

MOTIVE INC  
Form 10-Q  
August 15, 2005  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2005

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 number: 000-31409

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**MOTIVE, INC.**

*(Exact Name of Registrant as Specified in its Charter)*

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|--|--|
| <b>Delaware</b><br><i>(State or Other Jurisdiction of<br/>Incorporation or Organization)</i>                               | <b>74-2834515</b><br><i>(I.R.S. Employer<br/>Identification No.)</i> |
| <b>12515 Research Boulevard, Building 5</b><br><br><b>Austin, Texas</b><br><i>(Address of principal executive offices)</i> | <b>78759-2220</b><br><br><i>(Zip code)</i>                           |
| <b>(512) 339-8335</b><br><i>Registrant's telephone number, including area code</i>   |  |

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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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).     Yes     No

As of June 30, 2005, there were 26,281,119 outstanding shares of the common stock of Motive, Inc.

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**MOTIVE, INC.**

**FORM 10-Q QUARTERLY REPORT**

**QUARTERLY PERIOD ENDED JUNE 30, 2005**

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**Table of Contents****MOTIVE, INC.****CONSOLIDATED CONDENSED BALANCE SHEETS****(in thousands, except share amounts)**

|  | <b>June 30,</b>    | <b>December 31,</b> |
|--|--------------------|---------------------|
|  | <b>2005</b>        | <b>2004</b>         |
|  | <u>          </u>  | <u>          </u>   |
|  | <b>(unaudited)</b> |                     |
| <b>ASSETS</b>  |                    |                     |
| Current assets:  |                    |                     |
| Cash and cash equivalents  | \$ 36,367          | \$ 44,490           |
| Short-term investments   | 30,115             | 24,724              |
| Accounts receivable, net   | 22,896             | 18,823              |
| Prepaid expenses and other current assets  | 5,398              | 3,104               |
|  | <u>          </u>  | <u>          </u>   |
| Total current assets   | 94,776             | 91,141              |
|  | <u>          </u>  | <u>          </u>   |
| Property and equipment, net  | 6,483              | 6,850               |
| Goodwill   | 56,409             | 56,409              |
| Acquired technology, net   | 7,305              | 7,987               |
| Other intangibles, net   | 6,706              | 8,414               |
| Other assets   | 2,355              | 3,114               |
|  | <u>          </u>  | <u>          </u>   |
| Total assets   | \$ 174,034         | \$ 173,915          |
|  | <u>          </u>  | <u>          </u>   |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                    |                     |
| Current liabilities:   |                    |                     |
| Accounts payable   | \$ 6,683           | \$ 6,547            |
| Accrued liabilities  | 7,855              | 7,282               |
| Deferred revenue   | 9,616              | 11,576              |
|  | <u>          </u>  | <u>          </u>   |
| Total current liabilities  | 24,154             | 25,405              |
| Deferred revenue   | 3,856              | 4,526               |
|  | <u>          </u>  | <u>          </u>   |
| Total liabilities  | 28,010             | 29,931              |
|  | <u>          </u>  | <u>          </u>   |
| Stockholders' equity:  |                    |                     |
| Common stock: \$0.001 par value; 150,000,000 shares authorized; 26,281,119 shares issued and outstanding at June 30, 2005 (unaudited); 25,760,868 shares issued and outstanding at December 31, 2004 | 26                 | 26                  |
| Additional paid-in capital   | 236,986            | 234,417             |
| Deferred stock compensation  | (1,106)            | (1,796)             |
| Accumulated comprehensive loss   | (706)              | (724)               |
| Accumulated deficit  | (89,176)           | (87,939)            |
|  | <u>          </u>  | <u>          </u>   |
| Total stockholders' equity   | 146,024            | 143,984             |
|  | <u>          </u>  | <u>          </u>   |
| Total liabilities and stockholders' equity   | \$ 174,034         | \$ 173,915          |



See accompanying notes

**Table of Contents****MOTIVE, INC.****CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS****(in thousands, except per share amounts)**

|   | <b>Three Months Ended</b> |                   | <b>Six Months Ended</b> |                   |
|---|---------------------------|-------------------|-------------------------|-------------------|
|   | <b>June 30,</b>           |                   | <b>June 30,</b>         |                   |
|   | <b>2005</b>               | <b>2004</b>       | <b>2005</b>             | <b>2004</b>       |
|   | <b>(unaudited)</b>        |                   | <b>(unaudited)</b>      |                   |
| <b>Revenue:</b>                                 |                           |                   |                         |                   |
| License fees                                    | \$ 13,187                 | \$ 13,586         | \$ 27,255               | \$ 25,081         |
| <b>Services:</b>                                |                           |                   |                         |                   |
| Services  | 8,487                     | 8,374             | 17,722                  | 16,129            |
| Acquired in business combination                | 1,018                     | 2,062             | 2,276                   | 5,488             |
| <b>Total services revenue</b>                   | <b>9,505</b>              | <b>10,436</b>     | <b>19,998</b>           | <b>21,617</b>     |
| <b>Total revenue</b>                            | <b>22,692</b>             | <b>24,022</b>     | <b>47,253</b>           | <b>46,698</b>     |
| <b>Cost of revenue:</b>                         |                           |                   |                         |                   |
| License fees                                    | 199                       | 157               | 343                     | 351               |
| Amortization of acquired technology             | 351                       | 234               | 682                     | 448               |
| Services  | 6,620                     | 7,084             | 13,606                  | 14,621            |
| <b>Total cost of revenue</b>                    | <b>7,170</b>              | <b>7,475</b>      | <b>14,631</b>           | <b>15,420</b>     |
| <b>Gross margin</b>                             | <b>15,522</b>             | <b>16,547</b>     | <b>32,622</b>           | <b>31,278</b>     |
| <b>Operating expenses:</b>                      |                           |                   |                         |                   |
| Sales and marketing                             | 8,157                     | 8,262             | 16,477                  | 15,817            |
| Research and development                        | 4,908                     | 4,683             | 9,443                   | 8,917             |
| General and administrative                      | 2,605                     | 2,046             | 5,111                   | 4,215             |
| Amortization of intangibles                     | 858                       | 802               | 1,708                   | 1,575             |
| Amortization of deferred stock compensation (1) | 251                       | 637               | 589                     | 1,488             |
| <b>Total operating expenses</b>                 | <b>16,779</b>             | <b>16,430</b>     | <b>33,328</b>           | <b>32,012</b>     |
| <b>Income (loss) from operations</b>            | <b>(1,257)</b>            | <b>117</b>        | <b>(706)</b>            | <b>(734)</b>      |
| Interest income (expense), net                  | 332                       | (2,018)           | 621                     | (2,528)           |
| Legal settlement                                | (700)                     |                   | (700)                   |                   |
| Other income (expense), net                     | (109)                     | (55)              | (181)                   | 417               |
| <b>Loss before income taxes</b>                 | <b>(1,734)</b>            | <b>(1,956)</b>    | <b>(966)</b>            | <b>(2,845)</b>    |
| Provision for income taxes                      | 109                       | 187               | 271                     | 868               |
| <b>Net loss</b>                                 | <b>\$ (1,843)</b>         | <b>\$ (2,143)</b> | <b>\$ (1,237)</b>       | <b>\$ (3,713)</b> |

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
|   | _____     | _____     | _____     | _____     |
| Basic and diluted loss per share                          | \$ (0.07) | \$ (0.20) | \$ (0.05) | \$ (0.36) |
|   | _____     | _____     | _____     | _____     |
| Shares used in computing basic and diluted loss per share | 26,150    | 10,820    | 26,053    | 10,288    |

- (1) If the amortization of deferred stock compensation were allocated to specific operating statement line items, it would be allocated as follows:

|                            |        |        |        |          |
|----------------------------|--------|--------|--------|----------|
| Cost of services revenue   | \$ 14  | \$ 32  | \$ 33  | \$ 85    |
| Sales and marketing        | 82     | 248    | 224    | 568      |
| Research and development   | 92     | 210    | 192    | 498      |
| General and administrative | 63     | 147    | 140    | 337      |
|                            | _____  | _____  | _____  | _____    |
|                            | \$ 251 | \$ 637 | \$ 589 | \$ 1,488 |

See accompanying notes

**Table of Contents****MOTIVE, INC.****CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS****(in thousands)**

|   | <b>Six Months Ended</b> |                  |
|---|-------------------------|------------------|
|   | <b>June 30,</b>         |                  |
|   | <b>2005</b>             | <b>2004</b>      |
|   | <b>(unaudited)</b>      |                  |
| Cash flows from operating activities  |                         |                  |
| Net loss  | \$ (1,237)              | \$ (3,713)       |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                         |                  |
| Depreciation  | 1,766                   | 1,751            |
| Amortization of deferred stock compensation   | 589                     | 1,488            |
| Amortization and write-off of debt discount   |                         | 1,743            |
| Amortization of intangibles   | 2,390                   | 2,023            |
| Accretion of discount on short-term investments   | (166)                   |                  |
| Other noncash items   | (32)                    | (28)             |
| Changes in operating assets and liabilities   | (7,477)                 | 3,266            |
| <b>Net cash provided by (used in) operating activities</b>                                | <b>(4,167)</b>          | <b>6,530</b>     |
| Cash flows from investing activities  |                         |                  |
| Purchase of short-term investments  | (12,375)                | (8,116)          |
| Proceeds from maturities of short-term investments  | 7,200                   |                  |
| Restricted cash   |                         | 15,000           |
| Purchase of property and equipment  | (1,399)                 | (1,373)          |
| <b>Net cash provided by (used in) investing activities</b>                                | <b>(6,574)</b>          | <b>5,511</b>     |
| Cash flows from financing activities  |                         |                  |
| Payments made on long-term debt   |                         | (199)            |
| Payments made on subordinated debt  |                         | (12,500)         |
| Proceeds from IPO, net of offering costs  |                         | 44,134           |
| Proceeds from issuance of common stock  | 2,619                   | 747              |
| Repurchase of common stock  | (1)                     | (206)            |
| <b>Net cash provided by financing activities</b>  | <b>2,618</b>            | <b>31,976</b>    |
| <b>Net increase (decrease) in cash and cash equivalents</b>                               | <b>(8,123)</b>          | <b>44,017</b>    |
| Cash and cash equivalents at beginning of period  | 44,490                  | 23,234           |
| <b>Cash and cash equivalents at end of period</b>   | <b>\$ 36,367</b>        | <b>\$ 67,251</b> |



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See accompanying notes

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**MOTIVE, INC.**

**NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Basis of Presentation**

Motive, Inc., along with its wholly-owned subsidiaries (collectively, the Company or Motive ), is a leading supplier of management software for networked products and services. Motive s products build intelligent automation into networked products and services to expedite or eliminate various management tasks that both businesses and end-users must undertake in order to launch, maintain or update the products and services. The Company was incorporated in Delaware on April 25, 1997 and currently markets its products and services throughout the Americas, Europe and Asia. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited interim consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles and are presented in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC ) applicable to interim financial information. Accordingly, certain footnote disclosures have been condensed or omitted. In the Company s opinion, the unaudited interim consolidated condensed financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the Company s financial position, results of operations and cash flows for the periods presented. These financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in the Form 10-K filed with the SEC for the year ended December 31, 2004. The results of operations for the three-month and six month periods ended June 30, 2005 and 2004 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year.

The balance sheet at December 31, 2004 has been derived from audited financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Form 10-K filed with the SEC for the year ended December 31, 2004.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates, and such differences could be material to the financial statements.

**2. Initial Public Offering**

The SEC declared the Company s registration statement effective on June 24, 2004, which was filed on Form S-1 (Registration No. 333-111030) under the Securities Act of 1933 in connection with the initial public offering of the Company s common stock. On June 30, 2004, the Company completed its initial public offering in which it sold 5,000,000 shares of its common stock for \$10 per share, for an aggregate public offering price of \$50 million. Of this total, approximately \$3.5 million was applied to underwriting discounts and commissions; \$2.7 million to related

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costs; \$12.5 million to pay in full senior subordinated promissory notes; and \$6.0 million to pay in full outstanding term loans. As a result, approximately \$25.3 million of the offering proceeds was retained, which the Company has used and intends to continue using for working capital and general corporate purposes.

**Table of Contents****3. Stock-Based Compensation**

The following table illustrates the effect on net loss and earnings per share if the Company had applied the fair value recognition provision of Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation*, to stock-based compensation (in thousands, except per share data):

|   | Three Months Ended |            | Six Months Ended |            |
|---|--------------------|------------|------------------|------------|
|   | June 30,           |            | June 30,         |            |
|   | 2005               | 2004       | 2005             | 2004       |
|   | (unaudited)        |            | (unaudited)      |            |
| Net loss as reported  | \$ (1,843)         | \$ (2,143) | \$ (1,237)       | \$ (3,713) |
| Total stock-based compensation cost, net of related tax effects, included in the determination of net loss as reported  | 251                | 637        | 589              | 1,488      |
| Total stock-based compensation cost, net of related tax effects, that would have been included in the determination of net loss if the fair value method had been applied to all awards | (1,462)            | (1,157)    | (3,156)          | (2,035)    |
| Pro forma net loss  | \$ (3,054)         | \$ (2,663) | \$ (3,804)       | \$ (4,260) |
| Pro forma net loss per share, basic and diluted   | \$ (0.12)          | \$ (0.25)  | \$ (0.15)        | \$ (0.41)  |

**4. Goodwill and Other Intangible Assets**

Goodwill and other intangible assets consist of the following (in thousands):

|                                    | June 30,    | December 31, |
|------------------------------------|-------------|--------------|
|                                    | 2005        | 2004         |
|                                    | (unaudited) |              |
| Goodwill                           | \$ 56,409   | \$ 56,409    |
| Acquired Technology:               |             |              |
| Acquired technology                | \$ 9,351    | \$ 9,351     |
| Accumulated amortization           | (2,046)     | (1,364)      |
|                                    | \$ 7,305    | \$ 7,987     |
| Other Intangibles:                 |             |              |
| Customer contractual relationships | \$ 7,255    | \$ 7,255     |
| Order backlog                      | 920         | 920          |
| Patented technologies              | 500         | 500          |

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|                                    |          |          |
|------------------------------------|----------|----------|
| Trade secrets and other technology | 500      | 500      |
| Non-competition agreements         | 4,800    | 4,800    |
| Accumulated amortization           | (7,269)  | (5,561)  |
|                                    | \$ 6,706 | \$ 8,414 |
|                                    | \$ 6,706 | \$ 8,414 |

Estimated annual amortization expense of intangible assets for calendar years 2005, 2006, 2007 and 2008 is \$4,809,000, \$5,255,000, \$6,082,000 and \$255,000, respectively.

### 5. Earnings Per Share

In accordance with SFAS No. 128, *Earnings Per Share*, basic earnings (loss) per share is computed by dividing the earnings (loss) for the period by the weighted average number of common shares outstanding during the period less common shares subject to repurchase. Diluted earnings (loss) per share is computed by dividing the earnings (loss) for the period by the weighted average number of common and common equivalent shares outstanding during the period. The Company has excluded all convertible preferred stock, outstanding stock options, outstanding warrants to purchase common stock and common stock subject to repurchase from the calculation of diluted loss per common share because all such securities were antidilutive for the periods presented. The total number of shares excluded from the calculations of diluted loss per share, prior to application of the treasury stock method for options, was 4,606,779 and 13,878,860 for the second quarter of 2005 and 2004, respectively, and 4,567,352 and 14,229,977 for the six months ended June 30, 2005 and 2004, respectively.

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The following is a reconciliation of the numerator and denominator of basic and diluted net loss per share (in thousands, except per share amounts):

|   | Three Months Ended |            | Six Months Ended |            |
|---|--------------------|------------|------------------|------------|
|   | June 30,           |            | June 30,         |            |
|   | 2005               | 2004       | 2005             | 2004       |
|   | (unaudited)        |            | (unaudited)      |            |
| <b>Numerator:</b>   |                    |            |                  |            |
| Net loss  | \$ (1,843)         | \$ (2,143) | \$ (1,237)       | \$ (3,713) |
| <b>Denominator:</b>   |                    |            |                  |            |
| Weighted-average common shares outstanding  | 26,168             | 10,871     | 26,073           | 10,340     |
| Less: Common shares subject to repurchase   | (18)               | (51)       | (21)             | (52)       |
| Total weighted average common shares used in computing basic and diluted loss per share | 26,150             | 10,820     | 26,053           | 10,288     |
| Basic and diluted loss per share  | \$ (0.07)          | \$ (0.20)  | \$ (0.05)        | \$ (0.36)  |

**6. Recently Issued Accounting Standards**

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123R ). SFAS 123R addresses the accounting for share-based payments to employees, including grants of employee stock options. Under the new standard, companies will no longer be able to account for share-based compensation transactions using the intrinsic method in accordance with Accounting Principles Board Opinion ( APB ) No. 25, *Accounting for Stock Issued to Employees*. Instead companies will be required to account for such transactions using a fair-value method and recognize the expense in the consolidated statement of operations. SFAS 123R will be effective for years beginning after December 15, 2005 and allows, but does not require, companies to restate prior years presented to reflect the impact of expensing share-based payments under SFAS 123R. The Company has not yet determined which fair-value method and transitional provision it will follow. However, it expects that the adoption of SFAS 123R will have a significant impact on its results of operations. The Company does not expect that the adoption of SFAS 123R will impact its overall financial condition.

**7. Reclassifications**

Certain reclassifications have been made to conform prior period financial information to the current presentation. These reclassifications had no effect on reported net loss. The Consolidated Condensed Statement of Cash Flows for the six months ended June 30, 2004 includes the reclassification of certain mutual fund securities from cash and cash equivalents to short-term investments.

**8. Debt**

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The Company has a \$25 million revolving credit facility with a bank. There were no amounts outstanding under this loan as of December 31, 2004 or June 30, 2005. The Company is in compliance with all covenants under such facility.

In June 2004, the Company repaid in full its related party senior subordinated promissory notes in the aggregate principal amount of \$12.5 million using proceeds from its initial public offering. The Company allocated the remaining debt discount of approximately \$1.5 million to interest expense.

Total interest expense incurred during the three months ended June 30, 2005 and 2004 was approximately \$27,000 and \$2,141,000 respectively. Total interest expense incurred during the six months ended June 30, 2005 and 2004 was approximately \$55,000 and \$2,737,000, respectively.

**Table of Contents****9. Comprehensive Income (Loss)**

Comprehensive income (loss) is the total of net income (loss) and all other non-owner changes in stockholders' equity. The Company's other comprehensive income (loss) consists of unrealized gains or losses on available-for-sale investments and foreign currency translation adjustments. The components of comprehensive income (loss) are as follows (in thousands):

|  | <b>Three Months Ended</b> |                   | <b>Six Months Ended</b> |                   |
|--|---------------------------|-------------------|-------------------------|-------------------|
|  | <b>June 30,</b>           |                   | <b>June 30,</b>         |                   |
|  | <b>2005</b>               | <b>2004</b>       | <b>2005</b>             | <b>2004</b>       |
|  | <b>(unaudited)</b>        |                   | <b>(unaudited)</b>      |                   |
| Net loss                                 | \$ (1,843)                | \$ (2,143)        | \$ (1,237)              | \$ (3,713)        |
| Other comprehensive income (loss)        |                           |                   |                         |                   |
| Change in unrealized loss on investments | (42)                      | (115)             | (28)                    | (115)             |
| Foreign currency translation adjustment  | 6                         | (48)              | 46                      | (119)             |
| <b>Total comprehensive income (loss)</b> | <b>\$ (1,879)</b>         | <b>\$ (2,306)</b> | <b>\$ (1,219)</b>       | <b>\$ (3,947)</b> |

**10. Income Taxes**

The Company has incurred operating losses for all fiscal years from inception through December 31, 2003 and had only a small amount of income in 2004 and a loss during the first six months of 2005. The provision for income taxes consists primarily of foreign income tax withholdings related to international sales as well as foreign income taxes on the earnings of our foreign subsidiaries. The Company has recorded a valuation allowance for the full amount of our net deferred tax assets, which include net operating loss, research and development, and foreign tax credit carryforwards, because of the uncertainty regarding their realization.

**11. Stockholders' Equity*****Redeemable Convertible Preferred Stock***

In connection with the Company's initial public offering in June 2004, all series of redeemable convertible preferred stock, representing a total of 10,322,056 preferred shares, were automatically converted to common stock based on a one-for-one conversion ratio.

***Common Stock***



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In March 2004, the Board of Directors authorized a 4-for-1 reverse stock split for all common and preferred shares. All shares and per share amounts, including warrants and options to purchase such shares, included in the accompanying consolidated condensed financial statements have been adjusted to give retroactive effect to the reverse stock split.

During the quarter ended June 30, 2005, 201,974 shares of common stock were issued upon exercise of employee stock options, 539 shares of common stock were issued upon exercise of warrants and six outstanding shares of common stock were repurchased and retired.

### 12. Acquisition of BroadJump, Inc.

In connection with the January 2003 acquisition of BroadJump, Inc, the Company accrued total exit costs of \$13,894,000. The following table summarizes activity for the remaining exit costs included in accrued liabilities (in thousands):

|                                       | <b>Facility Lease</b> |
|---------------------------------------|-----------------------|
|                                       | <b>Commitments</b>    |
|                                       | <u>          </u>     |
| Balance at December 31, 2004          | \$ 2,766              |
| Cash activity (unaudited)             | (303)                 |
|                                       | <u>          </u>     |
| Balance at March 31, 2005 (unaudited) | 2,463                 |
| Cash activity (unaudited)             | (294)                 |
|                                       | <u>          </u>     |
| Balance at June 30, 2005 (unaudited)  | \$ 2,169              |
|                                       | <u>          </u>     |

The Company continues to pursue strategies to dispose of excess office space through subleasing and/or early termination negotiations where possible. The estimated costs of vacating these leased facilities, including estimated costs to sublease and any resulting sublease income, are based on market information and trend analysis. Actual results could differ from those estimates, and such differences could be material to the Company's financial statements.

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**13. Commitments and Contingencies**

United Parcel Service General Services Co. ( UPS ) previously alleged that the Company breached various provisions of a License Agreement for OEM Partners, dated as of May 23, 2000 (the License Agreement ), pursuant to which the Company agreed to license and support software to be used by UPS, in exchange for the payment by UPS of license and maintenance fees. The terms of the License Agreement called for binding arbitration to resolve any dispute between the parties, and UPS previously served the Company with a demand for arbitration. On July 6, 2005, the Company entered into a Settlement Agreement and Mutual Release with UPS that provided final resolution to all matters between the Company and UPS relating to the License Agreement. As a result of this Settlement Agreement, the Company incurred a charge of \$700,000, net of insurance proceeds, which was expensed in the three months ended June 30, 2005.

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

**Cautionary Statement**

The following discussion should be read along with the unaudited consolidated condensed financial statements and notes included in Item 1 of this Quarterly Report, as well as the audited consolidated financial statements and notes and Management's Discussion and Analysis of Financial Condition and Results of Operations for the fiscal year ended December 31, 2004, included in our Form 10-K filed with the Securities and Exchange Commission. This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements regarding future events and our future results are based on current expectations, estimates, forecasts, and projections and the beliefs and assumptions of our management. Words such as we expect, anticipate, target, project, believe, goals, estimate, potential, predict, may, might, could, intend, vary, and similar expressions are intended to identify these forward-looking statements. Readers are cautioned that these forward-looking statements are predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements.

Among the important factors that could cause actual results to differ materially from those indicated by our forward-looking statements are those discussed below under the subheading Risk Factors that May Affect Future Results and elsewhere in this report. We undertake no obligation to revise or update publicly any forward-looking statement for any reason. Readers should carefully review the risk factors described in Risk Factors that May Affect Future Results below, as well as in the documents filed by us with the Securities and Exchange Commission, specifically our Form 10-K relating to year ended December 31, 2004 and our Form 10-Q for the quarter ended March 31, 2005, as well as our most recent reports on Form 8-K, as they may be amended from time to time.

**Overview**

Motive, Inc. is a Delaware corporation formed in 1997. We are a leading supplier of management software for networked products and services. Our products build intelligent automation into networked products and services to expedite or eliminate various management tasks that both businesses and end-users must undertake in order to launch, maintain or update the products and services. Since our inception in 1997, more than one hundred businesses have used our software to design self-management into more than 200 different product and service offerings that they market and sell to their customers.

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Our future success will depend on many factors, including but not limited to:

the return on investment that our products provide to our customers, as compared with those of our competitors; and

our ability to continue to bring to market products that help our customers solve significant technological problems.

In evaluating our financial condition and operating performance, our management team and our board of directors focus on a wide variety of information and performance metrics, including, among others, the following:

the level of revenue generated from sales of our software products to existing and new customers;

the mix of revenue generated from license fees and services fees;

the mix of revenue generated within North America and outside North America;

the mix of revenue generated from our broadband products and our corporate enterprise products;

the extent to which customers license our products under term as opposed to perpetual licenses;

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our ability to manage our cost structure such that it supports our revenue generation efforts while optimizing profitability; and

our employee headcount numbers, both in terms of function within the company and in terms of geographic dispersal, which are directly reflective of our cost structure.

The principal operational challenge that we face is the fact that our quarterly revenue and results of operations are difficult to predict. Unlike more established software vendors, we have experienced, and expect to continue to experience, fluctuations in revenue and operating results from quarter to quarter. Weak spending and competitive pressures may challenge our future financial performance. Additionally, we typically derive a significant portion of our revenue each quarter from a number of license agreements closed in the last month of a quarter. If we fail to close certain agreements that are expected to be completed toward the end of a quarter, our quarterly results would suffer.

To address these challenges, we intend to continue to invest to enhance our current products and services and to develop new products and services. We also intend to increase our services, sales and development resources, and to invest in the continued expansion of our international operations. We may seek to accomplish these expansions by acquiring businesses that possess products, technology or operations that are complementary to ours.

Another operational challenge that we face is the fact that our operating expenses are, to a large extent, fixed in the short term. If our revenue falls below our expectation in a quarter and we are not able to greatly reduce our operating expenses in response, our operating results for that quarter could be adversely affected. To address this challenge, we attempt to closely monitor our cost structure and operating expense trends, as well as to closely monitor our sales pipeline and related sales activities.

In addition, our ability to compete effectively will depend on the timely introduction and success of future software products and releases and the ability of our products to interoperate and perform well with existing and future leading databases, applications, operating systems and other platforms. To address this challenge, we have made and will continue to make significant investments in research and development to keep pace with technological change in our industry.

On June 30, 2004, we completed our initial public offering in which we sold 5 million shares of our common stock at \$10 per share, for an aggregate public offering price of \$50.0 million. Our initial public offering resulted in aggregate net proceeds to us of approximately \$43.8 million. See Note 2 to the accompanying consolidated condensed financial statements for additional information.

We intend the following discussion of our financial condition and results of operations to provide information that will assist in understanding our financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our financial statements.

### ***Sources of Revenue***

Through June 30, 2005, substantially all of our revenue was derived from licensing our product suite and providing related services. Customers pay us license fees for the right to use our products for a fixed-term or perpetual basis. In recent years, approximately 70% to 80% of the license agreements we entered into were fixed-term as opposed to perpetual. The term of our licenses is typically three years. We price our license fees based on an expected volume of usage during the license term.

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We market one set of products to broadband service providers, and a separate set of products to corporate enterprises. The products that we market to corporate enterprises are Motive Remote Service Manager, Motive Desktop Manager, and Motive Profile. We sell our Motive Remote Service Manager and Motive Desktop Manager products primarily to technology hardware vendors, software vendors, and IT departments of corporations. This group of customers comprised the majority of our annual revenue contributed by corporate enterprises through 2004. In 2004 we began marketing Motive Profile, which is focused on configuration management for software applications. We are marketing this product primarily to software vendors and application development groups within other corporations. Revenue from Motive Profile comprised a negligible amount of our 2004 total revenue.

The relative percentages of our total revenue from broadband service providers and corporate enterprises fluctuates from period to period. In 2003 and 2004, broadband service providers comprised 64% and 78%, respectively, and corporate enterprises comprised 36% and 22%, respectively, of our total revenue (excluding revenue acquired in business combination). The decrease in revenue from corporate enterprises is primarily due to a decline in sales of our Remote Service Manager and Desktop Manager products, and we expect the declining sales of these products to continue. However, we expect that this decline will be offset by revenue from Motive Profile and future configuration application management products.

In order to increase the distribution of our products in new geographies and to companies that we might otherwise not be able to reach, we intend to increase our use of software resellers to license and distribute our software in the future. During the quarter ended March 31, 2005, we executed an agreement with a systems integrator, which permits distribution of our licensed software to a named

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customer, and potentially to other referred customers outside of North America that we mutually agree upon. In April 2005 we executed an agreement with Alcatel, a leading supplier of DSL equipment, which permits Alcatel to distribute a jointly developed software product that will allow the management of the next generation of intelligent home gateways that provide voice, video and data service to the home. In May 2005, we further extended our relationship with Alcatel, and granted Alcatel the right to resell additional Motive consumer related products. In June 2005, Alcatel purchased from us non-refundable licenses for resale to customers pursuant to this agreement. In addition, we have recently been engaging additional software resellers in various other geographies in order to further the distribution of our software products in those regions.

Our licensing arrangements may also include the provision of certain services. Services revenue is comprised of revenue from professional services, such as consulting services, maintenance and support services, and hosting and managed services. Consulting services include a range of services such as installation, implementation and non-complex interface development for the customer's specific applications. Maintenance and support services represent technical support of our software products and include the right to unspecified product upgrades on an if-and-when available basis. Hosting and managed services involve remote management of our solutions.

We experience seasonality in our revenue, with the fourth quarter of the year typically having the highest revenue for the year. We believe that this seasonality results primarily from customer budgeting cycles and our sales compensation model. We expect that this seasonality will continue.

In January 2003, we acquired BroadJump, a provider of solutions for broadband companies, to solidify our position as a leader in management software. As a result, we assumed liabilities related to existing software arrangements with a fair value of approximately \$40.1 million. The fair value of these assumed liabilities, which was recorded as deferred revenue, relates to the remaining contractual obligations under the BroadJump software arrangements and is being recognized ratably as services revenue acquired in business combination over the remaining life of the individual software arrangements. This revenue will continue to decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire. The following table summarizes how this revenue will be recognized in each calendar quarter of 2005 and 2006 (in millions):

|      | Quarter Ended |         |          |         |
|------|---------------|---------|----------|---------|
|      | Mar. 31       | June 30 | Sept. 30 | Dec. 31 |
| 2005 | \$ 1.3        | \$ 1.0  | \$ 0.9   | \$ 0.9  |
| 2006 | 0.9           | 0.9     | 0.6      | 0.3     |

Excluding services revenue acquired in business combination, license fees revenue in recent years has represented 63% to 77% of total revenue and services revenue has represented 23% to 37% of total revenue.

**Results of Operations**

In view of our limited operating history and changes in the general economic climate, we believe that period-to-period comparisons of revenue and operating results are not necessarily meaningful and should not be relied upon as indications of future performance. Our prospects must be considered in light of the risks, expenses and difficulties encountered by companies in new and rapidly evolving markets. Additionally, despite our revenue growth during prior periods, we do not believe that historical growth rates are necessarily sustainable or indicative of future growth.

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The following discussion and analysis of our financial condition and results of operations are based upon our consolidated condensed financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these consolidated condensed financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Estimates and assumptions are reviewed periodically, and actual results may differ from these estimates under different assumptions or conditions.

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The following table sets forth, for the periods indicated, our unaudited consolidated condensed statements of operations as a percentage of total revenue.

|   | Three Months Ended |             | Six Months Ended |             |
|---|--------------------|-------------|------------------|-------------|
|   | June 30,           |             | June 30,         |             |
|   | 2005               | 2004        | 2005             | 2004        |
| <b>Revenue:</b>                             |                    |             |                  |             |
| License fees                                | 58%                | 57%         | 58%              | 54%         |
| <b>Services:</b>                            |                    |             |                  |             |
| Services                                    | 37                 | 35          | 37               | 34          |
| Acquired in business combination            | 5                  | 8           | 5                | 12          |
| <b>Total services revenue</b>               | <b>42</b>          | <b>43</b>   | <b>42</b>        | <b>46</b>   |
| <b>Total revenue</b>                        | <b>100</b>         | <b>100</b>  | <b>100</b>       | <b>100</b>  |
| <b>Cost of revenue:</b>                     |                    |             |                  |             |
| License fees                                | 1                  | 1           | 1                | 1           |
| Amortization of acquired technology         | 2                  | 1           | 1                | 1           |
| Services                                    | 29                 | 29          | 29               | 31          |
| <b>Total cost of revenue</b>                | <b>32</b>          | <b>31</b>   | <b>31</b>        | <b>33</b>   |
| <b>Gross margin</b>                         | <b>68</b>          | <b>69</b>   | <b>69</b>        | <b>67</b>   |
| <b>Operating expenses:</b>                  |                    |             |                  |             |
| Sales and marketing                         | 36                 | 34          | 35               | 34          |
| Research and development                    | 22                 | 19          | 20               | 19          |
| General and administrative                  | 11                 | 9           | 11               | 9           |
| Amortization of intangibles                 | 4                  | 3           | 4                | 4           |
| Amortization of deferred stock compensation | 1                  | 3           | 1                | 3           |
| <b>Total operating expenses</b>             | <b>74</b>          | <b>68</b>   | <b>71</b>        | <b>69</b>   |
| <b>Income (loss) from operations</b>        | <b>(6)</b>         | <b>1</b>    | <b>(2)</b>       | <b>(2)</b>  |
| Interest income (expense), net              | 1                  | (9)         | 1                | (5)         |
| Legal settlement                            | (3)                |             | (1)              |             |
| Other income, net                           |                    |             |                  | 1           |
| <b>Loss before income taxes</b>             | <b>(8)</b>         | <b>(8)</b>  | <b>(2)</b>       | <b>(6)</b>  |
| Provision for income taxes                  |                    | 1           | 1                | 2           |
| <b>Net loss</b>                             | <b>(8)%</b>        | <b>(9)%</b> | <b>(3)%</b>      | <b>(8)%</b> |

*Comparison of the Three Months Ended June 30, 2005 and 2004*



**Revenue**

As discussed elsewhere in this report (see [Risk Factors That May Affect Future Results](#) ), our revenue may be subject to fluctuation from period to period. Our revenue recognition policy requires that we only recognize revenue when persuasive evidence of an agreement exists, delivery of the product has occurred, no unfulfilled vendor obligations remain, the fee is fixed and determinable and collectibility is probable. If the fee for a license has payment terms that exceed our normal payment terms, the fee is not considered to be fixed or determinable and we only recognize license revenue when amounts actually become due. As a result, the amount of revenue that we recognize in any given period is dependent upon the amounts that are due under customer agreements during that period, which can vary significantly from period to period. For a variety of reasons, we occasionally amend existing license agreements, which can result in changes to the dates and amounts of license fees payable to us and, therefore, changes to the timing and amounts of revenue recognized from such license agreement.

Total revenue decreased by \$1.3 million, or approximately 5%, from \$24.0 million for the three months ended June 30, 2004 to \$22.7 million for the three months ended June 30, 2005. The decrease was primarily due to a \$400,000 decrease in license fees revenue and a \$1.0 million decrease in services revenue acquired as a result of the BroadJump acquisition, partially offset by an increase in services revenue of \$100,000. As previously noted, the services revenue acquired as a result of the BroadJump acquisition will decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire (see [Overview Sources of Revenue](#) ).

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Revenue from broadband service providers decreased by \$3.0 million, or approximately 16%, from \$18.4 million for the three months ended June 30, 2004 to \$15.4 for the three months ended June 30, 2005, representing 84% and 71%, respectively, of our total revenue (excluding revenue acquired in business combination). Revenue from corporate enterprises increased by \$2.8 million, or approximately 80%, from \$3.5 million for the three months ended June 30, 2004 to \$6.3 million for the three months ended June 30, 2005, representing 16% and 29%, respectively, of our total revenue (excluding revenue acquired in business combination).

Revenue from North America decreased by \$3.4 million, or approximately 22%, from \$15.4 million for the three months ended June 30, 2004 to \$12.0 for the three months ended June 30, 2005. Revenue from Europe and Asia Pacific increased by \$1.6 million, or approximately 19%, from \$8.6 million for the three months ended June 30, 2004 to \$10.2 million for the three months ended June 30, 2005. Revenue from Latin America was \$500,000 for the three months ended June 30, 2005, and we did not recognize any revenue from Latin America for the three months ended June 30, 2004. Revenue from outside North America represented 36% and 47% of our total revenue for the three months ended June 30, 2004 and 2005, respectively. The increase in revenue from outside North America is consistent with our focus on further expanding our European and Asia/Pacific operations. However, as a result of the application of our revenue recognition policies, the amount of revenue attributable to any customer, and thus the amount of revenue attributable to any specific geographic area, can vary significantly within any period and from period to period. For more information about our international revenue and expansion plans, please see Item 3. Quantitative and Qualitative Disclosures About Market Risk. Although U.S. generally accepted accounting principles require us to report our revenue in terms of revenue from customers in the United States and revenue from customers outside the United States and we have done so elsewhere in this report (see Quantitative and Qualitative Disclosures About Market Risk ), we believe that it is more meaningful to view our business in terms of revenue from customers in North America and revenue from customers outside of North America.

**License Fees.** For the three months ended June 30, 2005, we had \$13.2 million in total license fees revenue, which consisted of \$2.3 million of license fees revenue from new customers, \$5.4 million of license fees revenue from new agreements entered into with existing customers, and \$5.5 million of license fees revenue from agreements with existing customers entered into in previous periods. The \$13.2 million of license fees revenue represented 58% of our total revenue for the three months ended June 30, 2005, and a decrease of \$400,000 from \$13.6 million in total license fees revenue for the three months ended June 30, 2004, which represented 57% of our total revenue for that period. License fees revenue from new customers decreased by \$400,000 from \$2.7 million for the three months ended June 30, 2004 to \$2.3 million for the three months ended June 30, 2005. License fees revenue from new agreements entered into with existing customers increased by \$0.6 million from \$4.8 million for the three months ended June 30, 2004 to \$5.4 million for the three months ended June 30, 2005. License fees revenue from agreements with existing customers entered into in previous periods decreased by \$0.6 million from \$6.1 million for the three months ended June 30, 2004 to \$5.5 million for the three months ended June 30, 2005. During the three months ended June 30, 2005, we amended a license agreement with an existing customer that had been recently purchased by a larger entity to convert that customer's use of our Remote Service Manager product from a fixed-term license to a perpetual license. In connection with such amendment, the amount and due dates of the license fees to be paid to us by such customer were also amended. The financial impact of this amendment was \$1.9 million in revenue, which is included in the \$5.5 million of license fees revenue recognized during the three months ended June 30, 2005 from agreements with existing customers entered into in previous periods.

We distribute our software products to customers directly and to a lesser extent through systems integrators and software resellers. License fees revenue from resellers decreased by \$400,000 from \$2.2 million, or approximately 16% of our total license fees revenue, for the three months ended June 30, 2004, to \$1.8 million, or approximately 14% of our total license fees revenue, for the three months ended June 30, 2005.

**Services.** Our revenue from services decreased by \$900,000, or approximately 9%, from \$10.4 million for the three months ended June 30, 2004 to \$9.5 million for the three months ended June 30, 2005, representing 43% and 42%, respectively, of our total revenue. This decrease was caused by an approximately \$1.0 million decline in services revenue from contracts acquired in the BroadJump acquisition and a \$400,000 decline in consulting and training services revenue. These decreases were partially offset by a \$300,000 increase in hosting revenue and a \$200,000 increase in maintenance revenue.

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Services revenue acquired in business combinations was \$2.1 million and \$1.0 million, or 8% and 5% of our total revenue, for the three months ended June 30, 2004 and 2005, respectively. As previously noted, this revenue will decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire (see Critical Accounting Policies Revenue Recognition ).

### *Cost of Revenue*

**Cost of License Fees Revenue.** Cost of license fees revenue includes third-party software royalties, product packaging, documentation production and shipping costs related to software used by our customers. Cost of license fees revenue remained relatively constant for the three months ended June 30, 2004 and 2005, representing 1% of our license fees revenue for each period. We have expensed all costs incurred in the research and development of our software products as incurred, and, as a result, cost of license fees revenue includes no amortization of capitalized software development costs.

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**Amortization of Acquired Technology.** As a result of our January 2003 purchase of BroadJump, we acquired certain intangible technology assets having an estimated fair value of \$9.4 million and an estimated useful life of five years. Amortization of these intangible assets in the amounts of \$234,000 and \$351,000 was recorded as a cost of revenue for the three months ended June 30, 2004 and 2005, respectively. These amounts represented 1% and 2%, respectively, of total revenue. The increase in amortization of acquired technology is due to the acquired technology being amortized over its estimated useful life using a method of amortization that reflects the pattern in which its economic benefits are consumed based upon estimated contributions to discounted cash flows during that period.

**Cost of Services Revenue.** Cost of services revenue includes salaries and related expenses for our customer support, consulting, training and hosting and managed services organizations, third-party contractor expenses and an allocation of our facilities, communications and depreciation expenses. Cost of services revenue also includes the costs incurred in connection with servicing the remaining contractual obligations under the acquired BroadJump software arrangements. Costs associated with these remaining obligations decreased by \$1.0 million from \$1.4 million for the three months ended June 30, 2004 to \$0.4 million for the three months ended June 30, 2005.

Excluding the costs incurred in connection with servicing the BroadJump software arrangements, total cost of services revenue increased by \$500,000 from \$5.7 million for the three months ended June 30, 2004 to \$6.2 million for the three months ended June 30, 2005. This increase was primarily due to an increase in salary related costs.

Total cost of services revenue represented 68% and 70% of total services revenue for the three months ended June 30, 2004 and 2005, respectively. Excluding the costs and revenue associated with the acquired BroadJump software arrangements, cost of services revenue represented 68% and 73% of total services revenue for the three months ended June 30, 2004 and 2005, respectively.

## ***Operating Expenses***

**Sales and Marketing.** Sales and marketing expenses consist of salaries and related costs of our sales and marketing organizations, sales commissions, travel and entertainment expenses, costs of our marketing programs, including public relations and collateral materials, and rent and facilities costs associated with our regional sales offices. Sales and marketing expenses decreased by \$100,000 from \$8.3 million for the three months ended June 30, 2004 to \$8.2 million for the three months ended June 30, 2005, representing 34% and 36%, respectively, of our total revenue. The decrease in absolute dollars was primarily due to a decrease of \$100,000 in marketing program costs and a decrease of \$100,000 in sales awards. These decreases were partially offset by a \$100,000 increase in travel costs.

**Research and Development.** Research and development expenses consist of employee salaries, benefits, consulting costs and the cost of software development tools and expenses associated with the development of new products, enhancements of existing products and quality assurance activities. Research and development expenses increased by \$200,000 from \$4.7 million for the three months ended June 30, 2004 to \$4.9 million for the three months ended June 30, 2005, representing 19% and 22%, respectively, of our total revenue. The increase in absolute dollars was primarily due to an increase in salary related costs.

**General and Administrative.** General and administrative expenses consist of salaries and related costs of our administrative, finance, business operations and information technology personnel as well as legal and accounting services and costs associated with our recruiting programs. General and administrative expenses increased by \$600,000 from \$2.0 million for the three months ended June 30, 2004 to \$2.6 million for the three months ended June 30, 2005, representing 9% and 11%, respectively, of our total revenue. The increase in absolute dollars was primarily due to an increase of approximately \$400,000 in legal costs relating to the UPS settlement and third-party consulting costs relating to Sarbanes-Oxley compliance and an increase of \$200,000 in salary related costs.

**Amortization of Intangibles.** In January 2003, we recorded \$13.0 million of definite-lived intangibles in connection with the BroadJump acquisition, which resulted in amortization expense of \$802,000 and \$858,000 for the three months ended June 30, 2004 and 2005, respectively, representing 3% and 4%, respectively, of our total revenue. These intangibles are being amortized over their estimated lives of four to five years through 2008 using a method of amortization that reflects the pattern in which their economic benefits are consumed based upon estimated contributions to discounted cash flows during the applicable period.

**Amortization of Deferred Stock Compensation.** We recorded deferred stock compensation in connection with stock options granted to employees and consultants. These amounts represent the difference between the exercise price of certain stock option grants and the deemed fair value of our common stock at the time of such grants. We are amortizing these amounts over the vesting periods of the applicable options using an accelerated method, resulting in amortization expense of \$637,000 and \$251,000 for the three months ended June 30, 2004 and 2005, respectively.

***Interest Income (Expense), Net***

Interest income (expense), net increased from \$(2.0) million for the three months ended June 30, 2004 to \$332,000 for the three months ended June 30, 2005. The increase in interest income (expense), net was primarily due to a decrease in interest expense incurred on our outstanding debt because our subordinated debt was repaid in full in June 2004 and our term loans were repaid in full in December 2004. In addition, interest income increased due to our investment of funds received from our initial public offering in June 2004.

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### ***Legal Settlement***

United Parcel Service General Services Co. ( UPS ) previously alleged that the Company breached various provisions of a License Agreement for OEM Partners, dated as of May 23, 2000 (the License Agreement ), pursuant to which the Company agreed to license and support software to be used by UPS, in exchange for the payment by UPS of license and maintenance fees. The terms of the License Agreement called for binding arbitration to resolve any dispute between the parties, and UPS previously served the Company with a demand for arbitration. On July 6, 2005, the Company entered into a Settlement Agreement and Mutual Release with UPS that provided final resolution to all matters between the Company and UPS relating to the License Agreement. As a result of this Settlement Agreement, the Company incurred a charge of \$700,000, net of insurance proceeds, which was expensed in the three months ended June 30, 2005.

### ***Other Income (Expense), Net***

Other income (expense), net decreased from \$(55,000) for the three months ended June 30, 2004 to \$(109,000) for the three months ended June 30, 2005 primarily due to an increase in foreign currency losses.

### ***Provision for Income Taxes***

We have incurred operating losses for all fiscal years from inception through December 31, 2003 and had only a small amount of income in 2004 and a loss for the six months ended June 30, 2005, and therefore have not recorded a material provision for income taxes. Our provision for income taxes consists primarily of foreign income tax withholdings related to international sales as well as foreign income taxes on the earnings of our foreign subsidiaries. We have recorded a valuation allowance for the full amount of our net deferred tax assets, which include net operating loss, research and development credit and foreign tax credit carryforwards, because of the uncertainty regarding their realization.

### ***Comparison of the Six Months Ended June 30, 2005 and 2004***

#### ***Revenue***

As discussed elsewhere in this report (see Risk Factors That May Affect Future Results ), our revenue may be subject to fluctuation from period to period. Our revenue recognition policy requires that we only recognize revenue when persuasive evidence of an agreement exists, delivery of the product has occurred, no unfulfilled vendor obligations remain, the fee is fixed and determinable and collectibility is probable. If the fee for a license has payment terms that exceed our normal payment terms, the fee is not considered to be fixed or determinable and we only recognize license revenue when amounts actually become due. As a result, the amount of revenue that we recognize in any given period is dependent upon the amounts that are due under customer agreements during that period, which can vary significantly from period to period. For a variety of reasons, we occasionally amend existing license agreements, which can result in changes to the dates and amounts of license fees payable to us and therefore changes to the timing and amounts of revenue recognized from such license agreement.

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Total revenue increased by \$600,000, or approximately 1%, from \$46.7 million for the six months ended June 30, 2004 to \$47.3 million for the six months ended June 30, 2005. The increase was primarily due to a \$2.2 million increase in license fees revenue and an increase in services revenue of \$1.6 million, partially offset by a \$3.2 million decrease in services revenue acquired as a result of the BroadJump acquisition. As previously noted, the services revenue acquired as a result of the BroadJump acquisition will decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire (see [Overview Sources of Revenue](#) ).

Revenue from broadband service providers decreased by \$600,000, or approximately 2%, from \$31.4 million for the six months ended June 30, 2004 to \$30.8 for the six months ended June 30, 2005, representing 76% and 68%, respectively, of our total revenue (excluding revenue acquired in business combination). Revenue from corporate enterprises increased by \$4.4 million, or approximately 45%, from \$9.8 million for the six months ended June 30, 2004 to \$14.2 million for the six months ended June 30, 2005, representing 24% and 32%, respectively, of our total revenue (excluding revenue acquired in business combination).

Revenue from North America decreased by \$3.4 million, or approximately 11%, from \$31.0 million for the six months ended June 30, 2004 to \$27.6 million for the six months ended June 30, 2005. Revenue from Europe and Asia Pacific increased by \$3.5 million, or approximately 22%, from \$15.7 million for the six months ended June 30, 2004 to \$19.2 million for the six months ended June 30, 2005. Revenue from Latin America was \$500,000 for the six months ended June 30, 2005, and we did not recognize any revenue from Latin America for the six months ended June 30, 2004. Revenue from outside North America represented 34% and 42% of our total revenue for the six months ended June 30, 2004 and 2005, respectively. The increase in revenue from outside North America is consistent with our focus on further expanding our European and Asia/Pacific operations. However, as a result of the application of our revenue recognition policies, the amount of revenue attributable to any customer, and thus the amount of revenue

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attributable to any specific geographic area, can vary significantly within any period and from period to period. For more information about our international revenue and expansion plans, please see Item 3. Quantitative and Qualitative Disclosures About Market Risk. Although U.S. generally accepted accounting principles require us to report our revenue in terms of revenue from customers in the United States and revenue from customers outside the United States and we have done so elsewhere in this report (see Quantitative and Qualitative Disclosures About Market Risk ), we believe that it is more meaningful to view our business in terms of revenue from customers in North America and revenue from customers outside of North America.

**License Fees.** For the six months ended June 30, 2005, we had \$27.3 million in total license fees revenue, which consisted of \$6.4 million of license fees revenue from new customers, \$12.0 million of license fees revenue from new agreements entered into with existing customers, and \$8.9 million of license fees revenue from agreements with existing customers entered into in previous periods. The \$27.3 million of license fees revenue represented 58% of our total revenue for the six months ended June 30, 2005, and an increase of \$2.2 million from \$25.1 million in total license fees revenue for the six months ended June 30, 2004, which represented 54% of our total revenue for that period. License fees revenue from new customers decreased by \$0.2 million from \$6.6 million for the six months ended June 30, 2004 to \$6.4 million for the six months ended June 30, 2005. License fees revenue from new agreements entered into with existing customers increased by \$4.9 million from \$7.1 million for the six months ended June 30, 2004 to \$12.0 million for the six months ended June 30, 2005. License fees revenue from agreements with existing customers entered into in previous periods decreased by \$2.5 million from \$11.4 million for the six months ended June 30, 2004 to \$8.9 million for the six months ended June 30, 2005. During the six months ended June 30, 2005, we amended two license agreements with existing customers to convert those customers' use of our Remote Service Manager product from fixed-term licenses to perpetual licenses. In connection with such amendments, the amount and due dates of the license fees to be paid to us by one of the two customers were also amended. The financial impact of these amendments was \$1.9 million, which is included in the \$8.9 million of license fees revenue recognized during the six months ending June 30, 2005 from agreements with existing customers entered into in previous periods.

We distribute our software products to customers directly and to a lesser extent through systems integrators and software resellers. License fees revenue from resellers increased by \$3.6 million from \$3.4 million, or approximately 14% of our total license fees revenue, for the six months ended June 30, 2004, to \$7.0 million, or approximately 26% of our total license fees revenue, for the six months ended June 30, 2005.

**Services.** Our revenue from services decreased by \$1.6 million, or approximately 7%, from \$21.6 million for the six months ended June 30, 2004 to \$20.0 million for the six months ended June 30, 2005, representing 46% and 42%, respectively, of our total revenue. This decrease was caused by a \$3.2 million decline in services revenue from contracts acquired in the BroadJump acquisition, partially offset by a \$700,000 increase in consulting and training services revenue, a \$500,000 increase in maintenance revenue and a \$400,000 increase in hosting revenue.

Services revenue acquired in business combinations was \$5.5 million and \$2.3 million, or 12% and 5% of our total revenue, for the six months ended June 30, 2004 and 2005, respectively. As previously noted, this revenue will decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire (see Critical Accounting Policies Revenue Recognition ).

### ***Cost of Revenue***

**Cost of License Fees Revenue.** Cost of license fees revenue includes third-party software royalties, product packaging, documentation production and shipping costs related to software used by our customers. Cost of license fees revenue remained relatively constant in both six month periods ending June 30, 2004 and 2005, representing 1% of our license fees revenue for each period. We have expensed all costs incurred in the research and development of our software products as incurred, and, as a result, cost of license fees revenue includes no amortization of capitalized software development costs.



**Amortization of Acquired Technology.** As a result of our January 2003 purchase of BroadJump, we acquired certain intangible technology assets having an estimated fair value of \$9.4 million and an estimated useful life of five years. Amortization of these intangible assets in the amounts of \$448,000 and \$682,000 was recorded as a cost of revenue for the six months ended June 30, 2004 and 2005, respectively. These amounts represented 1% of total revenue in both of these periods. The increase in amortization of acquired technology is due to the acquired technology being amortized over its estimated useful life using a method of amortization that reflects the pattern in which its economic benefits are consumed based upon estimated contributions to discounted cash flows during that period.

**Cost of Services Revenue.** Cost of services revenue includes salaries and related expenses for our customer support, consulting, training and hosting and managed services organizations, third-party contractor expenses and an allocation of our facilities, communications and depreciation expenses. Cost of services revenue also includes the costs incurred in connection with servicing the remaining contractual obligations under the acquired BroadJump software arrangements. Costs associated with these remaining obligations decreased by \$2.7 million from \$3.7 million for the six months ended June 30, 2004 to \$1.0 million for the six months ended June 30, 2005.

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Excluding the costs incurred in connection with servicing the BroadJump software arrangements, total cost of services revenue increased by \$1.7 million from \$10.9 million for the six months ended June 30, 2004 to \$12.6 million for the six months ended June 30, 2005. This increase was primarily due to \$1.4 million in increased salary related costs, \$200,000 in increased third-party consulting costs, and \$100,000 in increased costs associated with servicing our growing international customer base.

Total cost of services revenue represented 68% of total services revenue for both periods. Excluding the costs and revenue associated with the acquired BroadJump software arrangements, cost of services revenue represented 68% and 71% of total services revenue for the six months ended June 30, 2004 and 2005, respectively.

### ***Operating Expenses***

***Sales and Marketing.*** Sales and marketing expenses consist of salaries and related costs of our sales and marketing organizations, sales commissions, travel and entertainment expenses, costs of our marketing programs, including public relations, and collateral materials, and rent and facilities costs associated with our regional sales offices. Sales and marketing expenses increased by \$700,000 from \$15.8 million for the six months ended June 30, 2004 to \$16.5 million for the six months ended June 30, 2005, representing 34% and 35%, respectively, of our total revenue. The increase in absolute dollars was primarily due to an increase of \$400,000 in sales commissions, an increase of \$300,000 in salary related costs, an increase of \$100,000 in travel costs and an increase of \$100,000 in third-party consulting costs. These increases were partially offset by a decrease of \$200,000 in sales awards.

***Research and Development.*** Research and development expenses consist of employee salaries, benefits, consulting costs and the cost of software development tools and expenses associated with the development of new products, enhancements of existing products and quality assurance activities. Research and development expenses increased by \$500,000 from \$8.9 million for the six months ended June 30, 2004 to \$9.4 million for the six months ended June 30, 2005, representing 19% and 20%, respectively, of our total revenue. The increase in absolute dollars was primarily due to an increase in salary related costs.

***General and Administrative.*** General and administrative expenses consist of salaries and related costs of our administrative, finance, business operations and information technology personnel as well as legal and accounting services and costs associated with our recruiting programs. General and administrative expenses increased by \$900,000 from \$4.2 million for the six months ended June 30, 2004 to \$5.1 million for the six months ended June 30, 2005, representing 9% and 11%, respectively, of our total revenue. The increase in absolute dollars was primarily due to an increase of approximately \$400,000 in salary related costs, an increase of \$300,000 in third-party consulting costs and an increase of \$200,000 in costs related to our investor relations programs.

***Amortization of Intangibles.*** In January 2003, we recorded \$13.0 million of definite-lived intangibles in connection with the BroadJump acquisition, which resulted in amortization expense of \$1.6 million and \$1.7 million for the six months ended June 30, 2004 and 2005, respectively, representing 4% of our total revenue for each period. These intangibles are being amortized over their estimated lives of four to five years through 2008 using a method of amortization that reflects the pattern in which their economic benefits are consumed based upon estimated contributions to discounted cash flows during the applicable period.

***Amortization of Deferred Stock Compensation.*** We recorded deferred stock compensation in connection with stock options granted to employees and consultants. These amounts represent the difference between the exercise price of certain stock option grants and the deemed fair value of our common stock at the time of such grants. We are amortizing these amounts over the vesting periods of the applicable options using an accelerated method, resulting in amortization expense of \$1.5 million and \$589,000 for the six months ended June 30, 2004 and 2005,

respectively.

***Interest Income (Expense), Net***

Interest income (expense), net increased from \$(2.5) million for the six months ended June 30, 2004 to \$621,000 for the six months ended June 30, 2005. The increase in interest income (expense), net was primarily due to a decrease in interest expense incurred on our outstanding debt because our subordinated debt was repaid in full in June 2004 and our term loans which were repaid in full in December 2004. In addition, interest income increased due to our investment of funds received from our initial public offering in June 2004.

***Legal Settlement***

United Parcel Service General Services Co. ( UPS ) previously alleged that the Company breached various provisions of a License Agreement for OEM Partners, dated as of May 23, 2000 (the License Agreement ), pursuant to which the Company agreed to license and support software to be used by UPS, in exchange for the payment by UPS of license and maintenance fees. The terms of the License Agreement called for binding arbitration to resolve any dispute between the parties, and UPS previously served the Company with a demand for arbitration. On July 6, 2005, the Company entered into a Settlement Agreement and Mutual Release with UPS that provided final resolution to all matters between the Company and UPS relating to the License Agreement. As a result of this Settlement Agreement, the Company incurred a charge of \$700,000, net of insurance proceeds, which was expensed in the three months ended June 30, 2005.

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### ***Other Income (Expense), Net***

Other income (expense), net decreased from \$417,000 for the six months ended June 31, 2004 to \$(181,000) for the six months ended June 31, 2005 primarily due to large foreign currency gains recognized in 2004.

### ***Provision for Income Taxes***

We have incurred operating losses for all fiscal years from inception through December 31, 2003 and only a small amount of income in 2004 and a loss for the six months ended June 30, 2005, and therefore have not recorded a material provision for income taxes. Our provision for income taxes consists primarily of foreign income tax withholdings related to international sales as well as foreign income taxes on the earnings of our foreign subsidiaries. We have recorded a valuation allowance for the full amount of our net deferred tax assets, which include net operating loss, research and development credit and foreign tax credit carryforwards, because of the uncertainty regarding their realization.

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

Since inception, we have funded our operations and met our capital expenditure requirements through the private sale of equity securities and acquisitions, in addition to the completion of our initial public offering in June 2004. The net proceeds from our private securities issuances plus cash received from acquisitions was approximately \$107 million through June 30, 2005. The net proceeds from our initial public offering was \$43.8 million.

Cash provided by (used in) operating activities was \$6.5 million and \$(4.2) million for the six months ended June 30, 2004 and 2005, respectively. This difference is primarily due to changes in operating assets and liabilities, including accounts receivable, accounts payable, accrued liabilities and deferred revenues which can all fluctuate significantly based on timing of cash receipts and payments. To date, cash used in investing activities has consisted primarily of purchases of short-term investments, which were \$8.1 million and \$12.4 million during the six months ended June 30, 2004 and 2005, respectively. This was offset by \$7.2 million in proceeds from maturities of short-term investments during the six months ended June 30, 2005. In addition we had capital expenditures totaling \$1.4 million for each of the six month periods ended June 30, 2004 and 2005, to acquire property and equipment, mainly computer hardware and software for our employee base and our hosting and managed services operations. We had a decrease in restricted cash in the first quarter of 2004 in the amount of \$15.0 million due to the removal of covenants existing on the term loans and line of credit that we had at that time.

At June 30, 2005, we had cash and cash equivalents on hand of \$36.4 million and working capital of \$70.6 million. Our accounts receivable balance has increased \$4.1 million from December 31, 2004 to June 30, 2005. Accounts receivable can fluctuate significantly as we can experience fluctuations in revenue, timing of shipments and the timing of payments received from our customers. Our payment terms generally require payment within 30 to 90 days of invoicing.

In October 2002, we issued senior subordinated promissory notes totaling \$12.5 million, bearing interest at 11% annually, to certain of our stockholders. These notes were repaid in full in June 2004. On December 6, 2004, we entered into a Loan Agreement with a bank, pursuant to which the bank is providing us with a revolving credit facility of \$25 million, of which zero was outstanding at June 30, 2005. The lending commitments under the line of credit are scheduled to terminate on December 6, 2006. The Loan Agreement contains various covenants which, among other things require us to maintain a ratio of (a) cash equivalents at the Bank plus 70% of gross accounts receivable divided by (b) the

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aggregate balance of any obligations owing from us to the Bank of not less than 1.5 to 1. We must also maintain our primary operating accounts with the Bank, and invest with the Bank at least 50% of all amounts held by us in investment accounts. If our cash equivalents and short-term investments fall below \$40 million in total, or upon an uncured event of default under the Loan Agreement, we will grant to the Bank a first priority security interest in all of our assets. Additionally, the Loan Agreement includes various covenants which, among other things, impose limitations on our disposition of assets, changes in control, mergers and acquisitions, additional indebtedness, liens, distributions and investments, and transactions with affiliates. At June 30, 2005, we were in compliance with such covenants and restrictions.

We believe that cash on hand, cash equivalents, short-term investments and existing credit facilities will be sufficient to meet our working capital requirements for at least the next 12 months. Thereafter, we may require additional funds to support our working capital requirements or for other purposes and may seek to raise such additional funds through public or private equity financings or from other sources. There can be no assurance that additional financing will be available at all or that, if available, such financing will be obtainable on terms favorable to us or our stockholders. The sale of additional equity or convertible debt securities could dilute the per share value of our common stock. Additionally, we could be forced to engage in debt financing on terms that could restrict our ability to make capital expenditures or incur additional indebtedness, which could impede our ability to achieve our business objectives.

### **Off-Balance Sheet Arrangements**

We had no off-balance sheet arrangements as of December 31, 2004 or as of June 30, 2005.

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### **Critical Accounting Policies**

#### ***Revenue Recognition***

We recognize revenue in accordance with the American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. In addition, we apply the provisions of the Emerging Issues Task Force ( EITF ) Issue No. 00-3, *Application of AICPA SOP 97-2 to Arrangements that Include the Right to Use Software Stored on Another Entity's Hardware*, to our managed services software transactions.

License fees revenue is comprised of fees for term and perpetual licenses of our software. We generally do not enter into an arrangement solely for the license of products and, therefore, we have not demonstrated vendor specific objective evidence ( VSOE ) of fair value for the license element in the majority of our arrangements. We recognize revenue for the fees associated with both perpetual and term licenses using the residual method in accordance with SOP 98-9 regardless of any separate prices stated within the contract for each element. Under the residual method, the arrangement fee is first allocated to the undelivered elements based upon their VSOE of fair value; the remaining arrangement fee, including any discount, is allocated to the delivered element. Therefore, if and when we offer discounts on professional services or other elements, those discounts are applied to the license portion of the arrangement. License fees revenue is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no unfulfilled obligations remain, the fee is fixed or determinable and collectibility is probable.

If the fee for the license has any payment terms that are in excess of our normal payment terms, the fee is considered to not be fixed or determinable. In this scenario, the amount of revenue recognized is limited to the amount currently due from the customer. In such arrangements, license fees are recognized as license fees revenue as the related amounts become due. Because each such arrangement is individually negotiated, the payment schedule and resulting revenue recognition associated with each arrangement can vary.

If an arrangement includes a right of acceptance or a right to cancel, revenue is recognized when acceptance is received or the right to cancel has expired.

License fees revenue from arrangements with resellers involving nonrefundable fixed minimum license fees are recognized when payments are due within our normal payment terms from the reseller and delivery of the product has occurred, assuming no significant vendor obligations remain. Royalties related to such reseller arrangements in excess of the fixed minimum amounts are recognized as revenue when such amounts are reported to us.

Services revenue is comprised of revenue from professional services, such as consulting services, maintenance and support, and hosting and managed software services. Generally, we have determined that the service elements of our software arrangements are not essential to the functionality of our software. We have also determined that our professional services (1) are available from other vendors, (2) do not involve a significant degree of risk or unique acceptance criteria, and (3) qualify for separate accounting as we have sufficient experience in providing such services.

VSOE of fair value of services in multiple element arrangements is based upon rates for consulting and training services and annual subscription fees for pre-packaged technical support services which we have charged in stand-alone contracts for services. For both perpetual and term

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licensing arrangements, in accordance with paragraph 57 of SOP 97-2, VSOE of fair value for maintenance and hosting is determined by reference to the price the customer has paid or will be required to pay when maintenance and hosting are sold separately. VSOE of fair value for maintenance and hosting contracts is based upon our pricing practice that maintenance and hosting renewal rates are based upon a percentage of the quoted license fees in the related contract.

Consulting and training services are recognized as services revenue as the related consulting or training services are performed and payments are due within our normal payment terms. Maintenance revenue is deferred and recognized on a straight-line basis as services revenue over the life of the related agreement, which typically ranges from one to three years. Hosting and managed software services revenue is deferred and recognized on a straight-line basis as services revenue over the life of the related agreement, which typically ranges from three months to one year.

In January 2003, we assumed liabilities related to existing software arrangements with a fair market value of approximately \$40.1 million as a result of the BroadJump acquisition. The fair value of these assumed liabilities, which was recorded as deferred revenue, relates to the remaining contractual obligations under the BroadJump software arrangements and is being recognized ratably as services revenue acquired in business combination over the remaining life of each software arrangement. This revenue will continue to decline on a quarterly basis through 2006 when the remaining individual contractual obligations under the BroadJump software arrangements expire.

Accounts receivable include amounts due from customers for which revenue has been recognized. Deferred revenue includes amounts received from customers for which revenue has not been recognized.

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### ***Allowance for Doubtful Accounts***

We continuously assess the collectibility of outstanding customer invoices and in doing so, we maintain an allowance for estimated losses resulting from the non-collection of customer receivables. In estimating this allowance, we consider factors such as: historical collection experience; a customer's current credit worthiness; customer concentration; age of the receivable balance, both individually and in the aggregate; and general economic conditions that may affect a customer's ability to pay. Actual customer collections could differ from our estimates and accordingly could exceed our related loss allowance.

### ***Goodwill and Other Intangible Assets***

In January 2003, we acquired BroadJump and recorded certain intangibles, including acquired technology, customer contractual relationships, order backlog, non-competition agreements, and goodwill. Amounts allocated to acquired technology, customer contractual relationships and order backlog are being amortized over the respective assets' estimated useful lives of four to five years using a method of amortization that reflects the pattern in which their economic benefits are consumed based upon estimated contributions to discounted cash flows during the applicable period. Amounts allocated to non-compete agreements are being amortized over their estimated useful lives of three years using the straight line method. We periodically review the estimated useful lives of our identifiable intangible assets, taking into consideration any events or circumstances which might result in a diminished fair value or revised useful life.

We assess whether goodwill and indefinite-lived intangibles are impaired on an annual basis. Upon determining the existence of goodwill and/or indefinite-lived intangibles impairment, we measure that impairment based on the amount by which the book value of goodwill and/or indefinite-lived intangibles exceeds its fair value. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit's identifiable assets and liabilities from the fair value of the reporting unit as a whole, as if that reporting unit had just been acquired and the purchase price were being initially allocated. Additional impairment assessments may be performed on an interim basis if we encounter events or changes in circumstances that would indicate that, more likely than not, the book value of goodwill and/or indefinite-lived intangibles has been impaired.

### ***Stock-Based Compensation***

We account for our employee stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*. We make disclosures regarding employee stock-based compensation using the fair value method in accordance with SFAS No. 123, *Accounting for Stock Based Compensation*. We have calculated the fair value of options granted and have determined the pro forma impact on net income (loss). We use an accelerated method of amortization for both book and pro forma stock based compensation. We account for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services*.

### ***Recently Issued Accounting Standards***

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123R). SFAS 123R addresses the accounting for share-based payments to employees, including grants of employee stock options. Under the new standard, companies will no longer be able



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to account for share-based compensation transactions using the intrinsic method in accordance with APB No. 25, *Accounting for Stock Issued to Employees*. Instead companies will be required to account for such transactions using a fair-value method and recognize the expense in the consolidated statement of operations. SFAS 123R will be effective for years beginning after December 15, 2005 and allows, but does not require, companies to restate prior years presented to reflect the impact of expensing share-based payments under SFAS 123R. We have not yet determined which fair-value method and transitional provision we will follow. However, we expect that the adoption of SFAS 123R will have a significant impact on our results of operations. We do not expect that the adoption of SFAS 123R will impact our overall financial position.

### **Risk Factors that May Affect Future Results**

In addition to the other information included in this Quarterly Report, you should carefully consider the risks described below. The risks and uncertainties described below are not the only ones that we face. Additional risks and uncertainties not presently known to us or that we currently deem not significant may also affect our business operations. If any of these risks actually occur, our business, financial condition, or results of operations could be seriously harmed. In that event, the market price of our common stock could decline.

*Our total revenue may fluctuate and may be difficult to predict. If our future results are below the expectations of public market analysts and investors, the price of our common stock may decline.*

Our quarterly revenue and results of operations are difficult to predict. Unlike more established enterprise software vendors, we have experienced, and expect to continue to experience, fluctuations in revenue and operating results from quarter to quarter. As a

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result, we believe that quarter-to-quarter comparisons of our revenue and operating results are not necessarily meaningful, and that such comparisons may not be accurate indicators of future performance. The reasons for these fluctuations include, but are not limited to:

the timing of sales of our software, including the relatively long sales cycles of up to nine months or more associated with most of our larger software sales to large enterprises;

our quarterly revenue is dependent on larger software sales to a relatively small number of large enterprises;

our dependence on license revenue from new software sales (as opposed to recurring maintenance revenue) to achieve our revenue objectives;

budget and spending decisions by our customers, who are concentrated in the communications and high technology markets;

our ability to renew existing licenses, most of which are for a term of three years, or to secure new licenses on beneficial terms;

market acceptance of newly released products or delays in new product introductions;

our utilization and billing rates for our professional services personnel;

our history of growth through acquisitions which have typically affected our operating results;

the amount and timing of operating costs related to the expansion of our business, operations and infrastructure; and

changes in our pricing policies or our competitors' pricing policies.

In addition, we experience seasonality in our revenue, with the fourth quarter of the year typically having the highest revenue for the year. We believe that this seasonality results primarily from customer budgeting cycles and our sales compensation model. We expect that this seasonality will continue.

Our operating expenses, which include sales and marketing, research and development and general and administrative expenses, are based on our expectations of future revenue and are, to a large extent, fixed in the short term. If revenue falls below our expectations in a quarter and we are not able to quickly reduce our operating expenses in response, our operating results for that quarter could be adversely affected. It is possible that in some future quarter our operating results may be below the expectations of public market analysts and investors and, as a result, the price of our common stock may fall.

*Our customer base is concentrated. Accordingly, the loss of a major customer could cause our revenue to decline.*

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Our quarterly revenue is especially subject to fluctuation because it depends on the completion of large orders for our products and related services primarily from a small number of large customers. Although our customer make-up varies from quarter to quarter, a small number of customers are likely to continue to account for a significant portion of our revenue, and our revenue could decline due to the loss or delay of a single customer order or the failure of an existing customer to renew its license. Our ability to mitigate this risk is based almost entirely on our ability to obtain additional customers and to expand our sales to existing customers. Our failure to obtain additional customers, the loss or delay of customer orders or the failure of existing customers to renew their licenses will harm our business and operating results.

***We were first profitable on an annual basis in 2004, and we have incurred net losses in each prior year since we began operations. We may incur losses in the future.***

To date, we have only been profitable on an annual basis for the year ended December 31, 2004, and we have incurred net losses in almost every fiscal period since we began operations. For the year ended December 31, 2004, we had a net income of \$427,000, for the six months ended June 30, 2005 we had a net loss of \$1.2 million, and as of June 30, 2005, we had an accumulated deficit of approximately \$89.2 million. We will need to generate significant additional revenue and manage expenses appropriately to achieve and maintain profitability. Therefore, we may not be able to achieve or increase profitability on a quarterly or annual basis.

***We have a limited history of sales of some of our products, which makes it difficult to evaluate our prospects.***

Some of the products in our current product suite have been released recently, including Motive Profile, which was released in May 2004, and our Motive Home Device Manager, which was released in March 2005. These products target solving customers' problems that we have not previously addressed. There can be no assurance that our customers will perceive these products as adequately addressing those problems or that there will be substantial demand for them. It is difficult to evaluate our future prospects because of our limited experience with these products, the rapidly evolving and competitive nature of the markets in which we sell these products and other factors that are beyond our control.

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*The typical sales cycle for our products and services is long and it may be difficult for us to predict when certain customers will complete the sales cycle. As a result, our quarterly operating results may fluctuate and the price of our common stock could decline.*

We believe that a customer's decision to purchase our software and services is highly discretionary, involves a significant commitment of resources and is influenced by customer budgetary cycles. To successfully sell our software and services, we must educate potential customers regarding their use and benefits, which can require significant time and resources from us and our customers. The period between our initial contact with a potential customer and the purchase of our software and services is often long and subject to delays associated with the budgeting, approval and competitive evaluation processes that frequently accompany significant capital expenditures. Our sales cycle varies substantially and may require up to nine months or more depending on the customer and the size of the transaction. A lengthy sales cycle may have an impact on the timing of our revenue, which in turn could cause our quarterly operating results to fluctuate and our stock price to trade at lower levels than would otherwise be the case.

*If we do not successfully address the risks inherent in the expansion of our international operations, our business could suffer.*

We currently have operations in Canada, the United Kingdom, Germany, Switzerland, France, Spain, Italy, Hong Kong and Japan, and we intend to expand further into international markets. Unlike more established enterprise software vendors, we have limited experience in international operations and may not be able to compete effectively in international markets or to operate profitably in these markets. At the same time, our dependence on international revenue has steadily increased over time. Our international revenue was \$48.6 million for the year ended December 31, 2004, an increase of \$19.1 million, or approximately 65%, over international revenue of \$29.5 million for 2003. Our international revenue was \$26.2 million for the six months ended June 30, 2005, an increase of \$1.9 million, or approximately 8%, over international revenue of \$24.3 million for the six months ended June 30, 2004. Continued expansion of our international operations will require a significant amount of attention from our management and substantial financial resources and may require us to add qualified management in these markets. Our direct sales model requires us to attract, retain and manage qualified sales personnel capable of selling into markets outside the U.S. In our opinion, this is significantly more difficult in markets outside the U.S. Additionally, in some cases, our costs of sales may increase if our customers require us to sell through local distributors.

For the six months ended June 30, 2005, 56% of our revenue was derived from international operations. If we are unable to continue to grow our international operations in a cost effective and timely manner, our business and operating results could be harmed. Doing business internationally involves additional risks that could harm our operating results, particularly:

differing technology standards;

difficulties in collecting accounts receivable and longer collection periods;

political and economic instability;

fluctuations in currency exchange rates;

imposition of currency exchange controls;

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potentially adverse tax consequences;

reduced protection for intellectual property rights in certain countries;

dependence on local vendors;

compliance with multiple conflicting and changing governmental laws and regulations;

seasonal reductions in business activity specific to certain markets;

longer sales cycles;

restrictions on repatriation of earnings;

differing labor regulations;

restrictive privacy regulations in different countries, particularly in the European Union;

restrictions on the export of sensitive U.S. technologies such as data security and encryption; and

import and export restrictions and tariffs.

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***Our failure to adapt to technological change in our industry and to develop and achieve broad adoption and acceptance of our new products could cause the loss of existing and potential customers and therefore adversely affect our revenue and earnings. We are dependent on new product introductions for future revenue growth and such introductions involve significant risks.***

If we fail to keep pace with technological change in our industry, such failure would have an adverse effect on our revenue and earnings. During the past several years, many new technological advancements and competing products have entered the marketplace to address the same problems that our products and services are intended to address. Our ability to compete effectively and our growth prospects depend upon many factors, including the success of our existing software products, the timely introduction and success of future software products and releases and the ability of our products to interoperate and perform well with existing and future leading databases, applications, operating systems and other platforms. We have made significant investments in research and development and our business model requires us to generate substantial revenue from new product introductions. We released one new product in the second quarter of 2004, two new products in the third quarter of 2004 (which were subsequently incorporated into the product released in the second quarter of 2004), and one new product in the first quarter of 2005. New product introductions involve significant risks. For example, delays in new product introductions or less-than-anticipated market acceptance of our new products are possible and would have an adverse effect on our revenue and earnings. We cannot be certain that our new products or future enhancements to existing products will meet customer performance needs or expectations when shipped or that they will be free of significant software defects or bugs. If they do not meet customer needs or expectations, for whatever reason, upgrading or enhancing these products could be costly and time consuming. In addition, the selling price of software products tends to decline significantly over the life of the product. If we are unable to offset any reductions in the selling prices of our products by introducing new products at higher prices or by reducing our costs, our revenue, gross margin and operating results would be adversely affected.

***Our business is dependent on the renewal of licenses by our existing customers. If our customers do not renew their licenses for our products or if they do not renew their licenses on terms that are favorable to us, our operating results could be adversely affected and the price of our common stock could decline.***

Most of our licenses are for a fixed term of three years. For example, for the year ended December 31, 2004, approximately 79% of the license agreements we entered into were fixed term licenses, as opposed to perpetual licenses. As the end of the term of a fixed term license approaches, we attempt to negotiate the renewal of the license with the customer for the same product and/or for new products and services. If our customers choose not to renew their fixed term licenses with us or if we are unable to license additional products to our existing customers on beneficial terms, our business, operating results and financial condition could be harmed.

***If we do not expand our sales and distribution capabilities, we may not be able to expand the sales of our software and services and achieve revenue growth.***

We need to substantially expand our direct and indirect sales and distribution efforts, both domestically and internationally, in order to increase sales of our software and related services. Competition for qualified sales and marketing personnel is intense, and we might not be able to hire and retain adequate numbers of such personnel to maintain our growth. New hires require training and take time to achieve full productivity. Our competitors have attempted to hire our employees and we expect that they will continue to do so. We also plan to expand our relationships with system integrators, enterprise software vendors and other third-party resellers to develop our indirect sales channel. As we develop our indirect sales channel, we will need to manage potential conflicts between our direct sales force and third-party reselling efforts.

***If we do not expand our professional services organization, our customers may become dissatisfied and our operating results could suffer. Also, our professional services organization may not operate in a profitable manner.***

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Our software sales, particularly those to large enterprises, are often dependent on our ability to provide a significant level of professional services to our customers. Clients that license our software typically engage our professional services organization to assist with installation, training, consulting and implementation of our software. We believe that growth in our software sales depends to a significant degree on our ability to provide our clients with these services. We cannot be certain that our professional services business will operate in a profitable manner. We plan to further increase the number of services personnel to meet customer needs. New services personnel will require training and education and take time to reach full productivity. We may not be able to recruit the services personnel we need or retain our current services personnel because competition for qualified services personnel is intense. We are in a relatively new market and only a limited number of individuals have the skills needed to provide the services that our clients require. To meet our needs for services personnel, we may also need to use third-party consultants to supplement our own professional services organization.

*If we fail to attract, train, and retain highly qualified employees, our business may be harmed*

Our future success will depend on our continued ability to attract, train and retain highly qualified employees. As of June 30, 2005, we had 119 employees in our professional services organization, 83 employees in our sales and marketing organizations, 101 employees in our development organization, and 42 employees in our general and administrative organization. Our employees are not represented by a collective bargaining agreement and we have never experienced a strike or similar stoppage. We consider our relations with our employees to be good.

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***If we lose the services of any of our senior management or other key personnel, our business may be harmed.***

Our success will depend on the skills, experience and performance of our senior management, engineering, sales, marketing and other key personnel, many of whom have worked together for a relatively short period of time. Currently, we do not have long-term employment agreements with any of our executive officers, with the exception of Kenny Van Zant who joined us as a result of our acquisition of BroadJump in early 2003 and received an employment agreement as part of the terms and conditions of that acquisition. The loss of the services of any of our senior management or other key personnel, including our Chief Executive Officer, Scott Harmon, could harm our business. Mr. Harmon, in particular, is one of our co-founders and possesses unique knowledge of our markets, our products and our customers. We possess key man life insurance for Scott Harmon, but not for any of our other officers.

***If our independent registered public accounting firm is unable to provide us with the attestation of the adequacy of our internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of your shares.***

As directed by Section 404 of the Act, the SEC adopted rules requiring public companies to include a report of management on the company's internal control over financial reporting in their annual reports on Form 10-K that contains an assessment by management of the effectiveness of the company's internal control over financial reporting. We are required to include such a report in our annual reports on Form 10-K beginning with the year ended December 31, 2005. In addition, the registered public accounting firm auditing our financial statements must attest to and report on management's assessment of the effectiveness of our internal control over financial reporting beginning with the year ended December 31, 2005. While we intend to conduct a rigorous review of our internal control over financial reporting in order to assure compliance with the Section 404 requirements, if our independent registered public accounting firm interprets the Section 404 requirements and the related rules and regulations differently from us or if our independent registered public accounting firm is not satisfied with our internal control over financial reporting or with the level at which it is documented, operated or reviewed, they may decline to attest to management's assessment or issue a qualified report. This could result in an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements, which could cause the market price of our shares to decline.

***Our failure to expand our strategic alliances would impede our revenue growth.***

Unlike more established software vendors, we must successfully establish and extend relationships that enable us to expand market acceptance of our software solutions. Specifically, we must establish new and extend existing distribution alliances with specialized technology and services firms, such as support outsourcers. We must also establish new and extend existing solutions alliances with leading providers of complementary technologies. Although our business does not depend on any one strategic alliance, our strategic alliances as a whole are a valuable component of our business. Without adequate strategic alliances, we may have to devote substantially more resources than we would otherwise to the sales, marketing and implementation of our products and the development of complementary products in order to deliver comprehensive service management solutions, and our efforts may not be as effective as those who have such alliances. In many cases, the firms with which we wish to form alliances have extensive relationships with our existing and potential customers and may influence the decisions of these customers by recommending products. If we fail to establish, successfully implement or maintain these alliances, our ability to achieve market acceptance of our management software will suffer and our business and operating results will be harmed.

***We have experienced significant growth in our business in the past and we may not be able to manage our future growth efficiently or profitably.***



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We have expanded the scope of our operations at a rapid rate in the past. For example, in January 2003, we acquired BroadJump, Inc., a provider of solutions for broadband Internet companies. Primarily as a result of the BroadJump acquisition, the number of people we employ grew from 240 employees as of December 31, 2002 to 345 employees as of June 30, 2005. Future expansion efforts could be expensive and may strain our managerial and other resources. To manage future growth effectively, we must maintain and enhance our financial and accounting systems and controls, integrate new personnel and manage expanded operations. If we do not manage growth properly, it could harm our business, operating results and financial condition.

***We may find it difficult to integrate potential future business combinations, which could disrupt our business, dilute stockholder value and adversely affect our operating results.***

From inception to date, we have completed three acquisitions of other companies and businesses. We may acquire other companies and businesses in the future, which could add substantial complexity and additional burdens to the substantial tasks already performed by our management team. We may need to integrate operations that have different and unfamiliar corporate cultures. Likewise, we may need to integrate disparate technologies and product offerings, as well as multiple direct and indirect sales channels. These integration efforts may not succeed or may distract our management's attention from existing business operations. Our failure to successfully manage and integrate future acquisitions could seriously harm our business.

In addition, our existing stockholders' ownership would be diluted if we financed our acquisitions by issuing equity securities. Under the purchase method of accounting, now required under U.S. generally accepted accounting principles for all acquisitions, we could be required to incur in-process research and development or other charges in connection with future acquisitions, which would adversely affect our operating results.

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*The management software and services industry is highly competitive, the market for our products is subject to rapid change and we may not be able to compete effectively.*

The market for our products is intensely competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. Although we do not currently compete against any one entity with respect to all aspects of our software solutions, our solutions compete against various vendors' software products designed to accomplish specific elements of functionality. Moreover, these vendors may broaden their product portfolios to more directly compete against our products. Additionally, our customers may choose to develop their own management software.

Our current and potential competitors may have longer operating histories, significantly greater financial, technical and other resources or greater name recognition than we do. Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements. Competitive pressures could reduce our market share or require us to reduce the price of our products, either of which could harm our business and operating results.

*If our products fail to perform properly due to undetected errors or similar problems, our business could suffer because, among other things, we might have to limit or suspend product shipments, we might have to expand resources providing enhancements to correct such errors and we may experience other adverse consequences described below.*

Our software products are complex and have been more recently developed than those of more established enterprise software vendors. Software such as ours often contains undetected errors or bugs. Such errors are frequently found during the period immediately following introduction of new software or enhancements to existing software. We continually introduce new products. If we detect any errors before we ship a product, we might have to limit or suspend product shipments for an extended period of time while we address the problem. We may not discover software errors that affect our new or current products or enhancements until after they are deployed and we may need to provide enhancements to correct such errors. Therefore, it is possible that, despite testing by us, errors may occur in our software. These errors could result in:

damage to our reputation;

lost sales;

delays in commercial release;

product liability claims;

delays in or loss of market acceptance of our products;

license terminations or renegotiations; and

unexpected expenses and diversion of resources to remedy errors.

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Furthermore, our customers may use our software together with products from other companies. As a result, when problems occur, it may be difficult to identify the source of the problem. Even when these problems are not caused by our software, they may cause us to incur significant costs, divert the attention of our engineering personnel from our product development efforts, impact our reputation and cause significant customer relations problems.

***Our failure to integrate third-party technologies could harm our business because we may incur increased costs and experience delays procuring or building replacement technologies.***

We do not own all of the technology that is used in our business and that is incorporated into our products. Accordingly, we intend to continue licensing technologies from third parties, including applications used in our research and development activities and technologies that are integrated into our products. These technologies may not continue to be available to us on commercially reasonable terms or at all. Our inability to obtain any of these licenses could delay product development until equivalent technology can be identified, licensed and integrated. This inability in turn would harm our business and operating results. For example, we license security and encryption technology from RSA Security. The RSA agreement continues indefinitely unless terminated in the event of a material default by either party or insolvency, or unless we terminate for convenience on 90-days written notice. Our use of third-party technologies exposes us to increased risks, including, but not limited to, risks associated with the integration of new technology into our products, the diversion of our resources from development of our own proprietary technology and our inability to generate revenue from licensed technology sufficient to offset associated acquisition and maintenance costs.

***If the system security of our software is breached, our business and reputation could suffer.***

A fundamental and unique requirement for effective use of many of our products is the secure transmission, collection and storage of confidential end user information. Third parties may attempt to breach our security or that of our customers. We may be

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liable to our customers for any breach in such security and any breach could harm our customers, our business and our reputation. In addition, our software contains features which may allow us or our customers to control, monitor or collect data from computers running the software. Therefore, we may be subject to claims associated with invasion of privacy or inappropriate disclosure, use or loss of this information. Any imposition of liability, particularly liability that is not covered by insurance or is in excess of insurance coverage, could harm our reputation and our business and operating results. Also, computers, including those that utilize our software, are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We may be required to expend significant capital and other resources to further protect against security breaches or to rectify problems caused by any security breach.

*We rely upon patents, trademarks, copyrights and trade secrets to protect our proprietary rights, which may provide us with inadequate protection.*

Our success and ability to compete depend to a significant degree upon the protection of our software and other proprietary technology rights. We may not be successful in protecting our proprietary technology, and our proprietary rights may not provide us with a meaningful competitive advantage. To protect our proprietary technology, we rely on a combination of patents, trademarks, copyrights, trade secrets and non-disclosure agreements, each of which affords only limited protection. Any inability to protect our intellectual property rights could seriously harm our business, operating results and financial condition. It is possible that:

our pending patent applications may not result in the issuance of patents;

any patents issued to us may not be broad enough to protect our proprietary rights;

any issued patent could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in those patents; and

current and future competitors may independently develop similar technologies, duplicate our products or design around any of our patents.

In addition, the laws of some foreign countries do not protect our proprietary rights in our products to the same extent as do the laws of the U.S. Despite the measures taken by us, it may be possible for a third party to copy or otherwise obtain and use our proprietary technology and information without authorization. Policing unauthorized use of our products is difficult, and litigation may be necessary in the future to enforce our intellectual property rights. Any litigation could be time consuming and expensive to prosecute or resolve, result in substantial diversion of management attention and resources, and materially harm our business, financial condition and results of operations.

*Claims that we infringe upon third parties' intellectual property rights could be costly to defend or settle, thus adversely affecting our operating results.*

Litigation regarding intellectual property rights is common in the software industry. We expect that software products and services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. We may from time to time encounter disputes over rights and obligations concerning intellectual property. Although we believe that our intellectual property rights are sufficient to allow us to market our software without incurring liability to third parties, third parties may bring claims of infringement against us. Such claims may be with or without merit. Any litigation to defend against claims of infringement or invalidity could result in substantial costs and diversion of resources. Furthermore, a party making such

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a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our software. Our business, operating results and financial condition could be harmed if any of these events occurred.

In addition, we have agreed, and will likely agree in the future, to indemnify certain of our customers against certain claims that our software infringes upon the intellectual property rights of others. We could incur substantial costs in defending ourselves and our customers against infringement claims. In the event of a claim of infringement, we and our customers may be required to obtain one or more licenses from third parties. We, or our customers, may be unable to obtain necessary licenses from third parties at a reasonable cost, if at all. Defense of any lawsuit or failure to obtain any such required licenses could harm our business, operating results and financial condition.

***If we become subject to product liability claims, they could be time consuming and costly to defend, thus adversely affecting our operating results.***

Errors, defects or other performance problems in our software could result in financial or other damages to our customers. They could seek damages from us for losses associated with these errors, defects or other performance problems. If successful, these claims could have a material adverse effect on our business, operating results or financial condition. Although we possess product liability insurance and errors and omissions insurance, there is no guarantee that our insurance would be enough to cover the full amount of any loss we might suffer. Our license agreements typically contain provisions designed to limit our exposure to product liability claims, but existing or future laws or unfavorable judicial decisions could negate these limitation of liability provisions. We have not experienced any product liability claims to date. However, a product liability claim brought against us, even if unsuccessful, could be time consuming and costly to defend and could harm our reputation.

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### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We develop our products in the United States and market them in North America, South America, Europe and the Asia/Pacific markets. As a result, our future financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets.

From our inception through June 30, 2005, we have derived approximately \$121.7 million of revenue from customers outside the United States, and our international revenue was \$48.6 million for the year ended December 31, 2004, an increase of \$19.1 million, or approximately 65%, over international revenue of \$29.5 million for 2003. Our international revenue was \$26.2 million for the six months ended June 30, 2005, an increase of \$1.9 million, or approximately 8%, over international revenue of \$24.3 million for the six months ended June 30, 2004. We intend to continue to further expand our European and Asia/Pacific operations in the near term. To the extent that our foreign operations expenses increase or we experience increases in our foreign sales, which are generally denominated in local currencies, our foreign currency exchange rate risk will increase. We do not currently anticipate using hedging activities to mitigate these risks.

Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in short-term interest bearing instruments. Due to the short-term nature of our investments, we believe that our interest rate risk exposure is not significant. As of June 30, 2005, we have no outstanding debt. As a result, we currently have no interest expense sensitivity to changes in the prime interest rate.

### **ITEM 4. CONTROLS AND PROCEDURES**

In accordance with Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934 (the Exchange Act), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2005 to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There has been no change in our internal controls over financial reporting that occurred during the three months ended June 30, 2005 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II: OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

United Parcel Service General Services Co. ( UPS ) previously alleged that we breached various provisions of a License Agreement for OEM Partners, dated as of May 23, 2000 (the License Agreement), pursuant to which we agreed to license and support software to be used by UPS, in

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exchange for the payment by UPS of license and maintenance fees. The terms of the License Agreement called for binding arbitration to resolve any dispute between the parties, and UPS previously served us with a demand for arbitration. On July 6, 2005, we entered into a Settlement Agreement and Mutual Release with UPS that provided final resolution to all matters between us and UPS relating to the License Agreement.

From time to time, we may be involved in other disputes and litigation relating to claims arising out of the ordinary course of our business.

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

The following table provides information with respect to any purchase made by or on behalf of the Company or any affiliated purchaser of shares of the Company's common stock during the quarter ended June 30, 2005:

#### ISSUER PURCHASES OF EQUITY SECURITIES

| <u>Period</u> | <u>Total Number<br/>of Shares<br/>Purchased</u> | <u>Average Price<br/>Paid per Share</u> | <u>Total Number of<br/>Shares Purchased as<br/>Part of Publicly<br/>Announced Plans<br/>or Programs</u> | <u>Maximum Number (or<br/>Approximate Dollar Value)<br/>of Shares that May Yet Be<br/>Purchased under the Plans<br/>or Programs</u> |
|---------------|---|---|---|---|
| April 2005    | N/A   | N/A                                     | N/A   | N/A   |
| May 2005      | N/A   | N/A                                     | N/A   | N/A   |
| June 2005     | 6(1)  | \$ 6.5092                               | N/A   | N/A   |

- (1) Options issued to employees are subject to a time-based vesting schedule. Options can be exercised prior to vesting but the shares purchased as a result of such exercise are subject to repurchase by the Company upon termination of employment at a price per share equal to the original exercise price. All shares purchased were acquired by the Company in this manner.

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**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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

The 2005 Annual Meeting of the Stockholders ( the Meeting ) of Motive, Inc. was held at the Renaissance Hotel, 9721 Arboretum Blvd., Austin, TX 78759, at 10:00 a.m., Central Time, on Friday, May 20, 2005. At the Meeting, the following two persons were elected as Class I Directors to Motive s Board of Directors:

| <u>Nominee</u>       | <u>Votes For</u> | <u>Votes Withheld</u> |
|----------------------|------------------|-----------------------|
| Ms. Virginia Gambale | 24,194,128       | 609,941               |
| Mr. Scott Harmon     | 24,038,191       | 765,878               |

The following is a list of our other directors whose term of office continued after the Meeting:

Our Class II Directors, Mr. David Sikora and Mr. Harvey White, who will continue to serve until our 2006 Annual Meeting or until their successors have been elected and qualified; and

Our Class III Directors, Mr. Michael J. Maples, Sr. and Mr. Tom Meredith, who will continue to serve until our 2007 Annual Meeting or until their successors have been elected and qualified.

The following proposals were considered at the Meeting and approved by our stockholders by the respective votes set forth below:

PROPOSAL 2 Ratify and approve the Company s Amended and Restated Equity Incentive Plan.

| <u>Votes For</u> | <u>Votes Against</u> | <u>Abstentions (1)</u> | <u>Broker Non-Votes (1)</u> |
|------------------|----------------------|------------------------|-----------------------------|
| 12,249,412       | 7,620,775            | 11,963                 | 4,921,919                   |

PROPOSAL 3 Ratify the appointment of Ernst & Young LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2005.

| Votes For | Votes Against | Abstentions (1) | Broker Non-Votes (1) |
|-----------|---------------|-----------------|----------------------|
|-----------|---------------|-----------------|----------------------|



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|            |        |       |   |
|------------|--------|-------|---|
| 24,735,024 | 62,662 | 6,383 | 0 |
|------------|--------|-------|---|

- (1) Both abstentions and broker non-votes are counted as present for the purpose of determining the presence of a quorum. Broker non-votes occur when shares held by a broker on behalf of a beneficial owner are not voted with respect to a particular proposal, which generally occurs when the broker has not received voting instructions from the beneficial owner and lacks the discretionary authority to vote the shares itself.

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

- 3.1.1\* Amended and Restated Certificate of Incorporation, filed as Exhibit 3.1.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 and incorporated herein by reference.
- 3.2.2\* Amended and Restated Bylaws, filed as Exhibit 3.2.2 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 and incorporated herein by reference.
- 31.1 Certificate of the Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934, as amended.

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31.2 Certificate of the Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934, as amended.

32.1 Certificate of the Chief Executive Officer and Chief Financial Office pursuant to 18 U.S.C. § 1350 (Section 906 of the Sarbanes-Oxley Act of 2002).

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\* Incorporated by reference, as indicated.

(b) Reports on Form 8-K:

During the three months ended June 30, 2005, we filed with the SEC a report on Form 8-K on April 21, 2005. The April 21, 2005 Form 8-K was filed for the purpose of furnishing, under Items 2.02 and 9.01, the press release announcing our financial results for the fiscal quarter ended March 31, 2005. The information contained in this report shall not be deemed filed with the SEC as a result of its reference herein.

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**SIGNATURES**

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

MOTIVE, INC.

*/s/ Scott L. Harmon*

Scott L. Harmon  
President and Chief Executive Officer

Date: August 15, 2005

*/s/ Paul M. Baker*

Paul M. Baker  
Chief Financial Officer

Date: August 15, 2005

**Exhibit List**

| <b><u>Exhibit No.</u></b> | <b><u>Description</u></b>  |
|---------------------------|--|
| 3.1.1*                    | Amended and Restated Certificate of Incorporation, filed as Exhibit 3.1.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 and incorporated herein by reference. |
| 3.2.2*                    | Amended and Restated Bylaws, filed as Exhibit 3.2.2 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 and incorporated herein by reference.                       |
| 31.1                      | Certificate of the Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934, as amended.                                    |
| 31.2                      | Certificate of the Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934, as amended.                                    |
| 32.1                      | Certificate of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. § 1350 (Section 906 of the Sarbanes-Oxley Act of 2002).                                 |

\* Incorporated by reference, as indicated.