

EGAIN COMMUNICATIONS CORP  
Form 10-K  
September 28, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the Fiscal Year Ended June 30, 2007

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: 0-30260

**eGain Communications Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction)

of incorporation or organization)

**345 E. Middlefield Road, Mountain View, California 94043**  
(Address of principal executive offices, including zip code)

**77-0466366**  
(I.R.S. Employer

Identification No.)

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

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

**Securities registered pursuant to Section 12(g) of the Act:**

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Common Stock, par value \$0.001 per share

Indicate by check mark if registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

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

Indicate by check mark if registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates, on the OTC Bulletin Board on December 31, 2006 (the last business day of registrant's second quarter of fiscal 2007), was approximately \$7,077,011. For purposes of the foregoing calculation only, the registrant has included in the shares owned by affiliates the beneficial ownership of voting and non-voting common equity of officers and directors, and affiliated entities, of the registrant and members of their families. Such inclusion shall not be construed as an admission that any such person is an affiliate for any other purpose.

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

	Outstanding at
Class	September 21, 2007
Common Stock \$0.001 par value	15,323,376

DOCUMENTS INCORPORATED BY REFERENCE

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Items 10 (as to directors), 11, 12, 13 and 14 of Part III incorporate by reference information from the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant's 2007 Annual Meeting of Stockholders.

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**eGAIN COMMUNICATIONS CORPORATION**

**PART I**

**ITEM 1. BUSINESS**

*This report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements that involve risks and uncertainties. These statements may be identified by the use of the words such as anticipates, believes, continue, could, would, estimates, forecasts, expects, intends, may, might, plans, potential, predicts, should, or will and similar expressions or the negative of those terms. The forward-looking statements include, but are not limited to, risks stemming from: our failure to improve our sales results and grow revenue; our failure to compete successfully in the markets in which we do business; the impact of our hybrid revenue model; our history of net losses and our ability to achieve profitability; the adequacy of our capital resources and need for additional financing; the continued lengthy and delayed sales cycles of our goods and services; the development of our strategic relationships and third party distribution channels; broad economic and political instability around the world affecting the market for our goods and services; the continued adoption of customer service and contact center software solutions; our ability to respond to rapid technological change and competitive challenges; our substantial international operations; legal and regulatory uncertainties and other risks related to protection of our intellectual property assets; and the operational integrity and maintenance of our systems. Our actual results could differ materially from those discussed in statements relating to our future plans, product releases, objectives, expectations and intentions, and other assumptions underlying or relating to any of these statements. Factors that could contribute to such differences include those discussed in Factors That May Affect Future Results and elsewhere in this document. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or understanding to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

**Overview**

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

**Industry Background**

Customer service has become a key, if not the only, differentiator for businesses as products continue to become commoditized. Furthermore, businesses are under pressure to deliver a unified and seamless multichannel customer service experience, while doing more with less. Today's customers demand instant access to customer service and expect immediate, accurate, and consistent responses through a range of traditional and new interaction channels. The ability to deliver consistent service across a multichannel contact center and self-service is a must in today's competitive business environment. Failure to do so erodes customer loyalty and risks brand reputation.

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Over the past few years, numerous software vendors have developed point solutions designed to handle online customer communications through a specific channel such as email, real-time web collaboration, or web self-service.

However, we believe point solutions do not meet the demands of today's customers since they increasingly use multiple channels of communication. Point solutions also create interaction silos, making it difficult for

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customer service agents to easily reference a customer's past communications that originated from multiple channels. Nor do they use a common knowledge base to deliver consistent accurate responses. Moreover, many of these solutions do not integrate easily with a company's existing systems, making them difficult to implement and maintain.

To meet growing customer demand for seamless multichannel service, businesses need a comprehensive, functionally rich, yet deeply integrated customer service suite to serve customers across phone, web, email and other media. Our software suite enables companies to transform their siloed contact centers into multichannel customer interaction hubs that improve service quality and customer experience, dramatically reduce service costs, increase self-service adoption through highly flexible and adaptive self-service, boost agent productivity, and enhance end-to-end service process efficiencies.

## **The eGain Solution**

Recognized by leading industry analysts and customers alike, our application suite, eGain Service™, is available through licensed or hosted models. It includes integrated, best-in-class applications for web self-service, email management, paper/fax management, chat, cobrowsing, SMS, call tracking and resolution, proactive notifications, cross-channel knowledge management, case management and service fulfillment. These robust applications are built on the eGain Service Management Platform (eGain SMP™), a scalable next-generation framework that includes end-to-end service process management, multichannel, multi-site contact center management, and certified out-of-the-box integrations with leading call center, content, and business systems.

Our applications and platform are built on a service-oriented architecture, using open standards such as J2EE, XML, HTTP, JDBC and Java. They are designed to be modular (each application can be deployed stand-alone) while ensuring complete and simple integration across all applications in the suite. Finally, the eGain application suite comes with certified, out-of-the-box integrations with several third-party call center and business systems through eGain Adapters™.

Our products are designed to provide companies with the following benefits:

*Build profitable long-term customer relationships.* Whether a customer is asking a question, seeking a resolution to an issue, or making a purchase, our solution allows businesses to enhance the customer interaction experience. Using our solutions, businesses can provide 24x7 web self-service, respond rapidly and effectively to large volumes of email, communicate over the web in real time with their customers, answer questions using best-practice processes on the phone, track the history of individual customer interactions, fulfill service requests, send proactive notifications and allow customers to handle their own service needs at any time.

*Increase revenue through improved sales conversion and cross-sell.* In addition to strengthening customer relationships, our products help businesses convert website visitors into customers, and help agents to contextually upsell and cross-sell products and services. A visitor to a website utilizing eGain solutions can interact with a customer service representative live over the web through chat and cobrowse to inquire about a specific product or issue, thereby catalyzing the sales process. Furthermore, customers calling into a service center can be offered powerful cross-sell offers by agents using the best-practice capture and expert reasoning capability of eGain's knowledge management products.

*Reduce operating costs through improved agent productivity and self-service automation.* Our products are designed to enable companies to provide highly effective and efficient customer service while reducing operating costs. Our intelligent routing, autosuggest and autoresponse capabilities, tracking, and reporting features, complemented with agent-facing knowledge tools,

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measurably enhance the productivity of service agents. From an online service perspective, our robust self-service tools, integrated escalation paths, and sophisticated artificial intelligence engine help resolve business issues without human assistance.



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*Reduce total cost of ownership (TCO) through open architecture, integration adapters, and scalable design.* Our products are designed to integrate, not only with each other, but with data and processes residing in legacy systems and other enterprise data sources. By integrating out-of-the-box with leading business applications and content systems, our platform allows companies to leverage existing business data and content assets.

*Offer rapid time to value through flexible deployment options.* Our products are designed to allow companies to deploy on site or in a hosted environment operated and maintained by us. Customers using eGain OnDemand™, our secure, enterprise-class hosted solution, can take advantage of our on-demand expertise, thereby reducing the need for in-house information technology resources. eGain OnDemand also enables customers to virtually eliminate risk in the purchase process by quickly proving the value of our solution in the hosted mode. Thereafter, we can easily migrate the solution on-site to tightly integrate within the customer's IT and business infrastructure.

## **The eGain Strategy**

Our objective is to further enhance our position as a leading provider of customer interaction hub software. The key elements of our strategy include:

*Enhance and Expand our Leading Integrated, MultiChannel Customer Service Platform.* We believe we are one of the few companies that provide software to enable integrated communication across email, phone, paper, real-time web channels such as chat and cobrowsing, emerging channels such as SMS and multimodal web self-service, including chatbot technology. We have a strong track record of successfully extending our platform through internal development as well as acquisitions and continue to invest in research and development efforts. We believe we were the first company to unify electronic channels of communication by integrating email and real-time web interactions. We also believe we were the first company to offer self-service and knowledge management applications integrated into a complete customer service platform. In addition, our solution is designed to integrate easily with leading CRM, ERP and call center systems, enabling customers to leverage investments in existing systems.

*Provide Demonstrable Return on Investment to Customers.* In today's age of prudent IT investments, we believe customers will only buy enterprise software if they are convinced it will result in real return on investment, or ROI, in both the short and long run. A central element of our strategy is the ability to provide companies with demonstrable ROI from our software. Among the ways we believe our solutions deliver ROI to clients are:

Increase self-service adoption through multi-modal web self service

Improve contact center agent productivity in-house, or outsourced or hybrid

Ensure compliance and security in customer interactions

Enhance customer experience and retention

Reduce escalations, field visits and service costs

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Increase sales through upsell and cross-sell at the point of service

We believe our comprehensive ROI assessment tools make it easier for our customers and prospects to invest in our solutions.

*Technology Leadership.* With the creation of our flagship product, eGain Mail, we were the first company to introduce a 100% web-architected solution to address the need for online customer interaction management. Since inception, we have designed our products from the ground up for easy browser access from anywhere at any time, and rapid, flexible deployment via in-house or on-demand options. We intend to maintain our technology leadership by continuing to fine-tune our applications and user interfaces to a service-oriented

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architecture, or SOA for maximum performance, user adoption and productivity. We believe that the SOA approach provides true global access, improved scalability, easier integration with existing enterprise applications and systems, and lower deployment costs than alternative approaches.

*Flexible Delivery Options.* We believe that offering our solution on a hosted or licensed basis provides customers with a meaningful choice of deployment options. Customers can choose to license applications for deployment at their facilities, or employ our hosted operations. They may also choose hybrid options such as licensing the software but have it managed by us. Customers choosing to receive hosted access to our solutions can focus on core aspects of their business while benefiting from the rapid deployment, 24x7 reliability and support, scalability on demand, and lower up-front investment that the hosting option offers. We believe that we offer the highest level of deployment flexibility among enterprise-class customer service software vendors.

*Expand Global Distribution Capabilities.* We intend to expand our global distribution capabilities through our direct sales efforts as well as strategic partnerships with systems integrators, resellers, technology vendors and solution providers. We have sales presence in 18 countries through direct presence and distribution partnerships. We have offices in the United States, United Kingdom, Netherlands, Ireland, Italy and India.

## **Products and Services**

### *eGain Service™ 7.6 Suite of Applications*

eGain Service 7.6 is a complete customer service management solution. Built for rapidly implementing next-generation contact-center strategies, it consists of a multichannel customer interaction hub, or CIH platform-eGain CIH Platform and best-of-breed applications for web self-service and the contact center. The suite combines industry best practices and powerful service process management capabilities built on a service-oriented architecture and an industry-leading, browser-based rich user interface. The solution enables unified multichannel service and integrated work management, and is designed to leverage existing investments in contact centers, business systems, and web sites. The eGain CIH platform centralizes business rules, interactions, knowledge bases, workflow, analytics, administration and integrations in one common foundation, speeding up CIH implementation and time to value, while lowering total cost of ownership, TCO

The individual applications in the suite are described below:

*eGain Mail* is an industry-leading solution for processing inbound customer emails and providing mission-critical email customer service, incorporating hundreds of best-practices developed over years of serving innovative global enterprises. Secure messaging, lifecycle audits, and real-time archival are some of the features that provide our customers a next-generation email management platform for their enterprises. The first email management application designed as a true application utility, it can be implemented by corporate IT departments to deliver customer email management capability on-demand to multiple business units within the enterprise. Designed to process very high volumes of email and webform requests, eGain Mail allows companies to deliver consistent, high-quality service through flexible process automation, optimized user interface, and powerful reports. Additional modules include:

eGain Secure Mail™ to authenticate the customer for secure communication with the business.

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eGain Fax™ to route, track, and respond to faxes with the same infrastructure that is used to handle emails and webform submissions.

eGain SME™ to extend the use of enterprises' email management infrastructure to other parts of the enterprise with the help of webforms.

*eGain Calltrack™* is a comprehensive and a flexible phone call logging system. Together with eGain knowledge agent, it provides an integrated solution for phone call logging, tracking and resolution as well as follow-on task management for service fulfillment.

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*eGain Chat*<sup>TM</sup> gives contact center agents a comprehensive set of tools for serving customers in real-time. eGain Chat supports two-way, follow me web browsing so that agents and customers can lead each other to specific web pages for faster issue resolution. It also features powerful file-sharing capabilities. The system's powerful, query-specific routing and workflow maximize both agent productivity and the quality of service delivered.

*eGain Cobrowse*<sup>TM</sup> enables contact center agents to provide high-value, live collaboration options to online customers and prospects. It gives companies the ability to deliver real-time assistance and convert site visitors into profitable, long-term customers. The capabilities include: enabling the agent and the customer to fill out forms together, creation of business rules for specific web pages, and allowing phone agents to provide richer experience by conducting a cobrowse session.

*eGain Self-Service*<sup>TM</sup> is a comprehensive solution supporting what we believe to be the broadest set of self-service access options in the industry: dynamic FAQs, topic-based browsing, natural language search, guided help, virtual agent technology and case tracking. Shaped by our experience with enterprise customers, eGain Self-Service offers a unique combination of rich, multi-access self-service capabilities built on a collaborative knowledge management framework within eGain SMP<sup>TM</sup>. This framework makes it easy for organizations to create, maintain, and enhance common content in a distributed manner, as well as leverage existing content from across the enterprise.

*eGain Adviser*<sup>TM</sup> empowers agents—whether they are novice, expert, in-house, or outsourced—to handle complex customer interactions. Agents receive guided help for providing contextual upsell and cross-sell, follow-on service fulfillment, and value-added advice through conversations that are compliant with regulations and corporate best practices. The solution includes a highly flexible user interface, integrated workflow, and interactive process guidance, powered by the eGain Inference<sup>®</sup> Reasoning Engine, a proven technology used by enterprises for over 15 years.

*eGain KnowledgeAgent*<sup>TM</sup> empowers contact center agents with best-practice knowledge management and is designed to make every agent as productive and capable as the enterprise's best agent. This product delivers fast, consistent, and accurate answers to agents as they use the rich conversational interface while engaging customers over the phone. eGain KnowledgeAgent uses patented search and reasoning technology coupled with natural language and advanced linguistic processing to search, suggest additional questions, and recommend solutions. In the course of a natural conversation with the customer, a service agent is guided to the right answer by eGain KnowledgeAgent. Experienced agents can choose additional access models like browse and search to get to the answers in the knowledge base. In addition, this solution, in conjunction with eGain Content Adapter<sup>TM</sup>, allows an agent to access information stored in external systems.

*eGain Adapters* include a set of out-of-the-box integration modules for connecting eGain applications with content repositories, call center telephony or CTI solutions, databases, and business applications. Using eGain Adapters, companies can leverage existing investments and realize the benefits of an enterprise-wide business operation platform at reduced cost of ownership and reduced time to benefit. We offer three integration modules: eGain Content Adapter<sup>TM</sup>, eGain CTI Adapter<sup>TM</sup>, and eGain Data Adapter<sup>TM</sup>.

*eGain Campaign*<sup>TM</sup> is a full-featured, scalable outbound email management solution that offers comprehensive tools for planning, targeting and executing high-volume customer service and direct marketing campaigns. Features of our outbound management software include: targeting the right message to the right person, personalized one-to-one messages, high volume email delivery architecture and the capability to integrate with eGain Service Suite.

*eGain Notify*<sup>TM</sup> is a flexible, easy-to-use application for managing and delivering automatic reminders, alerts, and updates at all stages of the customer relationship cycle. It is used to provide proactive customer service by sending alerts to customers via multiple interaction channels such as email, phone and SMS. These alerts could span various stages of a service transaction, a customer's life event, or a

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customer's overall life progression where a business may want to add value by providing contextual customer service.

*eGain Customer Portal*<sup>TM</sup> delivers a secure, flexible, personalized web self-service gateway through which customers can retrieve information using a standard web browser. This online customer service portal delivers to customers the personal information they want, the way they want to see it, and when they want to see it. Customers can view the top frequently asked questions, manage their own accounts, review open ticket and service issues, and review their communications with the company within a secure, personalized environment.

*eGain Guided Help*<sup>TM</sup> customers have instant access to the company's knowledge base, allowing them to answer questions and troubleshoot problems by themselves when it is convenient for them.

*eGain MessageCenter*<sup>TM</sup> enables secure and authenticated email communications between the customer and the company. eGain MessageCenter is designed to help businesses provide their customers a secure web-based message center to read emails with confidential and sensitive information. Agent responses are automatically replaced with a dynamically generated URL which directs the customer to a secure message center to retrieve the response. Customers are authenticated before they can view their messages.

*eGain AutoClassify*<sup>TM</sup> enables companies to increase response turnaround and significantly improve problem resolution by intelligently categorizing and routing incoming email and other inquiries. It can also be set up to provide auto-suggestions and auto-responses. Powered by the patented eGain Inference<sup>®</sup> Reasoning Engine, it effectively adds a new staff member to the team one that can handle thousands of messages an hour, 24 x 7, without a break. eGain AutoClassify uses our powerful technology to understand the customer's issue and routes inquiries to queues based on categories and the confidence level assigned to those categories. Customer interactions can be placed into multiple independent categories. For example, messages can be sorted by product type as well as inquiry type.

## **Hosted Operations**

eGain OnDemand<sup>TM</sup> Hosting is a proven, robust and scalable solution that has been used by enterprise companies to rapidly build customer interaction hubs since 1998. Hosting our applications on servers located in our third party SAS 70 Type II data center allows: rapid deployment of eGain products, including seamless secure access to customer's in-house data systems; 24 x 7 management of infrastructure, security, servers, operating systems and databases; proprietary management systems to monitor servers and applications allowing for high availability and performance; easy migration from eGain OnDemand to in-house option and vice-versa. Designed with redundancy at all levels, the hosting network eliminates single points of failure. Value-added services include email spam and virus cleaning, post office services, virtual private networks, remote data access, encrypted backups, and test / reporting / warm spare servers. Enterprise customers receive full functionality access of eGain's application suite through a standard web browser over a secure Internet connection.

## **Professional Services**

Our worldwide professional services organization provides consulting, hosting, technical support, and education services designed to ensure customer success and build customer loyalty.

*Consulting Services.* Our consulting services group offers rapid implementation services, custom solution development and systems integration services. Consultants work with customers to understand their specific requirements, analyze their business needs and implement integrated solutions. We provide these services independently or in partnership with systems integrators who have developed consulting expertise on our platform.

*Education Services.* Our educational services group provides a comprehensive set of basic and customized training programs to our customers and partners. Training programs are offered either online, in-person at the customer site, or at one of our worldwide training centers.

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*Hosted Services.* Our hosted services group provides 24x7 application management, monitoring and response services. We also provide database services to maintain and enhance the performance, availability and reliability of production systems as well as network security services.

*Support Services.* We offer a comprehensive collection of support services designed to rapidly respond to inquiries. Our technical support services are available to customers worldwide under maintenance agreements.

As of fiscal year ended June 30, 2007 we had approximately 84 professionals providing worldwide services for systems installation, solutions development, application management, and education and support.

## **Sales and Marketing**

### *Sales Strategy*

Our sales strategy is to pursue targeted accounts through a combination of our direct sales force and strategic alliances. We target our sales efforts at Global 2000 companies. Our North American direct sales organization is based at our corporate headquarters in Mountain View, California, with field sales presence throughout the United States. Internationally, we have field offices in Ireland, Italy, India, the Netherlands and the United Kingdom.

The direct sales force is organized into teams that include both sales representatives and sales consultants. Our direct sales force is complemented by telemarketing representatives.

We also complement our direct sales force with reseller and sales alliances. We believe we are able to leverage additional sales, marketing and deployment capabilities through these alliances.

### *Marketing and Partner Strategy*

Our marketing strategy is to build market awareness that we are a leading provider of customer service and contact center software. We also communicate to the market that we enable Global 2000 companies to transform traditional call centers into multichannel customer interaction hubs that drive down service costs while enhancing customer service experience. Our marketing organization focuses on public relations, analyst relations, marketing communications and demand generation.

We employ a wide range of marketing avenues to deliver our message, including print and Internet advertising, targeted electronic and postal mailing, email newsletters and a variety of trade shows, seminars, webinars and interest groups.



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Our marketing group also produces sales tools, including product collateral, customer case studies, demonstrations, presentations and competitive analyses. In addition, the group performs market analyses and conducts focus group and customer reviews to identify and develop key partnership opportunities and product capabilities.

We believe that our partners help extend the breadth and depth of our product offerings, drive market penetration, and augment our professional service capabilities. We believe these relationships are important to delivering successful, integrated products and services to our customers, and scaling our business.

As of fiscal year ended June 30, 2007, there were approximately 76 employees engaged in worldwide sales and marketing activities.

### **Customers**

We serve a worldwide customer base across a wide variety of industry sectors including: telecommunications, financial services, insurance, outsourced services, retail, technology, manufacturing and

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consumer goods. Our revenues are divided between growing medium sized enterprises (companies with up to \$250 million in annual revenues) and large enterprises (over \$250 million in annual revenues). For the fiscal year ended June 30, 2007, international revenue accounted for 45% and domestic revenue for 55% of total revenue, compared to 51% and 49% respectively for fiscal year 2006 and 49% and 51% respectively for fiscal year 2005.

None of our customers accounted for more than 10% of our revenues in fiscal years 2007, 2006 or 2005.

## **Competition**

The market for customer service and contact center software is intensely competitive. Other than product innovation and existing customer relationships, there are no substantial barriers to entry in this market, and established or new entities may enter this market in the near future. While software internally developed by enterprises represents indirect competition, we also compete directly with packaged application software vendors in the customer service arena, including Art Technology Group, Inc., Avaya, Inc., Genesys Telecommunications (a wholly-owned subsidiary of Alcatel), Kana Software, Inc., LivePerson, Inc., RightNow Technologies, Inc., Knova, Inc. (a wholly-owned subsidiary of Cosona Corporation), and Talisma Corp. In addition, we face actual or potential competition from larger software companies such as Microsoft Corporation, Oracle Corporation and SAP Inc. and other such broad software companies that may attempt to sell customer service software to their installed base.

We believe competition will continue to be strong as current competitors increase the sophistication of their offerings and with the possibility of new participants entering the market. Many of our current and potential competitors have longer operating histories, larger customer bases, broader brand recognition, and significantly greater financial, marketing and other resources. With more established and better-financed competitors, these companies may be able to undertake more extensive marketing campaigns, adopt more aggressive pricing policies, and make more attractive offers to businesses to induce them to buy and use their products or services.

Further, any delays in the general market acceptance of our applications would likely harm our competitive position by allowing our competitors additional time to improve their product and service offerings, and also provide time for new competitors to develop applications and solicit prospective customers within our target markets. Increased competition could result in pricing pressures, reduced operating margins and loss of market share.

## **Product Development**

The market for our products changes rapidly and is characterized by evolving industry standards, swift changes in customer requirements and frequent new product introductions and enhancements. We believe that strong product development capabilities are essential to our strategy of maintaining technology leadership. This includes enhancing current technology, providing excellent quality, performance, and functionality, as well as developing additional applications and maintaining the competitiveness of our product and service offerings. We have invested significant time and resources to create a structured process for undertaking all product development. This process involves several functional groups at all levels within our organization and is designed to provide a framework for defining and addressing the activities required in bringing product concepts and development projects to market successfully.

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In addition, we continuously analyze market and customer requirements and evaluate technology that we believe will enhance platform acceptance in the market. We selectively choose partners with superior technology to enhance features and functionality of our product offerings.

As of fiscal year ended June 30, 2007, there were approximately 93 employees engaged in worldwide product development activities.

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### **Intellectual Property**

We regard our copyrights, service marks, trademarks and similar intellectual property as critical to our success. We rely on patent, trademark, copyright, trade secret and other laws, as well as confidentiality procedures and licensing arrangements, to protect the proprietary aspects of our technology and business. We own four patents in the field of case-based reasoning.

We are continually assessing the propriety of seeking patent and other intellectual property protection for those aspects of our technology that we believe constitute innovations providing significant competitive advantages. Future applications may or may not receive the issuance of valid patents and trademarks.

We routinely require our employees, customers, and potential business partners to enter into confidentiality and nondisclosure agreements before we will disclose any sensitive aspects of our products, technology, or business plans. In addition, we require employees to agree to surrender to us any proprietary information, inventions or other intellectual property they generate or come to possess while employed by us. Despite our efforts to protect our proprietary rights through confidentiality and license agreements, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. These precautions may not prevent misappropriation or infringement of our intellectual property. In addition, some of our license agreements with certain customers and partners require us to place the source code for our products into escrow. These agreements typically provide that some party will have a limited, non-exclusive right to access and use this code as authorized by the license agreement if there is a bankruptcy proceeding instituted by or against us, or if we materially breach a contractual commitment to provide support and maintenance to the party.

Third parties may infringe or misappropriate our copyrights, trademarks and similar proprietary rights. In addition, other parties may assert infringement claims against us. Our products may infringe issued patents that may relate to our products. In addition, because patent applications in the United States are not publicly disclosed until the patent is issued, applications may have been filed which relate to our software products. We may be subject to legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement of the trademarks and other intellectual property rights of third parties. Intellectual property litigation is expensive and time-consuming and could divert management's attention away from running our business. This litigation could also require us to develop non-infringing technology or enter into royalty or license agreements. These royalty or license agreements, if required, may not be available on acceptable terms, if at all, in the event of a successful claim of infringement. Our failure or inability to develop non-infringing technology or license the proprietary rights on a timely basis would harm our business.

### **Employees**

As of fiscal year ended June 30, 2007, we had 287 full-time employees, of which 93 were in product development, 84 in services and support, 76 in sales and marketing, and 34 in finance and administration.

None of our employees are covered by collective bargaining agreements. While we believe our relations with our employees are good, our future performance depends largely upon the continued service of our key technical, sales and marketing, and senior management personnel, none of whom are bound by employment agreements requiring service for a defined period of time. The loss of services of one or more of our key employees could have a material adverse effect on our business.

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We may not be successful in attracting, training and retaining qualified personnel, and the failure to do so, particularly in key functional areas such as product development and sales, could materially and adversely affect our business, results of operations and financial condition. Our future success will likely depend largely on our ability to attract and retain experienced sales, technical, marketing and management personnel.

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### **ITEM 1A. RISK FACTORS**

#### **Our lengthy sales cycles and the difficulty in predicting timing of sales or delays may impair our operating results**

The long sales cycle for our products may cause license revenue and operating results to vary significantly from period to period. The sales cycle for our products can be six months or more and varies substantially from customer to customer. Because we sell complex and deeply integrated solutions, it can take many months of customer education to secure sales. While our potential customers are evaluating our products before, if ever, executing definitive agreements, we may incur substantial expenses and spend significant management effort in connection with the potential customer. Our multi-product offering and the increasingly complex needs of our customers contribute to a longer and unpredictable sales cycle. Consequently, we often face difficulty predicting the quarter in which expected sales will actually occur. This contributes to the uncertainty and fluctuations in our future operating results. In particular, the corporate decision-making and approval process has become more complicated. This has caused our average sales cycle to further increase and, in some cases, has prevented deals from closing that we believed were likely to close. Consequently, we may miss our revenue forecasts and may incur expenses that are not offset by corresponding revenue.

#### **Our hybrid revenue model may impact our operating results**

We have a hybrid delivery model meaning that we offer our solutions on a hosted or license basis to our customers. For license transactions the license revenue amount is generally recognized in the quarter delivery and acceptance of our software takes place whereas, for hosting transactions, hosting revenue is recognized ratably over the term of the hosting contract, which is typically one to two years. As a result, our total revenue may increase or decrease in future quarters as a result of the timing and mix of license and hosting transactions.

#### **If we fail to improve our sales performance and marketing activities, we may be unable to grow our business, negatively impacting our operating results and financial condition**

Expansion and growth of our business is dependent on the ability of our recently expanded sales force to become more productive. Moreover, many of our competitors have sizeable sales forces and greater resources to devote to sales and marketing, which results in their enhanced ability to develop and maintain customer relationships. Thus, failure of our sales and marketing investments to translate into increased sales volume and enhanced customer relationships may hamper our efforts to achieve profitability. This may impede our efforts to ameliorate operations in other areas of the company and may result in further decline of our common stock price.

Due to the complexity of our customer interaction hub platform and related products and services, we must utilize highly trained sales personnel to educate prospective customers regarding the use and benefits of our products and services as well as provide effective customer support. Because, in the past, we have experienced turnover in our sales force and have fewer resources than many of our competitors, our sales and marketing organization may not be able to successfully compete with those of our competitors.

#### **We must compete successfully in our market segment**

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The market for customer service and contact center software is intensely competitive. Other than product innovation and existing customer relationships, there are no substantial barriers to entry in this market, and established or new entities may enter this market in the near future. While software internally developed by enterprises represents indirect competition, we also compete directly with packaged application software vendors in the customer service arena, including Art Technology Group, Inc., Avaya, Inc., Genesys Telecommunications (a wholly-owned subsidiary of Alcatel), Kana Software, Inc., LivePerson, Inc., RightNow Technologies, Inc., Knova, Inc. (a wholly-owned subsidiary of Cosona Corporation) and Talisma Corp. In addition, we face actual or potential competition from larger software companies such as Microsoft Corporation, Oracle Corporation and SAP Inc. and similar companies that may attempt to sell customer service software to their installed base.

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We believe competition will continue to be fierce as current competitors increase the sophistication of their offerings and as new participants enter the market. Many of our current and potential competitors have longer operating histories, larger customer bases, broader brand recognition, and significantly greater financial, marketing and other resources. With more established and better-financed competitors, these companies may be able to undertake more extensive marketing campaigns, adopt more aggressive pricing policies, and make more attractive offers to businesses to induce them to use their products or services.

Further, any delays in the general market acceptance of our applications would likely harm our competitive position by allowing our competitors additional time to improve their product and service offerings, and also provide time for new competitors to develop applications and solicit prospective customers within our target markets. Increased competition could result in pricing pressures, reduced operating margins and loss of market share.

### **We have a history of losses and may not be able to be profitable in the future**

We incurred a net loss of \$7.7 million for the year ended June 30, 2007. As of June 30, 2007, we had an accumulated deficit of approximately \$325.1 million. We do not know if we will be profitable in the foreseeable future. However, we must continue to spend resources on maintaining and strengthening our business, and this may, in the near term, have a continued negative effect on our operating results and our financial condition. If we incur net losses in future periods, we may not be able to retain employees, or fund investments in capital equipment, sales and marketing programs, and research and development to successfully compete against our competitors. We also expect to continue to spend financial and other resources on developing and introducing product and service offerings. Accordingly, if our revenue declines despite such investments, our business and operating results could suffer. This may also, in turn, cause the price of our common stock to demonstrate volatility and/or continue to decline.

### **We may not be able to pay our debt and other obligations**

If our cash flow is inadequate to meet our obligations, we could face substantial liquidity problems. If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments on our outstanding debt, we would be in default under the terms thereof. Any such default could have a material adverse effect on our business, prospects, financial condition and operating results.

### **Our failure to expand strategic and third-party distribution channels would impede our revenue growth**

To grow our revenue base, we need to increase the number of our distribution partners, including software vendors and resellers. Our existing or future distribution partners may choose to devote greater resources to marketing and supporting the products of our competitors which could harm our financial condition or results of operations. Our failure to expand third-party distribution channels would impede our future revenue growth.

In August 2006, we entered into an OEM agreement with Cisco Systems. Under this agreement, we will supply unified communications technology for use in certain Cisco products. Pursuant to the agreement, there are certain minimum royalty payments due to us from Cisco based upon our successful delivery of certain milestones that are projected over the first eighteen months of the relationship. This OEM agreement with Cisco includes multiple elements, including significant product customizations that are subject to Cisco's acceptance. We have and will continue to invest a significant amount of time and resources into this agreement. We have limited control, if any, as to whether Cisco will



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devote adequate resources to promoting and selling their products that incorporate our technology. For example, to date this OEM agreement has not contributed significantly to our annual revenues. If Cisco changes its strategy, reduces its efforts on our behalf or discontinues or alters its relationship with us, our reputation as a technology partner with them could be damaged and our revenues and operating results could decline.

To increase our revenue and implementation capabilities, we must continue to develop and expand relationships with systems integrators. We sometimes rely on systems integrators to recommend our products to

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their customers and to install and support our products for their customers. We likewise depend on broad market acceptance by these systems integrators of our product and service offerings. Our agreements generally do not prohibit competitive offerings and systems integrators may develop market or recommend software applications that compete with our products. Moreover, if these firms fail to implement our products successfully for their customers, we may not have the resources to implement our products on the schedule required by their customers. To the extent we devote resources to these relationships and the partnerships do not proceed as anticipated or provide revenue or other results as anticipated, our business may be harmed. Once partnerships are forged, there can be no guarantee that such relationships will be renewed in the future or available on acceptable terms. If we lose strategic third party relationships, fail to renew or develop new relationships, or fail to fully exploit revenue opportunities within such relationships, our results of operations and future growth may suffer.

### **Due to our limited operating history and the emerging market for our products and services, revenue and operating expenses are unpredictable and may fluctuate, which may harm our operating results and financial condition**

Due to the emerging nature of the multichannel contact center market and other similar factors, our revenue and operating results may fluctuate from quarter to quarter. Our revenues in certain past quarters fell and could continue to fall short of expectations if we experience delays or cancellations of even a small number of orders. It is possible that our operating results in some quarters will be below the expectations of financial analysts or investors. In this event, the market price of our common stock is also likely to decline.

A number of factors are likely to cause fluctuations in our operating results, including, but not limited to, the following:

demand for our software and budget and spending decisions by information technology departments of our customers;

the mix of hosted and license transactions;

seasonal trends in technology purchases;

our ability to attract and retain customers; and

litigation relating to our intellectual proprietary rights.

In addition, we base our expense levels in part on expectations regarding future revenue levels. In the short term, expenses, such as employee compensation and rent, are relatively fixed. If revenue for a particular quarter is below expectations, we may be unable to reduce our operating expenses proportionately for that quarter. Accordingly, such a revenue shortfall would have a disproportionate effect on expected operating results for that quarter. For this reason, period-to-period comparisons of our operating results may also not be a good indication of our future performance.

### **Changes to current accounting policies could have a significant effect on our reported financial results or the way in which we conduct our business**

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Generally accepted accounting principles and the related accounting pronouncements, implementation guidelines and interpretations for some of our significant accounting policies are highly complex and require subjective judgments and assumptions. Some of our more significant accounting policies that could be affected by changes in the accounting rules and the related implementation guidelines and interpretations include:

recognition of revenues;

contingencies and litigation;

accounting for income taxes; and

stock-based compensation.

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Changes in these or other rules, or scrutiny of our current accounting practices, could have a significant adverse effect on our reported operating results or the way in which we conduct our business.

### **We may need additional capital, and raising such additional capital may be difficult or impossible and will likely significantly dilute existing stockholders**

We believe that existing capital resources will enable us to maintain current and planned operations for the next 12 months. However, our working capital requirements in the foreseeable future are subject to numerous risks and will depend on a variety of factors, in particular, that revenues increase from levels achieved in fiscal year 2007 and that customers continue to pay on a timely basis. We may need to secure additional financing due to unforeseen or unanticipated market conditions. Such financing may be difficult to obtain on terms acceptable to us and will almost certainly dilute existing stockholder value.

### **We depend on broad market acceptance of our applications and of our business model**

We depend on the widespread acceptance and use of our applications as an effective solution for businesses seeking to manage high volumes of customer interactions across multiple channels, including web, phone, email, print and in-person. While we believe the potential to be very large, we cannot accurately estimate the size or growth rate of the potential market for such product and service offerings generally, and we do not know whether our products and services in particular will achieve broad market acceptance. The market for customer interaction software is relatively new and rapidly evolving, and concerns over the security and reliability of online transactions, the privacy of users and quality of service or other issues may inhibit the growth of the Internet and commercial online services. If the market for our applications fails to grow or grows more slowly than we currently anticipate, our business will be seriously harmed.

Furthermore, our business model is premised on business assumptions that are still evolving. Historically, customer service has been conducted primarily in person or over the telephone. Our business model assumes that both customers and companies will increasingly elect to communicate via multiple channels, as well as demand integration of the online channels into the traditional telephone-based call center. Our business model also assumes that many companies recognize the benefits of a hosted delivery model and will seek to have their customer interaction software applications hosted by us. If any of these assumptions is incorrect, our business will be seriously harmed and our stock price will decline.

### **Difficulties in implementing our products could harm our revenues and margins**

We generally recognize license revenue from a customer sale when persuasive evidence of an arrangement exists, the product has been delivered, the arrangement does not involve significant customization of the software, the license fee is fixed or determinable and collection of the fee is probable. If an arrangement requires significant customization or implementation services from us, recognition of the associated license and service revenue could be delayed. The timing of the commencement and completion of these services is subject to factors that may be beyond our control, as this process requires access to the customer's facilities and coordination with the customer's personnel after delivery of the software. In addition, customers could delay product implementations. Implementation typically involves working with sophisticated software, computing and communications systems. If we experience difficulties with implementation or do not meet project milestones in a timely manner, we could be obligated to devote more customer support, engineering and other resources to a particular project. Some customers may also require us to develop customized features or capabilities. If new or existing customers have difficulty deploying our products or require significant amounts of our professional services, support, or customized features, revenue recognition could be further delayed or canceled and our costs could increase, causing increased variability in our operating results.



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### **We may not be able to respond to the rapid technological change of the customer service and contact center industry**

The customer service and contact center industry is characterized by rapid technological change, changes in customer requirements and preferences, and the emergence of new industry standards and practices that could render our existing services, proprietary technology and systems obsolete. We must continually develop or introduce and improve the performance, features and reliability of our products and services, particularly in response to competitive offerings. Our success depends, in part, on our ability to enhance our existing services and to develop new services, functionality and technology that address the increasingly sophisticated and varied needs of prospective customers. If we do not properly identify the feature preferences of prospective customers, or if we fail to deliver product features that meet the standards of these customers, our ability to market our service and compete successfully and to increase revenues could be impaired. The development of proprietary technology and necessary service enhancements entails significant technical and business risks and requires substantial expenditures and lead-time. We may not be able to keep pace with the latest technological developments. We may also be unable to use new technologies effectively or adapt services to customer requirements or emerging industry standards or regulatory or legal requirements. More generally, if we cannot adapt or respond in a cost-effective and timely manner to changing industry standards, market conditions or customer requirements, our business and operating results will suffer.

### **Our international operations involve various risks**

We derived 45% of our revenues from international sales for the fiscal year 2007 compared to 51% for the fiscal year 2006, and 49% for fiscal year 2005. Including those discussed above, our international sales operations are subject to a number of specific risks, such as:

foreign currency fluctuations and imposition of exchange controls;

expenses associated with complying with differing technology standards and language translation issues;

difficulty and costs in staffing and managing our international operations;

difficulties in collecting accounts receivable and longer collection periods;

various trade restrictions and tax consequences; and

reduced intellectual property protections in some countries.

More than 50% of our workforce is employed through eGain's India subsidiary, and located in India. Of these employees more than 50% are allocated to research and development. Although the movement of certain operations internationally was principally motivated by cost cutting, the continued management of these remote operations requires significant management attention and financial resources that could adversely affect our operating performance. In addition, with the significant increase in the numbers of foreign businesses that have established operations in India, the competition to attract and retain employees there has increased significantly. As a result of the increased competition for skilled workers, we experienced increased compensation costs and expect these costs to increase in the future. Our reliance on our workforce in India makes us particularly susceptible to disruptions in the business environment in that region. In particular, sophisticated telecommunications links, high speed data communications with other eGain offices and customers, and overall consistency and stability of our business infrastructure are vital to our day to day operations, and any impairment of such infrastructure will cause our financial condition and results to suffer. The

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maintenance of stable political relations between the United States, European Union and India are also of great importance to our operations.

Any of these risks could have a significant impact on our product development, customer support or professional services. To the extent the benefit of maintaining these operations abroad does not exceed the expense of establishing and maintaining such activities, our operating results and financial condition will suffer.

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### **Fluctuations in exchange rates between the euro, the British pound, the rupee and the U.S. dollar in which we do business, may adversely affect our operating results**

We transact business in an international environment. As we report our results in U.S. dollars, the difference in exchange rates in one period compared to another directly impacts period to period comparisons of our operating results. We generate a substantial portion of our revenues and expenses in currencies other than the U.S. dollar, including the euro and the British pound and we incur Indian rupee expenses. Furthermore, currency exchange rates have been especially volatile in the recent past and these currency fluctuations may make it difficult for us to predict or provide guidance on our results.

Our international revenues and expenses are denominated in local currency. Therefore, a weakening of other currencies compared to the U.S. dollar could make our products less competitive in foreign markets and could negatively affect our operating results and cash flows. We have not yet experienced, but may in the future experience, significant foreign currency transaction losses, especially because we generally do not engage in currency hedging. To the extent the international component of our revenue grows, our results of operations will become more sensitive to foreign exchange rate fluctuations.

### **Our reserves may be insufficient to cover receivables we are unable to collect**

We assume a certain level of credit risk with our customers in order to do business. Conditions affecting any of our customers could cause them to become unable or unwilling to pay us in a timely manner, or at all, for products or services we have already provided them. In the past, we have experienced collection delays from certain customers, and we cannot predict whether we will continue to experience similar or more severe delays in the future. Although we have established reserves to cover losses due to delays or inability to pay, there can be no assurance that such reserves will be sufficient to cover our losses. If losses due to delays or inability to pay are greater than our reserves, it could harm our business, operating results and financial condition.

### **Litigation and infringement claims could be costly to defend and distract our management team**

We may be involved in legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement of the intellectual property or proprietary rights of third parties, employment claims and other commercial contract disputes. Third parties may also infringe or misappropriate our copyrights, trademarks and other proprietary rights for which we may be required to file suit to protect or mediate our rights. In the past we have had lawsuits brought or threatened against us in a variety of contexts including but not limited to claims related to issues associated with our initial public offering of common stock, breach of contract and litigation associated with the termination of employees.

From time to time, parties have also asserted or threatened infringement claims, and may continue to do so. Because the contents of patent applications in the United States are not publicly disclosed until the patent is issued, applications may have been filed which relate to our software products. In particular, intellectual property litigation is expensive and time-consuming and could also require us to develop non-infringing technology or enter into royalty or license agreements. These royalty or license agreements, if required, may not be available on acceptable terms, if at all, in the event of a successful claim of infringement. Our failure or inability to develop non-infringing technology or license the proprietary rights on a timely basis would harm our business.



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Where appropriate, we intend to vigorously defend all claims. However, any actual or threatened claims, even if not meritorious or material, could result in the expenditure of significant financial and managerial resources. The continued defense of these claims and other types of lawsuits could divert management's attention away from running our business. Negative developments in lawsuits could cause our stock price to decline as well. In addition, required amounts to be paid in settlement of any claims, and the legal fees and other costs associated with such settlement cannot be estimated and could, individually or in the aggregate, materially harm our financial condition.

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### **We rely on trademark, copyright, trade secret laws, contractual restrictions and patent rights to protect our intellectual property and proprietary rights and if these rights are impaired our ability to generate revenue will be harmed**

We regard our patents, copyrights, service marks, trademarks, trade secrets and similar intellectual property as critical to our success, and rely on trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, customers and partners to protect our proprietary rights. We have numerous registered trademarks as well as common law trademark rights in the United States and internationally. In addition, we own several patents in the area of case-based reasoning. We plan to seek additional trademark and patent protection in the future. We do not know if our trademark and patent applications will be granted, or whether they will provide the protection we desire, or whether they will subsequently be challenged or invalidated. It is difficult to monitor unauthorized use of technology, particularly in foreign countries, where the laws may not protect our proprietary rights as fully as in the United States. Furthermore, our competitors may independently develop technology similar to our technology.

Despite our efforts to protect our proprietary rights through confidentiality and license agreements, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. These precautions may not prevent misappropriation or infringement of our intellectual property. In addition, we routinely require employees, customers, and potential business partners to enter into confidentiality and nondisclosure agreements before we will disclose any sensitive aspects of our products, technology, or business plans. In addition, we require employees to agree to surrender any proprietary information, inventions or other intellectual property they generate or come to possess while employed by us. In addition, some of our license agreements with certain customers and partners require us to place the source code for our products into escrow. These agreements typically provide that some party will have a limited, non-exclusive right to access and use this code as authorized by the license agreement if there is a bankruptcy proceeding instituted by or against us, or if we materially breach a contractual commitment to provide support and maintenance to the party.

### **Unknown software defects could disrupt our products and services and problems arising from our vendors' products or services could disrupt operations, which could harm our business and reputation**

Our product and service offerings depend on complex software, both internally developed and licensed from third parties. Complex software often contains defects or errors in translation or integration, particularly when first introduced or when new versions are released or localized for international markets. We may not discover software defects that affect our new or current services or enhancements until after they are deployed. It is possible that, despite testing by us, defects may occur in the software and we can give no assurance that our products and services will not experience such defects in the future. Furthermore, our customers generally use our products together with products from other companies. As a result, when problems occur in the integration or network, it may be difficult to identify the source of the problem. Even when our products do not cause these problems, these problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from product development efforts and cause significant customer relations problems. These defects or problems could result in damage to our reputation, lost sales, product liability claims, delays in or loss of market acceptance of our products, product returns and unexpected expenses, and diversion of resources to remedy errors.

### **Our common stock has been delisted and thus the price and liquidity of our common stock has been affected and our ability to obtain future equity financing may be further impaired**

In February 2004, we were delisted from the Nasdaq SmallCap Market due to noncompliance with Marketplace Rule 4310(c)(2)(B), which requires companies listed to have a minimum of \$2,500,000 in stockholders' equity or \$35,000,000 market value of listed securities or \$500,000 of net income from continuing operations for the most recently completed fiscal year or two of the three most recently completed fiscal years.

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Our common stock now trades on the OTC Bulletin Board owned by the Nasdaq Stock Market, Inc., which was established for securities that do not meet the listing requirements of the Nasdaq Global Market.

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The OTC Bulletin Board is generally considered less efficient than the Nasdaq Global Market. Consequently, selling our common stock is likely more difficult because of diminished liquidity in smaller quantities of shares likely being bought and sold, transactions could be delayed, and securities analysts' and news media coverage of us may be further reduced. These factors could result in lower prices and larger spreads in the bid and ask prices for shares of common stock.

Our listing on the OTC Bulletin Board, or further declines in our stock price, may greatly impair our ability to raise additional necessary capital through equity or debt financing, and significantly increase the dilution to our current stockholders caused by any issuance of equity in financing or other transactions. The price at which we would issue shares in such transactions is generally based on the market price of our common stock and a decline in the stock price could result in our need to issue a greater number of shares to raise a given amount of funding.

In addition, as our common stock is not listed on a principal national exchange, we are subject to Rule 15c-2 under the Securities and Exchange Act of 1934, as amended. That rule imposes additional sales practice requirements on broker-dealers that sell low-priced securities to persons other than established customers and institutional accredited investors. For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to sale. Consequently, the rule may affect the ability of broker-dealers to sell our common stock and affect the ability of holders to sell their shares of our common stock in the secondary market. Moreover, investors may be less interested in purchasing low-priced securities because the brokerage commissions, as a percentage of the total transaction value, tend to be higher for such securities, and some investment funds will not invest in low-priced securities (other than those which focus on small-capitalization companies or low-priced securities).

### **Our stock price has demonstrated volatility and overall declines since being listed on the public market and continued market conditions may cause further declines or fluctuations**

The price at which our common stock trades has been and will likely continue to be highly volatile and show wide fluctuations and substantial declines due to factors such as the following:

the thinly traded nature of our stock on the OTC Bulletin Board;

concerns related to liquidity of our stock, financial condition or cash balances;

actual or anticipated fluctuations in our operating results, our ability to meet announced or anticipated profitability goals and changes in or failure to meet securities analysts' expectations;

announcements of technological innovations and/or the introduction of new services by us or our competitors;

developments with respect to intellectual property rights and litigation, regulatory scrutiny and new legislation;

conditions and trends in the Internet and other technology industries; and

general market and economic conditions.

Furthermore, the stock market has in the past experienced significant price and volume fluctuations that have affected the market prices for the common stock of technology companies, regardless of the specific operating performance of the affected company. These broad market fluctuations may cause the market price of our common stock to increase and decline.

In addition, in past periods of volatility in the market price of a particular company's securities, securities class action litigation has been brought against that company following such declines. To the extent our stock price precipitously drops in the future, we may become involved in this type of litigation. Litigation of this kind, or involving intellectual property rights, is often expensive and diverts management's attention and resources, which could continue to harm our business and operating results.

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### **Ability to hire and retain key personnel**

Our success will also depend in large part on the skills, experience and performance of our senior management, engineering, sales, marketing and other key personnel. The loss of the services of any of our senior management or other key personnel, including our Chief Executive Officer and co-founder, Ashutosh Roy, could harm our business.

Increased levels of attrition in the Indian workforce on which we deeply rely for research and development and where we have moved significant resources in recent years would have significant effects on the company and its results of operations.

### **Unplanned system interruptions and capacity constraints and failure to effect efficient transmission of customer communications and data over the Internet could harm our business and reputation**

Our customers have in the past experienced some interruptions with the eGain-hosted operations. We believe that these interruptions will continue to occur from time to time. These interruptions could be due to hardware and operating system failures. As a result, our business will suffer if we experience frequent or long system interruptions that result in the unavailability or reduced performance of our hosted operations or reduce our ability to provide remote management services. We expect to experience occasional temporary capacity constraints due to sharply increased traffic or other Internet wide disruptions, which may cause unanticipated system disruptions, slower response times, impaired quality, and degradation in levels of customer service. If this were to continue to happen, our business and reputation could be seriously harmed.

The growth in the use of the Internet has caused interruptions and delays in accessing the Internet and transmitting data over the Internet. Interruptions also occur due to systems burdens brought on by unsolicited bulk email or Spam, malicious service attacks and hacking into operating systems, viruses, worms and Trojan horses, the proliferation of which is beyond our control and may seriously impact our and our customers' businesses.

Because we provide Internet-based eService software, interruptions or delays in Internet transmissions will harm our customers' ability to receive and respond to online interactions. Therefore, our market depends on ongoing improvements being made to the entire Internet infrastructure to alleviate overloading and congestion.

Our success largely depends on the efficient and uninterrupted operation of our computer and communications hardware and network systems. Most of our computer and communications systems are located in Mountain View, California. Due to our locations, our systems and operations are vulnerable to damage or interruption from fire, earthquake, power loss, telecommunications failure and similar events.

We have entered into service agreements with some of our customers that require minimum performance standards, including standards regarding the availability and response time of our remote management services. If we fail to meet these standards, our customers could terminate their relationships with us, and we could be subject to contractual refunds and service credits to customers. Any unplanned interruption of services may harm our ability to attract and retain customers.

**We may be liable for activities of customers or others using our hosted operations**

As a provider of customer service and contact center software for the Internet, we face potential liability for defamation, negligence, copyright, patent or trademark infringement and other claims based on the actions of our customers, and their customers, or others using our solutions or communicating through our networks. This liability could result from the nature and content of the communications transmitted by customers through the hosted operations. We do not and cannot screen all of the communications generated by our customers, and we could be exposed to liability with respect to this content. Furthermore, some foreign governments, including

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Germany and China, have enforced laws and regulations related to content distributed over the Internet that are more strict than those currently in place in the United States. In some instances criminal liability may arise in connection with the content of Internet transmissions.

Although we carry general liability and umbrella liability insurance, our insurance may not cover claims of these types or may not be adequate to indemnify us for all liability that may be imposed. There is a risk that a single claim or multiple claims, if successfully asserted against us, could exceed the total of our coverage limits. There also is a risk that a single claim or multiple claims asserted against us may not qualify for coverage under our insurance policies as a result of coverage exclusions that are contained within these policies. Should either of these risks occur, capital contributed by our stockholders might need to be used to settle claims. Any imposition of liability, particularly liability that is not covered by insurance or is in excess of our insurance coverage could harm our reputation and business and operating results, or could result in the imposition of criminal penalties.

### **If our system security is breached, our business and reputation could suffer and we may face liability associated with disclosure of sensitive customer information**

A fundamental requirement for online communications and transactions is the secure transmission of confidential information over public networks. Third parties may attempt to breach our security or that of our customers. We may be liable to our customers for any breach in our security and any breach could harm our business and reputation. Although we have implemented network security measures, our servers 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 license encryption technology and additional technologies to protect against security breaches or to alleviate problems caused by any breach since our applications frequently manage sensitive and personally identifiable customer information. We may also be subject to claims associated with invasion of privacy or inappropriate disclosure, use or loss of this information and fraud and identity theft crimes associated with such use or loss. 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.

### **The regulatory environment for and certain legal uncertainties in the operation of our business and our customer s business could impair our growth or decrease demand for our services or increase our cost of doing business**

Few laws currently apply directly to activity on the Internet and related services for businesses operating commercial online service. However, new laws are frequently proposed and other laws made applicable to Internet communications every year both in the U.S. and internationally. In particular, in the operation of our business we face risks associated with privacy, confidentiality of user data and communications, consumer protection and pricing, taxation, content, copyright, trade secrets, trademarks, antitrust, defamation and other legal issues. In particular, legal concerns with respect to communication of confidential data have affected our financial services and health care customers due to newly enacted federal legislation. The growth of the industry and the proliferation of ecommerce services may prompt further legislative attention to our industry and thus invite more regulatory control of our business. Further, the growth and development of the market for commercial online transactions may prompt calls for more stringent consumer protection laws that may impose additional burdens on those companies engaged in ecommerce. Moreover, the applicability to the Internet of existing laws in various jurisdictions governing issues such as property ownership, sales and other taxes, libel and personal privacy is uncertain and may take years to resolve.

In addition, the applicability of laws and regulations directly applicable to the businesses of our customers, particularly customers in the fields of financial services, will continue to affect us. The security of information about our customers end-users continues to be an area where a variety of laws and regulations with respect to privacy and confidentiality are enacted. As our customers implement the protections and prohibitions with respect to the transmission of end-user data, our customers will look to us to assist them in remaining in





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compliance with this evolving area of regulation. In particular the Gramm-Leach-Bliley Act contains restrictions with respect to the use and protection of financial services records for end-users whose information may pass through our system.

The imposition of more stringent protections and/or new regulations and the application of existing laws to our business could burden our company and those with which we do business. Further, the adoption of additional laws and regulations could limit the growth of our business and that of our business partners and customers. Any decreased generalized demand for our services, or the loss/decrease in business by a key partner or customer due to regulation or the expense of compliance with any regulation, could either increase the costs associated with our business or affect revenue, either of which could harm our financial condition or operating results.

Finally, we face increased regulatory scrutiny and potential criminal liability for our executives associated with various accounting and corporate governance rules promulgated under the Sarbanes-Oxley Act of 2002. We have reviewed and will continue to monitor all of our accounting policies and practices, legal disclosure and corporate governance policies under the new legislation, including those related to relationships with our independent accountants, enhanced financial disclosures, internal controls, board and board committee practices, corporate responsibility and loan practices, and intend to fully comply with such laws. Nevertheless, such increased scrutiny and penalties involve risks to both eGain and our executive officers and directors in monitoring and insuring compliance. A failure to properly navigate the legal disclosure environment and implement and enforce appropriate policies and procedures, if needed, could harm our business and prospects.

### **We may need to license third-party technologies and may be unable to do**

To the extent we need to license third-party technologies, we may be unable to do so on commercially reasonable terms or at all. In addition, we may fail to successfully integrate any licensed technology into our products or services. Third-party licenses may expose us to increased risks, including risks associated with the integration of new technology, the diversion of resources from the development of our own proprietary technology, and our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs. Our inability to obtain and successfully integrate any of these licenses could delay product and service development until equivalent technology can be identified, licensed and integrated. This in turn would harm our business and operating results.

### **We may engage in future acquisitions or investments that could dilute our existing stockholders, cause us to incur significant expenses or harm our business**

We may review acquisition or investment prospects that might complement our current business or enhance our technological capabilities. Integrating any newly acquired businesses or their technologies or products may be expensive and time-consuming. To finance any acquisitions, it may be necessary for us to raise additional funds through public or private financings. Additional funds may not be available on terms that are favorable to us, if at all, and, in the case of equity financings, may result in dilution to our existing stockholders. We may not be able to operate acquired businesses profitably. If we are unable to integrate newly acquired entities or technologies effectively, our operating results could suffer. Future acquisitions by us could also result in large and immediate write-offs, incurrence of debt and contingent liabilities, or amortization of expenses related to goodwill and other intangibles, any of which could harm our operating results.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.



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**ITEM 2. PROPERTIES**

We lease all facilities used in our business. The following table summarizes our principal properties.

<b>Location</b>	<b>Principal Use</b>	<b>Approximate Square Footage</b>	<b>Lease Expiration Date</b>
Mountain View, California	Corporate Headquarters	16,000	2011
Pune, India	Corporate Offices	24,331	2010
Gurgaon, India	Corporate Offices	6,400	2009
Slough, England	European Headquarters	7,000	2008

Including a new office in Gurgaon, India which opened in September, 2006, we believe our facilities are suitable for our uses and are generally adequate to support the current level of operations for the next 12 months.

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**Table of Contents****ITEM 3. LEGAL PROCEEDINGS**

Beginning on October 25, 2001, a number of securities class action complaints were filed against us, and certain of our then officers and directors and underwriters connected with our initial public offering of common stock in the U.S. District Court for the Southern District of New York (*consolidated into In re Initial Public Offering Sec. Litig.*). The complaints alleged generally that the prospectus under which such securities were sold contained false and misleading statements with respect to discounts and excess commissions received by the underwriters as well as allegations of laddering whereby underwriters required their customers to purchase additional shares in the aftermarket in exchange for an allocation of IPO shares. The complaints sought an unspecified amount in damages on behalf of persons who purchased the common stock between September 23, 1999 and December 6, 2000. Similar complaints were filed against 55 underwriters and more than 300 other companies and other individuals. The over 1,000 complaints were consolidated into a single action. We reached an agreement with the plaintiffs to resolve the cases as to our liability and that of our officers and directors. The settlement involved no monetary payment or other consideration by us or our officers and directors and no admission of liability. On August 31, 2005, the court issued an order preliminarily approving the settlement and setting a public hearing on its fairness for April 24, 2006 (the postponement from January 2006 to April 2006 was because of difficulties in mailing the required notice to class members). On October 27, 2005, the court issued an order making some minor changes to the form of notice to be sent to class members. On January 17, 2006, the court issued an order modifying the preliminary settlement approval order to extend the time within which notice must be given to the class, which time had expired on January 15, 2006. On April 24, 2006, the Court held a public hearing on the fairness of the proposed settlement. Meanwhile the consolidated case against the underwriters proceeded. In October 2004, the district court certified a class. On December 5, 2006, however, the Second Circuit reversed, holding that a class could not be certified *In re Initial Public Offering Sec. Litig.*, 471 F.3d 24 (2d Cir. 2006), the Second Circuit's holding, while directly affecting only the underwriters, raised doubt as to whether the settlement class contemplated by the proposed issuer settlement would be approved in its present form. A petition for rehearing was filed January 5, 2007. The Court of Appeals denied a petition for rehearing on April 6, 2007. On June 25, 2007, the district court entered a stipulated order terminating the proposed issuer settlement. Plaintiffs are proceeding with discovery as to underwriters and issuers, although principally with respect to focus or test cases that do not name the Company as a defendant. The court set a briefing schedule for a new class certification motion, which is expected to be heard in early 2008. We have not accrued any liability or expect the outcome of this litigation to have a material impact on our financial condition.

On February 12, 2004, we filed suit in the Superior Court of the State of California, Santa Clara County against Insight Enterprises, Inc., the acquirer of Comark, Inc., a value-added reseller of our software, claiming *inter alia* breach of contract and failure to pay in connection with a sale of our software to one customer. On June 25, 2007 we entered into a settlement agreement with Insight Enterprises, Inc. In exchange for a one-time payment that we received in June 2007, we agreed to dismiss the lawsuit with prejudice.

On April 5, 2007, Polaris IP, LLC (Polaris) sued eGain, our subsidiary Inference Corp. and certain eGain Customers for patent infringement in the U.S. District Court for the Eastern District of Texas, Marshall Division, which alleged infringement of US patent Nos. 6,411,947 and 6,278,996. After various motions in this patent infringement case and the filing by eGain of a declaratory judgment action in Minnesota, the parties agreed to a settlement, which occurred on September 27, 2007. eGain and eGain related companies obtained a license to certain Polaris patents on terms that allow the license to continue until the expiration of these patents. The parties agreed to dismiss their claims against each other with prejudice. The terms of the settlement included the release and dismissal of our customers named in the litigation.

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

None.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDERS MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***Market Information*

eGain's Common Stock trades on the OTC Bulletin Board under the symbol EGAN.OB. The following table sets forth, for the periods indicated, high and low bid prices for eGain's Common Stock as reported by the OTC Bulletin Board.

	<b>High</b>	<b>Low</b>
<b>Year Ended June 30, 2007</b>		
First Quarter	\$ 1.65	\$ 1.04
Second Quarter	1.80	1.20
Third Quarter	1.45	1.01
Fourth Quarter	1.26	0.94
<b>Year Ended June 30, 2006</b>		
First Quarter	\$ 1.00	\$ 0.60
Second Quarter	0.90	0.60
Third Quarter	1.95	0.72
Fourth Quarter	1.75	1.21

*Holdings*

As of September 21, 2007, there were approximately 414 stockholders of record. This number does not include stockholders whose shares are held in trust by other entities. We estimate that there were approximately 5,300 beneficial stockholders of our common stock as of September 21, 2007.

*Dividends*

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain all available funds for use in the operation of our business and do not intend to pay any cash dividends in the foreseeable future.

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*Performance Graph*

The following graph illustrates a comparison of the cumulative total stockholder return (change in stock price plus reinvested dividends) of eGain's common stock with a Self-Determined Peer Group (the Peer Group) and the CRSP Total Return Index for the Nasdaq U.S. and Foreign Stocks (the Nasdaq Composite Index) for five years ended June 30, 2007. The graph and table assume that, an investment of \$100 in the common stock of eGain, and in each index on June 28, 2002, and that all dividends were reinvested. eGain has not paid or declared any cash dividends on its common stock. eGain's common stock is traded on the OTC Bulletin Board owned by the Nasdaq Global Market, Inc. The comparisons in the table are required by the Securities and Exchange Commission and are not intended to forecast or be indicative of possible future performance of eGain's common stock.

Notwithstanding any statement to the contrary in any of our previous or future filings with the SEC, the foregoing information relating to the price performance of our common stock shall not be deemed to be filed with the SEC or to be soliciting material under the Exchange Act, and it shall not be deemed to be incorporated by reference into any of our filings under the Securities Act or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

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

The selected consolidated financial data set forth on the following page should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, our Consolidated Financial Statements and Notes thereto, and other financial information included elsewhere in this Form 10-K. Historical results are not necessarily indicative of results that may be expected for future periods.

	Fiscal Years Ended June 30,				
	2007	2006	2005	2004	2003
	(in thousands, except per share information)				
<b>Revenue:</b>					
License	\$ 3,407	\$ 5,967	\$ 5,960	\$ 4,058	\$ 6,095
Support and Services	19,066	16,597	14,468	15,545	15,989
Total revenue	22,473	22,564	20,428	19,603	22,084
Cost of license	99	231	406	1,646	1,772
Cost of support and services	9,132	6,985	6,215	6,462	8,738
Cost of revenue acquisition related					827
Gross profit	13,242	15,348	13,807	11,495	10,747
<b>Operating costs and expenses:</b>					
Research and development	3,973	3,046	2,367	2,942	5,869
Sales and marketing	12,853	9,570	8,855	8,284	9,598
General and administrative	2,884	2,637	3,295	3,447	4,816
Amortization of intangible assets				1,203	1,307
Amortization of deferred compensation					157
Restructuring and other			(922)	23	620
Total operating costs and expenses	19,710	15,253	13,595	15,899	22,367
Income / (Loss) from operations	(6,468)	95	212	(4,404)	(11,620)
Interest expense, net	(1,167)	(1,040)	(954)	(596)	(283)
Other income	72	32	100	106	427
Loss before income tax	(7,563)	(913)	(842)	(4,894)	(11,476)
Income tax	(136)	(146)			
Net loss	(7,699)	(1,059)	(842)	(4,894)	(11,476)
Dividends on convertible preferred stock			(3,732)	(7,384)	(6,890)
Net loss applicable to common stockholders	\$ (7,699)	\$ (1,059)	\$ (4,574)	\$ (12,278)	\$ (18,366)
<b>Per share information:</b>					
Basic/Diluted net loss per common share	\$ (0.50)	\$ (0.07)	\$ (0.47)	\$ (3.33)	\$ (5.01)
Weighted average shares used in computing basic/diluted net loss per common share	15,317	15,308	9,731	3,688	3,664

Below is summary of stock based compensation included in the costs and expenses above:

Cost of support and services	\$ 47	\$ 34	\$	\$	\$
Research and development	39	53			



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Sales and marketing	127	80		
General and administrative	62	95		
Total stock-based compensation expense	\$ 273	\$ 262	\$	\$

	2007	2006	June 30, 2005	2004	2003
(in thousands)					
<b>Consolidated Balance Sheet Data:</b>					
Cash, cash equivalents and short-term investments	\$ 6,195	\$ 6,916	\$ 4,498	\$ 5,181	\$ 4,407
Working capital	(4,111)	347	794	2,009	(172)
Total assets	15,362	16,105	15,904	15,161	19,038
Deferred revenue	\$ 5,541	\$ 4,259	\$ 4,144	\$ 3,731	\$ 4,333
Long-term debt	11,820	8,729	7,648	6,607	1,974

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**Table of Contents****ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements that involve risks and uncertainties. These statements may be identified by the use of the words such as anticipates, believes, continue, could, would, estimates, forecasts, expects, intends, may, might, plans, potential, predicts, should, or will and similar expressions or the negative of those terms. The forward-looking statements include, but are not limited to, risks stemming from: our failure to improve our sales results and grow revenue; our failure to compete successfully in the markets in which we do business; the impact of our hybrid revenue model; our history of net losses and our ability to achieve profitability; the adequacy of our capital resources and need for additional financing; the continued lengthy and delayed sales cycles of our goods and services; the development of our strategic relationships and third party distribution channels; broad economic and political instability around the world affecting the market for our goods and services; the continued adoption of customer service and contact center software solutions; our ability to respond to rapid technological change and competitive challenges; our substantial international operations; legal and regulatory uncertainties and other risks related to protection of our intellectual property assets; and the operational integrity and maintenance of our systems. Our actual results could differ materially from those discussed in statements relating to our future plans, product releases, objectives, expectations and intentions, and other assumptions underlying or relating to any of these statements. Factors that could contribute to such differences include those discussed in *Factors That May Affect Future Results* and elsewhere in this document. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or understanding to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

**Overview**

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

We were founded in September 1997. Since inception, we have incurred substantial costs developing our proprietary technological solutions, recruiting and compensating personnel, and purchasing operating assets. In response to our revenues declining during fiscal years 2001 through 2004, we took actions to reduce overall expense rates. In fiscal year 2005, we started to make modest increases in sales and marketing investments and as a result of these actions, net revenues increased to \$22.6 million in fiscal year 2006 from \$20.4 in fiscal year 2005. In addition, we had income from operations of \$95,000 in fiscal year 2006 and income from operations of \$212,000 in fiscal year 2005. Our recorded net cash provided from operating activities of \$3.0 million in fiscal year 2006 compared to net cash used in operating activities of \$1.1 million in fiscal year 2005.

Based upon the increased revenues and income from operations in fiscal years 2006 and 2005 as well as the positive cash flow from operating activities in fiscal year 2006, we made increased investments in our business in fiscal year 2007 including an expansion of the product and sales and marketing teams. This investment was driven in part by the OEM agreement we signed with Cisco Systems in August 2006. Under this agreement we will supply unified communications technology for use in certain Cisco products. Pursuant to the agreement, there are certain minimum royalty payments due to us from Cisco based upon our successful delivery of certain milestones that are projected over the first eighteen months of the agreement. The first major milestone was delivered and accepted in December 2006. Given that the agreement required us to make significant product customizations before delivery to Cisco, there were limited sales of the OEM product in fiscal year 2007. The

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investment we made in our sales and marketing teams did not convert into revenue in fiscal year 2007 due to the ramp up time of the new sales personnel and the shift in our mix of customer contracts from license arrangements toward hosting arrangements. In fiscal year 2007, we recorded revenue of \$22.5 million, loss from operations of \$6.5 million and net cash used in operations of \$2.8 million. We anticipate an increase in revenue in fiscal year 2008 from the new business generated by our direct sales team, royalties from the Cisco OEM agreement and the recognition of deferred revenue. As of June 30, 2007 our cash and cash equivalents were \$6.2 million compared to \$6.9 million on June 30, 2006.

We believe that existing capital resources will enable us to maintain current and planned operations for the next 12 months. We intend to continue to make investments in product development and technology to enhance our current products and services, develop new products and services and further advance our solution offerings. We have only achieved profitability on an operating basis in fiscal years 2006 and 2005, and in view of the rapidly evolving nature of our business and limited operating history, we believe that period-to-period comparisons of our revenue and operating results may not be meaningful and should not be relied upon as indications of future performance.

## **Critical Accounting Policies and Estimates**

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

### *Revenue Recognition*

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

We apply the provisions of Statement of Position ( SOP ) No. 97-2, *Software Revenue Recognition*, ( SOP 97-2 ) as amended by SOP No. 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*, ( SOP 98-9 ) to all transactions involving the licensing of software products. In the event of a multiple element arrangement for a license transaction we evaluate the transaction to determine if each element represents a separate unit of accounting taking into account all factors following the guidelines set forth in SOP 97-2, or for a hosting transaction, Emerging Issues Task Force Issue ( EITF ) No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, ( EITF 00-21 ). For professional services, where the services are not essential to the functionality, the services revenues are recognized in accordance with SOP 97-2. If the services are essential to the functionality, the services revenues are recognized in accordance with the provisions of SOP No. 81-1, *Accounting for Performance of Construction Type and Certain Production Type Contracts*, ( SOP 81-1 ).

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When licenses are sold together with system implementation and consulting services, license fees are recognized upon delivery, generally the date of electronic transmission or shipment, provided that (i) payment of the

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

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

### *License Revenue*

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

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

We periodically sell to resellers. License sales to resellers as a percentage of total revenue was approximately 4 % in fiscal 2007 and 10% in fiscal 2006. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller's plans to sell the software, if there are any return provisions, price protection or other allowances, the reseller's financial status and our past experience with the particular reseller. Historically sales to resellers have not included any return provisions, price protections, other allowances or extended payment terms.

### *Professional Services Revenue*

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

fixed fee services are essential to the functionality, we recognize the revenue using contract accounting.

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In August 2006, we entered into an OEM agreement with Cisco Systems. Under this agreement we will supply unified communications technology for use in certain Cisco products. Pursuant to the agreement, there are certain minimum royalty payments due to us from Cisco based upon our successful delivery of certain milestones that are projected over the first eighteen months of the agreement. The first major milestone was delivered and accepted in December 2006. This OEM agreement with Cisco includes multiple elements, including significant product customizations that are subject to Cisco's acceptance. We have determined that this arrangement should be accounted for under the contract accounting method per paragraph 65 of SOP 97-2. In addition, we have determined that no loss will be incurred in the arrangement, however, at present the lowest probable level of profit cannot be determined, and therefore, a zero estimate of profit is used in calculating revenue. Revenue from this arrangement as a percentage of total revenue was approximately 4% for the fiscal year ended June 30, 2007, and is all related to professional services revenue.

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

Training revenue is recognized when training is provided, or in the case of hosting, when the customer also has access to the hosting services, if such training services meet the separable criteria.

### *Hosting Services Revenue*

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

We evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by EITF 00-21, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, (iii) there is objective reliable evidence of the fair value of the undelivered item, and (iv) there is a general right of return. We consider the applicability of EITF No. 00-03, *Application of SOP 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware*, ( EITF 00-03 ) on a contract-by-contract basis. In hosted term-based agreements, where the customer does not have the contractual right to take possession of the software, the revenue is recognized on a monthly basis over the term of the contract. Amounts that are billable are invoiced and recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. For professional services that we determine do not have stand-alone value to the customer, we recognize the services revenue ratably over the longer of the remaining contractual period or the remaining estimated life of the customer hosting relationship, once hosting has gone live. We currently estimate the life of our customer hosting relationship to be 20 months, based on the average life of all hosting customer relationships.

If we determine that the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty, and can feasibly run the software on its own hardware or enter into another arrangement with a third party to host the software, a software element covered by SOP 97-2 exists. When a software element exists in a hosting services arrangement, we recognize the license, professional services and hosting services revenues pursuant to SOP 97-2. We have established vendor specific objective evidence for the hosting and support elements of perpetual license sales, based on the prices charged when sold separately and substantive renewal terms. Accordingly, revenue for the perpetual software license element is determined using the residual method and is recognized upon delivery. Revenue for the hosting and support elements is recognized ratably over the contractual time period. Professional services are recognized as described above under *Professional Services Revenue* . If evidence of fair value cannot be established for the undelivered elements of an agreement, the entire amount of revenue from the arrangement is recognized ratably over the period that these elements are delivered.





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### *Maintenance and Support Revenue*

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

### *Stock-Based Compensation*

We adopted Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), *Share-Based Payment*, ( SFAS 123R ) effective July 1, 2005. SFAS 123R is a new and very complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility and expected option lives, as well as expected option forfeiture rates to value equity-based compensation. We determine the appropriate measure of expected volatility by reviewing historic volatility in the share price of our common stock. We base our assumptions for forfeiture rates on our historic activity. We used a temporary simplified method to develop the estimate of the expected life of a plain vanilla employee stock option. Under this approach, the expected life would be presumed to be the mid-point between the vesting date and the end of the contractual term. SFAS 123R also requires that the benefit of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement reduces net operating cash flows and increases net financing cash flows in periods after the effective date. This tax difference for unexercised options must also be recorded as a deferred tax item and recorded in additional paid in capital.

### *Valuation of Goodwill*

We review goodwill annually for impairment (or more frequently if impairment indicators arise). We perform an annual goodwill impairment review April 1 every year and we have found no impairment in the last three years.

### *Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts to reserve for potential uncollectible trade receivables. We review our trade receivables by aging category to identify specific customers with known disputes or collectibility issues. We exercise judgment when determining the adequacy of these reserves as we evaluate historical bad debt trends, general economic conditions in the U.S. and internationally, and changes in customer financial conditions. If we make different judgments or utilize different estimates, material differences may result in additional reserves for trade receivables, which would be reflected by charges in general and administrative expenses for any period presented.

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

The following table sets forth certain items reflected in our consolidated statements of operations expressed as a percent of total revenues for the periods indicated.

	2007	Fiscal Year 2006	2005
<b>Revenue:</b>			
License	15%	26%	29%
Support and Services	85%	74%	71%
Total revenue	100%	100%	100%
Cost of license	0%	1%	2%
Cost of support and services	41%	31%	30%
Gross profit (loss)	59%	68%	68%
Research and development	18%	13%	12%
Sales and marketing	57%	42%	43%
General and administrative	13%	12%	16%
Restructuring and other			(4)%
Total operating costs and expenses	88%	67%	67%
Income / (Loss) from operations	(29)%	1%	1%

**Revenue**

Total revenue, which consists of license revenue and support and services revenue, was \$22.5 million, \$22.6 million, and \$20.4 million, in fiscal years 2007, 2006, and 2005, respectively. In fiscal year 2007, total revenue remained substantially unchanged from fiscal year 2006. In fiscal year 2006, total revenue increased 10%, or \$2.1 million compared to fiscal year 2005. The unchanged total revenue in fiscal year 2007 was primarily due to the increase in support and services revenue offset by the decrease in license revenue. The increase in total revenue in fiscal year 2006 was also primarily due to the increase in support and services revenue.

We are continuing to see increased interest from medium to large-sized companies in our customer interaction solutions. Based upon this interest and our projected increase in sales and marketing activities we anticipate total revenue to increase over the next fiscal year. There is however general unpredictability of the length of our current sales cycles, the timing of revenue recognition on more complex license transactions and seasonal buying patterns. For example, in fiscal year 2007 we deferred license revenue of \$2.1 million due to the complexity of three large transactions we executed in the fourth quarter of fiscal year 2007 and our revenue in fiscal year 2006 was impacted by an anticipated large transaction that moved into fiscal year 2007. Also, because we offer a hybrid delivery model, the mix of new hosting and license business in a quarter could also have an impact on our revenue in a particular quarter. The value of new hosting transactions, as a percentage of combined new hosting and license business was over 39% and 30 % for the fiscal years 2007 and 2006, respectively. For license transactions the license revenue amount is generally recognized in the quarter delivery and acceptance of our software takes place whereas, for hosting transactions, hosting revenue is recognized ratably over the term of the hosting contract, which is typically one to two years. As a result, our total revenue may increase or decrease in future quarters as a result of the timing and mix of license and hosting transactions.



**Table of Contents***License*

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007		2005 to 2006	
	(in thousands)						
<b>Revenue:</b>							
License	\$ 3,407	\$ 5,967	\$ 5,960	\$ (2,560)	(43)%	\$ 7	0%
Percentage of total revenue	15%	26%	29%				

License revenue was \$3.4 million, \$6.0 million, and \$6.0 million in fiscal years 2007, 2006, and 2005, respectively. This represents a decrease of 43% or \$2.6 million in fiscal year 2007 from fiscal year 2006 and no change in fiscal year 2006 compared to fiscal year 2005. The decrease in fiscal year 2007 was primarily due in part to: (i) the shift in our customer's buying patterns resulting in an increase in new hosting business and (ii) the deferral of revenue for three large license transactions totaling \$2.1 million in the fourth quarter of fiscal year 2007. Even though license revenue decreased in fiscal year 2007, the size of license deals signed in fiscal year 2007 increased from fiscal year 2006. The total of the three largest license contracts signed in fiscal year 2007 was \$3.8 million including two transactions over \$1.0 million and one of approximately \$800,000 compared to two license transactions over \$1.0 million in fiscal year 2006. License revenue represented 15%, 26% and 29% of total revenue for the fiscal years 2007, 2006 and 2005, respectively. Given the general unpredictability of the length of current sales cycles and the mix of new hosting and license business, license revenue may increase or decrease in the future but we anticipate license revenues to increase in fiscal year 2008.

*Support and Services*

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007		2005 to 2006	
	(in thousands)						
<b>Revenue:</b>							
Hosting services	\$ 4,356	\$ 3,658	\$ 3,502	\$ 698	19%	\$ 156	4%
Maint. and support services	\$ 8,832	\$ 8,431	\$ 7,957	\$ 401	5%	\$ 474	6%
Professional services	\$ 5,878	\$ 4,508	\$ 3,009	\$ 1,370	30%	\$ 1,499	50%
Total support and services	\$ 19,066	\$ 16,597	\$ 14,468	\$ 2,470	15%	\$ 2,129	15%
Percentage of total revenue	85%	74%	71%				

Support and services includes hosting, software maintenance and support and professional services. Maintenance and support consists of technical support and software upgrades and enhancements. Professional services primarily consist of consulting and implementation services and training. Support and services revenue was \$19.1 million, \$16.6 million and \$14.5 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 15% or \$2.5 million in fiscal year 2007 compared to fiscal year 2006 and an increase of 15% or \$2.1 million in fiscal year 2006 compared to fiscal year 2005. Support and services revenue represented 85%, 74% and 71% of total revenue for the fiscal years 2007, 2006 and 2005, respectively.

Hosting revenue was \$4.4 million, \$3.7 million and \$3.5 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 19% or \$698,000 in fiscal year 2007 compared to 4% or \$156,000 in fiscal year 2006 compared to fiscal year 2005. Hosting revenues increased year-over-year from fiscal year 2006 to fiscal year 2007 due primarily to the increased size of new hosting contracts with larger enterprises. There were two new large hosting contracts totaling over \$2.5 million in fiscal year 2007 compared to four new hosting contracts over \$100,000 in fiscal year 2006 and three new hosting contracts over \$100,000 in fiscal year 2005. We expect hosting revenue to increase in fiscal year 2008 based upon current renewal rates for existing hosted customers, the new hosting agreements entered into in recent quarters that we expect to start generating hosting revenue in future quarters and the increased interest we are seeing for our hosting or on demand services

from our target customers.

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Maintenance and support revenue was \$8.8 million, \$8.4 million and \$8.0 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 5% or \$401,000 compared to fiscal year 2006 and an increase of 6% or \$474,000 in fiscal year 2006 compared to fiscal year 2005. The increase in fiscal year 2007 was primarily due to the change in the exchange rate between the US dollar and British pound. The increase in fiscal year 2006 was due to the increase of license revenue in the first three quarters in of the fiscal year compared to the comparable year-ago period while renewal rates for existing customers improved in fiscal year 2006 when compared to renewal rates for fiscal year 2005. We expect maintenance and support revenue to increase in fiscal year 2008 based upon current renewal rates for existing maintenance and support customers and the projected levels of new license sales.

Professional services revenue was \$5.9 million, \$4.5 million and \$3.0 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 30% or \$1.4 million in fiscal year 2007 compared to fiscal year 2006 and an increase of 50% or \$1.5 million in fiscal year 2006 compared to fiscal year 2005. The increase in fiscal year 2007 was primarily due to (i) approximately \$911,000 of services delivered associated with the OEM Agreement we entered into with Cisco Systems in August 2006, (ii) our increased focus in selling our products and services to larger organizations has resulted in an increase in the size of professional services engagements with these larger companies deploying our customer interaction solutions within their organizations, contributing to an increase of approximately \$600,000 in North America. The increase in fiscal year 2006 was primarily due to (i) our continued focus in selling our products and services to larger organizations that has resulted in an increase in the size of professional services engagements with these larger companies deploying our customer interaction solutions within their organizations, and (ii) existing customers upgrading to our eGain Service 7<sup>TM</sup> product.

In fiscal years 2007, 2006 and 2005, no single customer accounted for more than 10% of total revenue.

*Cost of Revenue*

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007	2005 to 2006		
	(in thousands)						
<b>Cost of revenue</b>	\$ 9,231	\$ 7,216	\$ 6,621	\$ 2,015	28%	\$ 595	9%
Percentage of total revenue	41%	32%	32%				
Gross Margin	59%	68%	68%				

Total cost of revenue was \$9.2 million, \$7.2 million and \$6.6 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 28% or \$2.0 million in fiscal year 2007 compared to fiscal year 2006 and an increase of 9% or \$595,000 in fiscal year 2006 compared to fiscal year 2005. Total cost of revenue as a percentage of total revenues was 41% (a gross margin of 59%) in fiscal year 2007 as compared to 32% (a gross margin of 68%) in fiscal year 2006. The increase in fiscal year 2007 was primarily due to (i) the research and development personnel cost related to the Cisco OEM agreement of approximately \$699,000, (ii) increased personnel expenses of \$629,000 from the additional headcount from our operations in North America and India (iii) the increase in hosting related cost of approximately \$177,000 and depreciation and software expenses of \$204,000, and (iv) an increase in European expenses of approximately \$229,000 related to the change in the exchange rate between the U.S. dollar and British pound.

Gross margin for fiscal year 2007 was 59% compared to 68% from the last year. The mix between license revenue and support and services revenue was the primary reason for the overall decrease in the gross margin.

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



**Table of Contents***Cost of License*

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007	2005 to 2006		
	(in thousands)						
<b>Cost of license</b>	\$ 99	\$ 231	\$ 406	\$ (132)	(57)%	\$ (175)	(43)%
Percentage of license revenue	3%	4%	7%				
Gross Margin	97%	96%	93%				

Cost of license primarily includes third-party software royalties and delivery costs for shipments to customers. Total cost of license was \$99,000, \$231,000 and \$406,000 in fiscal years 2007, 2006 and 2005, respectively. This represented a decrease of 57% or \$132,000 in fiscal year 2007 compared to 2006 and a decrease of 43% or \$175,000 in fiscal year 2006 compared to fiscal year 2005. Total cost of license decreased as a percentage of total license revenues to 3% in fiscal year 2007 as compared to 4% in the fiscal year 2006 but the gross margin increased to 97% in fiscal year 2007 as compared to 96% in fiscal year 2006. The decrease in fiscal year 2007 and 2006 were due to the expiration and renegotiation of certain royalty agreements that resulted in a reduction in the amortization of prepaid royalties. As part of our ongoing product development strategy, eGain Service 7 has less third-party software built into it than prior product releases and therefore lower corresponding costs for third-party intellectual property. We anticipate cost of license as a percentage of revenue to remain relatively constant in future periods, but to increase or decrease in absolute dollars based upon the increase or decrease in our license revenue in future periods.

*Cost of Support and Services*

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007	2005 to 2006		
	(in thousands)						
<b>Cost of support and services</b>	\$ 9,132	\$ 6,985	\$ 6,215	\$ 2,147	31%	\$ 770	12%
Percentage of supp. and serv. revenue	48%	42%	43%				
Gross Margin	52%	58%	57%				

Cost of support and services includes personnel costs for our hosting services, consulting services and customer support. It also includes depreciation of capital equipment used in our hosted network, cost of support for the third-party software and lease costs paid to remote co-location centers. In addition, as the Cisco OEM arrangement is being accounted for under the contract accounting method per paragraph 65 of SOP 97-2 and a zero estimate of profit is being used in calculating revenue, we recorded costs associated with this agreement of approximately \$911,000 for fiscal year 2007. The majority of the services delivered in connection with this agreement have been performed by research and development personnel totaling approximately \$680,000 and the remainder being performed by services and sales personnel totaling approximately \$231,000.

Total cost of support and services was \$9.1 million, \$7.0 million, and \$6.2 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 31% or \$2.1 million in fiscal year 2007 compared to fiscal year 2006 and an increase of 12% or \$770,000 in fiscal year 2006 compared to fiscal year 2005. Total cost of support and services as a percentage of total support and services revenue was 48% (a gross margin of 52%) in the fiscal year 2007 compared to 42% (a gross margin of 58%) in the fiscal year 2006 period and 43% (a gross margin of 57%) in the fiscal year 2005 period. The increase in fiscal year 2007 was primarily due to (i) the research and development personnel cost related to the Cisco OEM agreement of approximately \$699,000, (ii) increased personnel expenses of \$627,000 from the additional headcount from our operations in North America and India, (iii) the increase in hosting costs of approximately \$177,000 and depreciation and software expenses of \$204,000, and (iv) an increase in European expenses of approximately \$229,000 related to the change in the exchange rate between the U.S. dollar and British pound. The increase in fiscal year 2006 was primarily due to an increase of personnel costs by \$340,000 associated with delivering the increased professional





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services engagements and an increase of \$130,000 in depreciation expense related to the addition of hosting equipment. Based upon current revenue expectations, we anticipate cost of support and services to increase in absolute dollars in future periods but for the gross margins to remain relatively constant in future periods while we continue to account for the Cisco OEM agreement under a zero estimate of profit.

**Research and Development**

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007		2005 to 2006	
	(in thousands)						
<b>Research and Development</b>	\$ 3,973	\$ 3,046	\$ 2,367	\$ 927	30%	\$ 679	29%
Percentage of total revenue	18%	13%	12%				

Research and development expenses primarily consist of compensation and benefits for our engineering, product management and quality assurance personnel and, to a lesser extent, occupancy costs and related overhead. Research and development expense was \$4.0 million, \$3.0 million and \$2.4 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 30% or \$927,000 in the fiscal year 2007 compared to fiscal year 2006 and an increase of 29% or \$679,000 in fiscal year 2006 compared to fiscal year 2005. Total research and development expenses as a percentage of total revenues was 18% in the fiscal year 2007 compared to 13% in the fiscal year 2006 period. The increase in fiscal year 2007 was primarily due to (i) increased personnel and personnel-related costs of \$1.1 million and (ii) an increase of \$423,000 in outside consulting expenses. The increase was partially offset by the services performed by research and development personnel in connection with the Cisco OEM agreement charged to cost of support and services. The increase in fiscal year 2006 was primarily due to increased costs in our eGain India operations. This included an increase of approximately \$130,000 in outside consulting services and an increase of approximately \$518,000 in personnel costs related to (i) a 40% increase in research and development headcount, and (ii) salary adjustments for our existing employees. The increase is consistent with our continued commitment to invest in product innovation. Based upon our current product development plans we anticipate an increase in research and development expense in fiscal year 2008, primarily due to an increase in personnel costs.

**Sales and Marketing**

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007		2005 to 2006	
	(in thousands)						
<b>Sales</b>	\$ 10,673	\$ 7,846	\$ 7,051	\$ 2,827	36%	\$ 795	11%
<b>Marketing</b>	\$ 2,180	\$ 1,724	\$ 1,804	\$ 456	26%	\$ (80)	(4)%
<b>Total Sales and Marketing</b>	\$ 12,853	\$ 9,570	\$ 8,855	\$ 3,283	34%	\$ 715	8%
Percentage of total revenue	57%	42%	43%				

Sales and marketing expenses primarily consist of compensation and benefits for our sales, marketing and business development personnel, lead generation activities, advertising, trade show and other promotional costs and, to a lesser extent, occupancy costs and related overhead. Sales and marketing expense was \$12.9 million, \$9.6 million and \$8.9 million in fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 34% or \$3.3 million in fiscal year 2007 compared to fiscal year 2006 and an increase of 8% or \$715,000 in fiscal year 2006 compared to fiscal year 2005. Total sales and marketing expenses as a percentage of total revenues was 57% in the fiscal year 2007 compared to 42% in the fiscal year 2006.

Total sales expense was \$10.7 million for fiscal year 2007 compared to \$7.8 million for fiscal year 2006 and \$7.0 million for the fiscal year 2005. The increase in fiscal year 2007 was primarily due to the increased personnel and personnel related costs of approximately \$2.5 million

and an increase in European expenses of approximately \$338,000 related to the change in the exchange rate between the U.S. dollar and British pound.

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The increase in fiscal year 2006 was primarily due to an increase in personnel costs related to the expansion of our sales force that was partially offset by the reduced expenses resulting from the closure of our Japan office in fiscal year 2005. As part of the sales expansion, we hired a new vice president of worldwide sales in December 2005 who reorganized the sales force to focus our sales efforts towards our target market: larger enterprise customers with a need for our customer interaction solutions. As part of this expansion the tele-marketing sales group that had previously been managed within the marketing group moved under the responsibility of sales management. The increase in sales personnel costs related to the tele-marketing group was approximately \$123,000 and \$140,000 in fiscal years 2007 and 2006 respectively.

Total marketing expenses were \$2.2 million, \$1.7 million and \$1.8 million in fiscal years 2007, 2006 and 2005 respectively. The overall increase in fiscal year 2007 was primarily due to the increase in lead generation and marketing programs as well as the expansion of the marketing groups in both Europe and India. We maintained the level of spending in our lead generation and marketing programs in fiscal years 2006 and 2005; however, the overall marketing costs decreased by \$100,000 due in part to the shift of the tele-marketing sales group from marketing into sales expense in the first part of fiscal year 2006.

We expect sales and marketing expenses to remain constant in fiscal year 2008 as the planned expansion of our sales team for fiscal year 2007 is complete.

**General and Administrative**

	Fiscal Year Ended June 30			Year-Over-Year Change			
	2007	2006	2005	2006 to 2007		2005 to 2006	
	(in thousands)						
<b>General and administrative</b>	\$ 2,884	\$ 2,637	\$ 3,295	\$ 247	9%	\$ (658)	(20)%
Percentage of total revenue	13%	12%	16%				

General and administrative expenses primarily consist of compensation and benefits for our finance, human resources, administrative and legal services personnel, fees for outside professional services, provision for doubtful accounts and, to a lesser extent, occupancy costs and related overhead. General and administrative expense was \$2.9 million, \$2.6 million and \$3.3 million in the fiscal years 2007, 2006 and 2005, respectively. This represented an increase of 9% or \$247,000 in fiscal year 2007 compared to fiscal year 2006 and a decrease of 20% or \$658,000 in fiscal year 2006 compared to fiscal year 2005. Total general and administrative expenses as a percentage of total revenues increased to 13% in fiscal year 2007 as compared to 12% in the fiscal year 2006 period. The increase in fiscal 2007 was primarily due to (i) increased legal expense of \$171,000, (ii) an increase of \$115,000 in personnel expenses related to additional headcount and compensation increase for the North America and India operations and (iii) an increase in bad debt expense of \$101,000 that was primarily related to increased specific reserves for overdue accounts in our European Receivables and was partially offset by (i) a decrease in sales tax expense by \$94,000 and (ii) D&O insurance premiums reduced by \$83,000. The decrease in fiscal year 2006 compared to fiscal year 2005 was primarily due to a decrease in personnel costs, the reduction in bad debt expenses, a reduction in legal fees and a reduction in premiums for directors and officers liability insurance. The decrease in personnel costs of \$190,000 was mainly due to the reduction in personnel in Europe in the third quarter of fiscal year 2005. The bad debt expense reduction of \$170,000 was primarily due to the reduction in the bad debt provision, related to the successful collection efforts that resulted in the reduced accounts receivable balance as of June 30, 2006 compared to June 30, 2005. Legal fees decreased by \$141,000 primarily due to the increased legal fees in fiscal year 2005 associated with the conversion of all outstanding Series A Preferred Stock and accreted dividends into common stock in December 2004. Directors and officers liability insurance premiums decreased by \$121,000. Based upon current revenue expectations, we anticipate general and administrative expenses to increase in fiscal year 2008.

**Table of Contents****Impairment of Long Lived Assets**

In connection with the transitional goodwill impairment evaluation provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, ( SFAS 142 ) we performed an annual goodwill impairment review on April 30 every year, and we found no impairment in the last three years.

In accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, ( SFAS 144 ), we review long-lived assets for impairment, including property and equipment and intangible assets, whenever events or changes in business circumstances indicate that the carrying amounts of the assets may not be fully recoverable. Under SFAS 144, an impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. Impairment, if any, is assessed using discounted cash flows. During fiscal years 2007, 2006 and 2005, we did not have any such losses.

**Valuation and Amortization of Stock-Based Compensation**

	Fiscal Year Ended June 30,			
	2007	2006	Change	%
	(in thousands)			
Cost of support and services	\$ 47	\$ 34	\$ 13	28%
Research and development	\$ 39	\$ 53	\$ (14)	(26)%
Sales and marketing	\$ 127	\$ 80	\$ 47	59%
General and administrative	\$ 60	\$ 95	\$ (35)	(37)%
<b>Total Stock-Based Compensation</b>	<b>\$ 273</b>	<b>\$ 262</b>	<b>\$ 11</b>	<b>4%</b>
Percentage of total revenue	1%	1%		

Stock compensation expenses include the amortization of the fair value of share-based payments made to employees, members of our Board of Directors and consultants, primarily in the form of stock options as we adopted the provision of SFAS 123R on July 1, 2005. The fair value of stock options granted is recognized as an expense as the underlying stock options vest.

We use the modified prospective method to value our share-based payments under SFAS 123R. Accordingly, for fiscal year 2006, we accounted for stock compensation under SFAS 123R while for fiscal year 2005, we accounted for stock compensation under Accounting Principles Board ( APB ) No. 25, *Accounting for Stock Issued to Employees*, ( APB 25 ). Under APB 25, we were generally required to record compensation expense only if there were positive differences between the market value of our common stock and the exercise price of the options granted to employees as of the date of the grant. Under SFAS 123R, however, we record compensation expense for all share-based payments made to employees based on the fair value at the date of the grant. Therefore, stock compensation for fiscal year 2006 is not comparable to fiscal year 2005.

Based upon recent and anticipated option grants, we do not expect our stock compensation expense to increase significantly in fiscal year 2008.

**Restructuring and Other Expense**

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There was no restructuring and other expense for the fiscal year s 2007 or 2006, compared to a net restructuring benefit of \$944,000 in fiscal year 2005. All past restructuring activities were completed and paid in full as of September 30, 2005.

**Table of Contents****Income / (Loss) from Operations**

	Fiscal Year Ended June 30			Year-Over-Year Change	
	2007	2006	2005	2006 to 2007	2005 to 2006
	(in thousands)				
<b>Operating income / (loss)</b>	\$ (6,468)	\$ 95	\$ 212	\$ (6,563)	(6908)%
Operating margin	(49)%	1%	1%	\$ 117	(55)%

Loss from operations was \$6.5 million in fiscal year 2007 compared to income of \$95,000 in fiscal year 2006 and income of \$212,000 in fiscal years 2006 and 2005, respectively. This represented a decrease of \$6.6 million in fiscal year 2007 compared to fiscal year 2006 and a decrease of \$117,000 in fiscal year 2006 compared to fiscal year 2005. The operating margin was a negative 49% in fiscal year 2007 and 1% in the fiscal year 2006 compared to a 1% margin in fiscal year 2005. The operating loss in fiscal 2007 was primarily related to (i) the increased cost from our investment in research and development and expansion of the sales team and (ii) the shift in our customer's buying patterns that resulted in an increase in new hosting business as percentage of total new business booked in fiscal year 2007, where the hosting revenue is recognized ratably over the term of the hosting contract, which is typically one to two years. The most significant changes in operating income in fiscal year 2006 compared to fiscal year 2005 were that no restructuring expense was recorded in fiscal year 2006 compared to a restructuring benefit of \$944,000 recorded in fiscal year 2005 and stock based compensation expense of \$262,000 was recorded in fiscal year 2006 where none was recorded in fiscal year 2005.

**Interest Income**

Interest income consists of interest earned on cash, cash equivalents, and short-term investments. Interest income was \$96,000, \$83,000 and \$44,000 in fiscal years 2007, 2006 and 2005, respectively. The increase in fiscal year 2007 compared to fiscal years 2006 and 2005 was primarily due to an increase in interest rates.

**Interest Expense and Other Income (Expense)**

Interest expense was \$1.2 million, \$1.1 million and \$998,000 in fiscal years 2007, 2006 and 2005, respectively. This represents an increase of 12% or \$138,000 in fiscal year 2007 compared to fiscal year 2006 and an increase of 13% or \$126,000 in fiscal year 2006 compared to fiscal year 2005. The increase was primarily due to an increase in the compound interest rate applied to the related party notes balance.

Other income was \$72,000 in fiscal year 2007 compared to other income of \$32,000 in fiscal year 2006 and other expense of \$100,000 in fiscal year 2005. The other income in fiscal year 2007 was primarily from a foreign exchange gain related to the payments from international trade receivables.

**Related Party Transactions**

On December 24, 2002, we entered into a note and warrant purchase agreement with Ashutosh Roy, our Chief Executive Officer, pursuant to which Mr. Roy made loans to us evidenced by subordinated secured promissory notes and received warrants to purchase shares of our common

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stock in connection with each of such loans. Each five-year subordinated secured promissory note bears interest at an effective annual rate of 12% due and payable upon the term of such note. We have the option to prepay each note at any time subject to the prepayment penalties set forth in such note. On December 31, 2002, Mr. Roy loaned to us \$2.0 million under the agreement and received warrants that allow him to purchase up to 236,742 shares at an exercise price equal to \$2.11 per share. These warrants expired in December 2005. In connection with this loan, we recorded \$1.83 million in related party notes payable and \$173,000 of discount on the note related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the five-year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of 3 years, an expected stock price volatility of 75%, a risk free interest rate of 2%,



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and a dividend yield of 0%. On October, 31, 2003, we entered into an amendment to the 2002 note and warrant purchase agreement with Mr. Roy, pursuant to which he loaned to us an additional \$2.0 million and received additional warrants to purchase up to 128,766 shares at \$3.88 per share. In connection with this additional loan we recorded \$1.8 million in related party notes payable and \$195,000 of discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the five-year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of 3 years, an expected stock price volatility of 75%, a risk free interest rate of 2.25%, and a dividend yield of 0%. On June 29, 2007, we entered into an agreement that amends and restates the 2002 and 2003 notes with Mr. Roy pursuant to which he loaned to us an additional \$2.0 million and received additional warrants that allowed him to purchase up to 333,333 shares at \$1.20 per share. In connection with this additional loan we recorded \$1.8 million in related party notes payable and \$187,000 of discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the three-year life of the note. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of 3 years, an expected stock price volatility of 75%, a risk free interest rate of 4.28%, and a dividend yield of 0%. In addition, the amendment extended the maturity date of the previous notes through March 31, 2009. The principal and interest due on the loans as of June 30, 2007 was \$8.1 million. As of June 30, 2007, warrants to purchase 462,099 shares of common stock related to these financings were vested and outstanding.

On March 31, 2004, we entered into a note and warrant purchase agreement with Ashutosh Roy, our Chief Executive Officer, Oak Hill Capital Partners L.P., Oak Hill Capital Management Partners L.P., and FW Investors L.P. (the lenders ) pursuant to which the lenders loaned to us \$2.5 million evidenced by secured promissory notes and received warrants to purchase shares of our common stock in connection with such loan. The secured promissory notes have a term of five years and bear interest at an effective annual rate of 12% due and payable upon the maturity of such notes. We have the option to prepay the notes at any time subject to the prepayment penalties set forth in such notes. The warrants allow the lenders to purchase up to 312,500 shares at an exercise price of \$2.00. These warrants expired in March 2007. We recorded \$2.3 million in related party notes payable and \$223,000 of discount on the notes related to the relative value of the warrants issued in the transaction that will be amortized to interest expense over the five year life of the notes. The fair value of these warrants was determined using the Black-Scholes valuation method with the following assumptions: an expected life of 3 years, an expected stock price volatility of 75%, a risk free interest rate of 1.93%, and a dividend yield of 0%. The principal and interest due on the loans as of June 30, 2007 was \$3.5 million. As of June 30, 2007, there were no warrants outstanding related to this financing.

**New Accounting Pronouncements**

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, ( SFAS 159 ). SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for the company beginning in the first quarter of fiscal year 2008, although earlier adoption is permitted. We are currently assessing the impact of SFAS 159 on our financial statements.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Qualifying Misstatements in Current Year Financial Statements*, ( SAB 108 ) which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective for companies with fiscal years ending after November 15, 2006 and is required to be adopted by us for our fiscal year ending June 30, 2007. We adopted SAB 108 and there was no material effect on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement*, ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles,



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and expands disclosures about fair value measurements. This statement does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently assessing the impact of SFAS 157 on our financial statements.

In July 2006, the Financial Accounting Standard Board ( FASB ) issued FASB Interpretation No. 48, *Accounting for Income Tax Uncertainties*, ( FIN 48 ). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are currently assessing the potential impact of FIN 48 on its consolidated financial position and results of operations but we do not expect any material impact upon adoption on July 1, 2007.

## **Liquidity and Capital Resources**

### *Overview*

Based upon the increased revenues and income from operations in fiscal years 2006 and 2005 as well as the positive cash flow from operating activities in fiscal year 2006, we made increased investments in our business in fiscal year 2007 including the expansion in our product and sales and marketing teams. This investment was driven in part by the OEM agreement we signed with Cisco Systems in August 2006. Resulting from these investments we recorded a net loss from operations in fiscal year 2007 compared to a net income from operations in both fiscal years 2006 and 2005. In addition, net cash used in operating activities was \$2.8 million compared to net cash provided by operating activities of \$3.0 million in fiscal year 2006 and net cash used in operating activities of \$1.1 million in fiscal year 2005. To assist in the financing of our operating activities in fiscal year 2007, on June 29, 2007 we borrowed an additional \$2.0 million from Ashutosh Roy, our chief executive officer. As of June 30, 2007 our cash and cash equivalents were \$6.2 million compared to \$6.9 million on June 30, 2006 and \$4.5 million on June 30, 2005. As of June 30, 2007 we had a negative working capital of \$4.1 million, compared to working capital of \$347,000 at June 30, 2006. As of June 30, 2007, \$5.5 million of our current liabilities consisted of current deferred revenue compared to \$4.3 million on June 30, 2006. Based upon our fiscal year 2008 plan, we believe that existing capital resources will enable us to maintain current and planned operations for at least the next 12 months. However, if we do not experience the anticipated demand for our products, we will need to reduce costs, issue equity securities or borrow money to meet our cash requirements. From time to time, however, we may consider opportunities for raising additional capital and/or exchanging all or a portion of our existing debt for equity. We can make no assurances that such opportunities will be available to us on economic terms we consider favorable, if at all.

If adequate funds are not available on acceptable terms, our ability to achieve or sustain positive cash flows, maintain current operations, fund any potential expansion, take advantage of unanticipated opportunities, develop or enhance products or services, or otherwise respond to competitive pressures would be significantly limited. Our expectations as to our future cash flows and our future cash balances are subject to a number of assumptions, including assumptions regarding anticipated increases in our revenue, the mix of new hosting and license business, our ability to retain existing customers and customer purchasing and payment patterns, many of which are beyond our control.

On June 29, 2007 we entered into an agreement that amends and restates outstanding notes issued to Mr. Roy. Pursuant to this amendment, Mr. Roy loaned to us an additional \$2.0 million and extended the maturity date of the previous notes through March 31, 2009. The principal and interest due on the loans as of June 30, 2007 was \$8.1 million. As of June 30, 2007, warrants to purchase 462,099 shares of common stock were vested and outstanding.



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In December 2006, we entered into an amendment to our loan and security agreement (the *Credit Facility*) with Silicon Valley Bank (*SVB*) (See Note 4 *Bank Borrowings*). The *Credit Facility* provides for the advance of up to the lesser of \$2.0 million or the sum of 80% of certain qualified receivables and 50% of our unrestricted cash on deposit with *SVB* less the total outstanding obligations to *SVB* and any outstanding letters of credit. In addition, the amendment allows for the advance of up to an additional \$500,000 to be used to finance equipment purchases. There are financial covenants under this agreement that require us to meet certain minimum tangible net worth requirements during the term of the *Credit Facility*. *SVB* has agreed to forebear any non compliance through June 30, 2007. We are currently in discussions with *SVB* regarding possible changes to the financial covenants.

On March 31, 2004, we entered into a note and warrant purchase agreement with Mr. Roy, Oak Hill Capital Partners L.P., Oak Hill Capital Management Partners L.P., and FW Investors L.P. pursuant to which they loaned to us \$2.5 million evidenced by secured promissory notes and received warrants to purchase shares of our common stock in connection with such loan. The principal and interest due on the loans as of June 30, 2007 was \$3.5 million. As of June 30, 2007, no warrants were outstanding.

Please refer to Note 3 to the accompanying consolidated financial statements for a further discussion of our related party notes.

### *Cash Flows*

Net cash used in operating activities was \$2.8 million in fiscal year 2007 compared to net cash provided by operating activities of \$3.0 million in fiscal year 2006 and net cash used in operating activities of \$1.1 million in fiscal year 2005. The net cash provided by or used in operating activities consisted primarily of net income or loss, plus non-cash expenses related to depreciation, accrued interest and amortization of discount on related party notes, and the net change in operating assets and liabilities. It also included a non-cash charge of stock-based compensation starting in fiscal year 2006. Our net loss in 2007 was \$6.6 million higher than 2006 and a principal reason for the decline in operating cash flow.

The net change in operating assets and liabilities in fiscal year 2007 primarily consisted of the increases in deferred revenue by \$1.1 million, accrued compensation by \$576,000, accounts payable by \$522,000 and a decrease of \$344,000 in accounts receivables. The significant increase in deferred revenue primarily consists of increases in deferred hosting and consulting services which was due to an increase in prepayments from larger hosting customers and an increase in deferred hosting implementation services that will be recognized over the estimated life of the hosting arrangements. The increase in accrued compensation was associated with the increased commission resulting from the increase in new license and hosting contracts in the fourth quarter of fiscal year 2007, when compared to new contracts in the fourth quarter of fiscal year 2006. Accounts payable increase was related to the increased operating costs and expense from the investments in our business. The decrease in accounts receivables was primarily due to the continued improvement of our collection efforts proven by the reductions in days sales outstanding to 30 days for the quarter ended June 30, 2007 from 37 days for the comparable quarter a year ago.

The net change in operating assets and liabilities in fiscal year 2006 primarily consisted of the decreases in accounts receivable by \$2.5 million, prepaid and other current assets by \$493,000, and an increase in other assets by \$290,000. The significant decrease in accounts receivable was primarily due to the improvement of collections reflected by a days sales outstanding of 37 days for the quarter ended June 30, 2006 compared to 71 days for the quarter ended June 30, 2005. The decrease in prepaid and other assets was primarily due to the reduction in the amortization of prepaid royalties resulting from the expiration of certain royalty agreements and the refund of income tax in eGain India.

To operate a cash-positive business depends on our ability to realize the benefits from the increased investments we made in fiscal year 2007, including those made in connection with the Cisco OEM agreement, by



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increasing the level of our revenues, and continuing to effectively manage working capital including collecting outstanding receivables within our standard payment terms. In addition, our ability to generate future cash flows from operations could be negatively impacted by a decrease in demand for our products, which are subject to rapid technological change or a reduction of capital expenditures by our customers as a result of a downturn in the global economy, among other factors.

Net cash used in investing activities was \$722,000 in fiscal year 2007 compared to \$840,000 in fiscal year 2006 and \$616,000 in fiscal year 2005. Cash used in investing activities in both fiscal years 2006 and 2005 were due to the purchases of equipment.

Net cash provided by financing activities was \$2.7 million, \$123,000 and \$1.2 million in fiscal years 2007, 2006 and 2005, respectively. Cash provided by financing activities in fiscal year 2007 consisted primarily of proceeds from related party notes payable and proceeds from new bank borrowing, partially offset by the payments on existing bank borrowings. Cash provided by financing activities in fiscal year 2006 and 2005 consisted primarily of proceeds from new bank borrowing, partially offset by the payments on existing bank borrowings.

*Off-Balance Sheet Arrangements*

As of June 30, 2007, we did not have any off-balance sheet arrangements as defined by Securities and Exchange Commission regulations.

*Commitments*

The following table summarizes eGain's contractual obligations, excluding interest payments, as of June 30, 2007 and the effect such obligations are expected to have on its liquidity and cash flow in future periods (in thousands):

	Year Ended June 30, 2007					Total
	2008	2009	2010	2011	2012	
Operating leases	758	619	256	171		1,804
Bank borrowings	2,293	167				2,460
Related party notes payable		14,614				14,614
Co-Location	372	54				426
<b>Total</b>	<b>3,423</b>	<b>15,454</b>	<b>256</b>	<b>171</b>		<b>19,304</b>

The total related party notes payable of \$8.5 million with interest payable of \$6.1 million will be due in fiscal year 2009.

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

The following tables set forth certain unaudited consolidated statement of operations data for the eight quarters ended June 30, 2007. This data has been derived from unaudited consolidated financial statements that, in the opinion of management, include all adjustments consisting only of normal recurring adjustments, necessary for a fair presentation of such information when read in conjunction with the Consolidated Financial Statements and Notes thereto.

The unaudited quarterly information should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Form 10-K. We believe that period-to-period comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of future performance.

	Jun. 30,	Mar. 31,	Dec. 31,	Quarters Ended		Mar. 31,	Dec. 31,	Sep. 30,
	2007	2007	2006	Sep. 30,	Jun. 30,	2006	2005	2005
	(in thousands)							
<b>Consolidated Statements of Operations Data:</b>								
<b>Revenue:</b>								
License	\$ 322	\$ 599	\$ 850	\$ 1,635	\$ 718	\$ 1,859	\$ 2,013	\$ 1,377
Support and services	5,073	4,794	4,833	4,368	4,480	4,275	3,996	3,846
Total revenue	5,395	5,393	5,683	6,003	5,198	6,134	6,009	5,223
Cost of license	20	20	18	41	16	29	133	53
Cost of support and services	2,613	2,372	2,206	1,941	1,855	1,828	1,578	1,724
Gross profit	2,762	3,001	3,459	4,021	3,327	4,277	4,298	3,446
<b>Operating costs and expenses:</b>								
Research and development	1,182	933	833	1,025	847	782	704	713
Sales and marketing	3,484	3,161	2,921	3,287	2,597	2,588	2,258	2,127
General and administrative	659	802	484	940	684	585	739	629
Total operating costs and expenses	5,325	4,896	4,238	5,252	4,128	3,955	3,701	3,469
Income / (Loss) from operations	(2,563)	(1,895)	(779)	(1,231)	(801)	322	597	(23)
Interest expense, net	(329)	(294)	(276)	(270)	(260)	(267)	(259)	
Other income(expense), net	42	11	(5)	27	21	6	1	
Income / (Loss) before income tax	(2,850)	(2,178)	(1,060)	(1,474)	(1,040)	61	299	
Income tax	(64)	(3)	(54)	(15)	(55)	27	(54)	
Net income / (loss)	(2,914)	(2,181)	(1,114)	(1,489)	(1,095)	88	245	(297)
Net loss applicable to common stockholders	\$ (2,914)	\$ (2,181)	\$ (1,114)	\$ (1,489)	\$ (1,095)	\$ 88	\$ 245	\$ (297)
<b>Per share information:</b>								
Basic and diluted net income / (loss) per common share	\$ (0.19)	\$ (0.14)	\$ (0.07)	\$ (0.10)	\$ (0.07)	\$ 0.01	\$ 0.02	\$ (0.02)



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Shares used in computing basic and diluted net income / ( loss) per common share	15,322	15,317	15,315	15,314	15,312	15,305	15,302	15,302
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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We develop products in the United States and India and sell these products internationally. Generally, sales are made in local currency. As a result, our financial results and cash flows could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. To date, the effect of changes in foreign currency exchange rates on revenues and operating expense has not been material. Identifiable assets denominated in foreign currencies at June 30, 2007 totaled approximately \$3.7 million. We do not currently use derivative instruments to hedge against foreign exchange risk. As such, we are exposed to market risk from fluctuations in foreign currency exchange rates, principally from the exchange rate between the U.S. dollar and the Euro and the British pound and the Rupee. Based on our overall foreign currency rate exposure at June 30, 2007, we do not believe that a hypothetical 10% change in foreign currency rates would have a material adverse affect on our financial position or results of operations.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**eGain Communications Corporation**

**Consolidated Financial Statements**

**June 30, 2007 and 2006**

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**eGain Communications Corporation**

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**FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

eGain Communications Corporation

Mountain View, California

We have audited the accompanying consolidated balance sheets of eGain Communications Corporation as of June 30, 2007 and 2006 and the related consolidated statements of operations, stockholders' deficit and comprehensive loss, and cash flows for each of the three years in the period ended June 30, 2007. We have also audited the schedule listed in the accompanying index. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of eGain Communications at June 30, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2007, in conformity with accounting principles generally accepted in the United States of America.

Also in our opinion, the schedule presents fairly in all material respects, the information set forth there in.

As discussed in Note 1 to the financial statements, effective July 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payments.

(Signed BDO Seidman, LLP)

San Francisco, California

September 27, 2007

**Table of Contents****eGAIN COMMUNICATIONS CORPORATION****CONSOLIDATED BALANCE SHEETS****(in thousands, except per share amounts)**

	2007	June 30, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,195	\$ 6,916
Restricted cash	13	12
Accounts receivable, less allowance for doubtful accounts of \$221 and \$120 at June 30, 2007 and 2006, respectively	1,790	2,151
Prepaid and other current assets	662	623
<b>Total current assets</b>	<b>8,660</b>	<b>9,702</b>
Property and equipment, net	1,336	1,169
Goodwill	4,880	4,880
Other assets	486	354
	<b>\$ 15,362</b>	<b>\$ 16,105</b>
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
Current liabilities:		
Accounts payable	\$ 1,557	\$ 989
Accrued compensation	1,884	1,254
Accrued liabilities	1,496	1,156
Deferred revenue	5,541	4,259
Bank borrowings	2,293	1,697
<b>Total current liabilities</b>	<b>12,771</b>	<b>9,355</b>
Related party notes payable	11,653	8,652
Bank borrowings, net of current portion	167	77
Other long term liabilities	185	217
<b>Total liabilities</b>	<b>24,776</b>	<b>18,301</b>
Commitments and contingencies (notes 6 and 9)		
Stockholders' deficit:		
Common stock, \$0.001 par value, 50,000 shares authorized, 15,322 and 15,314 shares issued and outstanding at June 30, 2007 and 2006	15	15
Additional paid-in capital	316,202	315,736
Notes receivable from stockholders	(77)	(74)
Accumulated other comprehensive loss	(438)	(456)
Accumulated deficit	(325,116)	(317,417)
<b>Total stockholders' deficit</b>	<b>(9,414)</b>	<b>(2,196)</b>
	<b>\$ 15,362</b>	<b>\$ 16,105</b>

See accompanying notes.



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

	Years Ended June 30,		
	2007	2006	2005
<b>Revenue:</b>			
License	\$ 3,407	\$ 5,967	\$ 5,960
Support and services	19,066	16,597	14,468
Total revenue	22,473	22,564	20,428
Cost of license	99	231	406
Cost of support and services	9,132	6,985	6,215
Gross profit	13,242	15,348	13,807
<b>Operating costs and expenses:</b>			
Research and development	3,973	3,046	2,367
Sales and marketing	12,853	9,570	8,855
General and administrative	2,884	2,637	3,295
Restructuring and other			(922)
Total operating costs and expenses	19,710	15,253	13,595
Income (loss) from operations	(6,468)	95	212
Interest (expense), net	(1,167)	(1,040)	(954)
Other income (expense)	72	32	(100)
Loss before Income Tax	(7,563)	(913)	(842)
Income Tax	(136)	(146)	
Net loss	(7,699)	(1,059)	(842)
Dividends on convertible preferred stock			(3,732)
Net loss applicable to common stockholders	\$ (7,699)	\$ (1,059)	\$ (4,574)
<b>Per share information:</b>			
Basic net (loss) per common share	\$ (0.50)	\$ (0.07)	\$ (0.47)
Diluted net (loss) per common share	\$ (0.50)	\$ (0.07)	\$ (0.47)
Weighted average shares used in computing basic net income / (loss) per common share	15,317	15,308	9,731
Weighted average shares used in computing diluted net income / (loss) per common share	15,317	15,308	9,731
Below is a summary of stock based compensation included in the costs and expenses above :			
Cost of support and services	\$ 47	\$ 34	\$
Research and development	39	53	
Sales and marketing	127	80	
General and administrative	60	95	

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Total stock-based compensation expense	\$	273	\$	262	\$
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See accompanying notes.

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**eGAIN COMMUNICATIONS CORPORATION**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT AND COMPREHENSIVE LOSS**

(in thousands)

				Accumulated	
				Other	
Convertible	Common	Additional	Notes	Compre-	Accum-
Preferred	Stock	Paid-in	Receivable	hensive	ulated
Stock		Capital	From	Income	Deficit
			Stock-	(Loss)	
			holders		