORM 10-KSB ANNUAL REPORT

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PART I

IMPORTANT NOTE ABOUT FORWARD-LOOKING STATEMENTS This Form 10-KSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements may generally be identified by the use of such words as expect, anticipate, believe, intend, plan, will, or shall, or the negative of those ter based these forward-looking statements on our current expectations and projections about future events. Forward-looking statements involve certain risks and uncertainties and actual results may differ materially from those discussed in any such statement. Factors that could cause actual results to differ materially from such forward-looking statements include the risks described under the heading Risk Factors in Part II, Item 6 of this Form 10-KSB and elsewhere in this Form 10-KSB. The forward-looking statements contained in this Form 10-KSB include, but are not limited to statements about the following: (1) our future success, (2) our research and development efforts, (3) our future operating results and cash flow, (4) our competitive ability and position, (5) the markets in which we operate, (6) our revenue, (7) cost of license revenue and cost of service revenue, (8) our selling and marketing costs, (9) our general and administrative costs, (10) stock-based compensation expense and the impact of adopting SFAS 123R, (11) the possibility that we may seek to take advantage of opportunities in the equity and capital markets (12) our belief that our existing cash balances combined with our cash flow from operating activities will be sufficient to meet our operating and capital expenditure requirements for the remainder of the fiscal year ending March 31, 2007 and through the foreseeable future, (13) our belief that our credit facility is not required for liquidity purposes or to meet our cash flow needs for the foreseeable future and (14) our focus on the continued development and enhancement of the TigerLogic XDMS product line, identification of new and emerging application areas and discussions with channel partners for the sale and distribution of the TigerLogic product line. All forward-looking statements in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement.

ITEM 1. *Description of Business*

Restatement

The filing of this Annual Report on Form 10-KSB for the year ended March 31, 2006 was delayed to permit us to restate our consolidated financial statements for the years ended March 31, 2004 and 2005. The restatement adjustments relate to an error in adopting SFAS No. 142, *Goodwill and Other Intangible Assets,* in 2003, and an error in accounting for foreign net operating loss carryforwards acquired in a business combination. For a more complete description of the current restatement and the impact on specific periods, refer to Note 1 Restatement in notes to consolidated financial statements contained in this Form 10-KSB.

Overview

We were incorporated in the State of Delaware in August 1987. We were originally incorporated as Blyth Holdings, Inc. and our name was changed to Omnis Technology Corporation in September 1997. Effective December 1, 2000, we completed the acquisition of PickAx, Inc., a Delaware corporation (PickAx). Concurrent with the acquisition, we changed our name to Raining Data Corporation.

Products

Our principal business is the design, development, sale and support of software infrastructure. Our products allow customers to create and enhance flexible software applications for their own needs and our software may be categorized into three product lines: XML data management systems (XDMS), Multi-dimensional database management systems (MDMS), and Rapid Application Development (RAD) software tools.

Many of our products are based on the Pick Universal Data Model (Pick UDM), which we created, and are capable of handling data from many sources. The Pick UDM is a core component across the XDMS and MDMS product lines.

Beginning in 2001, we began an extensive effort to leverage our time-proven Pick UDM and core intellectual property to create an enterprise class XML database management system for the emerging XML market, the growing need for native XML data stores and the ability to handle structured and unstructured data. This significant investment of time and resources resulted in the TigerLogic XDMS product line. We are focused on the continued development and enhancement of this product line, identification of new and emerging application areas and discussions with channel partners for the sale and distribution of the TigerLogic product line.

TigerLogic XDMS

TigerLogic XML Data Management Server provides high-performance management and query of XML data by leveraging the time-proven Pick UDM. TigerLogic also enables the ability to query external data sources as if they were one logical database and maintains referential integrity across data sources. TigerLogic s patent-pending XML Indexing and Profiling technology enables it to access XML data via XQuery between 10x to 150x faster in internal tests than relational databases, XML repositories or XML Index and Search engines. TigerLogic provides XML, Java, WSDL and SOAP compatibility for simplified plug-in and integration with development environments of choice.

TigerLogic provides an extensible and flexible development and deployment environment. Unlike other XML data management alternatives, TigerLogic XDMS does not need to know the schema or structure of data before processing and storing it. We believe the ability to make XML schemas optional is a vital innovation because the structures of operational systems frequently change, and mapping schemas for the purpose of linking to a new data source is both difficult and time-consuming. The system also enables support for schema versioning, which is critical when addressing evolving standards and XML schemas. The General Availability Release of TigerLogic XDMS version 2.1, which included many feature enhancements and the full implementation of our XQuery engine, was released in May 2005, and Version 2.5, which included platform support for Linux in addition to Windows and Solaris, was released in October 2005. In September 2005, we announced our first commercial OEM agreement for TigerLogic XDMS.

Multi-dimensional Databases (MDMS)

The MDMS product line consists principally of the D3 Data Base Management System (D3), which runs on many operating systems such as IBM AIX, Linux and Windows NT. D3 allows application programmers to create new business solution software in less time than it normally takes in many other environments. This can translate into lower costs for the developer, lower software prices for the customer and reduced costs of ownership for both the developer and end user. Our MDMS products also include mvEnterprise, a scalable multi-dimensional database solution that allows the user to leverage the capabilities of the UNIX operating system, and mvBase, a multi-dimensional database solution that runs on all Windows platforms.

MDMS components include the Pick Data Provider for .Net (PDP) and our Pick Reporting Services Connector. The PDP component for the Microsoft .NET Framework is tightly integrated with Microsoft Visual Studio .NET. It allows software developers using IBM s Universe and Unidata databases and our D3 database platform to build client/server applications, Web applications or Web services using any of the languages and technologies that run on the Microsoft .NET Framework, such as Microsoft ASP.NET, Visual Basic .NET, Visual C# .NET and Visual J# .NET. Our Pick Reporting Services Connector enables a data connection that allows Pick database users to unlock the benefits of Microsoft Reporting Services to take advantage of a comprehensive, server-based reporting solution that can author, manage, and deliver both paper-oriented and interactive, Web-based reports. This solution also allows access to IBM UniVerse, IBM UniData and Pick D3 data. Our MDMS products also include mvEnterprise, a scalable multi-dimensional database solution that allows the user to leverage the capabilities of the UNIX operating system, and mvBase, a multi-dimensional database solution that runs on all Windows platforms.

Rapid Application Development (RAD) Tools

Our RAD products support the full life cycle of software application development and are designed for rapid prototyping, development and deployment of graphical user interface (GUI) client/server and Web applications. The RAD products include Omnis Studio, Omnis Studio for SAP and Omnis Classic, and are object-oriented and component-based, providing the ability to deploy applications on operating system platforms such as Windows, Unix and Linux, as well as database environments such as MySQL, Oracle, DB2, Sybase, Microsoft SQL Server and other Open Data Base Connectivity (ODBC) compatible database management systems.

Technical Support

Our products are used by our customers to build and deploy applications that may become a critical component of their business operations. As a result, continuing to provide customer technical support services is an important element of our business strategy. Customers who participate in our support programs receive periodic maintenance releases on a when-and-if available basis and direct technical support when required.

Sales and Distribution

In the United States, we sell our products through established distribution channels consisting of OEMs, system integrators, specialized vertical application software developers and consulting organizations. We also sell our products directly through our sales personnel to end user organizations. Outside the United States, we maintain direct sales offices in the United Kingdom, France and Germany. Approximately 31% of our revenue came from sales through our offices located outside the United States for the year ended March 31, 2006.

We sell our products in U.S. Dollars in North America, British Pounds Sterling in the United Kingdom and Euros in France and Germany. Because we recognize revenue and expense in these various currencies but report our financial results in U.S. Dollars, changes in exchange rates may cause variances in our period-to-period revenue and results of operations in future periods. Recorded foreign exchange gains and losses have not been material to our performance to date.

We license our software on a per-CPU, per-server, per-port or per-user basis. Therefore, the addition of CPU s, servers, ports or users to existing systems increases our revenue from our installed base of licenses. In addition to software products, we provide continuing maintenance and other services to our customers, including professional services, technical support and training to help plan, analyze, implement and maintain application software based on our products.

Customers

Our customers may be classified into two general categories:

- Independent Software Vendors and Software Developers. The majority of our revenue is derived from independent software vendors, which typically write their own vertical application software that they sell as a complete package to end user customers. This category includes value added resellers (VARs) and software-consulting companies that provide contract programming services to their customers.

- Corporate Information Technology (IT) Departments.

For each of the three years ended March 31, 2006, 2005 and 2004, no single customer accounted for more than 10% of our revenue.

Research and Development

We have devoted significant resources to the research and development of our products and technology. We believe that our future success will depend largely on a strong development effort with respect to both our existing and new products. These development efforts have resulted in updates and upgrades to existing MDMS and RAD products and the launch of new products including the XDMS product line. New product releases in all of our product lines are currently in progress. We expect to continue our research and development efforts in all product lines for the foreseeable future. We intend for these efforts to improve our future operating results and increase cash flow. However, such efforts may not result in additional new products or revenue, and we can make no assurances that the recently announced products or future products will be successful. We spent $9.6 million, $7.5 million and $7.7 million on research and development in fiscal years 2006, 2005 and 2004, respectively.

Competition

The application development tools software market is rapidly changing and intensely competitive. Our MDMS products compete with products developed by companies such as Oracle, Microsoft and IBM. Our RAD products currently encounter competition from several direct competitors, including Microsoft, and competing development environments, including JAVA. Competition is developing and evolving in the XML market for which our XDMS products are intended. Companies that do or are expected to compete in this market include Oracle, IBM, Microsoft and Sybase, as well as a number of smaller companies with products that directly and indirectly compete with our XDMS products. Most of our competitors have significantly more financial, technical, marketing and other resources than we do. As a result, these competitors may be able to respond more quickly to new or emerging technologies, evolving markets and changes in customer requirements, and may devote greater resources to the development, promotion and sale of their products.

We believe that our ability to compete in the various MDMS, RAD, and XDMS markets depends on factors both within and outside our control, including the timing of release, performance and price of new products developed by both us and our competitors. Although we believe that we currently compete favorably with respect to most of these factors, we may not be able to maintain our competitive position against current and potential competitors, especially those with greater resources.

Intellectual Property and Other Proprietary Rights

We rely primarily on a combination of trade secret, copyright and trademark laws and contractual provisions to protect our intellectual property and proprietary rights. Our trademarks include Raining Data, Pick, TigerLogic, D3, Omnis, Omnis Studio, mvEnterprise, mvBase, and mvDesigner, among others. We also have one pending U.S. patent application as of March 31, 2006.

We license our products to end users on a right to use basis pursuant to a perpetual license agreement that restricts use of products to a specified number of users. We generally rely on click-wrap licenses that become effective when a customer downloads and installs the software on its system. In order to retain exclusive ownership rights to our software and technology, we generally provide our software in object code only, with contractual restrictions on copying, disclosure, and transferability. There can be no assurance that these protections will be adequate, or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology.

Backlog

We generally ship software products as orders are received and have historically operated with little backlog. As a result, our license revenue in any given quarter is dependent upon orders received and product shipped during the quarter. Historically, there has been a short cycle between receipt of an order and shipment. Consequently, we do not believe that our backlog as of any particular date is meaningful.

Employees

At March 31, 2006, we had 133 employees worldwide of which 100 were in the United States and 33 were in our international offices. Of the 133 employees, 131 are full-time and approximately 50% are in research and development, 15% in technical support, 20% in sales and marketing and 15% in general and administrative functions.

Executive Officers

The following sets forth certain information regarding our executive officers as of March 31, 2006:

Name	Age	Position(s)
Carlton H. Baab	48	President, Chief Executive Officer and Director
Brian C. Bezdek	35	Chief Financial Officer and Secretary
Mark Allen	61	Vice President, Worldwide Customer Support & Training
Gwyneth M. Gibbs	62	Vice President, European Operations
Soheil Raissi	50	Vice President, Product Development & Professional Services
Ajay Ramachandran	32	CTO & Vice President, XML-Centric Applications & Platforms

Mr. Baab joined us as President and Chief Executive Officer in August 2001 and was appointed as a member of our Board of Directors in December 2001. From May 2001 to August 2001, Mr. Baab served as a Managing Principal of Astoria Capital Management (ACM), a Securities and Exchange Commission (the SEC) registered investment advisor and a General Partner of Astoria Capital Partners, L.P. (ACP), a significant stockholder of ours. In August 2001, Mr. Baab took a formal leave of absence from ACM to join us. From March 2000 to April 2001, Mr. Baab was the Vice President of Finance and Chief Financial Officer of Certive, Inc., a web-based small-business services firm. From January 1999 to March 2000, Mr. Baab was the Chief Operating Officer and Chief Financial Officer of RemarQ Communities, Inc., a web-based provider of discussion group services. Mr. Baab served as Chief Financial Officer of the CKS Group (CKS), a marketing communications company, from February 1994 through December 1998. In addition, Mr. Baab served as an Executive Vice President and the Secretary of CKS from August 1995 through December 1998 and as CKS s Chief Operating Officer from August 1995 through May 1996. Mr. Baab also served on the Board of Directors of Momentum Business Applications, Inc. (Nasdaq: MMTM), which provided research and development expertise on a contract basis, until it was acquired by PeopleSoft (Nasdaq: PSFT) in April 2002. Mr. Baab also serves on the University of Southern California, School of Engineering Board of Councilors. Mr. Baab holds a B.S. in Electrical Engineering, with honors, from the University of Southern California and an M.B.A. from the Harvard Graduate School of Business Administration.

Mr. Bezdek has served as our Chief Financial Officer since January 2003 and has served as Secretary since April 2002. Mr. Bezdek joined us as Vice President, Finance, Corporate Controller and Secretary in April 2002. From May 1996 to April 2002, Mr. Bezdek held various corporate finance positions, most recently as Vice President of Finance, at Activision Publishing Inc. (Nasdaq: ATVI), a worldwide publisher, developer and distributor of video games and interactive entertainment products. Mr. Bezdek holds a B.S. in Business Administration from Bowling Green State University and is a Certified Public Accountant as well as a Certified Treasury Professional. Mr. Bezdek resigned his position as Chief Financial Officer and Secretary effective May 5, 2006.

Mr. Allen joined us as Vice President, Worldwide Customer Support and Training in August 2001. From January 2000 to August 2001, Mr. Allen served as Vice President, Service and Support at Bay Logics, a computer software company. From July 1998 to December 1999, Mr. Allen served as Director, Software Services at SGI (formally Silicon Graphics Computer Systems). In addition, from June 1997 to June 1998, Mr. Allen served as Director, Research and Development at CoCreate Software, Inc. Mr. Allen attended the University of Massachusetts where he majored in Business Administration.

Mrs. Gibbs has served as our Vice President, European Operations from our offices in the United Kingdom since December 2000. Mrs. Gibbs served as President and Interim Chief Executive Officer of Omnis, Inc. from October 1998 until our merger with PickAx in December 2000. Mrs. Gibbs joined us in October 1994 and was initially responsible for Research and Development in Europe. Mrs. Gibbs holds a B.S. in Astronomy from the University of London.

Mr. Raissi has served as our Vice President, Product Development and Professional Services since September 2001. From March 2001 to September 2001, Mr. Raissi performed independent software and management consulting services. From September 2000 to March 2001, Mr. Raissi served as Vice President, Product Development for Equative, Inc., a computer software company providing web-based enterprise resource management applications to medium and larger enterprises. From September 1999 to August 2000, Mr. Raissi served as Vice President, Technical Services for Zland.com, an application service provider supplying hosted web-based applications through the Internet. From February 1996 to September 1999, Mr. Raissi served as the founding President of the Information Technology Group, which provided record and information management and retention scheduling software services to Fortune 1000 companies. Mr. Raissi holds a B.S. in Computer Science from California State University, Dominguez Hills and a B.A. in Literature from Pars University in Tehran, Iran. Mr. Raissi resigned his position as Vice President, Product Development and Professional Services effective April 26, 2006.

Mr. Ramachandran is disclosed because he is an employee expected to make a significant contribution to the business pursuant to item 401(b) of regulation SB. Mr. Ramachandran was not considered an executive officer as of March 31, 2006. Mr. Ramachandran joined Raining Data as Vice President and General Manager of the Enterprise Applications Group in April 2004. He was promoted to CTO and Vice President of XML-Centric Applications and Platforms in May 2006. From October 2001 to April 2004, Mr. Ramachandran served as a Founding General Partner of Ark Venture Partners LLC, a management advisory and private equity firm. From April 1999 to September 2001, Mr. Ramachandran was a Co-Founder at Electron Economy, a venture capital funded supply chain workflow and XML integration software company, where he was the Vice President of Business Development and Strategic Alliances between April 1999 to July 2000 and the Vice President of Business Development and Product Management from July 2000 to September 2001. From December 1997 to July 1999, Mr. Ramachandran was a Partner and Practice Leader of the E-Commerce Business Unit at USWeb/CKS Corporation, a leading Internet Professional Services Firm. From June 1996 to December 1997, Mr. Ramachandran was a Partner and Director of Technology and Internet Applications at Utopia Inc..
Mr. Ramachandran serves on the boards of several early stage ventures and is the technical chair of the World Wide Consortium of

the GRID. Mr. Ramachandran holds a B.S. in Molecular Cellular Biology and B.A. in Communications, from the University of California at Davis.

ITEM 2. *Description of Property*

We currently lease approximately 29,000 square feet of office space in Irvine, California. The lease commenced in November 2005 and has a five year term and provides for a base monthly rent of approximately $43,000. The facility accommodates our engineering, technical support, sales, marketing, and general and administrative personnel.

We own a building consisting of approximately 5,900 total square feet located on approximately six acres of land in Suffolk, England. The facility houses engineers, marketing, and technical support.

We currently lease approximately 5,000 square feet of office space in San Jose, California which houses engineering, business development, marketing, and general and administrative personnel.

We also lease a sales and support office in each of the UK, France and Germany.

We believe that our facilities are suitable and adequate for our current needs.

ITEM 3. *Legal Proceedings*

We are subject from time to time to litigation, claims and suits arising in the ordinary course of business. As of March 31, 2006, we were not a party to any material litigation, claim or suit.

ITEM 4. *Submission of Matters to a Vote of Security Holders*

No matters were submitted to a vote of our stockholders during the fourth quarter of the fiscal year ended March 31, 2006.

PART II

ITEM 5. ***Market for Common Equity and Related Stockholder Matters***

Market Information

Our common stock is traded on the Nasdaq SmallCap Market under the symbol RDTA.

The following table sets forth the high and low closing prices for our common stock for the periods indicated, as reported by Nasdaq:

	High	Low
Fiscal Year 2005		
First Quarter	$ 3.40	$ 2.52
Second Quarter	$ 2.90	$ 2.13
Third Quarter	$ 3.26	$ 2.09
Fourth Quarter	$ 3.38	$ 2.49

	High	Low
Fiscal Year 2006		
First Quarter	$ 2.79	$ 2.09
Second Quarter	$ 4.20	$ 2.06
Third Quarter	$ 4.33	$ 3.42
Fourth Quarter	$ 3.50	$ 2.53

On March 31, 2006, the closing price for our common stock on the Nasdaq SmallCap Market was $2.73 and there were approximately 138 holders of record of our common stock.

Dividends

We have never declared or paid dividends on our common stock. We intend to retain earnings, if any, for the operation and expansion of our business, and therefore do not anticipate paying any cash dividends in the foreseeable future. The terms of the Loan and Security Agreement with Silicon Valley Bank, dated February 11, 2004, prohibit the payment of dividends (except in specified circumstances) without Silicon Valley Bank s prior written consent, which will not be unreasonably withheld.

ITEM 6. ***Management s Discussion and Analysis***

The section entitled Management s Discussion and Analysis set forth below contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. When used herein, the words anticipates, believes, continue, could, estimates, expects, intends, may, plans, seeks, should, will or the negative of these terms or simi generally intended to identify forward-looking statements. Forward-looking statements involve certain risks and uncertainties, and actual results may differ materially from those discussed in any such statement. Factors that could cause actual results to differ materially from such forward-looking statements include the risks described in the Risk Factor section and elsewhere in this Form 10-KSB. All forward-looking statements in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement. See Important Note About Forward-Looking Statements in Part I of this 10-KSB.

This discussion and analysis of the financial statements and results of operations should be read in conjunction with our audited consolidated financial statements, including the related notes thereto, contained elsewhere in this Form 10-KSB.

Restatement

The Company s beginning accumulated deficit in the accompanying consolidated statements of stockholders equity and comprehensive loss has been adjusted to correct an error that occurred upon the adoption of SFAS No. 142, *Goodwill and Other Intangible Assets,* in 2003. Upon adoption, the Company appropriately reclassified a work force intangible asset to goodwill. However, the related deferred tax liability of approximately $460,000 was not reclassified to goodwill in accordance with SFAS No. 142. Had the Company appropriately reclassified the deferred tax liability, it would have increased its deferred tax asset valuation allowance by recording a corresponding charge to income tax expense, since the Company has determined it requires a full valuation allowance against its deferred tax assets. Our goodwill has been overstated and our accumulated deficit has been understated since the time of the error and have been corrected in this Annual Report on Form 10-KSB.

In addition, we utilized foreign net operating loss carryforwards acquired in a fiscal 2001 business combination and incorrectly recorded the benefit to income tax expense instead of goodwill. The net effect of this adjustment in the accompanying consolidated statement of operations was an increase to income tax expense of $73,000 and $173,000 for the years ended March 31, 2005 and 2004, respectively. Goodwill was reduced and accumulated deficit was increased in our March 31, 2005 and 2004 consolidated balance sheets for a corresponding amount. We also adjusted beginning accumulated deficit in the consolidated statements of stockholders equity and comprehensive loss by $57,000 for the cumulative effect of this error prior to April 1, 2003.

For a more complete description of the current restatement and the impact on specific periods, refer to Note 1 Restatement in notes to consolidated financial statements contained in this Form 10-KSB.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based on 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 judgments that affect the reported amounts of assets, liabilities, revenue and expenses and disclosure of contingent liabilities.

On an on-going basis, we evaluate our estimates, including those related to revenue recognition and accounting for goodwill. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We have identified the accounting policies below as the policies critical to our business operations and the understanding of our results of operations. We believe the following critical accounting policies and the related judgments and estimates affect the preparation of our consolidated financial statements:

REVENUE RECOGNITION. We recognize revenue using the residual method pursuant to the requirements of Statement of Position No. 97-2, Software Revenue Recognition (SOP 97-2), as amended. Under the residual method, revenue is recognized in a multiple element arrangement when company-specific objective evidence 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. At the outset of the arrangement with the customer, we defer revenue for the fair value of our undelivered elements (e.g., maintenance) based on company-specific objective evidence of the amount such items are sold individually to our customers and recognize revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (e.g., software license) when the basic criteria in SOP 97-2 have been met.

Under SOP 97-2, revenue attributable to an element in a customer arrangement is recognized when persuasive evidence of an arrangement exists and delivery has occurred, provided the fee is fixed or determinable, collectibility is probable and the arrangement does not require significant customization of the software. If, at the outset of the customer arrangement, we determine that the arrangement fee is not fixed or determinable, we defer the revenue and recognize the revenue when the arrangement fee becomes due and payable.

Service revenue relates primarily to consulting services, maintenance and training. Maintenance revenue is initially deferred and then recognized ratably over the term of the maintenance contract, typically 12 months. Consulting and training revenue is recognized as the services are performed and is usually calculated on a time and materials basis. Such services primarily consist of implementation services related to the installation of our products and do not include significant customization to or development of the underlying software code. We do not have price protection programs, conditional acceptance agreements, and sales of our products are made without right of return.

GOODWILL. We assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We also assess the value of goodwill at least annually. Factors we consider to be important which could trigger an impairment review include the following:

- Significant underperformance relative to expected historical or projected future operating results;
- Timing of our revenue, significant changes in the manner of use of the acquired assets or the strategy for the overall business;
- Significant negative industry or economic trends;
- Significant decline in our stock price for a sustained period; and
- Our market capitalization relative to net book value.

Following the adoption of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), we revised our policy for assessing and determining impairment of goodwill. The SFAS 142 goodwill impairment model is a two-step process. The first step is used to identify potential impairment by comparing the fair value of a reporting unit with its net book value (or carrying amount), including goodwill. If the fair value exceeds the carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit (including unrecognized intangible assets) under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and the magnitude of any such charge. However, we currently use our publicly-traded stock price to determine our fair value under step one of the goodwill impairment test.

Results of Operations

The following table sets forth certain consolidated statement of operations data in total dollars, as a percentage of total net revenue and as a percentage change from the prior year. Cost of license revenue and the cost of service revenue are expressed as a percentage of the related revenue. This information should be read in conjunction with the consolidated financial statements and the notes thereto included elsewhere in this Form 10-KSB.

	Year Ended March 31, 2006			Year Ended March 31, 2005 (As Restated)			Year Ended March 31, 2004 (As Restated)	
	Results	**% of Net Revenues**	**Percent Change**	**Results**	**% of Net Revenues**	**Percent Change**	**Results**	**% of Net Revenues**
Net revenues								
Licenses	$ 8,404	41 %	(10)%	$ 9,362	44 %	(5)%	$ 9,819	44 %
Services	11,890	59 %	(2)%	12.121	56 %	(3)%	12,478	56 %
Total net revenues	20,294	100 %	(6)%	21.483	100 %	(4)%	22,297	100 %
Operating expenses								
Cost of license revenues (as a% of license revenues)	207	2 %	(35)%	318	3 %	8 %	295	3 %
Cost of service revenues (as a% of service revenues)	2,274	19 %	(3)%	2,333	19 %	6 %	2,206	18 %
Selling and marketing	5,219	26 %	(7)%	5,582	26 %	(3)%	5,741	26 %
Research and development	9,628	47 %	28 %	7,506	35 %	(2)%	7,651	34 %
General and administrative	3,477	17 %	(7)%	3,739	17 %	0 %	3,746	17 %
Stock-based compensation	10	0 %	(85)%	66	0 %	(73)%	246	1 %
Amortization of intangible assets		0 %	(100)%	1,733	8 %	(33)%	2,600	12 %
Total operating expenses	20,815	103 %	(2)%	21,277	99 %	(5)%	22,485	101 %
Operating income (loss)	(521)	(3)%	353 %	206	1 %	(210)%	(188)	(1)%
Other income (expense), net	(1,027)	(5)%	(9)%	(1,127)	(5)%	(6)%	(1,196)	(5)%
Loss before income taxes	(1,548)	(8)%	68 %	(921)	(4)%	(33)%	(1,384)	(6)%
Provision for income taxes	76	0 %	4 %	73	0 %	(49)%	142	1 %
Net loss	$ (1,624)	(8)%	63 %	$ (994)	(5)%	(35)%	$ (1,526)	(7)%

REVENUE

NET REVENUE. Our revenue is derived principally from two sources: fees from software licensing and fees for services, including maintenance, consulting, training and technical support. We license our software on a per-CPU, per-server, per-port or per-user basis. Therefore, the addition of CPU s, servers, ports or users to existing systems increases our revenue from our installed base of licenses. We view the MDMS and RAD markets in which we operate to be relatively stable and consistent from period to period and anticipate that our revenue on an annual basis from those products will remain stable for the foreseeable future. Fluctuations in revenue between quarters or year-to-year are primarily the result of the timing of orders and customer order patterns. We do not view the changes in year-to-year revenues for the years ended March 31, 2006, 2005 and 2004 to be representative of immediate market trends. However, in the longer term, we expect that the MDMS and RAD markets will eventually contract as customers adopt newer technologies and, therefore, the revenue generated from sales of our MDMS and RAD products is expected to decrease.

We have been actively developing and marketing our XDMS product line. Should our development efforts and the adoption of these product lines be successful, we anticipate additional revenues in future periods related to the sale of these products. However, we can give no assurances as to customer acceptance of any new products or services, or the ability of the current or any new products and services to generate revenue. While we are committed to research and development efforts that are intended to allow us to penetrate new markets and generate new sources of revenue, such efforts may not result in additional products, services or revenue. In September 2005, we announced our first commercial OEM agreement for TigerLogic XDMS.

OPERATING EXPENSES

COST OF LICENSE REVENUE. Cost of license revenue is comprised of direct costs associated with software license sales including software packaging, documentation, physical media costs and

royalties. Cost of license revenue remained relatively consistent in fiscal 2006 as compared to fiscal 2005 and in fiscal 2005 as compared to fiscal 2004. We anticipate that the cost of license revenue, as a percentage of license revenue and in absolute dollars, will be relatively stable in future periods.

COST OF SERVICE REVENUE. Cost of service revenue includes primarily personnel costs relating to providing consulting, technical support and training services. Cost of service revenue remained relatively consistent in fiscal 2006 as compared to fiscal 2005 and in fiscal 2005 as compared to fiscal 2004. We anticipate that the cost of service revenue, as a percentage of service revenue and in absolute dollars, will be relatively stable in future periods.

SELLING AND MARKETING. Selling and marketing expense consists primarily of salaries, benefits, advertising, tradeshows, travel and overhead costs for our sales and marketing personnel. Selling and marketing expense remained relatively consistent in fiscal 2006 as compared to fiscal 2005 and in fiscal 2005 as compared to fiscal 2004. We anticipate that selling and marketing costs related to XDMS products may increase as we further develop the sales channel for these products and if customer acceptance of these products increases. In addition, if our continued research and development efforts are successful, including with respect to our XDMS products, and new products or services are created, we may incur increased sales and marketing expense to promote those new products in future periods.

RESEARCH AND DEVELOPMENT. Research and development expense consists primarily of salaries and other personnel-related expenses and overhead costs for engineering personnel, including employees in the US and the UK and contractors in the US and India. In fiscal 2006, spending related to our development efforts increased because our new products reached production release and we continued to refine and add certain features and functionality to these products. The majority of these costs have been personnel related, including salary and recruiting costs, as we have hired employees and contractors in association with the ongoing development and enhancement of our product lines. Research and development expense remained relatively consistent in fiscal 2005 as compared to fiscal 2004. We are committed to our research and development efforts and expect research and development expense will remain at the current level in future periods or increase if we believe that additional spending is warranted. Such efforts may not result in additional new products and any new products, including the XDMS products, may not generate sufficient revenue, if any, to offset the research and development expense.

GENERAL AND ADMINISTRATIVE. General and administrative expense consists primarily of costs associated with our finance, human resources, legal and other administrative functions. These costs consist principally of salaries and other personnel-related expenses, professional fees, depreciation and overhead costs. General and administrative spending remained relatively consistent in fiscal 2006 as compared to fiscal 2005 and in fiscal 2005 as compared to fiscal 2004. We anticipate that general and administrative costs as a percentage of revenue and in absolute dollars will remain relatively stable in future periods.

STOCK-BASED COMPENSATION. The decreases in stock-based compensation in fiscal 2006 and fiscal 2005 is attributable primarily to cancellations of previously issued options with an exercise price below fair value on date of grant for terminated employees, options reaching the end of their vesting periods, no new options being granted with an exercise price below fair value at the date of grant, and fewer options granted to non-employees. The adoption of Statement of Financial Accounting Standards No. 123 (as revised in 2004, SFAS No. 123R) to account for stock-based compensation is expected to increase our operating expenses and consequently reduce earnings in future periods.

AMORTIZATION OF INTANGIBLE ASSETS. We amortize our identifiable intangible assets in accordance with their determined useful life. The life of our existing intangible assets was estimated to be four years. As of March 31, 2005, our existing intangible assets were fully amortized.

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OTHER INCOME (EXPENSE). Other expense consists primarily of net interest expense and, to a much lesser extent, gains and losses on foreign currency transactions. Other expense remained relatively consistent during fiscal 2006 as compared to fiscal 2005 and in fiscal 2005 as compared to fiscal 2004. Due to the uncertainty in exchange rates, we may experience transaction gains or losses in future periods, the effect of which cannot be determined at this time.

PROVISION FOR INCOME TAXES. Our effective tax rate was 4.9%, 7.9%, and 10.3% for fiscal 2006, 2005, and 2004, respectively. The provision for income taxes reflects the tax on earnings from foreign subsidiaries. The Company is able to reduce the current tax liability at foreign subsidiaries with net operating loss carryforwards. However, certain carryforwards were acquired in our 2000 acquisition. Therefore, the benefit realized from utilizing those net operating loss carryforwards reduced goodwill instead of income tax expense. Due to uncertainties surrounding the timing of realizing the benefits of the net operating loss carryforwards in the future, the Company has established a full valuation allowance against its net deferred tax assets.

Liquidity and Capital Resources

In connection with the acquisition of PickAx, we assumed a Secured Promissory Note issued to Astoria Capital Partners, L.P. (Astoria) dated November 30, 2000, in the amount of $18.5 million. In January 2003, we entered into a Note Exchange Agreement (the Exchange Agreement) with Astoria to replace the existing Secured Promissory Note, as amended, with a Convertible Subordinated Note. Under the terms of the Exchange Agreement, the Secured Promissory Note was exchanged and replaced with a Convertible Subordinated Note having a principal amount of $22.1 million, which principal amount was equal to the outstanding principal and accrued interest payable on the Secured Promissory Note as of the date of the Exchange Agreement. In October 2005, Astoria assigned a portion of its common stock holdings totaling 870,536 shares and a portion of the Subordinated Convertible Note, totaling $1,751,832, to two of its limited partners. As such, we issued an Amended and Restated Note to Astoria for $20,749,581 and corresponding notes directly to the limited partners for $862,979 and $888,853, respectively. The Convertible Subordinated Notes are convertible into common stock at any time, at the option of the holder, at a price of $5.00 per share. The Convertible Subordinated Notes mature on May 30, 2008, extending the May 30, 2003 maturity date of the Secured Promissory Note. The interest rate of the Convertible Subordinated Notes is 5% per annum as compared to an interest rate of 10% per annum under the Secured Promissory Note. The interest is payable quarterly at our option in cash or through increases to the outstanding principal of the Convertible Subordinated Notes.

On December 14, 2004, we entered into an Agreement Regarding Amended and Restated Common Stock Purchase Warrant and 5% Convertible Subordinated Note Due 2008 with Astoria whereby we could redeem, in part, the Convertible Subordinated Note in advance of January 30, 2005. On December 14, 2004, Astoria exercised its warrant in the amount of $2,670,904. In lieu of a cash payment, we used the proceeds of the exercise to pay down a portion of the indebtedness to Astoria. The pay down consisted of $247,129 for accrued and unpaid interest, and $2,423,775 as a reduction of principal of the Convertible Subordinated Note. For the foreseeable future, we expect to increase the principal of the Convertible Subordinated Notes in lieu of cash payments for the interest. If the Convertible Subordinated Notes are converted into common stock, our stockholders may experience substantial dilution. Unlike the Secured Promissory Note, the Convertible Subordinated Notes are not secured by our assets.

If our future financial performance improves, we may seek to take advantage of opportunities in the equity and capital markets to raise additional funds for operating needs or to pay down our debt to Astoria and others. There can be no assurances that such opportunities will arise. In addition to holding the majority of the Convertible Subordinated Notes, Astoria is a major stockholder of ours, holding a majority of our outstanding common stock. Richard W. Koe, Chairman of the Board of Directors, serves as the Managing General Partner for Astoria. Carlton H. Baab, our President, Chief Executive Officer, and Director, served as a Managing Principal of Astoria Capital Management, which is a general partner of Astoria, until taking a formal leave of absence to join us in August 2001. Gerald F. Chew, a member of our Board of Directors, is the cousin of Mr. Koe.

At March 31, 2006, we had $10.8 million in cash. We believe that our existing cash balances combined with our cash flow from operating activities will be sufficient to meet our operating and capital expenditure requirements for the remainder of the fiscal year ending March 31, 2007 and through the foreseeable future. We are committed to research and development efforts that are intended to allow us to penetrate new markets and generate new sources of revenue and improve operating results. However, our research and development efforts have required, and will continue to require, cash outlays without the immediate or short-term receipt of related revenue. Our ability to service our long-term debt and meet our expenditure requirements is dependent upon our future financial performance, which will be affected by, among other things, prevailing economic conditions, our ability to penetrate new markets and attract new customers, market acceptance of our new and existing products and services, the success of research and development efforts and other factors beyond our control.

On February 11, 2004, we entered into a two year credit facility with Silicon Valley Bank which provided us with the ability to borrow up to $1.5 million at an annual interest rate of Prime plus 1.0%, provided that the annual interest rate shall never be less than 5%. We renewed this credit facility on February 11, 2006. The credit facility is collateralized by our assets and expires in February 2008. The credit facility contains financial and reporting covenants that require us to maintain certain financial ratios only when we have outstanding borrowings on the line. There were no outstanding borrowings at March 31, 2006. Upon expiration of the term of this facility we will assess our credit and liquidity needs in relation to market factors. However, we believe that the facility is not required for liquidity purposes or to meet our cash flow needs for the foreseeable future.

On November 9, 2004, we entered into a lease agreement with The Irvine Company whereby we leased one building in Irvine, California, comprising approximately 29,000 square feet, to replace our then headquarters facility. The lease commenced in November 2005 and has a five-year term. If certain conditions are met, we have the option to extend the term of the lease for an additional thirty-six months. The total basic rent over the five-year term is approximately $2.6 million, which represents a lower per square foot cost than our prior property lease. The annual basic rent during the five-year term ranges from approximately $475,000 during the first year to approximately $545,000 during the fifth year. The rent expense is being recognized on a straight line basis over the lease term.

We had no material commitments for capital expenditures at March 31, 2006.

Net cash used in operating activities was $0.2 million and net cash provided by operating activities was $2.8 million and $2.3 million for the years ended March 31, 2006, 2005 and 2004, respectively.

Our earnings before interest, taxes, depreciation and amortization (EBITDA) were negative $0.2 million, or negative 1% of total net revenue, $2.3 million, or 11% of total net revenue, and $3.0 million, or 13% of total net revenue, for the years ended March 31, 2006, 2005 and 2004, respectively. The reduction in fiscal 2006 EBITDA as compared to fiscal 2005 was a result of the reduction in revenues and increased spending for research and development. The reduction in fiscal 2005 EBITDA as compared to fiscal 2004 was a result of the reduction in revenues. EBITDA is defined as net loss with an add-back for depreciation and amortization, non-cash stock-based compensation expense, interest expense, other income and income taxes. The following table reconciles EBITDA to the reported net loss:

RAINING DATA CORPORATION AND SUBSIDIARIES
RECONCILIATION OF EBITDA TO NET LOSS
(In thousands)

	For the year ended March 31,		
In $000 s	**2006**	**2005 (As Restated)**	**2004 (As Restated)**
Reported net loss	$ (1,624)	$ (994)	$ (1,526)
Depreciation and amortization	276	2,021	2,935
Stock-based compensation	10	66	246
Interest expense net	952	1,155	1,215
Other income net	75	(28)	(19)
Provision for income taxes	76	73	142
EBITDA	$ (235)	$ 2,293	$ 2,993

EBITDA does not represent funds available for management s discretionary use and is not intended to represent cash flow from operations. EBITDA should not be construed as a substitute for net loss or as a better measure of liquidity than cash flow from operating activities, which are determined in accordance with United States generally accepted accounting principles (GAAP). EBITDA excludes components that are significant in understanding and assessing our results of operations and cash flows. In addition, EBITDA is not a term defined by GAAP and as a result our measure of EBITDA might not be comparable to similarly titled measures used by other companies.

However, EBITDA is used by management to evaluate, assess and benchmark our operational results and we believe that EBITDA is relevant and useful information, which is often reported and widely used by analysts, investors and other interested parties in our industry. Accordingly, we are disclosing this information to permit a more comprehensive analysis of our operating performance, to provide an additional measure of performance and liquidity and to provide additional information with respect to our ability to meet future debt service, capital expenditure and working capital requirements.

Our EBITDA financial information is also comparable to net cash provided by operating activities. The table below reconciles EBITDA to the GAAP disclosure of net cash provided by (used in) operating activities:

RAINING DATA CORPORATION AND SUBSIDIARIES
RECONCILIATION OF EBITDA TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES
(In thousands)

	For the year ended March 31,		
In $000 s	**2006**	**2005**	**2004**
Net cash provided by (used in) operating activities	$ (163)	$ 2,812	$ 2,328
Interest expense net	952	1,155	1,215
Other income net	75	(28)	(19)
Change in trade accounts receivable	110	38	(722)
Change in other current and non-current assets	(133)	101	97
Change in accounts payable	134	(188)	953
Change in accrued liabilities	(1,482)	(1,156)	(1,155)
Change in deferred revenue	355	(352)	379
Note payable discount amortization	(83)	(89)	(83)
EBITDA	$ (235)	$ 2,293	$ 2,993

RISK FACTORS

We operate in a rapidly changing environment that involves numerous risks and uncertainties. The following section lists some, but not all, of these risks and uncertainties that may have a material adverse effect on our business, financial condition or results of operation.

IF WE DO NOT DEVELOP NEW PRODUCTS AND ENHANCE EXISTING PRODUCTS TO KEEP PACE WITH RAPIDLY CHANGING TECHNOLOGY AND INDUSTRY STANDARDS, OUR REVENUE MAY DECLINE.

We have devoted significant resources to the research and development of products and technologies. We believe that our future success will depend in large part on a strong research and development effort with respect to both our existing and new products. Beginning in 2001, we began an extensive effort to leverage our time-proven Pick UDM and core intellectual property to create an enterprise class XML database management server for the emerging XML market. This significant investment of time and resources resulted in the TigerLogic XDMS product line. While we intend for these efforts to improve our future operating results and increase cash flow, such efforts may not result in new products or revenue, and any new products that do result may not be successful. The development of new or enhanced software products is a complex and uncertain process requiring high levels of innovation, as well as accurate anticipation of customer and technical trends. In developing new products and services, we may fail to develop and market products that respond to technological changes or evolving industry standards in a timely or cost-effective manner, or experience difficulties that could delay or prevent the successful development, introduction and marketing of these new products. The development and introduction of new or enhanced products also requires us to manage the transition from older products in order to minimize disruptions in customer ordering patterns and to ensure that adequate supplies of new products can be delivered to meet customer demand. Failure to develop and introduce new products, or enhancements to existing products, in a timely manner in response to changing market conditions or customer requirements, or lack of customer acceptance of our products, will materially and adversely affect our business, results of operations and financial condition.

OUR FAILURE TO COMPETE EFFECTIVELY MAY HAVE AN ADVERSE IMPACT ON OUR OPERATING RESULTS.

The market for our products is highly competitive, diverse and subject to rapid change. Our products and services compete on the basis of the following key characteristics: performance; inter-operability; scalability; functionality; reliability; pricing; post sale customer support; quality; compliance with industry standards; and overall total cost of ownership.

The application development tools software market is rapidly changing and intensely competitive. Our MDMS products compete with products developed by companies such as Oracle, Microsoft and IBM. Our RAD products currently encounter competition from several direct competitors, including Microsoft, and competing development environments, including JAVA. Competition is developing and evolving in the XML market for which our XDMS products are intended. Companies that do or are expected to compete in this market include Oracle, IBM, Microsoft and Sybase, as well as a number of smaller companies with products that directly and indirectly compete with our XDMS products. Additionally, as we expand our business, we expect to compete with a different group of companies, including smaller, highly focused companies offering single products.

Most of our competitors have significantly more financial, technical, marketing and other resources than we do. As a result, these competitors may be able to respond more quickly to new or emerging technologies, evolving markets and changes in customer requirements and may devote greater resources to the development, promotion and sale of their products. While we currently believe that our products and services compete favorably in the marketplace, our products and services could fall behind marketplace demands at any time. If we fail to address the competitive challenges, our business would suffer materially.

BECAUSE THE MARKET FOR OUR MDMS AND RAD PRODUCTS IS RELATIVELY STABLE OR MAY BE DECLINING, OUR REVENUE MAY DECLINE IF WE CANNOT MAINTAIN OUR SALES TO EXISTING CUSTOMERS OR GENERATE SALES TO NEW CUSTOMERS.

We believe that the markets for our MDMS and RAD products are relatively stable and consistent from period to period. As a result, to maintain or grow our revenue in these markets, we will need to maintain our sales to existing customers and to generate sales to new customers, including corporate development teams, commercial application developers, system integrators, independent software vendors and independent consultants. If we fail to attract new customers, if we lose our customers to competitors, or if the MDMS or RAD markets decline, our revenue may be adversely affected. In the longer term, it is expected that the MDMS and RAD markets will eventually decline as customers adopt newer technologies.

OUR PRODUCTS HAVE A LONG SALES CYCLE WHICH COULD RESULT IN DELAYS IN THE RECEIPT OF REVENUE.

The sales cycle for our MDMS and RAD products typically ranges from three to nine months or longer and the sales cycle for our XDMS products is anticipated to be significantly longer since these markets are emerging and the products are still in the process of being adopted by the marketplace. Our products are typically used by application developers, system integrators and value added resellers to develop applications that are critical to their corporate end user s business. Because our products are often part of an end user s larger business process, re-engineering initiative, or implementation of client/server or web-based computing, the end users frequently view the purchase of our products as part of a long-term strategic decision regarding the management of their workforce-related operations and expenditures. Thus, this sometimes results in end users taking a significant period of time to assess alternative solutions by competitors or to defer a purchase decision as a result of an unrelated strategic issue beyond our control. As a result, a significant period of time may elapse between our research and development efforts and recognition of revenue, if any.

IF WE FAIL TO INCREASE REVENUE OR IMPROVE OUR OPERATING RESULTS, WE MAY NOT BE ABLE TO REPAY OUR DEBT TO ASTORIA AND OTHERS.

We believe that our cash and cash flow from operating activities will be sufficient to meet our operating and capital expenditure requirements at least through the foreseeable future. Our ability to meet our expenditures and service our debt obligations is dependent upon our future financial performance, which will be affected by, among other things, prevailing economic conditions, our ability to penetrate new markets and attract new customers, market acceptance of our new and existing products and services, the success of research and development efforts and other factors beyond our control. As previously noted, in January 2003, we entered into the Exchange Agreement with Astoria to replace the existing Secured Promissory Note, which was due May 2003, with a Convertible Subordinated Note, which is due and payable in May 2008. The Convertible Subordinated Notes bear interest at 5% per annum and are convertible into common stock at any time at a price of $5.00 per share. If we are unable to penetrate new markets, generate new sources of revenue or otherwise improve our operating results, we may be unable to repay our debt to Astoria and others or to access opportunities in the equity and capital markets to raise additional funds for operating needs.

THE CONCENTRATION OF OUR STOCK OWNERSHIP AND THE DEBT OWED TO ASTORIA GIVE CERTAIN STOCKHOLDERS SIGNIFICANT CONTROL OVER OUR BUSINESS.

As of March 31, 2006, Astoria beneficially owned approximately 58% of our outstanding common stock. In addition, as of March 31, 2006, the Convertible Subordinated Note issued to Astoria had a balance of approximately $21.3 million in principal and accrued interest maturing on May 30, 2008. Richard W. Koe, Chairman of the Board of Directors, serves as the Managing General Partner for Astoria Capital Management, which is a general partner of Astoria. Carlton H. Baab, our President, Chief Executive Officer, and Director, served as a Managing Principal of Astoria Capital Management until taking a formal leave of absence to join us in August 2001. This concentration of stock ownership, together with the outstanding debt, would allow Astoria, acting alone, to block any actions that require approval of our stockholders, including the election of members to the Board of Directors and the approval of significant corporate transactions. Moreover, this concentration of ownership may delay or prevent a change in control.

RECENT RULEMAKING BY THE FINANCIAL ACCOUNTING STANDARDS BOARD WILL REQUIRE US TO EXPENSE EQUITY COMPENSATION GIVEN TO EMPLOYEES AND MAY HARM OPERATING RESULTS AND MAY REDUCE OUR ABILITY TO EFFECTIVELY UTILIZE EQUITY COMPENSATION TO ATTRACT AND RETAIN EMPLOYEES.

We historically have used stock options as a significant component of our employee compensation program in order to align employees interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board (FASB) has adopted changes that will require companies to record a charge to earnings for employee stock option grants and other equity incentives, which will impact our results of operations in future periods. We are required to implement SFAS No. 123R, *Share Based Payment,* (SFAS 123R) no later than our fiscal year 2007. By causing us to incur increased compensation costs, such accounting changes are expected to reduce our reported earnings and may require us to reduce the availability and amount of equity incentives provided to employees, which may make it more difficult for us to attract, retain and motivate key personnel. Each of these results could materially and adversely affect our business. The future impact of the adoption of this standard on our consolidated financial position and results of operations has not been determined at this time, however, the adoption of SFAS No. 123R is expected to reduce earnings in future periods.

WE MAY EXPERIENCE QUARTERLY FLUCTUATIONS IN OPERATING RESULTS, WHICH MAY RESULT IN VOLATILITY OF OUR STOCK PRICE.

We expect to continue to spend substantial amounts of money in the area of research and development, sales and marketing and operations in order to promote new product development and introduction. Because the expenses associated with these activities are relatively fixed in the short-term, we may be unable to timely adjust spending to offset any unexpected shortfall in revenue growth or any decrease in revenue levels. Operating results may also fluctuate due to factors such as:

- the size and timing of customer orders;
- changes in pricing policies by us or our competitors;
- our ability to develop, introduce, and market new and enhanced versions of our products;
- the number, timing, and significance of product enhancements and new product announcements by our competitors;
- the demand for our products;

- non-renewal of customer support agreements;
- software defects and other product quality problems; and
- personnel changes.

We operate without a significant backlog of orders. As a result, the quarterly sales and operating results in any given quarter are dependent, in large part, upon the volume and timing of orders booked and products shipped during that quarter. Accordingly, we may be unable to adjust spending in a timely manner to compensate for any unanticipated decrease in orders, sales or shipments. Therefore, any decline in demand for our products and services, in relation to the forecast for any given quarter, could materially and negatively impact the results of our operations. As a result, our quarterly operating results may fluctuate, which may cause our stock price to be volatile. In addition, we believe that period-to-period comparisons of our operating results should not be relied upon as indications of future performance.

THE SUCCESS OF OUR BUSINESS DEPENDS IN PART UPON OUR ABILITY TO RECRUIT AND RETAIN KEY PERSONNEL AND MANAGEMENT.

The majority of our executive officers joined us subsequent to the acquisition of PickAx, including our President, Chief Executive Officer, and Director, Carlton H. Baab, who joined us in August 2001. The loss of one or more of these or other executives could adversely affect our business. In addition, we believe that our future success will depend to a significant extent on our ability to recruit, hire and retain highly skilled management and employees with experience in engineering, product management, business development, sales, marketing and customer service. Competition for such personnel in the software industry can be intense, and there can be no assurance that we will be successful in attracting and retaining such personnel. If we are unable to do so, we may experience inadequate levels of staffing to develop and license our products and perform services for our customers, which could adversely affect our business.

THE INABILITY TO PROTECT OUR INTELLECTUAL PROPERTY COULD HARM OUR ABILITY TO COMPETE.

Our ability to compete successfully will depend, in part, on our ability to protect our proprietary technology and operations without infringing upon the rights of others. We may fail to do so. In addition, the laws of certain countries in which our products are, or may be, licensed may not protect our proprietary rights to the same extent as the laws of the United States. We rely primarily on a combination of trade secret, copyright and trademark laws and contractual provisions to protect our intellectual property and proprietary rights. Our trademarks include Raining Data, Pick, D3, Omnis, Omnis Studio, mvEnterprise, mvBase, mvDesigner and TigerLogic, among others. We also have one pending U.S. patent application as of March 31, 2006. In addition to trademark and copyright protections, we license our products to end users on a right to use basis pursuant to a perpetual license agreement that restricts use of products to a specified number of users.

We generally rely on click-wrap licenses that become effective when a customer downloads and installs software on its system. In order to retain exclusive ownership rights to our software and technology, we generally provide our software in object code only, with contractual restrictions on copying, disclosure and transferability. There can be no assurance that these protections will be adequate, or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology.

OUR PRODUCTS MAY CONTAIN SOFTWARE DEFECTS WHICH COULD HARM OUR BUSINESS.

Our enterprise applications software may contain undetected errors or failures. This includes our XDMS products, which are at higher risk given these products are in the earliest stages of the product life cycle. This may result in loss of, or delay in, customer acceptance of our products and could harm our reputation and our business. Undetected errors or failures in computer software programs are not uncommon. While we make every effort to thoroughly test our software, in the event that we experience significant software errors, we could experience delays in release, customer dissatisfaction and lost revenue. Any of these errors or defects could harm our business.

IF THE REGISTRATION RIGHTS HELD BY ASTORIA AND OTHER SECURITIES HOLDERS ARE EXERCISED, OR THESE SECURITIES HOLDERS SELL A SUBSTANTIAL AMOUNT OF RESTRICTED SECURITIES IN THE OPEN MARKET, OUR STOCK PRICE MAY DECLINE.

As of March 31, 2006, we had 20,644,576 outstanding shares of common stock, of which approximately 9,700,000 shares were restricted securities held by Astoria and other holders. Restricted securities may be sold in the public market only if they are registered or if they qualify for an exemption from registration promulgated under the Securities Act of 1933, as amended. At present, all of our outstanding restricted securities are either entitled to registration rights or eligible for public sale under Rule 144, subject to volume limitations and other requirements of Rule 144. If Astoria or other holders decide to exercise their demand registration rights, we would incur costs and expenses associated with the registration of securities.

Furthermore, sales of a substantial number of shares by Astoria or other securities holders in the public market, or the perception that those sales may occur, could cause the market price of our common stock to decline. In addition, if we register shares of our common stock in connection with a public offering of securities, we may be required to include shares of restricted securities in the registration, which may have an adverse effect on our ability to raise capital.

OUR GLOBAL OPERATIONS EXPOSE US TO ADDITIONAL RISKS AND CHALLENGES ASSOCIATED WITH CONDUCTING BUSINESS INTERNATIONALLY.

We operate on a global basis with offices or distributors in Europe, Africa, Asia, Latin America, South America, Australia and North America and development efforts in North America, India and Europe. Approximately 31% of our revenue for the year ended March 31, 2006 was generated from our international offices. We face several risks inherent in conducting business internationally, including but not limited to the following:

- fluctuations in interest rates or currency exchange rates;
- language and cultural differences;
- local and governmental requirements;
- difficulties and costs of staffing and managing international operations;
- differences in intellectual property protections;
- difficulties in collecting accounts receivable and longer collection periods;
- seasonal business activities in certain parts of the world; and
- trade policies.

Any of these factors could harm our international operations and, consequently, affect the international growth or maintenance of our business. These factors or any combination of these factors may adversely affect our revenue or our overall financial performance.

THE FAILURE OF OUR PRODUCTS TO CONTINUE TO CONFORM TO INDUSTRY STANDARDS MAY HARM OUR OPERATING RESULTS.

A key factor in our future success will continue to be the ability of our products to operate and perform well with existing and future leading, industry-standard enterprise software applications intended to be used in connection with our MDMS, RAD, and XDMS products. Inter-operability may require third party licenses, which may not be available to us on favorable terms or at all. Failure to meet existing or future inter-operability and performance requirements of industry standard applications in a timely manner could adversely affect our business. Uncertainties relating to the timing and nature of new product announcements or introductions or modifications of third party software applications could delay our product development, increase our product development expense or cause customers to delay evaluation, purchase, and deployment of our products.

THIRD PARTIES COULD ASSERT THAT OUR SOFTWARE PRODUCTS AND SERVICES INFRINGE ON THEIR INTELLECTUAL PROPERTY RIGHTS, WHICH COULD RESULT IN COSTLY LITIGATION, CAUSE PRODUCT SHIPMENT DELAYS, PROHIBIT PRODUCT LICENSING OR REQUIRE US TO ENTER INTO ROYALTY OR LICENSING AGREEMENTS.

There has been a substantial amount of litigation in the software industry regarding intellectual property rights. Third parties may claim that our current or potential future products and services infringe upon their intellectual property. We expect that software product developers and providers of software applications will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grow and the functionality of products in different industry segments overlap. Any claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays, prohibit product licensing or require us to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all, which could seriously harm our business.

ITEM 7. *Financial Statements*

Our consolidated financial statements, including the notes thereto, together with the report of KPMG LLP, independent registered public accounting firm, thereon are presented as a separate section of this Form 10-KSB, and the following are attached hereto beginning on Page F-1:

a) Consolidated Financial Statements: