SPESCOM SOFTWARE INC
Form 10-Q
May 15, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý	**QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the Quarterly Period Ended March 31, 2006.

OR

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

For the transition period from to .

Commission File Number 0-15935

SPESCOM SOFTWARE INC.

(Exact name of registrant as specified in its charter)

CALIFORNIA	**95-3634089**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

10052 MESA RIDGE COURT, SUITE 100, SAN DIEGO, CA 92121

(Address of principal executive offices and zip code)

(858) 625-3000

(Registrants telephone number, including area code)

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 ý NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12-b-2 of the Exchange Act).

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer ý

Indicate by check mark whether the registrant is a shell company (as defined in Rule 126-2 of the Exchange Act).

YES o NO ý

Number of shares of Common Stock outstanding at May 12, 2006: 37,144,494

ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SPESCOM SOFTWARE INC.

CONSOLIDATED BALANCE SHEETS

	March 31, 2006 (Unaudited)	September 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 620,000	$ 285,000
Receivables, net	712,000	613,000
Other current assets	209,000	72,000
Total current assets	1,541,000	970,000
Property and equipment, net	169,000	168,000
Computer software, net	477,000	477,000
Other assets	30,000	30,000
Total assets	$ 2,217,000	$ 1,645,000
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 732,000	$ 374,000
Payable to Spescom Ltd.	186,000	213,000
Preferred stock dividend payable to Spescom Ltd.	735,000	568,000
Accrued liabilities	1,167,000	1,407,000
Lease obligations current portion	44,000	41,000
Notes and accrued interest payable to Spescom Ltd.	968,000	
Deferred revenue	2,743,000	3,026,000
Series I redeemable preferred stock, par value $0.01 per share, 2,450 remaining shares authorized; 1,950 shares issued and outstanding at March 31, 2006	2,450,000	
Total current liabilities	9,025,000	5,629,000
Notes and accrued interest payable to Spescom Ltd.		917,000
Lease obligations	35,000	59,000
Total liabilities	9,060,000	6,605,000
Shareholders deficit:		
Convertible preferred stock, 243,239 remaining shares authorized		
Series F - par value $1.00 per share; 5,291 shares authorized, issued and outstanding at March 31, 2006 and September 30, 2005	6,790,000	6,790,000
Series G - par value $0.01 per share; 1,670 remaining shares authorized; 1,450 shares issued and outstanding in issued and outstanding at September 30, 2005		1,450,000
Common stock, no par value, 100,000,000 shares authorized; 37,144,494 and 36,818,528 shares issued and outstanding at March 31, 2006 and September 30, 2005, respectively	76,488,000	75,938,000
Common stock warrants	1,784,000	1,506,000
Accumulated other comprehensive loss	(333,000)	(353,000)
Accumulated deficit	(91,572,000)	(90,291,000)
Total shareholders deficit	(6,843,000)	(4,960,000)
Total liabilities and shareholders deficit	$ 2,217,000	$ 1,645,000

The accompanying notes are an integral part of these consolidated financial statements.

SPESCOM SOFTWARE INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended March 31, 2006	For the three months ended March 31, 2005	For the six months ended March 31, 2006	For the six months ended March 31, 2005
Revenues:				
Licenses	$ 652,000	$ 86,000	$ 1,216,000	$ 354,000
Services and other	1,408,000	1,587,000	2,676,000	2,972,000
Total revenues	2,060,000	1,673,000	3,892,000	3,326,000
Cost of revenues:				
Licenses	72,000	64,000	194,000	108,000
Services and other	721,000	620,000	1,261,000	1,234,000
Total cost of revenues	793,000	684,000	1,455,000	1,342,000
Gross profit	1,267,000	989,000	2,437,000	1,984,000
Operating expenses:				
Research and development	282,000	174,000	485,000	520,000
Marketing and sales	685,000	914,000	1,338,000	1,738,000
General and administrative	353,000	373,000	794,000	772,000
Total operating expenses	1,320,000	1,461,000	2,617,000	3,030,000
Loss from operations	(53,000)	(472,000)	(180,000)	(1,046,000)
Interest and other income	4,000	2,000	4,000	2,000
Interest and other expense	(53,000)	(38,000)	(105,000)	(68,000)
Net loss	(102,000)	(508,000)	(281,000)	(1,112,000)
Deemed preferred dividend	(500,000)		(1,000,000)	(2,200,000)
Net loss available after deemed preferred dividend	(602,000)	(508,000)	(1,281,000)	(3,312,000)
Cumulative preferred dividends	(98,000)	(86,000)	(186,000)	(169,000)
Net loss available to common shareholders	$ (700,000)	$ (594,000)	$ (1,467,000)	$ (3,481,000)
Earnings (loss) per share:				
Basic and diluted	$ (0.02)	$ (0.02)	$ (0.04)	$ (0.10)
Weighted average shares outstanding:				
Basic and diluted	36,895,000	34,215,000	36,857,000	34,187,000
Statement of Comprehensive Loss				
Net loss	$ (102,000)	$ (508,000)	$ (281,000)	$ (1,112,000)
Other Comprehensive income (loss):				
Foreign currency translation adjustment	(14,000)	5,000	20,000	(49,000)
Comprehensive loss	$ (116,000)	$ (503,000)	$ (261,000)	$ (1,161,000)

The accompanying notes are an integral part of these consolidated financial statements.

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SPESCOM SOFTWARE INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the six months ended March 31, 2006	For the six months ended March 31, 2005
Cash flows from operating activities:		
Net loss	$ (281,000)	$ (1,112,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	73,000	38,000
Unpaid interest on notes payable	98,000	66,000
Share-based compensation	92,000	
Compensation for warrants issued to consultants	40,000	
Changes in assets and liabilities:		
Receivables, net	(102,000)	58,000
Other current assets	(136,000)	31,000
Accounts payable	361,000	(1,000)
Payable to Spescom Ltd.	(22,000)	(7,000)
Accrued liabilities	(260,000)	52,000
Deferred revenue	(268,000)	287,000
Net cash used in operating activities	(405,000)	(588,000)
Cash flows from investing activities:		
Purchases of property and equipment	(40,000)	(13,000)
Capitalization of development costs	(35,000)	(209,000)
Purchases of software		(37,000)
Net cash used in investing activities	(75,000)	(259,000)
Cash flows from financing activities:		
Proceeds from exercise of stock options		2,000
Proceeds from exercise of warrants		17,000
Net proceeds from private placement	838,000	1,767,000
Payments on capital lease obligations	(21,000)	(11,000)
Net cash provided by financing activities	817,000	1,775,000
Effect of exchange rate changes on cash	(2,000)	(6,000)
Net increase in cash and cash equivalents	335,000	923,000
Cash and cash equivalents at beginning of period	285,000	109,000
Cash and cash equivalents at end of period	$ 620,000	$ 1,031,000

See Note 2 for supplemental cash flow information.

The accompanying notes are an integral part of these consolidated financial statements.

SPESCOM SOFTWARE INC.

CONDENSED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - Basis of Presentation

The accompanying consolidated financial statements as of March 31, 2006 and for the three and six months ended March 31, 2006 and 2005 are unaudited. The consolidated financial statements and related notes have been prepared in accordance with generally accepted accounting principles applicable to interim periods. In the opinion of management, the consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the consolidated financial position, operating results and cash flows for the periods presented.

The information contained in the following Condensed Notes to the Consolidated Financial Statements is condensed from that which would appear in the annual consolidated financial statements; accordingly, the consolidated financial statements included herein should be reviewed in conjunction with the consolidated financial statements and related notes thereto contained in the Company s Annual Report on Form 10-K/A for the year ended September 30, 2005. It should be understood that the accounting measurements at an interim date inherently involve greater reliance on estimates than at year-end. The results of operations for the interim periods presented are not necessarily indicative of the results expected for the entire year.

Note 2 Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements are prepared using accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly-owned United Kingdom subsidiary, Spescom Software, Ltd. All significant intercompany balances and transactions have been eliminated.

Foreign Currency

The functional currency of the Company s United Kingdom subsidiary is the pound sterling. Assets and liabilities are translated into U.S. dollars at end-of-period exchange rates. Revenues and expenses are translated at average exchange rates in effect for the period. Net currency exchange gains or losses resulting from such translations are excluded from net income and are accumulated in a separate component of shareholders deficit as accumulated other comprehensive income (loss). Gains and losses resulting from foreign currency transactions, which are not significant, are included in the consolidated statements of operations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and also requires disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates made by management include revenue recognition estimates, the viability of recognizing deferred income tax assets, capitalized software costs and the valuation of equity instruments, and the allowance for doubtful accounts. Significant changes in these estimates may have a material impact on the financial statements.

Revenue Recognition

The Company s revenues are derived from sales of its document and configuration management systems that are primarily composed of software and services, including maintenance, training and consulting services, and third party software and hardware. The Company recognizes revenue in accordance with Statement of Position (SOP) 97-2 Software Revenue Recognition, SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions , Staff Accounting Bulletin (SAB) No. 101, updated by SAB s 103 and 104 Update of Codification of Staff Accounting Bulletins, and Emerging Issues Task Force No. 00-21 (EITF 00-21) Accounting for Revenue Arrangements with Multiple Deliverables. Revenue through the Company s Value Added Resellers (VARS) are net of any VAR discount in accordance with EITF 99-19 Reporting Revenue Gross as a Principal versus Net as an Agent.

Software license and third party product revenues are recognized upon shipment of the product if no significant vendor obligations remain and collection is probable. In cases where a significant vendor obligation exists, revenue recognition is delayed until such obligation has been satisfied. For new software products where a historical record has not yet been demonstrated that acceptance is perfunctory, the Company defers recognition of revenue until acceptance has occurred. If an undelivered element of the arrangement exists under the license arrangement, a portion of revenue is deferred based on vendor-specific objective evidence (VSOE) of the fair value of the undelivered element until delivery occurs. If VSOE does not exist for all undelivered elements, all revenue is deferred until sufficient evidence exists or all elements have been delivered. Annual maintenance revenues, which consist of ongoing support and product updates, are recognized on a straight-line basis over the term of the contract. Payments received in advance of performance of the related service for maintenance contracts are recorded as deferred revenue. Revenues from training and consulting services are recognized when the services are performed and adequate evidence of providing such services is available. Contract revenues for long-term contracts or programs requiring specialized systems are recognized using the percentage-of-completion method of accounting, primarily based on contract labor hours incurred to date compared with total estimated labor hours at completion. Provisions for anticipated contract losses are recognized at the time they become known.

Contracts are billed based on the terms of the contract. There are no retentions in billed contract receivables. Unbilled contract receivables relate to revenues earned but not billed at the end of the period.

The Company considers many factors when applying accounting principles generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

- The actual contractual terms, such as payment terms, delivery dates, and pricing of the various product and service elements of a contract
- Availability of products to be delivered
- Time period over which services are to be performed
- Creditworthiness of the customer
- The complexity of customizations to the Company s software required by service contracts
- The sales channel through which the sale is made (direct, VAR, distributor, etc.)
- Discounts given for each element of a contract
- Any commitments made as to installation or implementation of go live dates

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, as well as whether or not each factor complies with such standards. Any misjudgment or error by management in its evaluation of the factors and the application of the standards, especially with respect to complex or new types of transactions, could have a material adverse effect on the Company s future operating results.

Fair Value of Financial Instruments

Statement of Financial Accounting Standards (SFAS) No. 107, Disclosures About Fair Value of Financial Instruments , requires management to disclose the estimated fair value of certain assets and liabilities defined by SFAS No. 107 as cash or a contractual obligation that both conveys to one entity a right to receive cash or other financial instruments from another entity, and imposes on the other entity the obligation to deliver cash or other financial instruments to the first entity. At March 31, 2006 and September 30, 2005, management believes that the carrying amounts of cash and cash equivalents, short-term investments, accounts receivable and accounts payable, and accrued expenses approximate fair value because of the short maturity of these financial instruments. The Company believes that the carrying value of its loans approximate their fair values based on current market rates of interest.

Concentration of Credit Risk

The Company provides products and services to customers in a variety of industries worldwide, including local governments, petrochemicals, utilities, manufacturing and transportation. Concentration of credit risk with respect to trade receivables is limited due to the geographic and industry dispersion of the Company s customer base. The Company has not experienced significant credit losses on its customer accounts. Constellation Energy Group and City of Lancaster accounted for 38% and 20%, respectively, of trade accounts receivable at March 31, 2006 as compared to W.H. Smith Ltd. and Entergy Operations, which accounted for 33% and 28%, respectively, of trade accounts receivable at September 30, 2005.

A small number of customers have typically accounted for a large percentage of the Company s annual revenues. Constellation Energy Group accounted for 15% of revenue for the six months ended March 31, 2006 while Network Rail and Computer Science Corporation accounted for 19% and 12%, respectively, of revenue for the six months ended March 31, 2005. The Company s reliance on relatively few customers could have a material adverse effect on the results of its operations on a quarterly basis.

Property and Equipment

Property and equipment is recorded at cost and depreciated using the straight-line method over useful lives of two to seven years. Leasehold improvements are amortized on a straight-line basis over the shorter of their useful life or the term of the related lease. Expenditures for ordinary repairs and maintenance are expensed as incurred while major additions and improvements are capitalized.

Software Development Costs

Software development costs are capitalized when technological feasibility and marketability of the related product have been established. Software development costs incurred solely in connection with a specific contract are charged to cost of revenues. Capitalized software development costs are amortized on a product-by-product basis, beginning when the product is available for general release to customers. Annual amortization expense is calculated using the greater of the ratio of each product s current gross revenues to the total of current and expected gross revenues or the straight-line method over the estimated useful life of three to five years. While there was no capitalized software cost for the three months ended March 31, 2006, there was $35,000 of capitalized software development costs for the six months ended March 31, 2006. Amortization expense for the three and six months ended March 31, 2006 totaled $26,000 and $35,000, respectively. As of March 31, 2006 and September 30, 2005, the balance of software development capitalized totaled $513,000 and $478,000, respectively, with accumulated amortization of $36,000 and $1,000, respectively.

Long-lived Assets

The Company assesses potential impairments to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the assets carrying value unlikely. An impairment loss would be recognized when the sum of the expected future net cash flows is less than the carrying amount of the asset.

Share-Based Payments

In April 1996, the Company adopted its 1996 Stock Incentive Plan (the 1996 Plan). The 1996 Plan is administered by either the Board of Directors or a committee designated by the Board to oversee the plan. The total number of authorized shares under the 1996 Plan is 7,425,000. As of March 31, 2006, options to purchase 6,390,000 shares are outstanding. The 1996 Plan expired as of March 31, 2006 and therefore no further grants are available from this Plan.

The option vesting period under the plan is determined by the Board of Directors or a Stock Option Committee and usually provides that 25% of the options granted can be exercised 90 days from the date of grant, and thereafter, those options vest and become exercisable in additional cumulative annual installments of 25% commencing on the first anniversary of the date of grant. Options granted are generally due to expire upon the sooner of ten years from date of grant, thirty days after termination of services other than by reason of convenience of the Company, three months after disability, or one year after the date of the option holder s death. The option exercise price is equal to the fair market value of the common stock on the date of grant. Options granted to employees under the 1996 Plan were either incentive stock options or nonqualified options. Only nonqualified options were granted to nonemployee directors.

In December 2004, the Financial Accounting Standards Board (FASB) revised Statement of Financial Accounting Standards No. 123 (FAS 123R), Share-Based Payment, which establishes accounting for share-based awards exchanged for employee services and requires companies to expense the estimated fair value of these awards over the requisite employee service period. On April 14, 2005, the U.S. Securities and Exchange Commission adopted a new rule amending the effective dates for FAS 123R. In accordance with the new rule, the accounting provisions of FAS 123R are effective for the Company beginning in the quarter ended December 31, 2005.

Under FAS 123R, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee s requisite service period. The Company has no awards with market or performance conditions. The Company adopted the provisions of FAS 123R on October 1, 2005, the first day of the Company s fiscal year 2006, using a modified prospective application, which provides for certain changes to the method for valuing share-based compensation. Under the modified prospective application, prior periods are not revised for comparative purposes. The valuation provisions of FAS 123R apply to new awards and to awards that are outstanding on the effective date and subsequently modified or cancelled. Estimated compensation expense for awards outstanding at the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under FASB Statement No. 123, Accounting for Stock-Based Compensation (FAS 123).

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. The Company has elected to adopt the alternative transition method provided in this FASB Staff Position for calculating the tax effects of share-based compensation pursuant to FAS 123R. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of FAS 123R.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants:

	For the three months ended March 31, 2006	**For the six months ended March 31, 2006**
Dividend Yield	0%	0%
Expected Volatility	165%	165%
Risk free interest rate	4.7%	4.7%
Expected lives (years)	10	10

The weighted average estimated fair value of employee stock options granted during the three and six months ended March 31, 2006 using the Black-Scholes model were as follows:

		For the three months ended March 31, 2006		**For the six months ended March 31, 2006**
Research and development	$	2,000	$	5,000
Marketing and sales		12,000		30,000
General and administrative		24,000		57,000
Share-based compensation	$	38,000	$	92,000
Basic and diluted net loss per share attributable to common shareholders				
Basic				
Diluted				

A summary of option activity under the Plan as of March 31, 2006, and changes during the six months then ended is presented below:

Options	**Shares (000)**		**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term**	**Aggregate Intrinsic Value**
Outstanding Options at September 30, 2005	4,856	$	0.30		
Granted	2,194	$	0.12		
Exercised		$			
Forfeited or expired	(660)	$	0.26		

Outstanding at March 31, 2006	6,390	$	0.25	7.7	$	17,400
Exercisable at March 31, 2006	3,532	$	0.31	6.5	$	4,350

The weighted average grant-date fair values of options granted during the six months ended March 31, 2006 were $0.12 per share. There were no options exercised for the six months ended March 31, 2006.

Pro Forma Information under FAS 123 for Periods Prior to Fiscal 2006

The Company measures compensation expense for its stock-based employee compensation plans using the intrinsic value method and provides pro forma disclosures of net loss and basic and diluted net loss per share as if the fair value-based method had been applied in measuring compensation expense. The Company applies SFAS No.123, *Accounting for Stock-Based Compensation* and Accounting Principles Board Opinion No. 25 and related Interpretations in accounting for its employee stock-based compensation plan.

No compensation cost was recognized for employee stock option grants during 2005 based upon the intrinsic value method, which were fixed in nature, as the options were granted at exercise prices equal to fair market value on the date of grant. Had compensation cost for the Company s employee stock-based compensation plan been determined based on the fair value at the grant dates the disclosure requirements of SFAS No. 148, which amends the disclosure requirements of FAS 123, would have been as follows:

		For the three months ended March 31, 2005		**For the six months ended March 31, 2005**
Net loss used in computing net loss per share				
As reported	$	(594,000)	$	(3,481,000)
Subtract:				
Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax		(56,000)		(114,000)
Pro forma net loss	$	(650,000)	$	(3,595,000)
Basic and diluted net loss per share attributable to common shareholders				
As reported	$	(0.02)	$	(0.10)
Pro forma	$	(0.02)	$	(0.10)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants:

	For the three months ended March 31, 2005	**For the six months ended March 31, 2005**
Dividend Yield	0%	0%
Expected Volatility	261%	261%
Risk free interest rate	4.5%	4.5%
Expected lives	10	10

Income Taxes

Current income tax expense is the amount of income taxes expected to be payable for the current year. A deferred income tax asset or liability is established for the expected future consequences resulting from the differences in the financial reporting and tax bases of assets and liabilities. Deferred income tax expense (benefit) is the change during the year in the deferred income tax asset or liability.

Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be more likely than not realized in the future based on the Company s current and expected operating results.

Net Income (Loss) per Common Share

Basic net income (loss) per common share is computed as net income (loss) divided by the weighted average number of common shares outstanding during the year. Diluted net income (loss) per common share is computed as net loss divided by the weighted average number of common shares and potential common shares, using the treasury stock method, outstanding during the year and assumes conversion into common stock at the beginning of each period of all outstanding shares of convertible preferred stock, stock options, warrants and other potential common stock. Computations of diluted net income (loss) per share do not give effect to individual potential common stock for any period in which their inclusion would be anti-dilutive.

Statements of Cash Flows

The following table provides supplemental cash flow information:

	For the six months ended March 31, 2006		For the six months ended March 31, 2005	
Supplemental cash flow information:				
Interest paid	$	7,000	$	4,000
Non-cash financing and investing activities:				
Accrued preferred stock dividends	$	187,000	$	132,000
Warrants issued for services		40,000		30,000
Deemed dividend on private placement		1,000,000		2,200,000
Expiration of warrants				133,000
	$	1,227,000	$	2,495,000

Note 3 Spescom Ltd. Transactions and Related Parties

As of March 31, 2006 and September 30, 2005 there were 5,291 shares of Series F Convertible Preferred Stock with a stated value of $1,000 per share held by Spescom Ltd., the majority shareholder of the Company. The Series F Convertible Preferred Stock is convertible into common stock, at a stated conversion price of $0.45 per share subject to certain adjustments. The conversion is at the option of Spescom Ltd. through September 30, 2008. The outstanding Series F Convertible Preferred Stock is entitled to receive dividends of 5% of the stated value of $1,000 per share per annum, payable on a quarterly basis in cash or common stock (valued on the basis of the average per share market value on the 30 trading days immediately prior to the date on which such dividend is declared by the Board of Directors). Unpaid dividends accrue interest at the rate of 8% per annum. As of March 31, 2006, unpaid dividends and accrued interest amounted to $661,000 and $63,000, respectively. As of September 30, 2005, unpaid dividends and accrued interest amounted to $529,000 and $39,000, respectively.

<u>Related party liabilities consist of the following:</u>

	March 31, 2006		September 30, 2005	
Payable to Spescom Ltd. UK	$	186,000	$	213,000
Payable to Spescom Ltd. S.A.	$	321,000	$	302,000
Notes and accrued interest payable on demand - Spescom Ltd. UK		647,000		615,000
	$	968,000	$	917,000

The Company has two existing demand notes payable to Spescom Ltd. UK, a wholly owned subsidiary of Spescom Ltd., for $400,000 and $100,000, each bearing interest rate of 10% per annum. As of March 31, 2006 and September 30, 2005, the balance owed on the notes including interest was $647,000 and $615,000, respectively. Spescom Ltd. has agreed that it will not cause Spescom Ltd. UK to demand repayment under the two notes prior to October 1, 2006. Interest expense on the notes was $16,000 and $14,000 for the three months ended March 31, 2006 and 2005, respectively. These notes are collateralized by a security interest in favor of both Spescom Ltd. and Spescom Ltd. UK in respect of all the Company s assets. In November 2005 the Company s wholly owned subsidiary, Spescom Software Ltd. agreed to guarantee certain loan obligations of Spescom Ltd. totaling $5.4 million as of March 31, 2006. The proceeds of these loans had been used by Spescom Ltd. in prior years to provide working capital to the Company. The guarantee is secured by the assets of Spescom Software Ltd. which totaled $369,000 as of March 31, 2006.

Under a royalty arrangement beginning in fiscal 2004, Spescom Ltd. resells the Company s software and maintenance services in South Africa. Royalty revenue recognized under this agreement for the three and six months ended March 31, 2006 totaled $34,000 and $117,000, respectively. In February 2006 the royalty arrangement with Spescom Ltd. was terminated and the company entered into a new reseller arrangement with a third party company DocQnet International for the South African market. In September 2005, Spescom Ltd. performed certain marketing and business development projects for the company along with assisting in raising working capital. Spescom Ltd. had agreed to defer payment for these services until after October 1, 2006. However, interest will accrue on the balance owed at a rate of 11%. The total expense relating to these services was $302,000 for the year ended September 30, 2005 and additional expense of $2,000 was recorded for the six months ended March 31, 2006. As of March 31, 2006, the total unpaid services and interest amounted to $304,000 and $17,000, respectively. At March 31, 2006 there were no personnel related charges due to Spescom, Ltd. S.A.

Spescom Ltd. UK provides certain administrative and accounting functions for the Company s United Kingdom subsidiary. The Company is billed a monthly fee by Spescom Ltd. UK for reimbursement of certain costs in the United Kingdom including the office facilities, all accounting and human resources services, and certain corporate marketing activities. For the three and six months ended March 31, 2006 the administrative fees totaled $83,000 and $226,000, respectively, as compared to $155,000 and $309,000, respectively, for the same periods in 2005. The office rent for the Company s United Kingdom operations included in the administrative fee totaled $48,000 and $132,000 for the three and six months ended March 31, 2006, respectively, as compared to $91,000 and $180,000, respectively, for the same periods in 2005. At March 31, 2006 and September 30, 2005 the Company had a payable to Spescom Ltd. UK of $186,000 and $213,000, respectively. In 1999, as part of an agreement to sell a 60% interest in its United Kingdom subsidiary to Spescom Ltd., the lease for the United Kingdom office facility was to be assigned to Spescom Ltd. UK; however, the landlord did not grant its consent to the assignment and as such Spescom Ltd.UK has paid the lease for the entire office directly to the landlord. The lease expired on March 14, 2006. The landlord has claimed that the Company owes certain dilapidation payments under the lease. The Company has disputed such claims and believes there will be no material effect once resolved.

Spescom Ltd. and the Company have entered into a license agreement pursuant to which Spescom Ltd. has licensed to the Company the right to use the name Spescom and to use a trademark owned by Spescom Ltd. related to certain computer software. The Company will not pay any royalties to Spescom Ltd. in connection with this license. The license is for an indefinite term, but is terminable by either party upon 60 days prior written notice. Under the license agreement, Spescom Ltd. has agreed to indemnify and hold harmless the Company and its directors, officers, employees and agents against liabilities arising from any claim brought against the Company that alleges that Spescom Ltd. s or the Company s use of the licensed trademark infringes the rights of any third party, provided that the Company is in material compliance with the provisions of the license agreement.

Note 4 Receivables

A summary of receivables and allowance for doubtful accounts as of March 31, 2006 and September 30, 2005 are as follows:

		March 31, 2006		September 30, 2005
Receivables consist of:				
Receivables	$	719,000	$	621,000
Less: allowance for doubtful accounts		(7,000)		(8,000)
	$	712,000	$	613,000

Note 5 Reconciliation of Net Income (Loss) and Shares Used in Per Share Computations:

	For the three months ended March 31,				For the six months ended March 31,	
		2006		2005	2006	2005
Net loss available for common shareholders	$	(700,000)	$	(594,000)	(1,467,000)	(3,481,000)
Common stock and common stock equivalents		36,895,000		34,215,000	36,857,000	34,187,000

Basic net income (loss) per share is computed using the weighted average number of common shares outstanding during the period. Contingently issued shares are included in the computation of basic net income (loss) per share when the related conditions are satisfied. Diluted net income (loss) per share is computed using the weighted average number of common shares and potentially dilutive securities outstanding during the period. Potentially dilutive securities consist of contingently issued shares, the common shares issuable upon conversion of preferred stock or convertible debt and shares issuable upon the exercise of stock options and common stock warrants. Potentially dilutive securities are excluded from the computation if their effect is anti-dilutive.

As of March 31, 2006, a total of 6,390,000 stock options, 7,644,354 common stock warrants, and 5,291 and 2,450 shares of Series F and Series I Convertible Preferred Stock, respectively, were excluded from the diluted net income (loss) per share calculation, as their effect would be anti-dilutive. There were no shares of Series H Convertible Preferred Stock at March 31, 2006 as the shares were exchanged for Series I Convertible Preferred Stock on March 10, 2006. As of March 31, 2005, a total of 3,919,860 stock options, 3,758,335 common stock warrants, and 5,291 and 2,200 shares of Series F and Series G Convertible Preferred Stock, respectively, were excluded from the diluted net income (loss) per share calculation, as their effect would be anti-dilutive.

Note 6 Segment and Geographic Information

The Company has one business segment, which consists of the development and sale of a suite of integrated document, configuration and records management software product.

Revenues by customer location and identifiable assets by location are as follows:

	For the three months ended March 31, 2006	2005	For the six months ended March 31, 2006	2005
Net sales:				
United States	$ 1,305,000	$ 730,000	$ 2,421,000	$ 1,647,000
Europe, primarily United Kingdom	407,000	934,000	986,000	1,657,000
Other International	348,000	9,000	485,000	22,000
	$ 2,060,000	$ 1,673,000	$ 3,892,000	$ 3,326,000

	March 31, 2006	September 30, 2005
Identifiable assets from continuing operations:		
United States	$ 1,848,000	$ 1,300,000
Europe, United Kingdom	369,000	345,000
	$ 2,217,000	$ 1,645,000

Note 7 Redeemable Preferred Stock

October 2005 Private Placement

On October 25, 2005, the Company completed a private placement issuing 1,950 shares of Series H Preferred Stock and warrants for the purchase of 925,926 common shares in exchange for cash of $500,000 and 1,450 shares of previously issued Series G Preferred Stock. The common stock warrants have an exercise price of $0.27 per share and expire October 25, 2008. In connection with this transaction, the 1,450 shares of Series G Preferred Stock were cancelled by the Company. Expenses relating to the transaction totaled $64,000 primarily relating to legal and accounting fees. In accordance with EITF 00-27 Application of Issue No 98-5 to Certain Convertible Instruments, the Company calculated, using the Black Scholes method, the intrinsic value of the convertible instruments issued and determined that there was a deemed preferred dividend equal to the gross proceeds received of $500,000. In March 2006 the Company completed a private placement exchanging all of the Series H Preferred Stock for Series I Convertible Preferred Stock. See March 2006 Private Placement below.

The shares of Series H Preferred Stock issued were convertible into common stock at the conversion rate in effect at the time of conversion. The conversion price per share of the Series H Preferred Stock was equal to 85% of the market price (the volume weighted average price of the Company s common stock during the 5 immediately preceding trading days), provided that in no event shall the conversion price exceed a ceiling price of $0.40 per share, or be less than a floor price which varies with the aggregate gross revenues of the Company during the last four fiscal quarters for which revenues have been reported by the Company prior to such time, but which will not be lower than $0.0725 per share and not higher than $0.16 per share. The Series H Preferred Stock accrued dividends at 6.75% of the stated value of $1,000 per share per annum. On

March 31, 2006 the Company issued 325,966 shares of common stock in payment of declared Series H Preferred Stock dividends of $44,000 based on a fair market value of $0.13 per share.

The terms of the October 2005 financing also provided for a second closing to have occurred no later than January 20, 2006, under which the Company would issue an additional 500 shares of Series H Preferred Stock and additional warrants for the purchase of 925,926 common shares in exchange for cash of $500,000. The obligations of the purchasers to consummate the second closing were subject to certain conditions, including that the closing price of the Company s common stock would be $0.16 or greater for 20 consecutive trading days. This stock price condition was not satisfied and the second closing was not completed.

March 2006 Private Placement

On March 10, 2006, the Company completed a private placement issuing 2,450 shares of Series I Convertible Preferred Stock (Series I Preferred Stock) and warrants, expiring March 10, 2009, to purchase 925,926 shares of common stock at $0.27 per share in exchange for cash $500,000 and 1,950 shares of the Company s Series H Convertible Preferred Stock, which have been cancelled. Expenses relating to the transaction totaled $98,000 primarily relating to legal and accounting fees. In accordance with EITF 00-27 Application of Issue No. 98-5 to Certain Convertible Instruments, the Company calculated, using the Black Scholes method, the intrinsic value of the convertible instruments issued and determined that there was a deemed preferred dividend equal to the gross proceeds received of $500,000. Pursuant to the terms of the financing, the Company filed a registration statement on April 7, 2006 for the common shares issuable under the Series I Preferred Stock and related warrants.

Each share of Series I Preferred Stock is convertible into a number of shares of common stock determined by dividing $1,000 by the conversion price per share in effect at the time of conversion. The conversion price per share is equal to 85% of the market price (the volume-weighted average price of the Company s common stock during the 5 immediately preceding trading days, subject to adjustment), provided that in no event shall the conversion price exceed a ceiling price of $0.21 per share, or be less than a floor price of $0.0725 per share.

Under the terms of the Series I Preferred Stock, if the Company did not entered into a binding agreement to consummate a consolidation, merger, reclassification of the stock of the Company (subject to certain exceptions), or disposition of all or substantially all of the assets of the Company on or before April 30, 2006, the holders of Series I Preferred Stock may, by the vote not later than December 31, 2006 of at least two-thirds of the then-outstanding shares, elect to have all of the outstanding shares of Series I Preferred Stock redeemed by the Company. Upon such election, the Company would be obligated to redeem the Series I Preferred Stock at an amount equal to $1,000 per share plus all declared but unpaid dividends. In the event that the holders of Series I Preferred Stock exercise their redemption right but the Company does not have sufficient funds available to redeem the Series I Preferred Stock in accordance with applicable law, the holders of Series I Preferred Stock as a class will be entitled to elect the smallest number of directors of the Company constituting a majority of the authorized number of directors. As of April 30, 2006 the Company has not entered into a binding agreement to consummate a consolidation, merger, reclassification of the stock of the Company; or disposition of all or substantially all of the assets of the Company; presently, however, the holders of the Series I Preferred Stock have not taken any action in regard to their rights under these terms. In the event the holders of the Series I Preferred Stock exercise their redemption right, the Company would not have sufficient funds available to redeem the Series I Preferred Stock and those holders would be entitled to elect a majority of the authorized directors of the Company. In this event, those holders, through their majority control of the Board of Directors, would be able to control or (with respect to matters requiring shareholder approval) exert significant influence over all matters affecting the Company. Under FAS 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity and EITF D-98 Classification and Measurement of Redeemable Securities and since a binding agreement was not entered into by April 30, 2006, the Company has reclassified the Series I Preferred Stock to liabilities as of March 31, 2006 as the Company may be obligated to repay the proceeds received.

Each holder of Series I Preferred Stock is entitled to a liquidation preference equal to the greater of (i) $1,000 per share plus declared but unpaid dividends per share and (ii) the amount such holder would be entitled to receive had such holder s shares been converted into shares of common stock immediately prior to the distribution in accordance with the terms of the Series I Preferred Stock. Commencing on the issuance date of the Series I Preferred Stock, the Series I Preferred Stock is entitled to receive dividends of 6.75% of the stated value of $1,000 per share per annum, only payable until the registration statement for the common stock underlying the Series I Preferred Stock is declared effective by the Securities and Exchange Commission.

Note 8 Equity

November 2004 Private Placement

On November 5, 2004, the Company completed a financing arrangement whereby the Company issued 2,200 shares of our Series G Preferred Stock along with 2,750,000 common stock warrants for gross proceeds of $2,200,000. The Series G Preferred Stock was convertible into common stock at a price equal to 85% of the volume weighted average price of the Company s common stock during the five trading days immediately preceding the conversion date; however, the conversion price could be no higher than $0.40 per share and no lower than $0.30 per share. The 2,750,000 warrants have an exercise price of $0.44 per share and expire November 5, 2007. The Company incurred $418,000 in expenses related to the transaction and issued 825,000 common stock warrants to an investment consulting firm. The 825,000 warrants were comprised of 550,000 warrants with an exercise price of $0.40 per share which expire November 5, 2009 and 275,000 warrants with an exercise price of $0.44 per share which expire on November 5, 2007. In connection with the financing, the Company recorded a beneficial conversion of $2,200,000 on the Series G Preferred Stock as a deemed dividend for the three months ended December 31, 2004. During fiscal 2005, 750 shares of the Series G Preferred Stock were converted into 2,428,000 shares of common stock. As part of the private placement in October 2005 the Company exchanged the 1,450 remaining shares of Series G Preferred Stock for 1,450 shares of Series H Preferred Stock. Those 1,450 shares of Series H Preferred Stock were exchanged for Series I Preferred Stock in March 2006. The shares of the Series G and H Preferred Stock have been cancelled by the Company. (See Note 7)

Issuance of Warrants to Investor Relations Firm

During November 2005, the Company entered into a six-month engagement with an investment relations firm to develop and implement a marketing program to promote financial market and investor awareness for the Company. Under the engagement agreement, the investor relations firm was entitled to receive, every month the agreement is effective, a warrant, expiring three years from the date of issuance, to purchase 50,000 shares of the Company s common stock at an exercise price of $0.10 per share for a total of 300,000 shares over the six-month contract. In addition, the investment relations firm was entitled under the agreement to a one time performance warrant to purchase 500,000 shares of the Company s common stock at $0.25 per share, which would vest if, during the term of the agreement, the volume weighted-average price of the Company s common stock were to exceed $0.50 for five consecutive days. On March 31, 2006, the Company issued to the investor relations firm a warrant, expiring on the third anniversary of its date of issuance, for the purchase of 300,000 shares of the Company s common stock at an exercise price of $0.10 per share. The investor relations firm agreed to accept that warrant for 300,000 in lieu of all of the warrants issuable to the investor relations firm as monthly compensation during the six-month term of the agreement and in lieu of the performance warrant. Under EITF 96-19 the fair value of the warrant to purchase 300,000 shares of common stock was determined to be $39,000 and has been expensed ratably over the six month term of the engagement agreement.

Note 9 - Recent Pronouncements

There have not been any recent accounting pronouncements since the Company s last filing that would have a material effect on the financial statements of the Company.

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

Forward Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or anticipated results, including those set forth under Certain Factors That May Affect Future Results below and elsewhere in, or incorporated by reference into, this report.

In some cases, you can identify forward looking statements by terms such as may, intend, might, will, should, could, would, expect, anticipate, estimate, predict, potential, or the negative of these terms, and similar expressions are intended to identify forward-looking statements. When used in the following discussion, the words believes, anticipates and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The forward-looking statements in this report are based upon management s current expectations and belief, which management believes are reasonable. These statements represent our estimates and assumptions only as of the date of this Quarterly Report on Form 10-Q, and we undertake no obligation to publicly release the result of any revisions to these forward-looking statements, which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following discussion should be read in conjunction with the Selected Consolidated Financial Data and the Consolidated Financial Statements, including the Notes thereto.

OVERVIEW

The Company develops, markets and supports *e*B, its integrated suite of collaborative document, configuration and records management software solutions. The *e*B suite enables organizations in a broad range of industries to create, capture, store, manage, share and distribute critical business information regarding their customers, products, assets and processes in an efficient manner. The *e*B suite also enables them to maintain complete, up-to-date information about the configuration of their products, assets and infrastructures so that they can achieve operational excellence and compliance with regulatory requirements. *e*B provides the capabilities of an Enterprise Content Management (ECM)/Electronic Document Management (EDM) System, but extends these capabilities by also managing the things that the content/documents relate to such as products, assets , functions, processes, requirements, projects, organizations, locations, work orders, etc. As a result, *e*B can be used to manage the lifecycle of physical items (e.g. products, equipment or assets), and the requirements (e.g. functional, safety, performance, environmental, etc.) that govern them. It enables intelligent relationships to be defined between these items thereby creating an interdependency model. As a result, the effects of any change on requirements, documents and items can be determined and change can be managed to effectively ensure information integrity. In particular, *e*B enables organizations with extensive and complex physical infrastructures to efficiently identify, classify, structure, link, and manage documents, physical items, and requirements throughout their lifecycles and ensure that conformance between these is maintained by means of an automated change process.

We develop, market and support *e*B, our integrated suite of collaborative document, configuration and records management software solutions. Our revenues in the three months ended March 31, 2006 increased by 23% from the same period in the prior fiscal year due to higher license sales as a result of a new South African partner DocQnet International and large software license sales sold to JEA and Constellation Energy Group. During the three months ended March 31, 2005 there were no large license sales. Our revenues in the six months ended March 31, 2006 increased by 17% from the same period in the prior fiscal year as a result of such higher license sales through DocQnet International and to Florida Power & Light, Constellation Energy Group and JEA. The Company s license revenue fluctuates from quarter to quarter as reflected by the increase in license sales during the quarter.

Our revenues are derived from licenses of our software to our customers, services that we provide under maintenance support contracts and our non-maintenance services, consisting primarily of design studies, system implementation and training. Of our total revenues for the three months ended March 31, 2006, license revenues accounted for 32%, maintenance services revenues accounted for 35% and non-maintenance services represented 33%. For the six months ended March 31, 2006, license revenue accounted for 31%, maintenance services revenues accounted for 37% and non-maintenance services revenues represented 32%.

Many of our customers are located outside the United States, with foreign-originated revenues accounting for 37% and 57% of revenues for the three months ended March 31, 2006 and 2005, respectively, and 38% and 50% of revenues for the six months ended March 31, 2006 and 2005, respectively. Our revenue for the three and six months ended March 31, 2006 reflected a foreign currency loss of $42,000 and $108,000, respectively, as compared to last year due to the declining value of the British pound to the dollar.

While revenues increased, our cost of revenues increased slightly due to third party scanning services when compared to the same period in the prior fiscal year. Operating expenses decreased by 14% primarily as a result of a reduction in personnel implemented in the second half of fiscal 2005 and lower professional fees during the current period.

At March 31, 2006, our principal sources of liquidity consisted of $620,000 of cash and cash equivalents, compared to $285,000 at September 30, 2005. On October 25, 2005 and March 10, 2006 we completed private placements of preferred stock which resulted in gross proceeds of $1,000,000.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. As such, management is required to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The significant accounting policies which are most critical to aid in fully understanding and evaluating reported financial results include the following:

Revenue Recognition

The Company enters into contractual arrangements with end-users that may include licensing of the Company s software products, product support and maintenance services, consulting services or various combinations thereof, including the sale of such products or services separately. The Company recognizes revenue in accordance with Statement of Position (SOP) 97-2 Software Revenue Recognition, SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions , Staff Accounting Bulletin (SAB) No. 101, updated by SAB s 103 and 104 Update of Codification of Staff Accounting Bulletins, and Emerging Issues Task Force No. 00-21 (EITF 00-21) Accounting for Revenue Arrangements with Multiple Deliverables. Revenue through the Company s Value Added Resellers (VARS) are net of any VAR discount in accordance with EITF 99-19 Reporting Revenue Gross as a Principal versus Net as an Agent.

Software license and third party product revenues are recognized upon shipment of the product if no significant vendor obligations remain and collection is probable. In cases where a significant vendor obligation exists, revenue recognition is delayed until such obligation has been satisfied. For new software products where a historical record has not yet been demonstrated that acceptance is perfunctory, the Company defers recognition of revenue until acceptance has occurred. If an undelivered element of the arrangement exists under the license arrangement, a portion of revenue is deferred based on vendor-specific objective evidence (VSOE) of the fair value of the undelivered element until delivery occurs. If VSOE does not exist for all undelivered elements, all revenue is deferred until sufficient evidence exists or all elements have been delivered. Annual maintenance revenues, which consist of ongoing support and product updates, are recognized on a straight-line basis over the term of the contract. Payments received in advance of performance of the related service for maintenance contracts are recorded as deferred revenue. Revenues from training and consulting services are recognized when the services are performed and adequate evidence of providing such services is available. Contract revenues for long-term contracts or programs requiring specialized systems are recognized using the percentage-of-completion method of accounting, primarily based on contract labor hours incurred to date compared with total estimated labor hours at completion. Provisions for anticipated contract losses are recognized at the time they become known.

Contracts are billed based on the terms of the contract. There are no retentions in billed contract receivables. Unbilled contract receivables relate to revenues earned but not billed at the end of the period.

The Company considers many factors when applying accounting principles generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

- The actual contractual terms, such as payment terms, delivery dates, and pricing of the various product and service elements of a contract
- Availability of products to be delivered
- Time period over which services are to be performed
- Creditworthiness of the customer
- The complexity of customizations to the Company s software required by service contracts
- The sales channel through which the sale is made (direct, VAR, distributor, etc.)
- Discounts given for each element of a contract
- Any commitments made as to installation or implementation of go live dates

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, as well as whether or not each factor complies with such standards. Any misjudgment or error by management in its evaluation of the factors and the application of the standards, especially with respect to complex or new types of transactions, could have a material adverse effect on the Company s future operating results.

Software Development Costs

Software development costs are capitalized when technological feasibility and marketability of the related product have been established. Software development costs incurred solely in connection with a specific contract are charged to cost of revenues. Capitalized software costs are amortized on a product-by-product basis, beginning when the product is available for general release to customers. Annual amortization expense is calculated using the greater of the ratio of each product s current gross revenues to the total of current and expected gross revenues or the straight-line method over the estimated useful life of three to five years.

Allowance for Doubtful Accounts

The Company sells its products directly to end-users, generally requiring a significant up-front payment and remaining terms appropriate for the creditworthiness of the customer. The Company also sells its products to VARs and other software distributors generally under terms appropriate for the creditworthiness of the VAR or distributor. The Company retains no continuing obligations on sales to VARs. Receivables from customers are generally unsecured. The Company continuously monitors its customer account balances and actively pursues collections on past due balances. The Company maintains an allowance for doubtful accounts which is comprised of a general reserve based on historical collections performance plus a specific reserve for certain known customer collections issues. If actual bad debts are greater than the reserves calculated based on historical trends and known customer issues, the Company may be required to book additional bad debt expense which could have a material adverse effect on our business, results of operations and financial condition for the periods in which such additional expense occurs.

RESULTS OF OPERATIONS

The following table sets forth the condensed consolidated statement of operations expressed as a percentage of total revenue for the periods indicated:

	For the three months ended March 31,		**For the six months ended March 31,**	
	2006	**2005**	**2006**	**2005**
Revenues				
Licenses	32%	5%	31%	11%
Services and other	68%	95%	69%	89%
Total revenues	100%	100%	100%	100%
Cost of revenues				
Licenses	3%	4%	5%	3%
Services and other	35%	37%	32%	37%
Total cost of revenues	38%	41%	37%	40%
Gross profit	62%	59%	63%	60%

Operating expenses:				
Research and development	14%	10%	12%	16%
Marketing and sales	34%	55%	34%	52%