

SUMTOTAL SYSTEMS INC

FORM 10-Q (Quarterly Report)

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended **March 31, 2007**

OR

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

For the transition period _____ to _____

Commission File Number **000-50640**

SUMTOTAL SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

42-1607228
(I.R.S. Employer
Identification No.)

**1808 North Shoreline Boulevard
Mountain View, California 94043**
(Address of principal executive offices, including zip code)

(650) 934-9500
(Registrant's telephone number, including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares outstanding of the issuer's Common Stock, par value \$0.001, as of May 1, 2007 was 27,171,308 shares.

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FORM 10-Q
For the Quarter Ended March 31, 2007

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PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

**SUMTOTAL SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands)**

	<u>March 31, 2007</u>	<u>December 31, 2006</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 13,683	\$ 10,176
Restricted cash	—	23
Short-term investments	3,361	5,530
Accounts receivable, net of allowance for sales returns and doubtful accounts of \$860 and \$899, respectively	24,134	28,516
Prepaid expenses and other current assets	4,153	3,891
Total current assets	<u>45,331</u>	<u>48,136</u>
Property and equipment, net	6,605	5,945
Goodwill	68,461	68,461
Intangible assets, net	19,078	21,327
Other assets	1,158	1,194
Total assets	<u>\$ 140,633</u>	<u>\$ 145,063</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 4,440	\$ 3,991
Accrued compensation and benefits	5,877	8,554
Other accrued liabilities	3,581	4,612
Restructuring accrual	117	866
Deferred revenue	29,791	29,958
Notes payable	6,125	6,095
Total current liabilities	<u>49,931</u>	<u>54,076</u>
Non-current liabilities:		
Other accrued liabilities, non-current	235	246
Deferred revenue, non-current	1,066	781
Notes payable, non-current	9,390	10,735
Total liabilities	<u>60,622</u>	<u>65,838</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock	—	—
Common stock	27	27
Additional paid-in capital	357,594	354,800
Accumulated other comprehensive loss	(312)	(332)
Accumulated deficit	(277,298)	(275,270)
Total stockholders' equity	<u>80,011</u>	<u>79,225</u>
Total liabilities and stockholders' equity	<u>\$ 140,633</u>	<u>\$ 145,063</u>

Refer to the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements.

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SUMTOTAL SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except per share data)

	Three-Months Ended	
	March 31,	
	2007	2006
Revenue:		
Subscriptions and support	\$14,468	\$10,944
Service	8,233	7,083
License	6,349	6,274
Total revenue	<u>29,050</u>	<u>24,301</u>
Cost of revenue:		
Subscriptions and support	4,746	3,537
Service	5,590	5,175
License	92	180
Amortization of intangible assets	2,250	2,327
Total cost of revenue	<u>12,678</u>	<u>11,219</u>
Gross margin	<u>16,372</u>	<u>13,082</u>
Operating expenses:		
Research and development	5,039	4,099
Sales and marketing	7,902	7,243
General and administrative	5,006	5,811
Total operating expenses	<u>17,947</u>	<u>17,153</u>
Loss from operations	(1,575)	(4,071)
Interest expense	(378)	(435)
Interest income	163	163
Other expense, net	(12)	(76)
Loss before provision for income taxes	(1,802)	(4,419)
Provision for income taxes	24	17
Net loss	<u>\$ (1,826)</u>	<u>\$ (4,436)</u>
Net loss per share, basic and diluted	<u>\$ (0.07)</u>	<u>\$ (0.18)</u>
Weighted average common shares outstanding, basic and diluted	<u>26,839</u>	<u>24,698</u>

Refer to the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements.

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SUMTOTAL SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Three-Months Ended	
	March 31,	
	2007	2006
Cash flows from operating activities:		
Net loss	\$ (1,826)	\$ (4,436)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	875	637
Amortization of intangible assets	2,250	2,327
Provision for (recovery of) sales returns and doubtful accounts	17	(175)
Accretion of interest on short-term investments	(26)	(12)
Amortization of discount on notes payable	71	62
Stock-based compensation	1,052	1,006
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	4,407	4,731
Prepaid expenses and other assets	(90)	(432)
Other assets	42	22
Accounts payable	447	187
Accrued compensation and benefits	(2,678)	6
Other accrued liabilities	(1,378)	(1,555)
Restructuring accrual	(749)	(1,071)
Deferred revenue	80	(368)
Net cash provided by operating activities	<u>2,494</u>	<u>929</u>
Cash flows from investing activities:		
Purchases of property and equipment	(1,476)	(598)
Purchases of short-term investments	(1,454)	—
Sales/maturities of short-term investments	3,605	—
Release of restricted cash	23	—
Net cash provided by (used in) investing activities	<u>698</u>	<u>(598)</u>
Cash flows from financing activities:		
Repayment of credit facility	(1,094)	(1,094)
Payment on notes payable	(292)	(292)
Net proceeds from the issuance of common stock pursuant to SumTotal Systems' Employee Stock Purchase Plan and exercises of common stock options	1,742	376
Net cash provided by (used in) financing activities	<u>356</u>	<u>(1,010)</u>
Effect of foreign exchange rate changes on cash and cash equivalents	(41)	(15)
Net increase (decrease) in cash and cash equivalents	3,507	(694)
Cash and cash equivalents at beginning of period	10,176	18,356
Cash and cash equivalents at end of period	<u>\$13,683</u>	<u>\$17,662</u>
Supplemental disclosure of cash flow information		
Interest paid	\$ 341	\$ 332
Taxes paid	\$ —	\$ 9

Refer to the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements.

**SUMTOTAL SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

NOTE 1: DESCRIPTION OF BUSINESS

SumTotal Systems, Inc. develops, markets, distributes and supports talent and learning management software products and on-demand subscriptions. SumTotal Systems' markets are worldwide and include a broad range of industries. SumTotal Systems was formed on March 18, 2004, as a result of the acquisition of Docent by Click2learn. The terms "SumTotal Systems", "SumTotal" and the "Company" refer to Click2learn prior to March 18, 2004 and SumTotal Systems, Inc. thereafter.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial data as of March 31, 2007, and for the three-months ended March 31, 2007 and 2006 has been prepared by SumTotal Systems, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations. Certain other amounts have been reclassified to conform to the current period presentation. The December 31, 2006 Condensed Consolidated Balance Sheet was derived from audited consolidated financial statements, but does not include all disclosures required by GAAP. However, SumTotal Systems believes that the disclosures are adequate to make the information presented not misleading.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (which include normal recurring adjustments, except as disclosed herein) necessary to present fairly SumTotal Systems' financial position, results of operations and cash flows for the interim periods presented. The results of operations for the three-months ended March 31, 2007 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

There were no significant changes in our accounting policies that occurred during our fiscal quarter ending March 31, 2007 from those policies outlined in our Annual Report of Form 10-K which was filed with the Securities and Exchange Commission on March 16, 2007 that have materially affected our financial reporting unless specifically outlined in these unaudited notes to the Condensed Consolidated Financial Statements. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited consolidated financial statements contained in the Company's Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 16, 2007.

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the financial statements of SumTotal Systems and its wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Such estimates and assumptions are based on historical experience, where applicable, and adequacy of other assumptions. On an ongoing basis, SumTotal Systems evaluates estimates, including those related to revenue recognition, allowance for sales returns and doubtful accounts, potential impairment of intangible assets, restructuring reserves, stock-based compensation and valuation reserves for deferred tax assets and income tax expense. Actual results could differ from those estimates.

Reclassification

Certain amounts in the prior year period's financial statements and related notes have been reclassified to conform to the 2007 presentation. These reclassifications have no material impact on previously reported net loss.

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Revenue Classification

SumTotal Systems derives its revenue from three sources: (1) Revenue resulting from the sales of on-demand subscriptions, maintenance and support services, hosting arrangements, and term rental arrangements; (2) revenue resulting from the sales of services performed in connection with consulting agreements and other “service transactions” as defined in the American Institute of Certified Public Accountants (“AICPA”) Statement of Position (“SOP”) No. 97-2, Software Revenue Recognition (“SOP No. 97-2”), as amended; and (3) revenue resulting from the sales of software licenses and related royalty arrangements.

Deferred revenue represents advanced payments for on-demand subscriptions, software licenses, services, maintenance and support, and hosting arrangements in advance of revenue recognition. These deferred amounts are expected to be recognized as the licenses are delivered or ratably over the service period as these services are provided.

Income Taxes

In June 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation (“FIN”) No. 48, *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 109, *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. SumTotal Systems adopted FIN 48 effective January 1, 2007.

As a result of the implementation of FIN 48, SumTotal Systems recognized a \$0.3 million increase in liability for unrecognized tax benefits, which was accounted for as a \$0.2 million reduction to the January 1, 2007 balance of retained earnings as a \$0.1 million increase in deferred tax assets. SumTotal Systems has unrecognized tax benefits of approximately \$0.3 million as of January 1, 2007, all of which if recognized would result in a reduction of SumTotal System’s effective tax rate. SumTotal Systems recorded no increase to its unrecognized tax benefits as of March 31, 2007. In accordance with FIN 48, paragraph 19, SumTotal Systems has decided to classify interest and penalties as a component of tax expense. Interest and penalties are immaterial at the date of adoption and are included in the unrecognized tax benefits. SumTotal Systems is subject to audit by various taxing authorities for open returns from 2000 through 2006.

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, less outstanding unvested shares. For the three months ended March 31, 2007, 92,500 shares held in escrow for the MindSolve acquisition are not included in the weighted average number of common shares outstanding during the period for both basic and diluted net loss per share. For the three months ended March 31, 2006, 391,665 shares held in escrow for the Pathlore acquisition were not included in the weighted average number of common shares outstanding during the period for both basic and diluted net loss per share. As SumTotal Systems had a net loss for each of the periods presented, basic and diluted net loss per share are the same since the inclusion of potential common stock would be antidilutive. Potential common shares are comprised of common stock subject to repurchase rights, incremental shares of common and preferred stock issuable upon the exercise of stock options or warrants and shares issuable upon conversion of convertible preferred stock.

The following table sets forth the computation of basic and diluted net loss per share for the three months ended March 31, 2007 and 2006 (in thousands, except per share amounts):

	Three-Months Ended	
	March 31,	
	2007	2006
Net loss	<u>\$ (1,826)</u>	<u>\$ (4,436)</u>
Weighted average common shares used to compute basic and diluted net loss per share	<u>26,839</u>	<u>24,698</u>
Net loss per share, basic and diluted	<u>\$ (0.07)</u>	<u>\$ (0.18)</u>

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The following table sets forth the common stock options and warrants that have been excluded from the computation of diluted loss per share because their effects would have been anti-dilutive for the three months ended March 31, 2007 and 2006 (in thousands, except per option and warrant amounts):

	Three-Months Ended March 31,	
	2007	2006
Options to acquire shares of common stock	1,891	3,270
Weighted average option price	\$10.98	\$10.29
Warrants to acquire shares of common stock	1,424	1,577
Weighted average warrant price	\$ 7.81	\$ 7.67

Comprehensive Loss and Accumulated Other Comprehensive Loss

The following table sets forth the components of comprehensive loss for the three-months ended March 31, 2007 and 2006 presented below (in thousands):

	Three-Months Ended March 31,	
	2007	2006
Net loss	\$(1,826)	\$(4,436)
Foreign currency translation adjustment	19	(17)
	<u>\$(1,807)</u>	<u>\$(4,453)</u>

SumTotal Systems' total comprehensive loss for the three months ended March 31, 2007 and 2006 consisted of net loss and the change in foreign currency translation adjustments. The tax effects on the foreign currency translation adjustments have not been significant. Accumulated other comprehensive loss consists of foreign currency translation adjustments of \$312,000 and \$332,000 at March 31, 2007 and December 31, 2006, respectively.

Stock-Based Compensation

On January 1, 2006, SumTotal Systems adopted SFAS No. 123R, *Share Based Payments*, which establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on accounting for transactions where an entity obtains employee services in share-based payment transactions. In March 2005, the SEC issued Staff Accounting Bulletin ("SAB") No. 107, *Share-Based Payment* relating to SFAS No. 123R. SumTotal Systems applied the provisions of SAB No. 107 in the adoption of SFAS No. 123R.

SumTotal Systems adopted SFAS No. 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of fiscal 2006. The consolidated financial statements as of and for the year ended December 31, 2006 reflect the impact of SFAS No. 123R. In accordance with the modified prospective transition method, the consolidated financial statements for prior periods have not been restated to reflect and do not include, the impact of SFAS No. 123R.

Valuation and Expense Information under SFAS No. 123R

The weighted-average fair value of stock-based compensation to employees is based on the single option valuation approach. Forfeitures are estimated and it is assumed no dividends will be declared. The estimated fair value of stock-based compensation awards to employees is amortized using the straight-line method over the vesting period of the options, except for restricted stock, which is amortized on a multi-option accelerated method, consistent with the prior year.

The weighted-average fair value calculations for options granted within the period below are based on the following weighted average assumptions:

	Three-Months Ended March 31, 2007
	<u>4.72%</u>
Expected volatility	<u>95.60%</u>
Expected life (years)	<u>6.25</u>

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Options that were granted in prior periods are based on assumptions prevailing at the date of grant.

The weighted-average fair value calculations for the Company's Employee Stock Purchase Plan ("ESPP") within the period below are based on the following weighted average assumptions:

	Three-Months Ended March 31, 2007
Risk-free interest rate	<u>5.16%</u>
Expected volatility	<u>51.96%</u>
Expected life (years)	<u>0.49</u>

The following table summarizes stock-based compensation expense related to employee stock options, ESPP and restricted stock units under SFAS No. 123R for the three months ended March 31, 2007 and 2006, respectively, were allocated as follows (in thousands):

	Three-Months Ended March 31, 2007	Three-Months Ended March 31, 2006
Subscriptions and support	\$ 60	\$ 47
Service	<u>137</u>	<u>191</u>
Cost of revenue	<u>197</u>	<u>238</u>
Research and development	138	123
Sales and marketing	275	242
General and administrative	<u>442</u>	<u>403</u>
Stock-based compensation expense included in operating expenses	<u>855</u>	<u>768</u>
Total stock-based compensation expense	<u>\$ 1,052</u>	<u>\$ 1,006</u>

A summary of option activity under the Company's stock equity plans during the three months ended March 31, 2007 is as follows:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2006	6,300	\$ 6.80	<u>7.12</u>	
Granted	150	7.54		
Exercised	(251)	5.24		
Cancelled	(125)	8.49		
Outstanding at March 31, 2007	<u>6,074</u>	<u>\$ 6.84</u>	<u>7.11</u>	<u>\$ 13,003</u>
Exercisable at March 31, 2007	<u>4,074</u>	<u>\$ 7.48</u>	<u>6.28</u>	<u>\$ 8,144</u>

A summary of the status of the changes in the Company's restricted stock units during the three months ended March 31, 2007 is as follows:

Non-vested restricted shares	Number of Shares (in thousands)	Weighted Average Grant - Date Fair Value
Non-vested at December 31, 2006	75	\$ 4.30
Granted	—	—
Vested	—	—
Cancelled	—	—
Non-vested at March 31, 2007	<u>75</u>	<u>\$ 4.30</u>

The following table summarizes significant ranges of outstanding and exercisable options as of March 31, 2007.

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Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number (in thousands)	Weighted Average Remaining Contractual Term (in years)	Weighted Average Exercise Price	Number (in thousands)	Weighted Average Exercise Price
\$1.07 - \$4.34	1,170	6.54	\$ 3.37	1,007	\$ 3.23
\$4.39 - \$4.65	1,116	8.10	4.50	459	4.51
\$4.67 - \$6.45	1,061	8.41	5.66	416	5.44
\$6.49 - \$7.60	800	8.10	6.90	326	7.03
\$7.62 - \$7.62	1,100	6.24	7.62	1,100	7.62
\$7.68 - \$83.42	827	5.14	15.35	766	15.91
<u>\$1.07 - \$83.42</u>	<u>6,074</u>	<u>7.11</u>	<u>\$ 6.84</u>	<u>4,074</u>	<u>\$ 7.48</u>

The total intrinsic value of options exercised during the three months ended March 31, 2007 was approximately \$652,000. The total intrinsic value of shares issued under the employee stock purchase plan during the three months ended March 31, 2007 was approximately \$141,000. The fair value of options vested was approximately \$896,000 for the three months ended March 31, 2007. As of March 31, 2007, total unrecognized compensation costs related to non-vested stock options was \$8.4 million, which is expected to be recognized as expense over a weighted average period of approximately 2.7 years. The weighted average grant date fair value of options granted in the first fiscal quarter of 2007 was \$6.03.

Adoption of Accounting Standards

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Instruments*, which permits, but does not require, fair value accounting for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The statement was adopted as of January 1, 2007 and did not have a material impact on SumTotal Systems' results of operations and financial condition.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, which provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB No. 108 was adopted as of January 1, 2007 and did not have a material impact on SumTotal Systems' results of operations and financial condition.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement clarifies the definition of fair value, establishes a framework for measuring fair value and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. SumTotal Systems is currently evaluating the impact of adopting SFAS No. 157 on its financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 provides that companies may elect to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings in each reporting period. The election, called the "fair value option" will enable some companies to reduce the variability in reported earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective for SumTotal Systems' first fiscal year beginning after November 15, 2007. Management is currently evaluating whether SFAS No. 159 will have an impact on SumTotal Systems' results of operations and financial condition.

NOTE 3: ACQUISITIONS AND INTANGIBLE ASSETS

MindSolve Acquisition

On November 14, 2006, SumTotal Systems acquired MindSolve Technologies, Inc. ("MindSolve"), a leading provider of Performance Management products and services for the delivery and administration of performance appraisals, multi-source assessments, career and succession planning, goal tracking functions and accountability management.

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The total purchase price is estimated to be \$11,263,000 and is comprised of (in thousands):

Cash consideration for common stockholders	\$ 2,615
Cash consideration for employees	427
Fair value of common stock issued (1)	6,432
Note payable to shareholder	1,261
Estimated acquisition related costs (2)	<u>528</u>
Total consideration	<u>\$11,263</u>

- (1) The stockholders of MindSolve received \$2,615,000 in net cash consideration and 925,000 shares of SumTotal Systems' common stock. The fair value of SumTotal Systems' common shares issued is based on a per share value of \$6.954, which is equal to SumTotal Systems' average of the last sale price per share as reported on the National Association of Securities Dealers Automated Quotations ("NASDAQ") Global Market for the trading-day period beginning two days before and ending two days after November 14, 2006, the date of announcement of the acquisition.
- (2) The estimated acquisition related costs consist primarily of banking, legal and accounting fees and other directly related costs.

The total purchase consideration has been allocated to the assets and liabilities acquired, including identifiable intangible assets, based on their respective fair values at the acquisition date and resulting in excess purchase consideration over the net tangible liabilities and identifiable intangible assets acquired of \$6.2 million. The following condensed balance sheet data presents the estimated fair value of the assets and liabilities assumed (in thousands):

Assets acquired:	
Cash and cash equivalents	\$ 123
Accounts receivable	936
Prepaid expenses and other assets	119
Equipment and leasehold improvements, net	150
In-process research and development	1,120
Goodwill	6,155
Intangible assets	4,450
Other assets	<u>78</u>
	<u>13,131</u>
Liabilities assumed:	
Accrued liabilities	(220)
Deferred revenue	<u>(1,648)</u>
	<u>(1,868)</u>
Total consideration	<u>\$11,263</u>

Goodwill of \$6.2 million, representing the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired in the acquisition, will not be amortized, but is instead tested for impairment at least annually. In addition, a portion of the purchase price was allocated to the following identifiable intangible assets (in thousands, except years):

	<u>Allocated Purchase Price</u>	<u>Estimated Weighted Average Useful Lives in Years</u>
Core and developed technologies	\$ 2,190	3.00
Customer installed-base relationships	1,710	5.00
Customer backlog	<u>550</u>	<u>3.00</u>
Total intangible assets	<u>\$ 4,450</u>	<u>3.77</u>

In connection with the MindSolve acquisition in November 2006, SumTotal Systems has two notes payable to a former MindSolve officer. Total future obligations amount to \$1,438,000 and will be paid in two equal installments of \$719,000 in December 2007 and 2008, respectively. In addition, effective with the MindSolve acquisition, SumTotal Systems has change of control payments to be made to certain employees of MindSolve who are now employees of SumTotal Systems. These contractual change of control payments are being expensed ratably over the contractual performance period. Total future obligations amount to \$1,544,000 with scheduled payments of \$956,000 and \$588,000 in 2007 and 2008, respectively.

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The results of operations of MindSolve since November 14, 2006 are included in SumTotal Systems' statement of operations.

NOTE 4: GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets at March 31, 2007 and December 31, 2006 are as follows (in thousands):

Acquired technology

	March 31, 2007		
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>
Goodwill	\$		