CHORDIANT SOFTWARE INC
Form 10-Q
April 29, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

for the quarterly period ended December 31, 2004

OR

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

For the transition period from _____ to _____

Commission File Number 000-29357

Chordiant Software, Inc.

(Exact name of Registrant as specified in its Charter)

Delaware	**93-1051328**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**

20400 Stevens Creek Boulevard, Suite 400

Cupertino, CA 95014

(Address of Principal Executive Offices including Zip Code)

(408) 517-6100

(Registrant s Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO ¨

The number of shares of the Registrant s common stock outstanding as of March 31, 2005 was 77,008,337.

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CHORDIANT SOFTWARE, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED DECEMBER 31, 2004

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

CHORDIANT SOFTWARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, unaudited)

	December 31, 2004	September 30, 2004 (Restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 47,287	$ 55,748
Marketable securities	4,000	4,000
Restricted cash	1,780	279
Accounts receivable, net	17,928	20,161
Prepaid expenses and other current assets	3,841	3,097
Total current assets	74,836	83,285
Restricted cash	558	2,057
Property and equipment, net	3,172	3,237
Goodwill	32,028	24,874
Intangible assets, net	6,178	244
Other assets	2,419	1,643
Total assets	$ 119,191	$ 115,340
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,656	$ 6,394
Accrued expenses	13,981	11,681
Deferred revenue	18,582	18,459
Current portion of capital lease obligations	201	191
Total current liabilities	39,420	36,725
Deferred revenue, long-term	1,622	2,122
Long term portion of capital lease obligations	257	317
Total liabilities	41,299	39,164
Stockholders equity:		
Common stock	77	72
Additional paid-in capital	271,890	262,703
Deferred stock-based compensation	(4,391)	(339)

Accumulated deficit	(193,411)	(189,349)
Accumulated other comprehensive income	3,727	3,089
Total stockholders equity	77,892	76,176
Total liabilities and stockholders equity	$ 119,191	$ 115,340

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

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CHORDIANT SOFTWARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except per share data, unaudited)

	Three Months Ended	
	December 31, 2004	December 31, 2003
Revenues:		
License	$ 8,842	$ 9,248
Service	12,835	10,352
Total revenues	21,677	19,600
Cost of revenues:		
License	166	574
Service	7,503	6,237
Stock based compensation	(56)	676
Amortization of intangible assets	131	794
Total cost of revenues	7,744	8,281
Gross profit	13,933	11,319
Operating expenses:		
Sales and marketing	7,215	5,695
Research and development	4,865	4,176
General and administrative	3,912	1,291
Stock based compensation	(105)	2,671
Amortization of intangible assets	24	96
Purchased in-process research and development	1,940	
Restructuring expense	(123)	1,028
Total operating expenses	17,728	14,957
Loss from operations	(3,795)	(3,638)
Interest income, net	210	17
Other income (expense), net	(397)	141
Net loss before income taxes	(3,982)	(3,480)
Provision for income taxes	80	457
Net loss	$ (4,062)	$ (3,937)
Other comprehensive income:		
Foreign currency translation gain	638	1,135
Comprehensive loss	$ (3,424)	$ (2,802)

Net loss per share basic and diluted	$ (0.06)	$ (0.06)
Weighted average shares used in computing basic and diluted loss per share	72,223	61,560

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

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CHORDIANT SOFTWARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands, unaudited)

	Three Months Ended	
	December 31, 2004	**December 31, 2003**
Cash flows from operating activities:		
Net loss	$ (4,062)	$ (3,937)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	372	539
Amortization of intangibles	155	890
Purchased in-process research and development	1,940	
Non-cash stock-based compensation expense	(161)	3,149
Provision for doubtful accounts	79	
Warrants issued to customers	(15)	95
Loss on disposal of assets		11
Other non-cash charges	105	
Changes in assets and liabilities net of effect of acquisitions:		
Accounts receivable	2,983	1,091
Prepaid expenses and other current assets	(637)	502
Other assets	(736)	139
Accounts payable	(2,094)	938
Accrued expenses	1,755	1,366
Deferred revenue	(1,487)	(1,215)
Other liabilities		(90)
Net cash provided by (used in) operating activities	(1,803)	3,478
Cash flows from investing activities:		
Property and equipment purchases, net	(196)	(173)
Proceeds from release of restricted cash	(3)	
Cash used for acquisitions, net of cash acquired	(7,869)	
Net cash used for investing activities	(8,068)	(173)
Cash flows from financing activities:		
Proceeds from exercise of stock options	135	617
Payment on capital leases	(50)	
Collection of notes receivable		400
Repayment of borrowings		(2,131)
Net cash provided by (used in) financing activities	85	(1,114)
Effect of exchange rate changes	1,325	1,933
Net increase (decrease) in cash and cash equivalents	(8,461)	4,124
Cash and cash equivalents at beginning of period	55,748	32,094

Cash and cash equivalents at end of period	$ 47,287	$ 36,218

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

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CHORDIANT SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting of only normal recurring adjustments, which in the opinion of management, are necessary to state fairly the financial position, results of operations and cash flows for the interim periods presented. The results of operations for interim periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. These unaudited condensed financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Transition Report on Form 10-K/T for the nine months ended September 30, 2004 filed with the Securities and Exchange Commission (SEC) on March 29, 2005 (2004 Form 10-K).

Change in year end

On December 29, 2004, Chordiant Software s Board of Directors approved a change in the Company s fiscal year end from December 31 to September 30. The three months ended December 31, 2004 reported by the Company in this Quarterly Report on Form 10-Q relate to the fiscal year ending September 30, 2005.

Restatement

The financial information as of September 30, 2004 is labeled restated as it has been revised from the amounts previously filed with the SEC. The restatement is further discussed in Note 2 and Note 18 of the Consolidated Financial Statements in our 2004 Form 10-K.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current year presentation.

Principles of consolidation

The accompanying unaudited condensed consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods.

On an on-going basis, we evaluate the estimates, including those related to our allowance for doubtful accounts, valuation of goodwill and intangible assets, valuation of deferred tax assets, restructuring costs, contingencies and the estimates associated with the percentage-of-completion method of accounting for certain of our revenue contracts. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying 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 licenses of our software and related services, which include assistance in implementation, customization and integration, post-contract customer support, training and consulting. The amount and timing of our revenue is difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in operating losses.

At the time of entering into a transaction, we assess whether any services included within the arrangement require us to

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perform significant implementation or customization essential to the functionality of our products. For contracts involving significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenues using the percentage-of-completion method using labor hours incurred as the measure of progress towards completion as prescribed by Statement of Position (SOP) No. 81-1, Accounting for Performance of Construction-Type and Certain Product-Type Contracts. The progress toward completion is measured based on the go-live date. We define the go-live date as the date the essential product functionality has been delivered or the application enters into a production environment or the point at which no significant additional Chordiant supplied professional services resources are required. Estimates are updated when new information becomes available. We account for the change in estimate when the information becomes known in the period the change was identified. Provisions for estimated contract losses are recognized in the period in which the loss becomes probable and can be reasonably estimated. When we sell additional licenses related to the original licensing agreement, revenue is recognized either upon delivery if the project has reached the go-live date, or if the project has not reached the go-live date, revenue is recognized under the percentage-of-completion method. We classify revenues from these arrangements as license and service revenues based upon the estimated fair value of each element.

On contracts for products not involving significant implementation or customization essential to the product functionality, we recognize license revenues when there is persuasive evidence of an arrangement, the fee is fixed or determinable, collection of the fee is probable and delivery has occurred as prescribed by SOP No. 97-2, Software Revenue Recognition, as amended.

We assess collectibility based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We generally do not request collateral from our customers. If we determine that collection of a fee is not probable, we defer the fee and recognize revenue at the time collection becomes probable, which is generally upon receipt of cash.

For arrangements with multiple elements, we recognize revenue for services and post-contract customer support based upon vendor specific objective evidence (VSOE) of fair value of the respective elements. VSOE of fair value for the services element is based upon the standard hourly rates we charge for the services when such services are sold separately. VSOE of fair value for annual post-contract customer support is established with the optional substantive stated future renewal rates included in the contracts. When contracts contain multiple elements, and VSOE of fair value exists for all undelivered elements, we account for the delivered elements, principally the license portion, based upon the residual method as prescribed by SOP No. 98-9, Modification of SOP No. 97-2 with Respect to Certain Transactions.

In situations in which we are obligated to provide unspecified additional software products in the future, we recognize revenue as a subscription ratably over the term of the commitment period.

For all sales we use either a signed license agreement or a binding purchase order as evidence of an arrangement. Sales through our third party systems integrators are evidenced by a master agreement governing the relationship together with binding purchase orders on a transaction-by-transaction basis. Revenues from reseller arrangements are recognized on the sell-through method, when the reseller reports to us the sale of our software products to end-users. Our agreements with customers and resellers do not contain product return rights.

We recognize revenue for post-contract customer support ratably over the support period which ranges from one to three years. Our training and consulting services revenues are recognized as such services are performed.

Restricted cash

At December 31, 2004 and September 30, 2004, we had interest bearing certificates of deposit aggregating $0.6 million classified as long-term restricted cash and $0.3 million classified as short-term restricted cash. These balances primarily relate to funds pledged as collateral for letters of credit against certain lease obligations. As of December 31, 2004 and September 30, 2004, we also had a balance of $1.5 million in the form of cash equivalents which is restricted from withdrawal. This balance serves as a security deposit in a long-term, post-contract customer support revenue transaction expiring on December 31, 2005 and accordingly, it has been reclassified from non-current to current assets as of December 31, 2004.

Stock-based compensation

We account for stock-based employee compensation arrangements in accordance with provisions of Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, FASB Interpretation No. 44 (FIN 44),

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Accounting for Certain Transactions Involving Stock Based Compensation an Interpretation of APB No. 25, and related interpretations and comply with the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation. Under APB No. 25 and FIN 44, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of our stock and the exercise price of the stock option being granted. Stock-based compensation is amortized in accordance with FIN 28 using the multiple option approach. SFAS No. 123 defines a fair value based method of accounting for an employee stock option or similar equity instrument.

We account for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services.

We have adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation Transition and Disclosure during the quarter ended March 31, 2003. SFAS No. 148 amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation and also amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the methods of accounting for stock-based employee compensation and the effect of the method used on reported results. As permitted by SFAS 148 and SFAS 123, we continue to apply the accounting provisions of APB No. 25. We generally grant stock options at exercise prices equal to the fair market value of the underlying stock on the date of grant and, therefore, under APB No. 25, no compensation expense is recognized in the statements of operations. Had we recorded compensation expense based on the estimated grant date fair value, as defined by SFAS No. 123, for awards granted under our stock option plans and stock purchase plan, our net loss and loss per share would have been increased to the pro forma amounts below (in thousands, except per share amounts):

	Three Months Ended	
	December 31, 2004	December 31, 2003
Net loss as reported	$ (4,062)	$ (3,937)
Add: Stock-based compensation expense (benefit) included in reported net loss	(161)	3,149
Less: Stock-based compensation expense determined under fair value method	1,299	2,121
Net loss pro forma	$ (5,522)	$ (2,909)
Basic and diluted net loss per share as reported	$ (0.06)	$ (0.06)
Basic and diluted net loss per share pro forma	$ (0.08)	$ (0.05)

Under SFAS No. 123, the fair value of each option grant is estimated on the grant date using the following weighted average assumptions:

	Three Months Ended	
	December 31, 2004	December 31, 2003

Expected lives in years		
Stock options	2.4	3.1
Employee stock purchase plan	N/A	N/A
Risk free interest rates		
Stock options	2.9%	2.3%
Employee stock purchase plan	N/A	N/A
Volatility		
Stock options	88%	100%
Employee stock purchase plan	N/A	N/A
Dividend yield	0%	0%

The weighted average fair value of options granted during the three months ended December 31, 2004 and 2003 was $1.16 and $2.51, respectively.

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Because the determination of the fair value of all options granted after we became a public entity includes an expected volatility factor in addition to the other factors described in the table above and because additional option grants are expected to be made each year, the above pro forma disclosures are not representative of the pro forma effects of option grants on reported results for future years.

The related functional breakdown of total stock-based compensation is outlined below (in thousands):

	Three Months Ended	
	December 31, 2004	December 31, 2003
Stock-based compensation expense (benefit):		
Cost of revenues - service	$ (56)	$ 676
Sales and marketing	(14)	685
Research and development	(61)	860
General and administrative	(30)	1,126
Total stock-based compensation expense (benefit)	$ (161)	$ 3,347

On August 23, 2002, we implemented a stock option exchange program (the Program). Under the Program, holders of outstanding options with an exercise price of $3.00 or greater per share (the Eligible Options) were given the choice of retaining these options or canceling the options in exchange for (i) restricted shares of common stock (Restricted Stock) to be issued as soon as possible after the expiration of the Program period and/or (ii) replacement options issuable six (6) months and one (1) day following the cancellation of the Program (Replacement Options) at the closing market price on that date. The Program, as amended, also provided our Chief Executive Officer and former Chief Financial Officer of the Company, if they participated in the Program, with a Separate Restricted Stock Agreement (the CEO and CFO Agreement). There were 11,668,875 options subject to the Program, which closed on October 9, 2002.

Employees tendered 8,109,640 stock options and received 2,780,967 shares of Restricted Stock pursuant to the Program. In addition, employees tendered 672,948 stock options, which were cancelled and to the extent an employee was still employed by us were replaced six (6) months and one (1) day following the expiration of the Program. The tendered stock options represented approximately 59% of our total outstanding stock options as of the expiration date of the Program. In addition, in October 2002, we issued 3,706,745 shares of Restricted Stock to our employees residing in the United Kingdom, including to our Chief Executive Officer. The Restricted Stock issued to our Chief Executive Officer is subject to the CEO and CFO Agreement. In November 2003, our then acting Chief Financial Officer left our employ and, as a result, we are no longer subject to stock-based compensation expense related to the vesting of his restricted stock. In connection with his departure, we accelerated the vesting of 154,723 shares of restricted stock resulting in a compensation expense of $0.6 million during the fourth quarter of fiscal year 2003.

The Program has been accounted for under the guidance of Emerging Issues Task Force Issue No. 00-23, Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25, and Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation-an Interpretation of APB Opinion No. 25. Because we offered to cancel existing fixed stock options in exchange for a grant of restricted stock within six months of the cancellation date of the existing options, the Eligible Options became subject to variable accounting treatment at the commencement date of the Program. Variable accounting ceased upon cancellation of the tendered options. A total of 2,886,287 Eligible Options that were not tendered will remain subject to variable accounting. The remaining unearned stock-based compensation expense associated with the Eligible Options amounted to approximately $0.2 million at December 31, 2004. Due to the decline in our stock price, for the three months ended December 31, 2004, a credit of ($0.2) million was recorded as stock-based compensation expense. The compensation expense on variable options will be re-measured at the end of each operating period until the options are exercised, forfeited or have expired.

Depending upon the change in the market value of our common stock, this accounting treatment may result in significant additional stock-based compensation charges or credits in future periods.

As part of the Program implemented in 2002, we issued 499,068 replacement options at the current market value of $0.88 per share on April 11, 2003 to employees.

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In September 2001, we issued warrants to Accenture plc to purchase up to 600,000 shares of our common stock subject to performance-based vesting. No warrants have vested through December 31, 2004.

Concentrations of credit risk

Financial instruments that potentially subject us to concentrations of credit risk consist of cash and cash equivalents, marketable securities, restricted cash and accounts receivable. To date, we have invested excess funds in money market accounts and marketable securities consisting of auction rate securities. We have cash equivalents and investments with various high quality institutions domestically and internationally.

Our accounts receivable are derived from revenues earned from customers located in North America, Europe, and elsewhere in the world. We perform ongoing credit evaluations of our customers financial condition and, generally, require no collateral from our customers. We maintain an allowance for doubtful accounts when deemed necessary. To date, bad debts have not been material and have been within management expectation.

The following table summarizes the revenues from customers that accounted for 10% or more of total revenues:

	Three Months Ended	
	December 31, 2004	December 31, 2003
Barclays	26%	*
Capital One	19%	*
Canadian Imperial Bank of Commerce	*	16%
Signal Iduna	*	15%

* Represents less than 10% of revenue

At December 31, 2004, Capital One and Time Warner Cable accounted for approximately 30% and 18% of accounts receivable, respectively. At September 30, 2004, Time Warner Cable, Capital One and Canadian Imperial Bank of Commerce accounted for approximately 24%, 22% and 12% of accounts receivable, respectively.

Research and Development

Costs incurred in the research and development of new products and enhancements to existing products are charged to expense as incurred until the technological feasibility of the product or enhancement has been established. Technological feasibility of the product is determined after the completion of a detailed program design and a determination has been made that any uncertainties related to high-risk development issues have been resolved. If the process of developing the product does not include a detail program design, technological feasibility is determined only after completion of a working model. After establishing technological feasibility, additional development costs incurred through the date the product is available for general release to customers is capitalized and amortized over the estimated product life.

When technological feasibility is established through the completion of a working model the period of time between achieving technological feasibility and the general release of new products is generally short and software development costs qualifying for capitalization are insignificant. During the quarter ended September 30, 2004, technological feasibility for an acquired banking product was established through the completion of a detailed program design. As a result, as of December 31, 2004, costs aggregating $1.3 million associated with this product have been capitalized and included in Other Assets. No amortization expense relating to this product has been recorded as the product development was still in progress at December 31, 2004. Amortization in future periods will be calculated as the greater of (a) the ratio that current gross revenue for the product bears to the total of current and anticipated future gross revenue for the product or (b) the straight-line method over the remaining estimated economic life of the product.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R). This standard requires expensing of stock options and other share-based payments and supersedes SFAS No. 123, which had allowed companies to choose between expensing stock options or showing pro forma disclosure only. On April 14, 2005, the standard was delayed to the

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first interim period after the Company s fiscal year, accordingly, effective October 1, 2005, the Company will be required to apply the standard to all awards granted, modified, cancelled or repurchased after that date as well as the unvested portion of prior awards. SFAS 123(R) permits public companies to adopt its requirements using one of two methods:

A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123(R) for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date.

A prospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123(R) for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company expects the adoption to have a material adverse effect on its financial statements.

In December 2004, the FASB issued SFAS No. 153 (FAS 153), *Exchange of Nonmonetary Assets an amendment of APB Opinion No. 29,* which amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. FAS 153 defines a nonmonetary exchange as having commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005 and shall be applied prospectively. The Company will adopt FAS 153 in fiscal 2005 and its adoption is not expected to have a material effect on the Company s financial position or financial statements.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2 (FAS 109-2), *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004.* FAS 109-2 provides guidance under FASB Statement No. 109, *Accounting for Income Taxes,* with respect to recording the potential impact of the repatriation provisions of the American Jobs Creation Act of 2004 (the Jobs Act) on enterprises income tax expense and deferred tax liability. The Jobs Act was enacted on October 22, 2004. FAS 109-2 states that an enterprise is allowed time beyond the financial reporting period of enactment to evaluate the effect of the Jobs Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB Statement No. 109. The Company has not yet completed evaluating the impact of the repatriation provisions, however it does not anticipate the adoption will have a material impact on its consolidated financial statements. Accordingly, as provided for in FAS 109-2, we have not adjusted our tax expense or deferred tax liability to reflect the repatriation provisions of the Jobs Act.

In March 2004, the FASB issued EITF Issue No. 03-1 (EITF 03-1), *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* which provided new guidance for assessing impairment losses on investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company will evaluate the impact of EITF 03-1 once final guidance is issued, however it does not anticipate the adoption will have a material impact on its financial statements.

NOTE 3 BALANCE SHEET COMPONENTS

The main components of accounts receivable, net are as follows (in thousands):

	December 31, 2004	September 30, 2004 (Restated)
Accounts receivable, net:		
Accounts receivable	$ 18,143	$ 20,272
Less: allowances for doubtful accounts and credits	(215)	(111)
	$ 17,928	$ 20,161

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The main components of accrued expenses are as follows (in thousands):

	December 31, 2004	September 30, 2004 (Restated)
Accrued expenses:		
Accrued payroll and related expenses	$ 6,338	$ 4,919
Accrued restructuring expenses	2,835	3,368
Other accrued liabilities	4,808	3,394
	$ 13,981	$ 11,681

The components of intangible assets, excluding goodwill, are as follows (in thousands):

	December 31, 2004			September 30, 2004 (Restated)		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets:						
Developed technologies	$ 6,904	$ (2,293)	$ 4,611	$ 2,374	$ (2,162)	$ 212
Purchased technologies	7,162	(7,162)		7,162	(7,162)	
Customer list	1,750	(183)	1,567	190	(158)	32
Tradenames	982	(982)		982	(982)	
	$ 16,798	$ (10,620)	$ 6,178	$ 10,708	$ (10,464)	$ 244

All of our acquired intangible assets, excluding goodwill, are subject to amortization and are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives which are as follows: developed technologies-one and one half to five years; purchased technologies-three years; tradenames-three years; customer list-three to five years. Aggregate amortization expense for intangible assets totaled $0.2 million and $0.9 million for the three months ended December 31, 2004 and 2003, respectively. We expect amortization expense on acquired intangible assets as of December 31, 2004 to be $1.1 million for the remaining nine months in fiscal 2005, $1.2 million in fiscal 2006, $1.2 million in fiscal 2007, $1.2 million in fiscal 2008, $1.2 million in fiscal 2009 and $0.3 million in fiscal 2010.

NOTE 4 ACQUISITION

On December 21, 2004, we acquired KiQ Limited, a privately held United Kingdom software company with branch offices in the Netherlands (KiQ), specializing in the development and sales of decision management systems. The aggregate purchase price was approximately $20

million, which was comprised of $9.7 million in cash, 4,352,084 shares of our common stock valued at $9.4 million and approximately $0.9 million in associated transaction costs. Through this transaction we acquired decision management system products and technology.

The acquisition has been accounted for as a business combination. Assets acquired and liabilities assumed were recorded at their fair values as of December 21, 2004. The table below summarizes the total purchase price for the acquisition (in thousands, except share and per share data,):

Acquisition date	**December 21, 2004**
Shares issued	4,352,084
Average per share value used to value the share consideration	$ 2.17
Purchase price:	
Value of shares issued	$ 9,444
Cash in consideration of cancelled options	1,049
Cash	8,604
Direct acquisition costs	935
Total purchase price	$ 20,032

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The value of the shares issued was determined based on the weighted average value of our stock s market price, two days before, the day of, and two days after the date the terms of the acquisition were agreed upon and announced.

The total purchase price has been allocated to the fair value of assets acquired and liabilities assumed as follows (in thousands):

Fair value of assets acquired and liabilities assumed (net)	$ 586
In-process research and development	1,940
Deferred compensation	4,262
Developed technology	4,530
Customer list	1,150
Tradename	410
Goodwill	7,154
Total purchase price	$ 20,032

Assets acquired principally include cash and cash equivalents, accounts receivable, fixed assets and other assets. Liabilities assumed principally include accounts payable and accrued expenses. The excess of the purchase price over the identified tangible and intangible assets was recorded as goodwill and amounted to approximately $7.2 million. In accordance with SFAS No. 142 (SFAS 142), *Goodwill and Other Intangible Assets,* the goodwill will not be amortized but instead tested for impairment in accordance with the provisions of SFAS 142 at least annually and more frequently upon the occurrence of certain events. For income tax purposes the Company does not believe the goodwill balances will be deductible.

The value of the purchased in-process research and development was determined by estimating the projected net cash flows related to products under development, based upon our estimates of costs to complete the development of the technology, and the future revenue to be earned upon commercialization of the related products. The estimated stage of completion (expressed as a percentage of completion) was calculated and then applied to the net cash flow for these products. A discount rate of 25% was then applied to the projected cash flows associated with the in-process research and development to determine the net present value. KiQ s in-process research and development efforts consisted of developing a new product module based on an improved architecture to allow for more power, functionality, improved performance, as well as enhancing the product s scalability and increasing automation to existing modules. Also included were development efforts to complete a new user interface and various optimized data preparation projects. The estimated state of completion for all projects was approximately 80%. In accordance with application of SFAS 141, the value attributed to in-process research and development was charged to expense in the period we completed the acquisition.

It is anticipated that the two principal sellers, in addition to other employees of KiQ, will remain our employees. We issued 1,964,279 shares of our common stock to the two principal sellers, which we are allowed to buy back from them at a price of $.001 per share if their employment is terminated under certain circumstances. Our right to repurchase these shares diminishes on a monthly basis in accordance with a 30 month vesting schedule which begins on the acquisition date. We are recognizing the $4.3 million deferred compensation as stock-based compensation expense over the period of the vesting schedule.

The value of the developed, core technology was determined by estimating the projected net cash flows related to products which are or anticipated to be commercialized based on this technology, less any estimated cost to complete commercialization. A discount rate of 20% was then applied to the projected cash flows associated with the developed, core technology to determine the net present value. We plan to amortize the intangible asset related to the developed, core technology over a period of five years.

The value of the customer list was determined by estimating the projected net cash flows associated with existing customers and applying estimated attrition rates for these customers of from 5% to 95% over future periods. A discount rate of 22.5% was then applied to the projected cash flows associated with the customer relationships to determine the net present value. The value of the tradename was determined by estimating what the projected net cash flows associated with royalties derived from licensing KiQ s trade name would be over future periods if a third party were using the name. A discount rate of 22.5% was then applied to the projected cash flows associated with the tradename to determine the net present value. We are amortizing the intangible assets related to the customer list and tradename over a period of five years.

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The operating results of KiQ have been included in the condensed consolidated financial statements since the acquisition date. The following unaudited pro forma condensed consolidated financial information reflects the results of operations for the three months ended December 31, 2004, and December 31, 2003 as if the acquisition of KiQ had occurred on October 1, 2003, after giving effect to purchase accounting adjustments. The purchased in-process research and development of $1.9 million has not been included in the pro forma results of operations for the three months ended December 31, 2004 because it is considered a non-recurring charge. These pro forma results have been prepared for comparative purposes only, do not purport to be indicative of what operating results would have been had the acquisition actually taken place at the beginning of each period, and may not be indicative of future operating results (in thousands, except per share data):

	Three Months Ended December 31, 2004	Three Months Ended December 31, 2003
Pro forma adjusted total revenue	$ 22,571	$ 19,877
Pro forma adjusted net loss	$ (2,586)	$ (4,793)
Pro forma adjusted net loss per share basic and diluted	$ (0.03)	$ (0.07)
Pro forma weighted average shares basic and diluted	76,575	65,912

NOTE 5 RESTRUCTURING

Restructuring Costs

During the quarter ended September 30, 2004, we announced plans to reallocate staff between our North American and European operations in order to better support our growth in North America. This restructuring plan included a reduction in workforce.

During fiscal years 2003 and 2002, based upon our continued evaluation of economic conditions in the information technology industry and our expectations regarding revenue levels, we restructured several areas of the Company to reduce expenses and improve our revenue per employee. This restructuring program included a worldwide workforce reduction and consolidation of excess facilities and certain business functions. We believe that these reductions and realignments have resulted and will continue to result in a more responsive management structure.

As part of the fiscal year 2003 restructuring, we entered into an agreement with Ness Technologies Inc., Ness Global Services, Inc. and Ness Technologies India, Ltd. (collectively, Ness), effective December 15, 2003 wherein Ness will provide our customers with technical product support through a worldwide 24x7 help desk facility, a sustaining engineering function which serves as the interface between technical product support and our internal engineering organization, product testing services, and product development services (collectively, the Services). The agreement has an initial term of three years and may be extended for additional one year terms at our discretion. Under the terms of the agreement, we pay for services rendered on a monthly fee basis, including the requirement to reimburse Ness for approved out-of-pocket expenses. The agreement may be terminated for convenience by the Company, subject to the payment of a termination fee that declines over time. At December 31, 2004 the estimated fee was $0.5 million. The maximum termination fee is initially equal to three months of fees, declining to zero after 30 months.

Severance costs associated with the fourth quarter of fiscal year 2003 employee reductions were accounted for in accordance with SFAS No. 112, Employers Accounting for Post-Employment Benefits. Other one-time benefit arrangements are accounted for in accordance with SFAS

No. 146, Accounting for Costs Associated with Exit or Disposal Activities.

Workforce reductions

The prior period restructuring programs resulted in the reduction of 74 regular employees and 108 regular employees during the years ended December 31, 2003 and 2002, respectively. All areas of the Company were affected by this restructuring.

Consolidation of excess facilities

Included in accrued restructuring as of December 31, 2004 are the estimated future obligations for non-cancelable lease payments for the consolidation of excess facilities relating to lease terminations and non-cancelable lease costs. These costs

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are offset by estimated sub-lease income based on current comparable rates for leases in the respective markets. If facilities rental rates decrease in these markets or if it takes longer than expected to sublease these facilities, the maximum amount by which the actual loss could exceed the original estimate is approximately $0.9 million.

A summary of the activity of accrued restructuring for the three months ended December 31, 2004 is as follows (in thousands):

	Facilities	Severance and Benefits	Total
Reserve balance at September 30, 2004	$ 2,781	$ 587	$ 3,368
Provision adjustments (1)		(123)	(123)
Non-cash		9	9
Cash paid	(71)	(348)	(419)
Reserve balance at December 31, 2004	$ 2,710	$ 125	$ 2,835

(1) Provision adjustments relate to a change in estimates.

As of December 31, 2004, $2.8 million related to the restructuring reserve is included in accrued expenses on the balance sheet. Amounts related to net lease expenses due to the consolidation of facilities will be paid over the lease terms through fiscal 2011. However, management will seek ways to exit the facilities earlier if economically feasible. The remaining accrual primarily relates to the termination and/or sublease of our excess facilities and to severance and other benefits for impacted employees.

NOTE 6 BORROWINGS

Revolving line of credit

Our two-year line of credit with Comerica Bank, effective from March 28, 2003 and extended to May 27, 2005, is comprised of a $5.0 million accounts receivable line and a $2.5 million equipment line. The terms of the line of credit require us to maintain a minimum quick ratio of 2.00 to 1.00, a tangible net worth of at least $15.0 million plus 60% of the proceeds of any equity offerings and subordinated debt issuances subsequent to the effective date of the line of credit agreement, and certain other covenants. All assets of the Company have been pledged as collateral on the credit facility. As of December 31, 2004, the Company was in compliance with the respective debt covenants, with the exception of filing its 2004 Form 10-K and its quarter ended December 31, 2004 Form 10-Q within time periods prescribed by the bank. Subsequently, the Company filed its 2004 Form 10-K on March 29, 2005 and obtained a waiver from the bank related to the filing of its quarter ended December 31, 2004 Form 10-Q until May 16, 2005.

The accounts receivable line of credit contains a provision for a sub-limit of up to $2.0 million for issuances of standby commercial letters of credit. As of December 31, 2004, we had utilized $1.4 million of the $2.0 million standby commercial letter of credit limit of which $0.9 million serves as collateral for computer equipment leases for our outsourcing partner in India (See Note 5). The accounts receivable line of credit also contains a provision for a sub-limit of up to $2.0 million for issuance of foreign exchange forward contracts. As of December 31, 2004, we had not entered into any foreign exchange forward contracts.

Borrowings under the accounts receivable line of credit will bear interest at the lending bank s prime rate plus 0.5%. Advances are available on a non-formula basis up to $2.0 million (non-formula portion); however, if advances exceed $2.0 million, then subsequent advances cannot exceed 80% of eligible accounts receivable balances, and the bank would hold a security interest in those accounts receivable. As of December 31, 2004, there was no outstanding balance on our accounts receivable line of credit.

Borrowings under the $2.5 million equipment line bear interest at the lending bank s prime rate plus 1.0%, and the bank would hold a security interest in the equipment. As of December 31, 2004, there was no outstanding balance on our equipment line of credit and our ability to use the line to purchase equipment had expired.

NOTE 7 LITIGATION

Beginning in July 2001, we and certain of our officers and directors (Individuals) were named as defendants in a series of

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class action shareholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, In re Chordiant Software, Inc. Initial Public Offering Securities Litigation, Case No. 01-CV-6222. In the amended complaint, filed in April 2002, the plaintiffs allege that we, the Individuals, and the underwriters of our initial public offering (IPO) violated section 11 of the Securities Act of 1933 and section 10(b) of the Exchange Act of 1934 based on allegations that the our registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, our IPO underwriters. The complaint also contains claims against the Individuals for control person liability under Securities Act section 15 and Exchange Act section 20. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies (Issuers) that conducted IPO s of their common stock in the late 1990s or in the year 2000 (collectively, the IPO Lawsuits).

In August 2001, all of the IPO Lawsuits were consolidated for pretrial purposes before United States Judge Shira Scheindlin of the Southern District of New York. In July 2002, we joined in a global motion to dismiss the IPO Lawsuits filed by all of the Issuers (among others). In October 2002, the Court entered an order dismissing the Individuals from the IPO Cases without prejudice, pursuant to an agreement tolling the statute of limitations with respect to the Individuals. In February 2003, the court issued a decision denying the motion to dismiss the Section 11 claims against Chordiant and almost all of the other Issuers and denying the motion to dismiss the Section 10(b) claims against Chordiant and many of the Issuers.

In June 2003, Issuers and plaintiffs reached a tentative settlement agreement that would, among other things, result in the dismissal with prejudice of all claims against the Issuers and Individuals in the IPO Lawsuits, and the assignment to plaintiffs of certain potential claims that the Issuers may have against the underwriters. The tentative settlement also provides that, in the event that plaintiffs ultimately recover less than a guaranteed sum of $1 billion from the IPO underwriters, plaintiffs would be entitled to payment by each participating Issuer s insurer of a pro rata share of any shortfall in the plaintiffs guaranteed recovery. In September 2003, in connection with the possible settlement, those Individuals who had entered tolling agreements with plaintiffs (described above) agreed to extend those agreements so that they would not expire prior to any settlement being finalized. In June 2004, Chordiant and almost all of the other issuers entered into a formal settlement agreement with the plaintiffs. On February 15, 2005, the Court issued a decision certifying a class action for settlement purposes, and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. In addition, the settlement is still subject to statutory notice requirements as well as final judicial approval. This action may divert the efforts and attention of our management and, if determined adversely to us, could have a material impact on our business, results of operations, financial condition or cash flows.

A former sales employee of the Company s subsidiary in France filed a lawsuit against the Company claiming his termination was an unfair dismissal. The former employee offered to settle his claims against the Company in return for the Company s payment of 75,000. The Company estimates that its range of possible loss is from no loss to the full amount the court could award the plaintiff. The Company believes it has valid defenses for such claims and intends to vigorously defend itself in the matter.

In March 2005, the Company settled an employment litigation claim in the amount of $50,000. This amount was included in accrued expenses as of December 31, 2004.

We are also subject to various other claims and legal actions arising in the ordinary course of business. The ultimate disposition of these various other claims and legal actions is not expected to have a material effect on our business, financial condition, results of operations or cash flows. However, litigation is subject to inherent uncertainties.

NOTE 8 COMMITMENTS AND CONTINGENCIES

The Company leases its facilities and certain equipment under non-cancelable operating leases with various expiration dates through 2011. In addition, the Company has entered into non-cancelable capital leases involving computer equipment with various expiration dates through 2007. Future minimum lease payments under non-cancelable capital and operating leases as of December 31, 2004 are as follows (in thousands):

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	Capital Leases	Operating Leases	Operating Sublease Income	Net Operating Leases
Remaining portion of Fiscal 2005	$ 171	$ 2,628	$ (143)	$ 2,485
Fiscal 2006	228	3,430		3,430
Fiscal 2007	97	3,406		3,406
Fiscal 2008		3,093		3,093
Fiscal 2009		2,130		2,130
Thereafter		1,331		1,331
Total minimum payments	496	$ 16,018	$ (143)	$ 15,875
Less: amount representing interest	(38)			
Present value of minimum lease payments	458			
Less: current portion of capital lease obligations	(201)			
Capital lease obligations, non-current	$ 257			

Certain operating leases included in the table above are part of our restructuring activities and lease payments on such leases are charged against the restructuring accrual.

In conjunction with our agreement with Ness (see Note 5), Ness may procure equipment to be used in performance of the Services, either through leasing arrangements or direct cash purchases, for which we are obligated under the agreement to reimburse them. In connection with the procurement of equipment, Ness Technologies India has entered into a 36 month equipment lease agreement with IBM India and, in connection with the lease agreement we have issued a standby letter of credit in the amount of $0.9 million in guarantee of Ness Technologies India, Ltd s financial commitments under the lease. Over the term of the lease, our obligation to reimburse Ness is approximately equal to the amount of the guarantee.

We have evaluated the obligation under the standby letter of credit and, pursuant to the requirements as set forth under FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Other.* We have recorded a $0.1 million liability equal to the estimated fair value of the guarantee, which is included in accrued expenses as of December 31, 2004.

NOTE 9 NET LOSS PER SHARE

Basic and diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock outstanding during the period. The calculation of diluted net loss per share includes potential shares of common stock unless their effect is anti-dilutive. Potential shares of common stock consists of common shares issuable upon the exercise of stock options (using the treasury stock method) and common shares subject to repurchase by us.

The following table sets forth the computation of basic and diluted net loss per share for the three months ended December 31, 2004 and 2003 (in thousands, except per share data):

	Three Months Ended	
	December 31, 2004	December 31, 2003
Net loss available to common stockholders	$ (4,062)	$ (3,937)
Weighted average common stock outstanding	73,067	62,034
Common stock subject to repurchase	(844)	(474)
Denominator for basic and diluted calculation	72,223	61,560
Net loss per share basic and diluted	$ (0.06)	$ (0.06)

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The following table sets forth the potential total outstanding common shares at December 31, 2004 and 2003, respectively, that are excluded from the calculation of diluted net loss per share as their effect is anti-dilutive (in thousands):

	Three Months Ended	
	December 31, 2004	December 31, 2003
Warrants outstanding	1,662	1,850
Employee stock options	10,146	9,458
Common stock subject to repurchase	2,391	2,555
	14,199	13,863

NOTE 10 SEGMENT INFORMATION

Our chief operating decision maker reviews financial information presented on a consolidated basis, accompanied by desegregated information about revenues by geographic regions for purposes of making operating decisions and assessing financial performance. Accordingly, we have concluded that we have one reportable segment.

License revenues for enterprise solutions amounted to $8.2 million and $7.0 million for the three months ended December 31, 2004 and 2003, respectively. License revenues for marketing solutions were approximately $0.6 million and $2.2 million for the three months ended December 31, 2004 and 2003, respectively.

Service revenues consist of consulting assistance and implementation, customization and integration and post-contract customer support, training and certain reimbursable out-of-pocket expenses. Service revenues, including reimbursable out-of-pocket expenses, for enterprise solutions were approximately $10.4 million and $7.2 million for the three months ended December 31, 2004 and 2003, respectively. Service revenues, including reimbursable out-of-pocket expenses, for marketing solutions were approximately $2.4 million and $3.1 million for the three months ended December 31, 2004 and 2003, respectively.

Foreign revenues are based on the country in which the customer is located. The following is a summary of total revenues by geographic area (in thousands):

	Three Months Ended	
	December 31, 2004	December 31, 2003
North America	$ 8,095	$ 6,346
Europe	13,566	13,203
Rest of World	16	51

	$ 21,677	$ 19,600

Property and equipment information is based on the physical location of the assets. The following is a summary of property and equipment by geographic area (in thousands):

	December 31, 2004	September 30, 2004
		(Restated)
North America	$ 1,958	$ 2,034
Europe	1,214	1,203
	$ 3,172	$ 3,237

NOTE 11 SUBSEQUENT EVENTS

Related Parties

In January 2005, Charles E. Hoffman became a director of the Company. Mr. Hoffman is the President and Chief Executive Officer of Covad Communications Group, Inc. (Covad), a customer of ours. Pursuant to software license and services agreements, revenue from Covad was approximately $0.5 million for the three months ended December 31, 2004 and accounts receivable as of December 31, 2004 were approximately $0.1 million.

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In January 2005, David A. Weymouth became a director of the Company. Mr. Weymouth is the Corporate Responsibility Director of Barclay s Group, a customer of ours. Pursuant to software license agreements, software maintenance agreements, and professional services agreements, revenue from Barclay s Group was approximately $5.6 million for the three months ended December 31, 2004 and accounts receivable as of December 31, 2004 were approximately $0.1 million.

Delinquent SEC Filings

Subsequent to December 31, 2004, the Company failed to file certain required reports with the SEC on a timely basis. As a result, the NASDAQ Listing Qualifications Department notified us on February 15, 2005 that we were not in compliance with the requirements of NASDAQ Marketplace Rule 4310(c)(14), affixed an E to the end of our trading symbol, and began delisting proceedings. We appealed this delisting to the NASDAQ Listing Qualifications Panel (the Panel) for a conditional listing on the NASDAQ National Market until April 22, 2005 to provide the Company with the opportunity to file its periodic reports with the SEC and become compliant with NASDAQ listing requirements.

On April 19, 2005, NASDAQ notified the Company that the Panel accepted the Company s request to continue the NASDAQ listing. As a result, the Company must file its Form 10-Q for the quarter ended December 31, 2004 with the SEC on or before April 30, 2005 and demonstrate its compliance with all requirements to continue being listed on the NASDAQ National Market.

Suspension of Employee Stock Purchase Plan

In conjunction with the failure to file timely its periodic reports with the SEC, the Company has suspended the sale of stock under the Employee Stock Purchase Plan. Funds withheld from employee payroll, normally resulting in proceeds to the Company for newly issued shares, have been refunded to employees for the last offering period ended February 15, 2005.

Potential Damages Associated With Failure to File

In its Transition Report on Form 10-K/T filed with the SEC on March 29, 2004, the Company disclosed that it may be subject to penalties of up to $500,000 per month from February 2005 through January 2006 (the Penalties) payable to Acqua Wellington Opportunity I Limited (Acqua Wellington). In January 2004, the Company sold 4,854,368 shares of its common stock (the Shares) to Acqua Wellington in a private placement. As part of the sale, the Company agreed to file and keep effective with the SEC a registration statement on Form S-3 until the earlier of January 2006 or the sales of the Shares by Acqua Wellington pursuant to the effective registration statement. As a result of the Company s failure to timely file this quarterly report for the period ended December 31, 2004, the Company could not maintain the required registration statement on Form S-3. On April 14, 2005, Acqua Wellington filed with the SEC Amendment No.1 to Schedule 13G disclosing that as of February 14, 2005 it no longer beneficially owned the Shares. Upon receipt of Acqua Wellington s Amendment No. 1, the Company has been advised by Acqua Wellington that on May 17, 2004, it disposed of all the Shares pursuant to the registration statement on Form S-3. As a result, the Company does not have any further obligation to maintain an effective registration statement on Form S-3 for Acqua Wellington or its successor in interest and therefore is not obligated to pay any Penalties.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

This discussion and analysis should be read in conjunction with our financial statements and accompanying notes included in this report and the 2004 audited financial statements and notes thereto included in our Transition Report on Form 10-K/T for the year ended September 30, 2004 filed with the SEC on March 29, 2005. Operating results are not necessarily indicative of results that may occur in future periods.

The following discussion and analysis contains forward-looking statements. These statements are based on our current expectations, assumptions, estimates and projections about our business and our industry, and involve known and unknown risks, uncertainties and other factors that may cause our or our industry s results, levels of activity, performance or achievement to be materially different from any future results, levels of activity, performance or achievements expressed or implied in or contemplated by the forward-looking statements. Words such as believe, anticipate, expect, intend, plan, will, may, should, estimate, predict, guidance, potential, continue or the n other similar expressions, identify forward-looking statements. Our actual results and the timing of events may differ significantly from those discussed in the forward-looking statements as a result of various factors, including but not limited

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to, those discussed under the subheading Risk Factors and those discussed elsewhere in this report, in our other SEC filings and under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations in our 2004 Transition Report on Form 10-K/T . Chordiant undertakes no obligation to update any forward-looking statement to reflect events after the date of this report.

Overview

As an enterprise software vendor, we (Chordiant Software, Inc.) generate substantially all of our revenues from the financial services and telecommunications industries. Our customers typically fund purchases of our software and services out of their lines of business and information technology budgets. As a result, our revenues are heavily influenced by our customers long-term business outlook and willingness to invest in new enterprise information systems and business applications.

Beginning in late calendar 2000, the financial services and telecommunications industries entered into a steep and long economic downturn, with industry sales dropping from late 2000 through the first part of 2003. Over the past three years, our customers have focused on controlling costs and reducing risk, including constraining information technology and lines of business expenditures and requiring more favorable pricing terms from their suppliers and pursuing consolidation within their own industries. As a result of this downturn, our license fee revenues have declined 18% and 19% in fiscal 2002 and 2003, respectively.

Beginning in the latter part of 2003, economic conditions began to show signs of improvement, which were reflected in increases in various economic indicators such as productivity, labor statistics and consumer confidence. This trend has continued through the first three calendar quarters of 2004 and our first fiscal quarter of 2005 and appears to have a favorable impact, specifically in information technology spending. For the three months ended December 31, 2004, total revenues have increased on a year over year basis.

Financial Trends

Management focuses on license and service gross margin in evaluating our financial condition and operating performance. Gross margin on license revenues was 98% and 94% for the three months ended December 31, 2004 and 2003, respectively. The gross margin for the December 31, 2004 quarter is higher than in the recent past, due to a significant transaction during the quarter having nominal royalty costs. We expect license gross margin to range from 93% to 96% in the foreseeable future. Gross margin on service revenues was 42% and 40% for the three months ended December 31, 2004 and 2003, respectively.

Service revenues as a percentage of total revenues were 59% and 53% for the three months ended December 31, 2004 and 2003, respectively. We expect that service revenues will continue to represent over 50% of our total revenues in the foreseeable future.

For the three months ended December 31, 2004 and 2003, revenues were principally derived from customer accounts in North America and Europe. For the three months ended December 31, 2004 and 2003, international revenues were $13.6 million and $13.3 million, or approximately 63% and 68% of our total revenues, respectively. We believe international revenues will continue to represent a significant portion of our total revenues in future periods.

For the three months ended December 31, 2004 and 2003, North America revenues were $8.1 million and $6.3 million, or approximately 37% and 32% of our total revenues, respectively. As the U.S. economy has strengthened, we have seen an increase in North America revenues. We believe North America revenues will continue to represent an increasing portion of our total revenues in future periods.

For the three months ended December 31, 2004 general and administrative expenses included significant costs relating with efforts to comply with the Sarbanes-Oxley Act of 2002. We expect these costs to continue the remainder of fiscal 2005.

We believe that period-to-period comparisons of our operating results should not be relied upon as indicative of future performance. Our prospects must be considered given the risks, expenses and difficulties frequently encountered by companies in early stages of development, particularly companies in new and rapidly evolving businesses. There can be no assurance we will be successful in addressing these risks and difficulties. Moreover, we may not achieve or maintain profitability in the future.

Results of Operations

The following table sets forth, as a percentage of total revenues, unaudited condensed consolidated statements of operations data for the periods indicated:

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	Three Months Ended	
	December 31, 2004	December 31, 2003
Revenues:		
License	41%	47%
Service	59	53
Total revenues	100	100
Cost of revenues:		
License	1	3
Service	35	32
Stock-based compensation		3
Amortization of intangible assets		4
Total cost of revenues	36	42
Gross profit	64	58
Operating expenses:		
Sales and marketing	33	29
Research and development	22	21
General and administrative	18	7
Stock-based compensation		14
Amortization of intangible assets		1
Purchased in-process research and development	9	
Restructuring expense		5
Total operating expenses	82	77
Loss from operations	(18)	(19)
Interest income (expense), net	1	
Foreign exchange and other income (expense), net	(2)	1
Net loss before income taxes	(19)	(18)
Provision for income taxes		2
Net loss	(19)%	(20)%

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Comparison of the Three Months Ended December 31, 2004 and 2003

Revenues

License. Total license revenues decreased to $8.8 million for the three months ended December 31, 2004 from $9.2 million, or approximately 4%, from the three months ended December 31, 2003. License revenues for enterprise solutions increased to $8.2 million for the three months ended December 31, 2004 from $7.0 million, or approximately 16%, from the three months ended December 31, 2003. This increase was primarily due to a follow-on order from an existing customer in the quarter ended December 31, 2004 that exceeded our historical average. License revenues for marketing solutions decreased to $0.6 million for the three months ended December 31, 2004 from $2.2 million, or approximately 71%, from the three months ended December 31, 2003. This decrease was due to the timing of large dollar transactions from quarter to quarter.

Service. Total service revenues, which include reimbursement of out-of-pocket expenses, increased to $12.8 million for the three months ended December 31, 2004 from $10.4 million, or approximately 24%, for the three months ended December 31, 2003. Service revenues for enterprise solutions increased to $10.4 million for the three months ended December 31, 2004 from $7.2 million, or approximately 44%, from the three months ended December 31, 2003. This increase was due to a continuation in large customer implementations as well as maintenance, support and consulting revenues associated with license agreements entered into in current and prior periods. Service revenues for marketing solutions were $2.4 million for the three months ended December 31, 2004, a decrease from $3.1 million, or approximately 21%, for the three months ended December 31, 2003.

Reimbursement of out-of-pocket expenses (which is included in total service revenues) increased to $0.9 million for the three months ended December 31, 2004 from $0.6 million, or approximately 57%, for the three months ended December 31, 2003. This increase is partially due to the higher number of third party consultants working on projects.

Cost of revenues

License. Cost of license revenues decreased to $0.2 million for the three months ended December 31, 2004 from $0.6 million, or approximately 71%, for the three months ended December 31, 2003. These costs resulted in license gross margins of approximately 98% and 94% for the three months ended December 31, 2004 and 2003, respectively. The margin for the December 31, 2004 quarter is higher than in the recent past, due to a significant transaction during the quarter having nominal royalty costs. We expect cost of license revenues to remain in the range of approximately four to seven percent of license revenues.

Service. Cost of service revenues increased to $7.5 million for the three months ended December 31, 2004 from $6.2 million, or approximately 20%, for the three months ended December 31, 2003. These costs resulted in service gross margins of 42% for the three months ended December 31, 2004, and 40% for the three months ended December 31, and 2003. We expect cost of service revenues to remain at or above 40% of service revenues.

Stock-based compensation (cost of revenues). Stock-based compensation resulted in a benefit of approximately $0.1 million for the three months ended December 31, 2004 as compared to a charge of $0.7 million for the three months ended December 31, 2003. The change in stock-based compensation is mainly due to the decrease in our stock price since September 30, 2004, which affects the variable accounting calculation to

which restricted stock and some outstanding stock options are subject. Please refer to Note 2, Summary of Significant Accounting Policies , under the heading Stock-based compensation. Amortization of deferred stock-based compensation attributable to the acquisition of KiQ will be expensed through June 2007.

Amortization of intangibles (cost of revenues). Amortization of intangible assets was $0.1 million for the three months ended December 31, 2004 compared to $0.8 million for the three months ended December 31, 2003. The amortization expense in the three months ended December 31, 2004 primarily related to the acquisition of OnDemand in April 2002. Intangibles attributable to the acquisitions of certain assets from ActionPoint and ASP Outfitter in May 2001 became fully amortized during 2004. On December 21, 2004 we recorded, and began to amortize, aggregate additions of $6.1 million to intangible assets related to the acquisition of KiQ. Amortization of intangible assets attributable to the acquisition of KiQ will be expensed through December 2009. We expect total amortization expense, including amounts allocated to operating expense, on purchased intangible assets to be $1.1 million for the remaining nine months in fiscal 2005.

Operating Expenses

Sales and marketing. Sales and marketing expenses increased to $7.2 million for the three months ended December 31, 2004

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from $5.7 million, or approximately 27%, for the three months ended December 31, 2003. Headcount in the sales and marketing department increased approximately 18% over the prior year. The $1.5 million increase in these expenses was mainly attributable to an increase of $0.9 million in personnel related expenses due to a higher number of sales representatives in 2005, a $0.2 million increase in recruiting fees, $0.2 million of increases relating to travel and entertainment, and a $0.2 million increase in allocated costs to the department caused by the higher headcount.

Research and development. Research and development expenses increased to $4.9 million for the three months ended December 31, 2004 from $4.2 million, or approximately 16%, for the three months ended December 31, 2004. This $0.7 million increase was mainly attributable to an increase of approximately $0.6 million in research and development consulting related expenses, $0.2 million in equipment rental expenses, net of decreases in depreciation expense, $0.1 million in increased travel costs related to our outsourcing of technical support and certain sustaining engineering functions, and $0.1 million for recruiting, training and relocating staff. Offsetting the increase was the capitalization of internal salary and fringe benefit costs of approximately $0.4 million associated with the development of a banking product that were capitalized during the quarter ended December 31, 2004.

General and administrative. General and administrative expenses increased to $3.9 million for the three months ended December 31, 2004 from $1.3 million, or approximately 204%, for the three months ended December 31, 2003. The increase in these expenses was mainly attributable to an increase of $1.0 million in consulting related expenses associated with efforts to comply with the Sarbanes-Oxley Act of 2002 (SOX), a $0.4 million increase in professional related expenses primarily associated with accounting and legal fees associated with SOX, additional procedures relating to the material weaknesses identified at June 30, 2004 and September 30, 2004 and the change in year end. We anticipate that the higher costs associated with efforts to comply with SOX will continue for the remainder of fiscal 2005. In addition to these increases, personnel costs increased $0.7 million and recruiting costs increased $0.3 million in conjunction with new hires in the accounting and finance areas. During the three months ended December 31, 2003, taxes were reclassified to the provision for income taxes. This reclassification resulted in a $0.5 million non-recurring reduction of general and administrative expenses during the three months ended December 31, 2003.

Stock-based compensation (operating expenses). Stock-based compensation resulted in a benefit of approximately $0.1 million for the three months ended December 31, 2004 from a charge of $2.7 million for the three months ended December 31, 2003. The change in stock-based compensation is mainly due to the decrease in our stock price since March 31, 2004, which affects the variable accounting calculation to which restricted stock and some outstanding stock options are subject. Please refer to Note 2, Summary of Significant Accounting Policies , under the heading Stock-based compensation. Amortization of deferred stock-based compensation attributable to the acquisition of KiQ will be expensed through June 2007.

Purchased in-process research and development. In-process research and development expense represents acquired technology that, on the date of acquisition, had not achieved technological feasibility and did not have an alternative future use, based on the state of development. Because the product under development may not achieve commercial viability, the amount of acquired in-process research and development was immediately expensed. The nature of the efforts required to develop the purchased in-process research and development into a commercially viable product principally relate to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its designed specifications, including functions, features and technical performance requirements.

For the three months ended December 31, 2004, we expensed $1.9 million related to acquired in-process technology attributable to the acquisition of KiQ. There was no purchased in-process research and development expense for the three months ended December 31, 2003.

Amortization of intangibles (operating expenses). Amortization of intangible assets was less than $0.1 million for the three months ended December 31, 2004 compared to $0.1 million for the three months ended December 31, 2003. The $0.1 million amortization expense for the

three months ended December 31, 2003 is mainly attributable to the acquisition of Prime Response in March 2001. On December 21, 2004 we recorded, and began to amortize, aggregate additions of $6.1 million to intangible assets related to the acquisition of KiQ. Amortization of intangible assets attributable to the acquisition of KiQ will be expensed through December 2009. We expect total amortization expense, including amounts allocated to cost of revenues, on purchased KiQ intangible assets to be $1.1 million for the remaining nine months in fiscal 2005.

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Restructuring expenses. During the three months ended September 30, 2004, we announced plans to reallocate staff between our North American and European operations in order to better support our growth in North America, and an associated restructuring expense was recorded. Restructuring programs were also implemented during the years ended December 31, 2003 and 2002. During the three months ended December 31, 2004, as the earned portions of severed employee retention bonus were paid, adjustments to the previously recorded estimates were recorded. These adjustments resulted in a $0.1 million benefit for the three months ended December 31, 2004 as compared to an expense of $1.0 million for the three months ended December 31, 2003. Please refer to Note 5, Restructuring.

Interest income, net

Interest income, net, consists primarily of interest income generated from our cash, cash equivalents and short-term investments, offset by interest expense incurred in connection with outstanding borrowings and letters of credit. Interest income, net, increased to approximately $0.2 million for the three months ended December 31, 2004 from less than $0.1 million for the three months ended December 31, 2003. This increase is primarily due to interest earned on larger cash and cash equivalent balances during the three months ended December 31, 2004, and lower interest expense as no balances were outstanding on the revolving line of credit in 2004. The increase in cash balances over the prior year was due, in part, to the proceeds of $25.0 million from the sale of our common stock to Acqua Wellington in the quarter ended March 31, 2004.

Foreign exchange and other expenses, net

Realized foreign currency gains and losses and other non-operating income and expenses resulted in a net expense of $0.4 million for the three months ended December 31, 2004 as compared to net income of $0.1 million for the same period in the prior year. The change is primarily attributable to currency exchange losses recognized during the three months ended December 31, 2004. These losses are primarily associated with our U.S. dollar account balances held in Europe and the U.S. dollar s decline in value against the Euro and U.K. Pound Sterling.

Provision for income taxes

Our provisions for income taxes were $0.1 million and $0.5 million for the three months ended December 31, 2004 and 2003, respectively. The provisions were attributable to taxes on earnings from our foreign subsidiaries and certain state income taxes.

Our deferred tax assets primarily consist of net operating loss carryforwards, nondeductible allowances and research and development tax credits. We have recorded a valuation allowance for the full amount of our net deferred tax assets, as the future realization of the tax benefit is not considered by management to be more-likely-than-not.

Liquidity and capital resources

Historically, we have not been profitable and we have financed our activities through the issuance of our common stock. Our cash, cash equivalents, short-term investments, restricted cash and long-term restricted cash consist principally of money market accounts, certificates of deposit and marketable equity securities consisting of auction rate securities and totaled $53.6 million and $62.1 million at December 31, 2004

and September 30, 2004, respectively, a decrease of $8.5 million. At December 31, 2004, $1.5 million of restricted cash, previously recorded as non-current, was reclassified to current assets, as the restriction expires in December of 2005.

Cash used in operating activities was $1.8 million during the three months ended December 31, 2004, which consisted primarily of our net loss of $4.1 million adjusted for non-cash items (primarily the write off of in-process research and development costs associated with the KiQ acquisition, depreciation, amortization, non-cash stock-based compensation expense and other non-cash charges) aggregating approximately $2.5 million and the net cash outflow effect from changes in assets and liabilities of approximately $0.2 million. This net cash inflow was primarily caused by the improved collection of accounts receivable during the quarter.

In the same quarter of the prior year, cash provided by operating activities was $3.5 million during the three months ended December 31, 2003, which consisted primarily of our net loss of $3.9 million adjusted for non-cash items (primarily depreciation, amortization and non-cash stock-based compensation expense) aggregating approximately $4.7 million and the net cash inflow effect from changes in assets and liabilities of approximately $2.7 million.

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Cash used in investing activities during the three months ended December 31, 2004 was $8.1 million and primarily related to the acquisition of KiQ at December 21, 2004. Cash used in investing activities also includes $0.2 million of equipment and software purchases for both the three months ended December 31, 2004 and 2003.

Cash provided by (used in) financing activities was $0.1 million and ($1.1) million during the three months ended December 31, 2004 and 2003, respectively. In the three months ended December 31, 2004 the amount primarily relates to the proceeds from stock option exercises. For the three months ended December 31, 2003 the balance consists of $0.6 million received from stock option exercises, the collection of $0.4 million of notes receivable, and repayments of $2.1 million on the Company s line of credit. There were no borrowings on the line of credit in 2004.

Subsequent to December 31, 2004 we have been notified by the NASDAQ Listing Qualifications Department that we were not in compliance with the requirements of certain NASDAQ rules and are subject to delisting proceedings. As a result we have suspended our Employee Stock Purchase Plan and our stock option plans are subject to black out restrictions. During the nine months ended September 30, 2004 and the years ended December 31, 2003 and 2002, these two sources of financing provided proceeds to the company in the aggregate amounts of $3.9 million, $2.3 million and $3.4 million, respectively. The timing and amounts of future cash flows to the Company from these plans is uncertain. Subsequent to December 31, 2004, funds withheld from employee payroll, normally resulting in proceeds to the Company for newly issued shares, has been refunded to employees for the current offering period ending on February 15, 2005.

Revolving line of credit

Our line of credit, which is comprised of an accounts receivable line and an equipment line with Comerica Bank expired on March 27, 2005. We received a 60-day extension on this line of credit and are currently in negotiations to obtain a new line of credit. As of December 31, 2004, there were no outstanding borrowings against the line of credit.

The terms of the line of credit require us to maintain at least a $5.0 million cash balance in Comerica Bank accounts, a quick ratio of 2.00 to 1.00, a tangible net worth of at least $15.0 million plus 60% of the proceeds of any equity offerings and subordinate any debt issuances subsequent to the effective date of the line of credit agreement.

Under the terms and conditions of the accounts receivable line, the total amount of credit is $5.0 million. The facility contains a provision for a sub-limit of up to $2.0 million for issuances of standby commercial letters of credit. As of December 31, 2004, we had utilized $1.4 million of the $2.0 million standby commercial letter of credit limit. The facility also contains a provision for a sub-limit of up to $2.0 million for issuance of foreign exchange forward contracts. As of December 31, 2004, we had not entered into any foreign exchange forward contracts. Borrowings under the accounts receivable line of credit will bear interest at the lending bank s prime rate plus 0.5%. Advances are available on a non-formula basis up to $2.0 million (non-formula portion); however, if advances exceed $2.0 million, then subsequent advances cannot exceed 80% of eligible accounts receivable balances, and the bank would hold a security interest in those accounts receivable. Borrowings under the $2.5 million equipment line bear interest at the lending bank s prime rate plus 1.0%, and the bank would hold a security interest in the equipment. In March 2003, we borrowed $2.5 million against the equipment line of credit. We paid off the outstanding line of credit balance in December 2003 and as of December 31, 2004, there was no outstanding balance. As of December 31, 2004, the Company was in compliance with the debt covenants with the exception of filing its 2004 Form 10-K and its quarter ended December 31, 2004 Form 10-Q within time periods prescribed by the bank. Subsequently, the Company filed its 2004 Form 10-K on March 29, 2005 and obtained a waiver from the bank related to the filing of its quarter ended December 31, 2004 Form 10-Q until May 16, 2005.

Future commitments

The Company leases its facilities and certain equipment under non-cancelable operating leases with various expiration dates through 2011. In addition, the Company has entered into non-cancelable capital leases involving computer equipment with various expiration dates through 2007. Future minimum lease payments under non-cancelable capital and operating leases as of December 31, 2004 are as follows (in thousands):

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	Capital Leases	Operating Leases	Operating Sublease Income	Net Operating Leases
Remaining portion of Fiscal 2005	$ 171	$ 2,628	$ (143)	$ 2,485
Fiscal 2006	228	3,430		3,430
Fiscal 2007	97	3,406		3,406
Fiscal 2008		3,093		3,093
Fiscal 2009		2,130		2,130
Thereafter		1,331		1,331
Total payments	496	$ 16,018	$ (143)	$ 15,875

Certain operating leases included in the table above are part of our restructuring activities and lease payments on such leases are charged against the restructuring accrual.

As of December 31, 2004, we had approximately $1.3 million in standby letters of credit securing operating leases relating to computer equipment. Of this $1.3 million, $0.9 million of the letters of credit secure computer equipment leases for our outsourcing partner in India.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to estimates of percentage of completion on our service contracts, uncollectible receivables, valuation allowances, intangible assets, income taxes, restructuring costs and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying 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.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

- Revenue recognition, including estimating the total estimated days to complete sales arrangements involving significant implementation or customization essential to the functionality of our product;
- Estimating valuation of the allowance for doubtful accounts;
- Restructuring costs; and

Determining functional currencies for the purposes of consolidating our international operations.

We have reviewed our critical accounting policies, critical accounting estimates, and the related disclosures with our Disclosure and Audit Committees. Additional information about our critical accounting policies may by found in our September 30, 2004 Form

10-K/T, in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, under the heading Application of Critical Accounting Policies and Use of Estimates. We have not changed those policies since such date. Investors should therefore read this Item 2 in conjunction with such description.

RISK FACTORS

Weakness in technology spending in our target markets combined with geopolitical concerns could make the closing of license transactions with new and existing customers difficult.

Our revenues will decrease in 2005 if we are unable to enter into new large-scale license transactions with new and existing customers. The current state of world affairs and geopolitical concerns have left many customers reluctant to enter into new large value license transactions without some assurance that the economy both in the customer s home country and worldwide will have some economic and political stability. Continued or further weakness in technology spending and

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geopolitical instability will continue to make closing large license transactions difficult. In addition, we cannot predict what effect the U.S. military presence overseas or potential or actual political or military conflict have had or are continuing to have on our existing and prospective customers decision-making process with respect to licensing or implementing enterprise-level products such as ours. Our ability to enter into new large license transactions also directly affects our ability to create additional consulting services and maintenance revenues, on which we also depend.

Historically, we have not been profitable and we may continue to incur losses, which may raise vendor viability concerns thereby making it more difficult to close license transactions with new and existing customers.

We incurred losses of $4.1 million for the three months ended December 31, 2004 and $0.4 million for the nine months ended September 30, 2004. We incurred losses of $16.4 million and $32.3 million for years ended December 31, 2003 and 2002, respectively. As of December 31, 2004, we had an accumulated deficit of $193.4 million. We may continue to incur losses and cannot be certain that we can achieve or generate sufficient revenues to achieve profitability. Continued losses may leave many customers reluctant to enter into new large value license transactions without some assurance that we will operate profitably. If we fail to enter into new large value license transactions due to lack of vendor profitability and or viability concerns, our revenues will decline, which would further adversely affect our operating results.

Because a small number of customers account for a substantial portion of our revenues, the loss of a significant customer could cause a substantial decline in our revenues.

We derive a significant portion of our software license revenues in each quarter from a limited number of customers. The loss of a major customer in a particular quarter could cause a decrease in revenues and net income. For the three months ended December 31, 2004, Barclays and Capital One accounted for 26% and 19% of our total revenues, respectively. For the three months ended December 31, 2003, the Canadian Imperial Bank of Commerce and Signal Iduna accounted for 16% and 15% of our total revenues, respectively. While our customer concentration has fluctuated, we expect that a limited number of customers will continue to account for a substantial portion of our revenues. As a result, if we lose a major customer, or if a contract is delayed or cancelled or we do not contract with new major customers, our revenues and net loss would be adversely affected. In addition, customers that have accounted for significant revenues in the past may not generate revenues in any future period, causing our failure to obtain new significant customers or additional orders from existing customers to materially affect our operating results.

If we fail to adequately address the difficulties of managing our international operations, our revenues and operating expenses will be adversely affected.

For the three months ended December 31, 2004, international revenues were $13.6 million or approximately 63% of our total revenues. For the three months ended December 31, 2003, international revenues were $13.3 million or approximately 68% of our total revenues. While we expect North American revenues to increase as a percentage of our overall revenues, international revenues will continue to represent a significant portion of our total revenues in future periods. We have faced, and will continue to face, difficulties in managing international operations which include:

Difficulties in hiring qualified local personnel;

Seasonal fluctuations in customer orders;

Longer accounts receivable collection cycles;

Expenses associated with licensing products and servicing customers in foreign markets; and

Economic downturns and political uncertainty in international economies.

Any of these factors could have a significant impact on our ability to license products on a competitive and timely basis and could adversely affect our operating expenses and net income.

If we cannot meet the NASDAQ Listing requirements and NASDAQ rules, NASDAQ may delist our common stock, which could negatively affect the price of our common stock, your ability to sell our common stock and generally could harm our business.

On February 15, 2005, we were notified by the NASDAQ Listing Qualifications Panel that we were not in compliance with the requirements of certain NASDAQ rules as a result of the Company s failure to file its quarterly report on Form 10-Q for

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the period ended December 31, 2004 and our stock was subject to delisting from the NASDAQ National Market. On March 17, 2005, the Company attended a hearing before the Panel to request a conditional listing on the NASDAQ National Market until April 22, 2005 to provide the Company an opportunity to file its periodic reports with the SEC and become compliant with NASDAQ listing requirements. On April 19, 2005, NASDAQ notified us that the Panel accepted our request to continue the NASDAQ listing. As a result, we must file our Form 10-Q for the quarter ended December 31, 2004 with the SEC on or before April 30, 2005 and demonstrate its compliance with all requirements to continue being listed on the NASDAQ National Market. If we are delisted from NASDAQ, trading of our common stock would thereafter occur in the over-the-counter market or on the National Association of Securities Dealers, Inc. electronic bulletin board. As a consequence of any such delisting, the value of our common stock could be adversely affected, which could negatively affect our operations. Market liquidity for our common stock could be severely and adversely affected as a stockholder would likely find it more difficult to sell shares of our common stock or to obtain accurate quotations as to the prices of our common stock. Delisting could also result in the loss of confidence by prospective and existing customers and employees, which would further harm our business.

Fluctuations in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets and could negatively affect our operating results and cash flows.

A significant portion of our sales and operating expenses result from transactions outside of the United States, often in foreign currencies. These currencies include the United Kingdom Pound Sterling, the Euro and Canadian Dollars. Our international sales comprised 63% and 67% of our total sales for the three months ended December 31, 2004 and 2003, respectively. Our future operating results will continue to be subject to fluctuations in foreign currency rates, especially if international sales grow as a percentage of our total sales, and we may be negatively impacted by fluctuations in foreign currency rates in the future.

Competition in our markets is intense and could reduce our sales and prevent us from achieving profitability.

Increased competition in our markets could result in price reductions for our products and services, reduced gross margins and loss of market share, any one of which could reduce our future revenues. The market for our products is intensely competitive, evolving and subject to rapid technological change. We consider our primary competition to be from internal development, custom systems integration projects and application software competitors. In particular, we compete with:

Internal information technology departments: in-house information technology departments of potential customers have developed or may develop systems that provide some or all of the functionality of our products. We expect that internally developed application integration and process automation efforts will continue to be a significant source of competition.

Point application vendors: we compete with providers of stand-alone point solutions for web-based customer relationship management and traditional client/server-based, call-center service customer and sales-force automation solution providers.

Many of our competitors have greater resources and broader customer relationships than we do. In addition, many of these competitors have extensive knowledge of our industry. Current and potential competitors have established, or may establish, cooperative relationships among themselves or with third parties to offer a single solution and to increase the ability of their products to address customer needs.

We may experience a shortfall in revenue, earnings, cash flow or otherwise fail to meet public market expectations, which could materially and adversely affect our business and the market price of our common stock.

Our revenues and operating results may fluctuate significantly because of a number of factors, many of which are outside of our control. Some of these factors include:

Size and timing of individual license transactions;

Delay or deferral of customer implementations of our products and subsequent impact on services revenues;

Lengthening of our sales cycle;

Further deterioration and changes in domestic and foreign markets and economies;

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Success in expanding our global services organization, direct sales force and indirect distribution channels;

Timing of new product introductions and product enhancements;

Appropriate mix of products licensed and services sold;

Levels of international transactions;

Activities of and acquisitions by competitors;

Product and price competition; and

Our ability to develop and market new products and control costs.

One or more of the foregoing factors may cause our operating expenses to be disproportionately high during any given period or may cause our revenues and operating results to fluctuate significantly. Based upon the preceding factors, we may experience a shortfall in revenues and earnings or otherwise fail to meet public market expectations, which could materially and adversely affect our business, financial condition, results of operations and the market price of our common stock.

Our operating results fluctuate significantly and delays in implementation of our products may cause unanticipated declines in revenues or cash flow, which could disappoint investors and result in a decline in our stock price.

Our quarterly revenues depend primarily upon product implementation by our customers. We have historically recognized a significant portion of our license and services revenue through the percentage-of-completion method, using labor hours incurred as the measure of progress towards completion of implementation of our products and we expect this practice to continue. The percentage of completion accounting method requires ongoing estimates of progress of complicated and frequently changing technology projects. Documenting the measure of progress towards completion of implementation is subject to potential errors and changes in estimates. As a result, even minor errors or minor changes in estimates may lead to significant changes in accounting results which may be revised in later quarters due to subsequent information and events. Thus, delays or changes in customer business goals or direction when implementing our software may negatively impact our quarterly revenue. In addition, a significant portion of new customer orders have been booked in the third month of the calendar quarter, with many of these bookings occurring in the last two weeks of the third month. We expect this trend to continue and, therefore, any failure or delay in bookings would decrease our quarterly revenue. If our revenues or operating margins are below the expectations of the investment community, our stock price is likely to decline.

If we fail to maintain and expand our relationships with systems integrators and other business partners, our ability to develop, market, sell, and support our products may be adversely affected.

Our development, marketing and distribution strategies increasingly rely on our ability to form and maintain long-term strategic relationships with system integrators, in particular, our existing business alliance partners, IBM and Accenture. These business relationships often consist of joint marketing programs, technology partnerships and resale and distribution arrangements. Although most aspects of these relationships are

contractual in nature, many important aspects of these relationships depend on the continued cooperation between the parties. Divergence in strategy, change in focus, competitive product offerings or potential contract defaults may interfere with our ability to develop, market, sell, or support our products, which in turn could harm our business. If either IBM or Accenture were to terminate their agreements with us or our relationship were to deteriorate, it could have a material adverse effect on our business, financial condition and results of operations. In many cases, these parties have extensive relationships with our existing and potential customers and influence the decisions of these customers. A number of our competitors have stronger relationships with IBM and Accenture and, as a result, these parties may be more likely to recommend competitors products and services.

Our primary products have a long sales and implementation cycle, which makes it difficult to predict our quarterly results and may cause our operating results to vary significantly.

The period between initial contact with a prospective customer and the implementation of our products is unpredictable and often lengthy, ranging to date from three to twenty-four months. Thus, revenue and cash receipts could vary significantly from quarter to quarter. Any delays in the implementation of our products could cause reductions in our revenues. The licensing of our products is often an enterprise-wide decision that generally requires us to provide a significant level of education to prospective customers about the use and benefits of our products. The implementation of our products involves significant commitment of technical and financial resources and is commonly associated with substantial implementation

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efforts that may be performed by us, by the customer or by third-party systems integrators. Customers generally consider a wide range of issues before committing to purchase our products, including product benefits, ability to operate with existing and future computer systems, vendor financial stability and longevity, ability to accommodate increased transaction volume and product reliability.

If we do not continue to successfully implement our plan to improve our internal control over financial reporting, investors could lose confidence in our financial reporting and customers may delay purchasing decisions, which would harm our business and the market price of our common stock.

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our business could be harmed. For example, during the quarter ended September 30, 2004, our independent registered public accounting firm brought to our attention a need to increase the size and effectiveness of our finance department and management and the Audit Committee determined that, as a result of such inadequate staffing, a material weakness in our internal control over financial reporting existed. This material weakness has contributed to increased expenses and efforts required for our financial reporting. As a result of this, we have implemented and continue to implement changes, including the hiring of additional employees in our finance department, to strengthen our internal control over financial reporting in this area. If we are not successful in implementing effective internal controls over financial reporting, customers may delay purchasing decisions or we may lose customers, create investor uncertainty, face litigation and the market price of our common stock may decline. For more information, please refer to the discussion below under the heading Item 4. Controls and Procedures.

If we are not able to successfully manage our partner operations in India, our operations and financial results may be adversely affected.

In fiscal year 2003, we entered into an agreement with an independent contracting company with global technical resources and an operations center in Bangalore, India. The agreement provides for the independent contractor, at our direction, to attract, train, assimilate and retain sufficient highly qualified personnel to perform technical support, product test and certain sustaining engineering functions. In fiscal year 2005, we plan to continue increasing the size of this organization and expand its scope. The expansion of this organization is an important component of our strategy to address the business needs of our customers and manage our expenses. The success of this operation will depend on our ability and our independent contractor s ability to attract, train, assimilate and retain highly qualified personnel in the required periods. A disruption of our relationship with the independent contractor could adversely affect our operations. Failure to effectively manage the organization and operations will harm our business and financial results.

Our stock price is subject to significant fluctuations, which may adversely affect the value of your investment in our common stock.

Since our initial public offering in February 2000, the price of our common stock has fluctuated widely. During the three-month period ended December 31, 2004, the closing price of our common stock on the NASDAQ National Market ranged from a low of $1.78 to a high of $3.50 per share. We believe that factors such as the risks described herein or other factors could cause the price of our common stock to continue to fluctuate, perhaps substantially. In addition, recently, the stock market in general, and the market for high technology stocks in particular, has experienced extreme price fluctuations, which have often been unrelated to the operating performance of the affected companies. Such fluctuations could adversely affect the market price of our common stock.

We may incur in future periods significant stock-based compensation charges related to certain stock options and stock awards, which may adversely affect our reported financial results.

Based on current accounting standards involving stock compensation, we may incur variable accounting costs related to the issuance of restricted stock and certain stock options, including those associated with our stock option cancellation/re-grant program. Current accounting standards require us to re-measure compensation cost for such options each reporting period based on changes in the market value of the underlying common stock. Depending upon movements in the market value of our common stock, the variable accounting treatment of those stock options may result in significant additional stock-based compensation costs in future periods. Future accounting standards may have a greater impact. We are the target of a securities class action complaint and are at risk of securities class action litigation, which may result in substantial costs and divert management attention and resources.

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We are the target of a securities class action complaint and are at risk of securities class action litigation, which may result in substantial costs and divert management attention and resources.

Beginning in July 2001, Chordiant and certain of our officers and directors were named as defendants in several class action shareholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, In re Chordiant Software, Inc. Initial Public Offering Securities Litigation, Case No. 01-CV-6222. In the amended complaint, the plaintiffs allege that Chordiant, certain of our officers and directors and the underwriters of our initial public offering (IPO) violated Section 11 of the Securities Act of 1933 based on allegations that Chordiant s registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, the IPO underwriters. The complaint also contains a claim for violation of Section 10(b) of the Securities Exchange Act of 1934 based on allegations that this omission constituted a deceit on investors. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies that conducted IPOs of their common stock in the late 1990s. In June 2004, Chordiant and almost all of the other issuers entered into a formal settlement agreement with the plaintiffs. On February 15, 2005, the Court issued a decision certifying a class action for settlement purposes, and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. In addition, the settlement is still subject to statutory notice requirements as well as final judicial approval. This action may divert the efforts and attention of our management and, if determined adversely to us, could have a material impact on our business, results of operations, financial condition or cash flows.

If our products do not operate effectively in a company-wide environment, we may lose sales and suffer decreased revenues.

If existing customers have difficulty deploying our products or choose not to fully deploy our products, it could damage our reputation and reduce revenues. Our success requires that our products be highly scalable, and able to accommodate substantial increases in the number of users. Our products are expected to be deployed on a variety of computer hardware platforms and to be used in connection with a number of third-party software applications by personnel who may not have previously used application software systems or our products. These deployments present very significant technical challenges, which are difficult or impossible to predict. If these deployments do not succeed, we may lose future sales opportunities and suffer decreased revenues.

Defects in our products could diminish demand for our products and result in decreased revenues, decreased market acceptance and injury to our reputation.

Errors may be found from time-to-time in our new, acquired or enhanced products. Any significant software errors in our products may result in decreased revenues, decreased sales, and injury to our reputation and/or increased warranty and repair costs. Although we conduct extensive product testing during product development, we have in the past discovered software errors in our products as well as in third-party products, and as a result have experienced delays in the shipment of our new products.

Because competition for qualified personnel could again become intense, we may not be able to retain or recruit personnel, which could impact the development and sales of our products.

If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or fail to reach expected levels of productivity, our ability to develop and market our products will be weakened. Our success depends largely on the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel. We have been targeted by recruitment agencies seeking to hire our key management, finance, engineering, sales and marketing and professional services personnel. To date, our sales have been concentrated in the financial services, telecommunications and retail markets, and if we are unable to continue sales in

these markets or successfully penetrate new markets, our revenues may decline.

Sales of our products and services in three large markets-financial services, telecommunications and retail-accounted for approximately 96% and 89% of our total revenues for the three months ended December 31, 2004 and 2003, respectively. We expect that revenues from these three markets will continue to account for a substantial portion of our total revenues for the foreseeable future. If we are unable to successfully increase penetration of our existing markets or achieve sales in additional markets, or if the overall economic climate of our target markets deteriorates, our revenues may decline.

Low gross margin in services revenues could adversely impact our overall gross margin and income.

Our services revenues have had lower gross margins than our license revenues. Service revenues comprised 59% and 53% of

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our total revenues for the three months ended December 31, 2004 and 2003, respectively. Gross margin on service revenues was 42% and 40% for the three months ended December 31, 2004 and 2003, respectively. License revenues comprised 41% and 47% of our total revenues for the three months ended December 31, 2004 and 2003, respectively. Gross margins on license revenues were 98% and 94% for the three months ended December 31, 2004 and 2003. As a result, an increase in the percentage of total revenues represented by services revenues, or an unexpected decrease in license revenues, could have a detrimental impact on our overall gross margins. To increase services revenues, we must expand our services organization, successfully recruit and train a sufficient number of qualified services personnel and obtain renewals of current maintenance contracts by our customers. This expansion could further reduce gross margins in our services revenues.

We may not have the workforce necessary to support our platform of products if demand for our products substantially increased, and, if we need to rebuild our workforce in the future, we may not be able to recruit personnel in a timely manner, which could negatively impact the development and sales of our products.

In the event that demand for our products increases as a result of a positive turn in the economy, we may need to rebuild our workforce or increase outsourced functions to companies based in foreign jurisdictions and we may be unable to hire, train or retain qualified personnel in a timely manner, which may weaken our ability to market our products in a timely manner, negatively impacting our operations. Our success depends largely on ensuring that we have adequate personnel to support our platform of products as well as the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel.

If we fail to introduce new versions and releases of functional and scalable products in a timely manner, customers may license competing products and our revenues may decline.

If we are unable to ship or implement enhancements to our products when planned, or fail to achieve timely market acceptance of these enhancements, we may suffer lost sales and could fail to achieve anticipated revenues. We have in the past, and expect in the future, to derive a significant portion of our total revenues from the license of our primary product suite. Our future operating results will depend on the demand for the product suite by future customers, including new and enhanced releases that are subsequently introduced. If our competitors release new products that are superior to our products in performance or price, or if we fail to enhance our products or introduce new features and functionality in a timely manner, demand for our products may decline. We have in the past experienced delays in the planned release dates of new versions of our software products and upgrades. New versions of our products may not be released on schedule or may contain defects when released.

We depend on technology licensed to us by third parties, and the loss or inability to maintain these licenses could prevent or delay sales of our products.

We license from several software providers technologies that are incorporated into our products. We anticipate that we will continue to license technology from third parties in the future. This software may not continue to be available on commercially reasonable terms, if at all. While currently we are not materially dependent on any single third party for such licenses, the loss of the technology licenses could result in delays in the license of our products until equivalent technology is developed or identified, licensed and integrated into our products. Even if substitute technologies are available, there can be no guarantee that we will be able to license these technologies on commercially reasonable terms, if at all.

Defects in third party products associated with our products could impair our products functionality and injure our reputation.

The effective implementation of our products depends upon the successful operation of third-party products in conjunction with our products. Any undetected errors in these third-party products could prevent the implementation or impair the functionality of our products, delay new product introductions or injure our reputation. In the past, while our business has not been materially harmed, product releases have been delayed as a result of errors in third-party software and we have incurred significant expenses fixing and investigating the cause of these errors.

Our customers and system integration partners may have the ability to alter our source code and resulting inappropriate alterations could adversely affect the performance of our products, cause injury to our reputation and increase operating expenses.

Customers and system integration partners may have access to the computer source code for certain elements of our products and may alter the source code. Alteration of our source code may lead to implementation, operation, technical support and upgrade problems for our customers. This could adversely affect the market acceptance of our products, and any necessary investigative work and repairs could cause us to incur significant expenses and delays in implementation.

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If our products do not operate with the hardware and software platforms used by our customers, our customers may license competing products and our revenues will decline.

If our products fail to satisfy advancing technological requirements of our customers and potential customers, the market acceptance of these products could be reduced. We currently serve a customer base with a wide variety of constantly changing hardware, software applications and networking platforms. Customer acceptance of our products depends on many factors such as:

Our ability to integrate our products with multiple platforms and existing or legacy systems;

Our ability to anticipate and support new standards, especially Internet and enterprise Java standards; and

The integration of additional software modules and third party software applications with our existing products.

Our failure to successfully integrate with future acquired or merged companies and technologies could prevent us from operating efficiently.

Our business strategy includes pursuing opportunities to grow our business, both through internal growth and through merger, acquisition and technology and other asset transactions. To implement this strategy, we may be involved in merger and acquisition activity, additional technology and asset purchase transactions. Merger and acquisition transactions are motivated by many factors, including, among others, our desire to grow our business, acquire skilled personnel, obtain new technologies and expand and enhance our product offerings. Growth through mergers and acquisitions has several identifiable risks, including difficulties associated with successfully integrating distinct businesses into new organizations, the substantial management time devoted to integrating personnel, technology and entire companies, the possibility that we might not be successful in retaining the employees, undisclosed liabilities, the failure to realize anticipated benefits (such as cost savings and synergies) and issues related to integrating acquired technology, merged/acquired companies or content into our products (such as unanticipated expenses). Realization of any of these risks in connection with any technology transaction or asset purchase we have entered into, or may enter into, could have a material adverse effect on our business, operating results and financial condition.

If we become subject to intellectual property infringement claims, these claims could be costly and time-consuming to defend, divert management s attention, cause product delays and have an adverse effect on our revenues and net income.

We expect that software product developers and providers of software in markets similar to our target markets will increasingly be subject to infringement claims as the number of products and competitors in our industry grows and the functionality of products overlap. Any claims, with or without merit, could be costly and time-consuming to defend, divert our management s attention or cause product delays. If any of our products were found to infringe a third party s proprietary rights, we could be required to enter into royalty or licensing agreements to be able to sell our products. Royalty and licensing agreements, if required, may not be available on terms acceptable to us or at all.

The application of percentage of completion accounting to our business is complex and may result in delays in the reporting of our financial results and revenue not being recognized as we expect.

Although we attempt use standardized license agreements designed to meet current revenue recognition criteria under generally accepted accounting principles, we must often negotiate and revise terms and conditions of these standardized agreements, particularly in multi-product transactions. At the time of entering into a transaction, we assess whether any services included within the arrangement require us to perform significant implementation or customization essential to the functionality of our products. For contracts involving significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenues using the percentage-of-completion method using labor hours incurred as the measure of progress towards completion. The application of the percentage of completion method of accounting is complex and involves judgments and estimates, which may change based on customer requirements. This complexity combined with changing customer requirements could result in delays in the proper determination of our percentage of completion estimates and revenue not being recognized as we expect.

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We may be subject to an investigation by the SEC or litigation by private parties in connection with the restatement of our interim financial statements for the fiscal quarters ended March 31, June 30 and September 30, 2004.

In March 2005, we concluded that our interim financial statements for the fiscal quarters ended March 31, June 30, and September 30, 2004 should no longer be relied upon because of various errors in such financial statements. We restated those financial statements, which were reported in our Transition Report on Form 10-K/T. As a result, the SEC may choose to begin an investigation or we may be subject to litigation, which could require significant management and financial resources which could otherwise be devoted to the operation of our business. If we are subject to an SEC investigation or litigation, we could be required to pay penalties or damages or have other remedies imposed upon us. In addition, we could become the target of expensive securities litigation related to other matters in the future. Any SEC investigation or litigation could adversely affect our business, results of operations, financial position or cash flows.

We may encounter unexpected delays in implementing the requirements relating to internal controls and we expect to incur additional expenses and diversion of management s time as a result of performing the system and process evaluation, testing and remediation required to comply with the management assessment and auditor attestation requirements. We have recently replaced the outside consultant retained by the Company as the project manager and in that process reduced the number of consultants being utilized by the Company on this project and significantly reduced the number of processes that must be documented and tested.

We continue to document our internal controls to allow management to report on, and our independent registered public accounting firm to attest to, our internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002, within the time frame required by Section 404. We changed our fiscal year end to September 30 because of management s conclusion that it would not complete documenting the Company s internal controls over financial reporting by December 31, 2004, and it was unlikely the Company would complete its assessment of design and operating effectiveness of internal controls over financial reporting by April 30, 2005, the extended time period allowed by the SEC. We may encounter unexpected delays in implementing the requirements relating to internal controls, therefore, we cannot be certain about the timing of the completion of our evaluation, testing and remediation actions or the impact that these activities will have on our operations. We also expect to incur additional expenses and diversion of management s time as a result of performing the system and process evaluation, testing and remediation required to comply with management s assessment and auditor attestation requirements. If we are not able to timely comply with the requirements set forth in Section 404, we might be subject to sanctions or investigation by the regulatory authorities. Any such action could adversely affect our business or financial results. The requirement to comply with Section 404 of the Sarbanes-Oxley Act of 2002 will be effective for our fiscal year ending September 30, 2005.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to the impact of interest rate changes, foreign currency fluctuations and change in the market values of our investments. The following table presents the amounts of short-term investments and restricted cash that are subject to interest rate risk by year of expected maturity and average interest rates as of December 31, 2004 (in thousands):

	December 31, 2004	Fair Value	Average Interest Rate
Restricted cash in short-term investments	$ 1,780	$ 1,780	2.13%
Short-term investments	$ 4,000	$ 4,000	1.25%

Interest Rate Risk. Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We have not used derivative financial instruments to hedge our investment portfolio. We invest excess cash in debt instruments of the U.S. Government and its agencies, and in high-quality corporate issuers and, by policy, limit the amount of credit exposure to any one issuer. We protect and preserve invested funds by limiting default, market and reinvestment risk. Investments in both fixed rate and floating rate interest earning instruments carries a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities, which have declined in market value due to changes in interest rates.

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Foreign Currency Risk. A significant portion of our sales and operating expenses result from transactions outside of the United States, often in foreign currencies. These currencies include the United Kingdom Pound Sterling, the Euro and Canadian Dollars. International revenues from our foreign subsidiaries accounted for approximately 63% and 67% of total revenues for the three months ended December 31, 2004 and 2003, respectively. International sales are made mostly from our foreign sales subsidiaries in their respective countries and are typically denominated in the local currency of each country. These subsidiaries also incur most of their expenses in the local currency. Accordingly, all foreign subsidiaries use the local currency as their functional currency.

Additionally, two of our foreign subsidiaries hold cash equivalent investments in currencies other than its respective local currency. Such holdings increase our exposure to foreign exchange rate fluctuations. As exchange rates vary, the holdings may magnify foreign currency exchange rate fluctuations or upon translation or adversely impact overall expected profitability through foreign currency losses incurred upon the sale or maturity of the investments.

Our international business is subject to risks, including, but not limited to changing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility when compared to the United States. Accordingly, our future results could be materially adversely impacted by changes in these or other factors.

Item 4. Controls and Procedures.

(a) Management s responsibility for financial statements

Our management is responsible for the integrity and objectivity of all information presented in this quarterly report. The consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America and include amounts based on management s best estimates and judgments. Management believes the consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements fairly represent the Company s financial position and results of operations.

The Audit Committee of the Board of Directors, which is composed solely of independent directors, meets regularly with our independent registered public accounting firm, PricewaterhouseCoopers LLP, and representatives of management to review accounting, financial reporting, internal control and audit matters, as well as the nature and extent of the audit effort. The Audit Committee is responsible for the engagement of the independent auditors. The independent auditors have free access to the Audit Committee.

(b) Evaluation of disclosure controls and procedures

Based on their evaluation as of April 2005, our Chairman of the Board, Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were not effective to ensure that the information required to be disclosed by us in this quarterly report on Form 10-Q was recorded, processed, summarized and reported within the time periods specified in the SEC s rules and Form 10-Q.

In light of this determination and as part of the work undertaken in connection with this report, we have applied compensating procedures and processes as necessary to ensure the reliability of our financial reporting. Accordingly, management believes, based on its knowledge, that (i) this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading with respect to the period covered by this report and (ii) the financial statements, and other financial information included in this report, fairly present in all material respects our financial condition, results of operations and cash flows as at, and for, the periods presented in this report.

(c) Changes in internal controls

In this report, unless otherwise indicated, a significant deficiency is defined as a control deficiency, or combination of deficiencies, that adversely affects the company s ability to initiate, authorize, record, process or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company s financial statements that is more than inconsequential will not be prevented or detected. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

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Material Weakness Reported for the Quarter ended June 30, 2004

As previously disclosed in our quarterly report on Form 10-Q filed on August 16, 2004, in July 2004, PricewaterhouseCoopers LLP (PwC), our independent public accounting firm, informed our Audit Committee of possible revenue recognition problems for the quarter ended June 30, 2004 arising out of two contracts involving the sale of our enterprise solutions software. The issue with one of the contracts related to the timing of the execution of the contract and the issue with the other contract involved percentage of completion accounting. Our Audit Committee initiated an investigation and also engaged outside legal counsel to assist in the investigation. The investigation was conducted to (i) identify whether any revenue recognition issues existed at Chordiant generally, and (ii) review the business practices of our employees as they relate to procedures and controls applicable to the execution of our contracts. Through this investigation, management and our Audit Committee determined that a material weakness in our internal control over financial reporting existed relating to our revenue recognition controls.

As a result, the Audit Committee made a series of recommendations to management that it believed would address the material weakness identified, which we endorsed. Although we knew it would take some time to fully implement such recommendations, we have made substantial progress on the implementation of the recommendations relating to the material weakness in our revenue recognition controls, including the following measures:

Subsequent to the end of our fiscal year ended September 30, 2004, on November 17, 2004, George de Urioste was hired as our new Chief Operating Officer, and effective January 1, 2005, was also appointed the Chief Financial Officer and Principal Accounting Officer.

We have appointed a financial director as our Corporate Controller.

We have hired a full-time accounting employee to the newly-created position of Revenue Recognition Manager. This employee has significant experience and specialized expertise with revenue recognition issues involving enterprise software companies.

We hired full-time employees to serve in the newly-created positions of Assistant Controller and Senior Accountant.

We converted to a new financial information system.

Material Weakness Reported for the Quarter ended September 30, 2004

As we reported in a report filed on Form 8-K on January 4, 2005, the Board of Directors approved a change in our fiscal year end from December 31st to September 30th because management concluded in December that it would not complete documenting Chordiant s internal control over financial reporting by December 31, 2004, and that it was unlikely that the Company could complete its assessment of design and operating effectiveness of internal control over financial reporting by April 30, 2005, the extended time period allowed by the SEC to complete this assessment. As the Board of Directors did not make the decision to change the year end until December 29, 2004, we filed a quarterly report on Form 10-Q on November 9, 2004 for the quarter ended September 30, 2004. In that report for the quarter ended September 30, 2004, we reported that in October 2004, PwC informed Chordiant and our Audit Committee that the following material weakness arose in the quarter ended September 30, 2004 with respect to our internal control over financial reporting relating to staffing of our finance department and the fact that many finance employees are new hires: (1) inadequate staffing and supervision leading to untimely identification and resolution of certain accounting matters, (2) failure of financial reporting controls in preventing or detecting misstatements of accounting information that resulted in certain adjustments to the financial statements and (3) incomplete or inadequate account analysis, account reconciliations and consolidation procedures. We agreed with PwC s assessment. Since October 2004, we have taken the following steps to remediate the material

weakness:

In the aggregate, we have hired five individuals to replace the members of the finance team that resigned and added six new members to the finance team to provide additional resources in the department, including two additional senior accountants, one to concentrate on accounting for consulting services revenue and expenses and one concentrating on general accounting matters. The Company s staff now includes four certified public accountants and two chartered accountants in financial operations.

As discussed above, we hired a permanent chief operating officer and chief financial officer.

Our chief operating officer and chief financial officer has been delegated the responsibility for the Company s compliance with SOX, including section 404. In addition:

We have appointed a project leader for the SOX program on a company-wide basis and individual project managers for international operations and information technology.

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We have initiated weekly conference calls involving our lead independent director, chairman of the board of directors, chief executive officer, chief operating officer/chief financial officer, and the SOX project team to review progress against the implementation plan for section 404 and section 406 compliance.

We implemented an automated system to allow our professional services consultants to report their hours and expenses relating to their services electronically. This system is on line for our North American operations (for both hours and expenses) and for non-North American operations (for expenses). The system is also being implemented for hours in non-North American operations.

Management will continue its efforts and management and the Audit Committee will continue to monitor the effectiveness of our internal control over financial reporting, including those pertaining to revenue recognition, and staffing of our finance team, on an ongoing basis and will take further action, as appropriate. While neither material weakness has been fully remediated, management believes significant progress has been made to do so.

Other than as described above, there have been no changes in our internal control over financial reporting during the quarter ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION.

Item 1. Legal Proceedings.

Information with respect to this Item may be found in Note 7 of Notes to the unaudited Condensed Consolidated Financial Statements in this Form 10-Q. The information relating to the IPO Lawsuits is incorporated into this Item 1 by reference.

Item 6. Exhibits.

The exhibits listed on the accompanying index to exhibits are filed or incorporated by reference (as stated therein) as part of this Quarterly Report on Form 10-Q.

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Chordiant Software, Inc.

SIGNATURES

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

Dated: April 29, 2005

Chordiant Software, Inc.

(Registrant)

By: /s/ George de Urioste

George de Urioste

Chief Operating Officer and

Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	
3.1	Amended and Restated Certificate of Incorporation of Chordiant Software, Inc. (filed as Exhibit 3.1 to Chordiant s Registration Statement on Form S-1 (No. 333-92187) filed on December 6, 1999 and incorporated herein by reference).
3.2	Amended and Restated Bylaws of Chordiant Software, Inc. (filed as exhibit 3.2 to Chordiant s Form 10-Q for the Quarterly period ended June 30, 2004 and incorporated herein by reference)
21.1	Subsidiaries of Chordiant Software, Inc.
31.1	Certification required by Rule 13a-14(a) or Rule15d-14(a).
31.2	Certification required by Rule 13a-14(a) or Rule15d-14(a).
31.3	Certification required by Rule 13a-14(a) or Rule15d-14(a).
32.1	Certification required by Rule 13a-14(a) or Rule15d-14(a) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).