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 June 30, 2008

OR

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

Commission File Number: 000-50640

SUMTOTAL SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**42-1607228**
(State or other jurisdiction of incorporation or organization)	**(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, a non-accelerated filer or a smaller reporting company. 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	☐ Smaller reporting company

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 July 31, 2008 was 31,861,681 shares.

SUMTOTAL SYSTEMS, INC.

FORM 10–Q

For the Quarter Ended June 30, 2008

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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)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 45,511	$ 19,182
Short-term investments	5,069	30,143
Accounts receivable, net of allowance for sales returns and doubtful accounts of $783 and $722, respectively	25,124	26,734
Prepaid expenses and other current assets	4,108	4,482
Total current assets	79,812	80,541
Property and equipment, net	7,180	7,901
Goodwill	68,461	68,461
Intangible assets, net	9,856	12,924
Other assets	1,359	1,213
Total assets	$ 166,668	$ 171,040
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,699	$ 2,326
Accrued compensation and benefits	8,097	8,630
Other accrued liabilities	4,223	3,759
Restructuring accrual	170	100
Deferred revenue	33,890	35,898
Notes payable	5,929	6,157
Total current liabilities	54,008	56,870
Non-current liabilities:		
Other accrued liabilities, non-current	158	193
Deferred revenue, non-current	1,059	858
Notes payable, non-current	2,187	4,661
Total liabilities	57,412	62,582
Commitments and contingencies		
Stockholders' equity:		
Preferred stock	—	—
Common stock	33	33
Additional paid-in capital	397,971	395,069
Treasury stock	(5,690)	(3,353)
Accumulated other comprehensive loss	(372)	(92)
Accumulated deficit	(282,686)	(283,199)
Total stockholders' equity	109,256	108,458
Total liabilities and stockholders' equity	$ 166,668	$ 171,040

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 June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Revenue:				
Subscriptions and support	$17,361	$15,104	$34,988	$29,572
Service	8,735	7,979	18,407	16,212
License	5,849	7,143	14,542	13,492
Total revenue	31,945	30,226	67,937	59,276
Cost of revenue:				
Subscriptions and support	6,330	5,166	12,291	9,912
Service	6,205	5,636	13,096	11,226
License	54	200	118	292
Amortization of acquired intangible assets	1,385	2,051	3,069	4,301
Total cost of revenue	13,974	13,053	28,574	25,731
Gross margin	17,971	17,173	39,363	33,545
Operating expenses:				
Research and development	5,565	5,258	11,395	10,297
Sales and marketing	8,617	8,954	17,345	16,857
General and administrative	4,885	4,414	10,061	9,420
Restructuring	37	—	122	—
Total operating expenses	19,104	18,626	38,923	36,574
Income (loss) from operations	(1,133)	(1,453)	440	(3,029)
Interest expense	(178)	(364)	(400)	(743)
Interest income	344	379	837	541
Other, net	(17)	(34)	4	(43)
Income (loss) before provision for income taxes	(984)	(1,472)	881	(3,274)
Provision for income taxes	5	47	368	71
Net income (loss)	$ (989)	$ (1,519)	$ 513	$ (3,345)
Net income (loss) per share, basic	$ (0.03)	$ (0.05)	$ 0.02	$ (0.12)
Net income (loss) per share, diluted	$ (0.03)	$ (0.05)	$ 0.02	$ (0.12)
Weighted average common shares outstanding, basic	31,937	29,609	32,057	28,224
Weighted average common shares outstanding, diluted	31,937	29,609	32,796	28,224

	Three-Months Ended June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Stock-based compensation expenses:				
Cost of revenue - subscriptions and support	$ 72	$ 60	$ 142	$ 120
Cost of revenue - service	143	128	293	265
Research and development	193	141	368	279
Sales and marketing	367	257	722	532
General and administrative	482	503	951	945
Total stock-based compensation expense	$ 1,257	$ 1,089	$ 2,476	$ 2,141

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

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

	Six-Months Ended June 30, 2008	Six-Months Ended June 30, 2007
Cash flows from operating activities:		
Net income (loss)	$ 513	$ (3,345)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,379	1,843
Amortization of intangible assets	3,068	4,301
Provision for (recovery of) sales returns and doubtful accounts	51	(85)
Accretion of interest on short-term investments	(158)	(191)
Amortization of discount on notes payable	70	137
Stock-based compensation	2,476	2,141
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	1,483	4,561
Prepaid expenses and other current assets	390	(744)
Other assets	(120)	50
Accounts payable	(618)	(838)
Accrued compensation and benefits	(558)	(1,713)
Other accrued liabilities	415	(1,423)
Restructuring accrual	70	(807)
Deferred revenue	(1,746)	5,117
Net cash provided by operating activities	7,715	9,004
Cash flows from investing activities:		
Purchases of property and equipment	(1,813)	(3,306)
Purchases of short-term investments	(6,323)	(13,885)
Sales/maturities of short-term investments	31,555	5,101
Release of restricted cash	—	23
Net cash provided by (used in) investing activities	23,419	(12,067)
Cash flows from financing activities:		
Net proceeds from the issuance of common stock pursuant to registered direct offering	—	32,710
Repayment of credit facility	(2,188)	(2,187)
Payment of notes payable	(584)	(584)
Purchase of treasury stock	(2,337)	—
Issuance of common stock pursuant to Employee Stock Purchase Plan and exercises of stock options	426	2,063
Net cash provided by (used in) financing activities	(4,683)	32,002
Effect of foreign exchange rate changes on cash and cash equivalents	(122)	(151)
Net increase in cash and cash equivalents	26,329	28,788
Cash and cash equivalents at beginning of period	19,182	10,176
Cash and cash equivalents at end of period	$45,511	$ 38,964
Supplemental disclosure of cash flow information		
Interest paid	$ 360	$ 653
Income taxes paid	$ 265	$ 1

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 learning, performance and talent 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, Inc. ("Docent") by Click2learn, Inc. ("Click2Learn").

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial data as of June 30, 2008, and for the three-months and six-months ended June 30, 2008 and 2007, 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, 2007 condensed consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by GAAP.

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. There were no significant changes in our accounting policies that occurred during the three-month and six-month periods ended June 30, 2008 from those policies outlined in SumTotal Systems' Annual Report of Form 10-K which was filed with the SEC on March 13, 2008 that have materially affected its 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 SumTotal Systems' audited consolidated financial statements contained in the Annual Report on Form 10-K.

Principles of Consolidation

All significant inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. 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 other assumptions. On an ongoing basis, SumTotal Systems evaluates estimates, including those related to revenue recognition, allowance for sales returns and doubtful accounts, intangible assets, restructuring reserves, stock-based compensation, valuation reserves for deferred tax assets and the income tax provision. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents of $45.5 million and $19.2 million at June 30, 2008 and December 31, 2007, respectively, are comprised of highly liquid financial instruments consisting primarily of investments in money market funds and commercial paper, with insignificant interest rate risk and with original maturities of three-months or less. Cash equivalents are stated at amounts that approximate fair value, based on quoted market prices.

Short-term Investments

Short-term investments of $5.1 million and $30.1 million at June 30, 2008 and December 31, 2007, respectively, are stated at fair value. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities* , management determines the appropriate classification of the debt securities at the time of purchase and re-evaluates the designation as of each balance sheet date. SumTotal Systems classified all of the debt securities as available-for-sale pursuant to SFAS No. 115. Short-term investments consist principally of taxable, short-term marketable investment instruments; such as commercial paper, publicly traded common stock and treasury notes, with maturities or callable dates between three-months and one year. SumTotal Systems states its investments at estimated fair value with unrealized gains and losses reported in accumulated other comprehensive income (loss). A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in an impairment to reduce the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, SumTotal Systems considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the costs of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reason for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, forecasted performance of the investee, and the general market condition in the geographic area or industry the investee operates in. The specific identification method is used to determine the costs of securities disposed of, with realized gains and losses reflected in other expense, net. Investments are anticipated to be used for current operations.

Fair Value of Financial Instruments

The carrying amounts of certain of SumTotal Systems' financial instruments including cash, cash equivalents, short-term investments, accounts receivable, accounts payable, accrued liabilities and deferred revenue approximate fair value due to their short maturities. The carrying amount of the credit facility approximates fair value as this facility bears interest at a variable rate tied to the current market, and has terms similar to other borrowing arrangements available to SumTotal Systems.

Concentration of Credit Risk

Financial instruments that potentially subject SumTotal Systems to concentration of credit risk consist principally of cash, cash equivalents, short-term investments and accounts receivable. SumTotal Systems' cash, cash equivalents and short-term investments are deposited with several financial institutions, which, at times, may exceed federally insured limits. Cash, cash equivalents and short-term investments are invested in short-term highly liquid investment-grade obligations of commercial issuers.

Accounts receivable include amounts due from customers in a wide variety of industries, throughout North and South America, Europe, Middle East and Africa and the Asia/Pacific region. Accounts receivable are recorded at the invoiced amount and do not bear interest. SumTotal Systems performs ongoing credit evaluations of its customers, does not require collateral and maintains allowances for potential credit losses based on the expected collectability of its accounts receivable. To date, such losses have been within management's expectations. At June 30, 2008 and December 31, 2007, respectively, SumTotal Systems had no customers that accounted for greater than 10% of accounts receivable, net of allowance for sales returns and doubtful accounts. One of our global retail customers accounted for 11.6% of total revenue in the six-months ended June 30, 2008. No customer accounted for greater than 10% of total revenue in the three-months ended June 30, 2008, or the three-months or six-months ended June 30, 2007.

Revenue Recognition

SumTotal Systems recognizes revenue from three sources: (1) maintenance, support services and subscription fees from clients accessing its on-demand software and hosting arrangements, all of which SumTotal Systems refers to as subscriptions and support sales, (2) services performed in connection with consulting arrangements, and (3) sales of software licenses and related products. Revenue derived from software licenses and related products is subject to the guidance and requirements of American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition* , as amended by SOP No. 98-9, *Software Revenue Recognition with Respect to Certain Arrangements* . Revenue from on-demand subscriptions is recognized in accordance with SEC Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition* . In the event of a multiple element arrangement, SumTotal Systems evaluates the transaction as if each element represents a separate unit of accounting taking into account all factors following the guidelines set forth in SOP No. 97-2 and Emerging Issues Task Force ("EITF") No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* . In accordance with these standards, SumTotal Systems recognizes revenue when all of the following four conditions are met:

1. *Persuasive evidence of an arrangement exists.* For the vast majority of transactions, SumTotal Systems considers a non-cancelable agreement signed by a customer and SumTotal Systems to be persuasive evidence of an arrangement. For maintenance renewals, an arrangement is evidenced by cash collection or a customer purchase order;
2. *Delivery has occurred* . In perpetual licensing arrangements, SumTotal Systems considers delivery to have occurred when the software has been delivered to the customer in the manner prescribed in the contractual arrangement and there are no further performance obligations. Services (including professional services, maintenance, and hosting) and on-demand subscriptions are typically considered delivered as performed;
3. *Fee is fixed or determinable* . SumTotal Systems considers the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within SumTotal Systems' standard payment terms. SumTotal Systems considers payment terms greater than ninety days to be beyond SumTotal Systems' customary payment terms. In these cases, or if the arrangement price is subject to refund, concession or other adjustment, then SumTotal Systems considers the fee to not be fixed or determinable. In these cases, revenue is deferred and recognized when payments become due and payable, or the right to refund or adjustment lapses; and
4. *Collection is probable* . SumTotal Systems conducts a credit review for all significant transactions at the time of the arrangement to determine the creditworthiness of the customer. Collection is deemed probable if SumTotal Systems expects that the customer will be able to pay amounts under the arrangement as payments become due. If SumTotal Systems determines that collection is not probable, SumTotal Systems defers the recognition of revenue until cash collection.

SumTotal Systems sells both perpetual and term-based software licenses. SumTotal Systems' customers may or may not purchase with licenses the following: (i) support services that provide for technical support and product updates, generally over renewable 12-month periods, (ii) professional services including consulting and training, and (iii) hosting. Depending upon the elements and the terms of the arrangement, SumTotal Systems recognizes license revenues under the residual method or using contract accounting.

Residual Method. License fees are recognized upon delivery whether sold separately or together with other services, described above, provided that: (i) the revenue recognition above have been met, (ii) payment of the license fees is not dependent on any implementation or performance criteria, (iii) the related services do not contain any acceptance provisions, and (iv) services are not essential to the functionality of the software. In these cases, SumTotal Systems recognizes license revenue utilizing the residual method, as prescribed in SOP No. 97-2, as amended by SOP No. 98-9. Under the residual method, revenue is recognized when vendor-specific objective evidence of fair value exists for all of the undelivered elements in the arrangement (i.e.: maintenance, professional services and hosting), but does not exist for one or more of the delivered elements in the arrangement (i.e.: software license). Under the residual method, SumTotal Systems defers the fair value of undelivered elements and the remainder of the arrangement fee is then allocated to the delivered elements and is recognized as revenue assuming the other revenue recognition criteria are met. Each license arrangement requires careful analysis to ensure that all of the individual elements in the license transaction have been identified, along with the fair value of each undelivered element.

SumTotal Systems allocates revenue to each undelivered element based on its fair value, with the fair value determined by the price charged when that element is sold separately. If evidence of fair value cannot be established for the undelivered elements of a license agreement, the entire amount of revenue from the arrangement is deferred until evidence of fair value can be established, or until the items for which evidence of fair value cannot be established are delivered. If the only undelivered element is maintenance or hosting, then the entire amount of revenue is recognized over the delivery period.

Vendor-specific objective evidence is established for most maintenance and hosting of SumTotal Systems' products based upon the amounts SumTotal Systems charges when maintenance and hosting are sold separately (renewals). Vendor-specific objective evidence for maintenance in arrangements where license value is greater than one million dollars, SumTotal Systems utilizes the contractual stated renewal rate, provided that the stated renewal rate is considered substantive.

Partner Arrangements. Distributors, resellers and systems integrators purchase products for specific projects of the end-user and do not hold inventory. They perform functions that include importation, delivery to the end-customer, installation or integration and post-sales service and support. The agreements with these partners have terms which are generally consistent with the standard terms and conditions for the sale of SumTotal Systems' software to end-users and do not provide for product rotation or pricing allowances, as are typically found in agreements with stocking distributors. Revenue on shipments to SumTotal Systems' partners is generally recognized on sell-through after the end user has been identified and the product has been delivered.

Contract Accounting. When the services are deemed essential to the functionality of the software element of the arrangement and separate accounting for the services is not permitted, or the contracts have fixed fees, milestones or acceptance clauses, contract accounting is applied to both the software and service elements. For these projects, revenue is recognized in accordance with SOP No. 81-1, *Accounting for Performance of Construction Type and Certain Production Type Contracts* .

Typically, a percentage-of-completion basis is evidenced by labor costs incurred compared to estimated total labor costs to complete the project. The application of the appropriate accounting principle to SumTotal Systems' revenue is dependent upon the specific transaction and whether the sale includes software and software-related products, on-demand subscriptions, services, or a combination of these items. SumTotal Systems utilizes the cost basis alternative to allocate revenue under SOP No. 81-1. For percentage-of-completion basis contracts, SumTotal recognizes revenue at the lesser of the percentage-of-completion basis or the contractual ability to invoice. SumTotal Systems has the ability to produce reasonably dependable estimates of contract billings and contract costs.

Estimated losses on uncompleted contracts are recorded in the period in which it is first determined that a loss is apparent. Amounts billed in excess of revenue recognized are recorded as deferred revenue in the accompanying consolidated balance sheets, net of any direct incremental costs which have been determined to be recoverable. Revenue recognized in accordance with SOP No. 81-1 is allocated for classification purposes in the statement of operations between license and service revenues based on an estimate of the fair value of the service portion of the arrangement as indicated by rates that SumTotal Systems separately sells similar services and use of the residual method for the license component.

Professional services from time and materials contracts and training services, along with the related costs are recognized as these services are performed.

Maintenance and Hosting Revenue

These arrangements are recognized on a straight-line basis over the life of the contract. Based on the criteria outlined in EITF No. 00-03, *Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware* , SumTotal Systems has determined that the vast majority of SumTotal Systems' hosting arrangements are within the scope of SOP No. 97-2. The applicability of EITF No. 00-03 allows SumTotal Systems to recognize that portion of the fee attributable to the license on delivery, while that portion of the fee related to the hosting element is recognized ratably as the service is provided, assuming all other revenue recognition criteria of SOP No. 97-2 have been met. In cases where the hosting arrangement falls outside of the scope of SOP No. 97-2, SumTotal Systems recognizes the arrangement ratably under the provisions of SAB No. 104.

On-Demand Subscriptions

In hosted arrangements where SumTotal Systems provides its software applications as a service, SumTotal Systems considered EITF No. 00-03 and concluded that generally these transactions are considered service arrangements and fall outside of the scope of SOP No. 97-2. Accordingly, SumTotal Systems follows the provisions of SAB No. 101, SAB No. 104 and EITF No. 00-21 . Customers typically prepay for these services, amounts which SumTotal Systems defers and recognizes ratably over the non-cancelable term of the customer contract. In addition to the hosting services, these arrangements may also include set-up fees which are sold at a fixed fee and/or customizations which are billed on a time-and-materials basis. SumTotal Systems recognizes the revenue from these set-up fees ratably over the term of the expected customer relationship once the implementation is complete and the customer has access to the software. SumTotal Systems recognizes the revenue from related professional services ratably over the remaining term of the initial contract once the implementation is complete and the customer has access to the software. In addition, SumTotal Systems defers the direct and incremental costs of the implementation and configuration services and amortizes those costs over the same time period as the related revenue is recognized. If the direct costs incurred for a contract exceed the non-cancelable contract value, then SumTotal Systems will recognize a loss for incurred and projected direct costs in excess of the contract value as a period expense when the loss first becomes apparent.

Allowance for Sales Returns and Doubtful Accounts

SumTotal Systems assesses the credit worthiness of its customers based on multiple sources of information and analyzes such factors as its historical bad debt experiences, industry and geographic concentrations of credit risk, economic trends and changes in customer payment terms. This assessment requires significant judgment. Because of this assessment, which covers the sales of all SumTotal Systems' products and services, SumTotal Systems maintains an allowance for doubtful accounts for potential future estimated losses resulting from the inability of certain customers to make all of their required payments. In making this estimate, SumTotal Systems analyzes historical payment performance, current economic trends, changes in customer demand of its products when evaluating the adequacy of the allowance for sales returns and doubtful accounts. A reserve for future sales returns is also established based on historical trends in product return rates and is recorded as a reduction to SumTotal Systems' revenue and accounts receivable. Accounts receivable are written-off to revenue or the allowance for doubtful accounts when all collection efforts have been exhausted and it is deemed uncollectible.

Commissions

Commissions are generally expensed as they are earned per the terms of the sales compensation plans. SumTotal Systems' commissions on noncancelable subscriptions are deferred and amortized to sales expense over the noncancelable term of the related customer contracts, which are typically 12 to 36 months.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the related assets. Computer equipment and software have estimated useful lives typically ranging from between three to five years. Furniture and fixtures have useful lives typically of five years. Leasehold improvements and assets acquired under capital leases are amortized on a straight-line basis over the term of the lease, or the estimated useful life of the assets, whichever is shorter. Maintenance and repairs are charged to expense as incurred and improvements and betterments are capitalized. When assets are retired or otherwise disposed of, the cost and accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is reflected in the statement of operations for the period realized.

Impairment of Long-Lived Assets

Long-lived assets, such as property, plant and equipment and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* . Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset group exceeds the fair value of the asset group.

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Business Combinations

In accordance with SFAS No. 141, *Business Combinations* , all acquisitions have been accounted for under the purchase method of accounting and include the results of operations of the acquired businesses since the date of acquisition. The net assets of the companies acquired were recorded at their estimated fair value as of the date of acquisition.

Goodwill and Intangible Assets

Goodwill represents the excess of costs over the net fair value of net identifiable assets acquired in a business combination. Goodwill is not amortized, but is instead tested for impairment at least annually, typically during the fourth quarter, in accordance with the provisions of SFAS No. 142, *Goodwill and Intangible Assets* . The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, *Business Combinations* . The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value for the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. For purposes of the annual goodwill impairment test, SumTotal Systems considers itself to be one reporting unit as management does not currently use product line financial performance as a basis for business operating decisions.

Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values using straight-line and accelerated methods designed to match the amortization to the benefits received where applicable. Purchased intangible assets subject to amortization are reviewed for impairment in accordance with SFAS No. 144, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset group exceeds the fair value of the asset group.

Restructuring Costs and Accruals for Excess Facilities

Restructuring costs and accruals for excess facilities are accounted for in accordance with SFAS No. 146, *Accounting for Exit or Disposal Activities,* as a liability for costs associated with an exit or disposal activity is recognized and measured initially at fair value only when the liability is incurred. Refer to Note 5, *Restructuring,* in the Notes to the Condensed Consolidated Financial Statements.

Capitalized Software

Costs related to internally developed software and software purchased for internal use, are capitalized pursuant to SOP No. 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use* . SumTotal Systems will capitalize qualifying internal payroll and external contracting and consulting costs related to the application development stage activities of internal use software after the conceptualization and formulation stage has been completed. SumTotal Systems ceases capitalization at the time the software is placed in service and amortizes such costs which are included in property, plant and equipment over the estimated useful life of the software. SumTotal Systems has not capitalized any software development costs in the six-months ended June 30, 2008.

Advertising

Costs related to advertising and promotion of products are charged to sales and marketing expense as incurred.

Income Taxes

Income taxes are accounted for under the asset and liability method in accordance with SFAS No. 109, *Accounting for Income Taxes* . Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to amounts expected to be realized.

Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of shares of common stock outstanding during the period, less outstanding unvested shares. The calculation of diluted net income per share includes potential dilutive common shares. Potential dilutive 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 income (loss) per share for the three-months and six-months ended June 30, 2008 and 2007 (in thousands, except per share amounts):

	Three-Months Ended June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Net income (loss)	$ (989)	$ (1,519)	$ 513	$ (3,345)
Weighted average common shares used to compute basic net income (loss) per share	31,937	29,609	32,057	28,224
Weighted average common shares used to compute diluted net income (loss) per share	31,937	29,609	32,796	28,224
Net income (loss) per share, basic	$ (0.03)	$ (0.05)	$ 0.02	$ (0.12)
Net income (loss) per share, diluted	$ (0.03)	$ (0.05)	$ 0.02	$ (0.12)

The following tables sets forth the reconciliation between basic and diluted weighted average common shares outstanding for the three-months and six-months ended June 30, 2008 and 2007 (in thousands):

	Three-Months Ended June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Weighted average common shares used to compute basic net income (loss) per share	31,937	29,609	32,057	28,224
Issuance of shares from stock options exercisable	—	—	2,708	—
Repurchase of shares from stock options proceeds	—	—	(1,969)	—
Weighted average common shares used to compute diluted net income (loss) per share	31,937	29,609	32,796	28,224

The following table sets forth the common stock options and warrants that have been excluded from the computation of diluted net income (loss) per share because their effects would have been anti-dilutive due to their exercise prices being in excess of market price for the three-months and six-months ended June 30, 2008 and 2007 (in thousands, except per option and warrant amounts):

	Three-Months Ended June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Options to acquire shares of common stock	4,201	749	4,935	749
Weighted average option price	$ 7.80	$ 15.94	$ 7.31	$ 15.94
Warrants to acquire shares of common stock	587	1,424	587	1,424
Weighted average warrant price	$ 9.80	$ 7.54	$ 9.80	$ 7.54

SumTotal Systems awarded restricted stock unit awards to select employees in both the first and second quarters of 2008 and recognizes these awards in equity upon vesting. Unvested restricted stock unit awards are excluded in the three-months ended June 30, 2008, as SumTotal Systems incurred a net loss in this period and the effect of including these awards would have been anti-dilutive. SumTotal Systems recognizes restricted stock awards in equity upon issuance and excludes the unvested portion from earnings per share.

For the three-months ended June 30, 2008, SumTotal Systems had 2,257,000 options with exercise prices below the weighted average fair market value of common stock for the period which were excluded from diluted weighted average shares calculation because of SumTotal Systems' net loss position in the period. For the three-months and six-months ended June 30, 2007, SumTotal Systems had 5,863,000 and 5,862,000 options, respectively, with exercise prices below the weighted average fair market value of common stock for the period which were excluded from diluted weighted average shares calculation because of SumTotal Systems' net loss position in the periods.

Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

The following table sets forth the components of comprehensive income (loss) for the three-months ended June 30, 2008 and 2007 presented below (in thousands):

	Three-Months Ended June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Net income (loss)	$ (989)	$(1,519)	$ 513	$(3,345)
Unrealized loss on investments	—	(2)	(7)	(2)
Foreign currency translation adjustment	(331)	(15)	(272)	4
Comprehensive income (loss)	$(1,320)	$(1,536)	$ 234	$(3,343)

SumTotal Systems' total comprehensive income (loss) for the three-months and six-months ended June 30, 2008 and 2007 consisted of net income (loss), the change in foreign currency translation adjustments and unrealized gain/loss on investments. The tax effects on the foreign currency translation adjustments have not been significant. Accumulated other comprehensive loss at June 30, 2008, consists of foreign currency translation loss adjustments of $369,000 and unrealized loss on investments of $3,000.

Stock-Based Compensation

On January 1, 2006, SumTotal Systems adopted SFAS No. 123R, *Share-Based Payment* , 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. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award and to recognize it as compensation expense over the period the employee is required to provide service in exchange for the award, usually the vesting period. SFAS No. 123R supersedes SumTotal Systems previous accounting under Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees* , for periods beginning in fiscal year 2006. In March 2005, the SEC issued SAB No. 107 relating to SFAS No. 123R. SumTotal Systems applied the provisions of SAB No. 107 and SAB No. 110 in the adoption of SFAS No. 123R.

SumTotal Systems adopted SFAS No. 123R using the modified prospective transition method. 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.

SFAS No. 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in SumTotal Systems' consolidated statement of operations. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The estimated forfeiture rates the three-months ended June 30, 2008 and 2007 were 10.54% and 11.85%, respectively, and were based on historical compound annual forfeiture experience.

The fair value of stock options-based awards to employees is calculated using the Black-Scholes option pricing model, even though this model was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which differ significantly from SumTotal Systems' stock options. The Black-Scholes model also requires subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The expected term of options granted during fiscal year 2007 was derived from the use of the simplified method under SAB No. 107 and the expected term of options granted subsequent to December 31, 2007 was derived as governed by SAB No. 110. The risk-free rate is based on the U.S. Treasury rates in effect which most closely corresponds to a period of grant. The expected volatility is based on the historical volatility of the stock price over a period at least as long as the expected term of the options. These factors could change in the future, which would affect the stock-based compensation expense in future periods.

For restricted stock and restricted stock unit awards, stock-compensation is calculated based on the fair market value of the stock on the actual grant date.

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 based on historical experience 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.

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The weighted-average fair value calculations for options granted within the period are based on the following weighted average assumptions set forth in the table below. Options that were granted in prior periods are based on assumptions prevailing at the date of grant.

	Three-Months Ended June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Risk-free rate	3.4%	4.7%	3.3%	4.7%
Expected volatility	76.1%	88.2%	76.7%	89.2%
Expected life (years)	6.25	6.13	6.25	6.14

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

	Six-Months Ended June 30,	
	2008	2007
Risk-free rate	2.2%	5.2%
Expected volatility	48.9%	52.0%
Expected life (years)	0.5	0.49

The following table summarizes stock-based compensation expense related to employee stock options, shares associated with the ESPP and restricted stock and restricted stock units under SFAS No. 123R for the three-month and six-month periods ended June 30, 2008 and 2007 which were allocated as follows (in thousands):

	Three-Months Ended June 30,		Six-Months Ended June 30,	
	2008	2007	2008	2007
Stock-based compensation expenses:				
Subscriptions and support	$ 72	$ 60	$ 142	$ 120
Service	143	128	293	265
Total costs of revenue	215	188	435	385
Research and development	193	141	368	279
Sales and marketing	367	257	722	532
General and administrative	482	503	951	945
Stock-based compensation included in operating expenses	1,042	901	2,041	1,756
Total stock-based compensation expense	$ 1,257	$ 1,089	$ 2,476	$ 2,141

A summary of option activity under SumTotal Systems' stock equity plans during the six-months ended June 30, 2008 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, 2007	6,407	$ 6.74	6.64	
Granted	304	4.50		
Exercised	(46)	2.55		$ 101
Cancelled	(346)	7.60		
Outstanding at June 30, 2008	6,319	$ 6.62	6.46	$ 1,521
Exercisable at June 30, 2008	4,500	$ 6.89	5.62	$ 1,414

A summary of the status of the changes in SumTotal Systems' restricted stock during the six-months ended June 30, 2008 is as follows:

	Number of Shares (in thousands)	Weighted Average Grant Date Fair Value
Non-vested restricted stock at December 31, 2007	54	$ 4.69
Granted	—	—
Vested	25	4.30
Cancelled	—	—
Non-vested restricted stock at June 30, 2008	29	$ 5.03

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A summary of the status of the changes in SumTotal Systems' restricted stock units during the six-months ended June 30, 2008 is as follows:

	Number of Shares (in thousands)	Weighted Average Grant Date Fair Value
Non-vested restricted stock units at December 31, 2007	67	$ 5.03
Granted	427	4.61
Vested	—	—
Cancelled	(3)	4.57
Non-vested restricted stock units at June 30, 2008	491	$ 4.67

The total intrinsic value of options exercised during the three-months and six-months ended June 30, 2008 was approximately $46,000 and $101,000, respectively. The total intrinsic value of shares issued under the employee stock purchase plan during the six-months ended June 30, 2008, was approximately $40,000. The fair value of options vested during the three-months and six-months ended June 30, 2008, was approximately $1.3 million and $2.4 million, respectively. As of June 30, 2008, total unrecognized compensation costs related to non-vested stock options, restricted stock and restricted stock units was $10.8 million, which is expected to be recognized as expense over a weighted average period of approximately 2.4 years. The weighted average grant date fair value of options granted in the three-months and six-months ended June 30, 2008, was $4.52 and $4.57, respectively.

Adoption of Accounting Standards

In February 2006, the Financial Accounting Standards Board ("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.

Effective January 1, 2007, SumTotal Systems adopted FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* , which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with 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 No. 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. In accordance with FIN No. 48, paragraph 19, SumTotal Systems has decided to classify interest and penalties as a component of income 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 2007.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-2, *Effective Date of FASB Statement No. 157* , which delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. On January 1, 2008, SumTotal Systems adopted SFAS No. 157 which did not have a material impact on its financial position and results of operations.

SFAS No. 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are either directly or indirectly observable; and
- Level 3: unobservable inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing.

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides the assets and liabilities carried at fair value measured on a recurring basis as of June 30, 2008 (in thousands):

	Total Carrying Value	Fair Value Measurements at June 30, 2008 Using: Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 45,511	$ 45,511	$ —	$ —
Short-term investments	5,069	5,069	—	—
Total cash, cash equivalents and short-term investments	$ 50,580	$ 50,580	$ —	$ —

Short-term investments are measured at fair value using quoted market prices and are classified within Level 1 of the valuation hierarchy.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* . SFAS No. 159 permits entities to measure many financial instruments and certain other items at fair value at specified election dates. Under SFAS No. 159, any unrealized holding gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. If elected, the fair value option (1) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (2) is irrevocable (unless a new election date occurs); and (3) is applied only to entire instruments and not to portions of instruments. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 provided the entity also elects to apply the provision of SFAS No. 157. On January 1, 2008, SumTotal Systems adopted SFAS No. 159 which did not have a material impact on its financial position, results of operations and cash flows.

In June 2007, the FASB ratified EITF 07-03, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* . EITF No. 07-03 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF No. 07-03 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007. On January 1, 2008, SumTotal Systems adopted EITF No. 07-03 which did not have a material impact on its financial position, results of operations and cash flows.

In December 2007, the SEC issued SAB No. 110, which expressed the views of the SEC staff regarding the use of a “simplified” method, as discussed in SAB No. 107, in developing an estimate of expected term of “plain vanilla” share options in accordance with SFAS No. 123R. In particular, the staff indicated in SAB No. 107 that it will accept a company’s election to use the simplified method, regardless of whether the company has sufficient information to make more refined estimates of expected term. At the time SAB No. 107 was issued, the staff believed that more detailed external information about employee exercise behavior would, over time, become readily available to companies. Therefore, the SEC staff stated in SAB No. 107 that it would not expect a company to use the simplified method for share option grants after December 31, 2007. SumTotal Systems adopted SAB No. 110 for all share option grants issued subsequent to December 31, 2007 which did not have a material effect on its financial position, results of operations and cash flows. SumTotal Systems is currently accumulating the information required to calculate a more precise stock option term estimation.

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised), *Business Combinations* . SFAS No. 141(R) changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer’s income tax valuation allowance. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. SumTotal Systems will be required to adopt SFAS No. 141(R) in the first quarter of fiscal year 2009. Depending on the size, nature and complexity of a future acquisition transaction, such transaction costs could be material to SumTotal Systems’ financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* , an amendment of ARB No. 51, Consolidated Financial Statements. SFAS No. 160 changes the accounting for noncontrolling (minority) interests in consolidated financial statements including the requirements to classify noncontrolling interests as a component of consolidated stockholders’ equity, and the elimination of “minority interest” accounting in results of operations with earnings attributable to noncontrolling interests reported as part of consolidated earnings. Additionally, SFAS No. 160 revises the accounting for both increases and decreases in a parent’s controlling ownership interest. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. SumTotal Systems will be required to adopt SFAS No. 160 in the first quarter of fiscal year 2009. SumTotal Systems does not expect the adoption of SFAS No. 160 to have a material effect on its financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, *Disclosure about Derivative Instruments and Hedging Activities* . SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments. SFAS No. 161 applies to all entities that prepare consolidated financial statements and to all derivative instruments, including bifurcated derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments as defined in SFAS No. 133) and related hedged items accounted for under SFAS No. 133 and its related interpretations. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early adoption is encouraged. SumTotal Systems is currently assessing the financial impact the adoption of SFAS No. 161 will have on its financial position, results of operations and cash flows.

In May 2008, the FASB issued SFAS No. 162, The *Hierarchy of Generally Accepted Accounting Principles* . SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP in the U.S. The current GAAP hierarchy is set forth in the AICPA Statement of Auditing Standards ("SAS") No. 69, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles* . The FASB believes that GAAP hierarchy should be directed to entities because it is the entity (not it's auditor) that is responsible for selecting accounting principles for financial statements that are presented in confirmity with GAAP. Accordingly, the FASB concluded that the GAAP hierarchy should reside in the accounting literature established by the FASB and has issued SFAS No. 162 to achieve that result. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to SAS No. 69. SumTotal Systems is currently assessing the financial impact the adoption of SFAS No. 162 will have on its financial position, results of operations and cash flows.

NOTE 3: GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets at June 30, 2008 and December 31, 2007 are as follows (in thousands):

	June 30, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill	$68,461	$ —	$ 68,461
Intangible assets:			
Acquired technology	$13,312	$ (11,984)	$ 1,328
Customer installed-base relationships	17,094	(9,546)	7,548
Customer hosted relationships	1,014	(870)	144
Customer contract relationships	8,525	(7,689)	836
Non-compete covenant	980	(980)	—
Total intangible assets	$40,925	$ (31,069)	$ 9,856

	December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill	$68,461	$ —	$ 68,461
Intangible assets:			
Acquired technology	$13,312	$ (11,178)	$ 2,134
Customer installed-base relationships	17,094	(7,844)	9,250
Customer hosted relationships	1,014	(768)	246
Customer contract relationships	8,525	(7,231)	1,294
Non-compete covenant	980	(980)	—
Total intangible assets	$40,925	$ (28,001)	$ 12,924

There was no impairment of goodwill or intangible assets for the three-months ended June 30, 2008 and 2007, respectively.

The following represents the expected future amortization of intangible assets as of June 30, 2008 (in thousands):

Remainder of 2008	$2,771
2009	4,038
2010	1,841
2011	1,080
2012	126
Total expected future amortization of intangible assets	$9,856

Amortization expense related to intangible assets was approximately $1,385,000 and $2,051,000 in the three-months ended June 30, 2008 and 2007, respectively and approximately $3,069,000 and $4,301,000 in the six-months ended June 30, 2008 and 2007, respectively.

NOTE 4: BORROWINGS

The current portion of notes payable consists of the following (in thousands):

	June 30, 2008	December 31, 2007
Credit facility	$4,375	$ 4,375
Litigation settlement	858	1,116
MindSolve shareholder	696	666
Total current portion of notes payable	$5,929	$ 6,157

The non-current portion of notes payable consists of the following (in thousands):

	June 30, 2008	December 31, 2007
Credit facility	$2,187	$ 4,375
Litigation settlement	—	286
Total non-current portion of notes payable	$2,187	$ 4,661

Credit Facility

Concurrent with the closing of the acquisition of Pathlore, Inc. (“Pathlore”) on October 4, 2005, SumTotal Systems entered into a credit facility with Wells Fargo Foothill, principally to fund a portion of the acquisition price and to provide for its ongoing working capital requirements. Under the terms of the facility, Wells Fargo Foothill loaned SumTotal Systems $17.5 million to complete the acquisition of Pathlore and provided a revolving credit facility to a maximum of $5.0 million (the “Revolver”), as adjusted, to meet the working capital requirements of the business.

Prior to the amendment of the credit facility on June 19, 2007, outstanding loan balances would bear interest at Wells Fargo Foothill’s base rate plus 2%, unless SumTotal Systems elected to be charged at the London Intrabank Offered Rate (“LIBOR”) rate plus 3.5%. On June 19, 2007, SumTotal Systems entered into an amendment of its credit facility in which, among other things, the determination of the interest rate was changed from the description above to a scalable schedule of the base rate, based on earnings before interest, taxes, depreciation and amortization (“EBITDA”), as defined in the agreement. As of June 30, 2008, SumTotal Systems’ interest rate under the credit facility was the contractual 6% minimum rate, versus a calculated LIBOR rate of 2.6838% plus 2.25%, resulting in a total calculated interest rate of 4.9338%. The Term Loan is due in principal installments of $1,093,750 quarterly commencing January 1, 2006 and is secured by SumTotal Systems’ assets. The Term Loan and any remaining balance on the Revolver are due and payable on October 5, 2009. Any interest due on the Revolver must be paid at least every three months.

The Term Loan is subject to certain restrictive covenants which include, but are not limited to, maintaining certain levels of EBITDA, leverage ratios, as well as restrictions on capital expenditures, indebtedness, distributions, investments and on change of control. There is only monitoring and no enforcement of the financial covenants if SumTotal Systems maintains a minimum balance of at least $15.0 million between qualified cash accounts (accounts pledged to the lender) and excess availability under the Revolver. As of June 30, 2008, SumTotal Systems had $53.8 million, comprised of $49.0 million in qualified cash accounts and $4.8 million in excess availability under the Revolver and therefore no test of the covenants was required. SumTotal Systems was in compliance with all terms of its credit facility as of June 30, 2008. In the event that SumTotal Systems’ qualified cash balance falls below the $15.0 million threshold and it cannot achieve the financial results necessary to maintain compliance with these covenants, SumTotal Systems could be declared in default and be required to sell or liquidate its assets to repay the outstanding credit facility of $6.6 million at June 30, 2008.

In accordance with the terms of the Term Loan, SumTotal Systems made total payments of $1.2 million and $2.5 million to Wells Fargo Foothill during the three-months and six-months ended June 30, 2008, of which $1.1 million and $0.1 million were principal and interest, respectively, for the three-month period ended June 30, 2008, and $2.2 million and $0.3 million were principal and interest, respectively, for the six-month period ended June 30, 2008.

During July 2006, SumTotal Systems entered into an agreement with Wells Fargo Foothill in which SumTotal Systems will enter into forward foreign exchange contracts to mitigate certain foreign exchange exposures related to foreign trade receivables. As part of this agreement, the credit facility provides for a 5% reserve against the Revolver. As a result of the 5% reserve requirement, we have $250,000 less in funds available for use from the Revolver including debt covenant compliance and, accordingly, only

$4,750,000 was available for borrowings at June 30, 2008. Prospectively, at this time, SumTotal Systems anticipates it will only enter into forward foreign exchange hedging contracts to mitigate foreign currency exposures and will not enter into forward foreign exchange contracts for trading or speculative purposes.

On June 26, 2008, SumTotal Systems entered into a forward contract and sold approximately 2.5 million United Kingdom ("U.K.") Pound Sterling ("GBP"), equivalent $5.0 million United States Dollars ("USD"), with a maturity date of July 31, 2008, for which a hypothetical 10% appreciation of the GBP to USD would result in a $0.5 million gain and a hypothetical 10% depreciation of GBP to USD would result in a $0.5 million loss.

The effect of foreign exchange rate fluctuations accounted for in accumulated other comprehensive income for the three-months and six-months ended June 30, 2008 was a foreign translation loss of approximately $331,000 and a loss of $272,000, respectively, as compared to a foreign translation loss of approximately $16,000 and a gain of $2,000, in the comparable prior year periods, respectively. Due to the substantial volatility of currency exchange rates, among other factors, SumTotal Systems cannot predict the effect of exchange rate fluctuations on its future operating results.

Litigation Settlement

On March 14, 2006, SumTotal Systems entered into an agreement to settle all patent infringement claims with IpLearn that included, among other terms, a binding mutual release of all claims the parties may have had against each other, certain licenses and covenants not to sue, a payment from SumTotal Systems to IpLearn of $3.5 million, payable over three years and the issuance of 50,000 shares of SumTotal Systems' common stock to IpLearn valued at $181,000. The settlement was reached with no admission of liability or wrongdoing by any party. The aggregate amount of the settlement was accrued as of December 31, 2005. The remaining liability of $0.9 million is included in current notes payable on the accompanying Condensed Consolidated Balance Sheet.

MindSolve Stockholder

In connection with the MindSolve acquisition in November 2006, SumTotal Systems established two notes payable in the amount of $719,000 each to a former MindSolve officer. The remaining future obligation at June 30, 2008 amounts to $719,000 and will be paid in November 2008.

NOTE 5: RESTRUCTURING

The following table depicts restructuring activity for the six-months ended June 30, 2008 (in thousands):

	Balance at December 31, 2007	Additions	Reductions/ Cash Expenditures	Balance at June 30, 2008
Vacated facilities	$ 9	$ —	$ (5)	$ 4
Employee severance and other related costs	91	122	(47)	166
	$ 100	$ 122	$ (52)	$ 170

Obligations for restructured facility leases are accrued on the consolidated balance sheet at their net present values including estimated future sublease rentals based on current market expectations. Employee severance and other related costs consist of severance and other benefits resulting from our fourth quarter 2007 reduction in force. Additions to the restructuring for employee severance and other related costs in the six-months ended June 30, 2008 result primarily from extensions of severance packages to certain employees.

NOTE 6: TREASURY SHARE PURCHASES

On August 20, 2007, SumTotal Systems' Board of Directors authorized the repurchase up to $15.0 million of SumTotal Systems' outstanding shares of common stock. Stock repurchases will be made in the open market, in block purchase transactions, or in structured Rule 10b5-1 share repurchase plans, and may be made from time to time or in one or more larger repurchases. SumTotal Systems intends to conduct the repurchase in compliance with Rule 10b-18 of the Securities Exchange Act of 1934. The program does not obligate SumTotal Systems to acquire any particular amount of common stock and the program may be modified, suspended or terminated at any time at SumTotal Systems' discretion. As of June 30, 2008, SumTotal Systems has purchased 1,162,314 shares of common stock for an aggregate cost of approximately $5.7 million as follows:

Period	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Average Price Paid Per Share	Total Dollar Value of Shares Purchased as Part of Publicly Announced Plans or Programs (in thousands)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Programs (in thousands)
Through March 31, 2008	803,461	$ 4.98	$ 3,999	$ 11,001
April 1-30, 2008	2,000	3.93	8	10,993
May 1-31, 2008	210,731	4.74	999	9,994
June 1-30, 2008	146,122	4.68	684	9,310

Total	1,162,314	$ 4.90	$ 5,690	$ 9,310

NOTE 7: COMMITMENTS AND CONTINGENCIES

Commitments

SumTotal Systems leases office space and certain equipment under non-cancelable operating leases expiring in years through 2015. Rent expense under operating leases was approximately $709,000 and $658,000 during the three-months ended June 30, 2008 and 2007, respectively, and $1,413,000 and $1,340,000 during the six-months ended June 30, 2008 and 2007, respectively.

Future payments under operating lease obligations at June 30, 2008 are presented in the table below (in thousands):

	Payments Due by Period						
	Total	Remainder of 2008	2009	2010	2011	2012	Thereafter
Operating leases	$11,807	$ 1,324	$2,871	$2,003	$1,747	$1,754	$ 2,108

On February 14, 2008, SumTotal Systems entered into an additional amendment of its lease for the Bellevue, Washington facility which will extend the lease for an additional five years after the original lease expiration date of December 31, 2008. Included in the table above are aggregate base rent payments for the Bellevue, Washington lease of approximately $7.5 million for the five year period ended December 31, 2013.

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. In connection with the 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 and are being expensed ratably over the contractual performance period. Total remaining future obligations amount to $588,000 at June 30, 2008 and are scheduled to be paid in the fourth quarter of 2008.

Contingencies

On August 16, 2006, the Compensation Committee approved and adopted the form of Amended and Restated Change of Control Agreement for each of SumTotal Systems’ Section 16 officers. In the event of a change of control of SumTotal Systems and the subsequent termination of a Section 16 officer in a manner defined in the agreement as a termination event, SumTotal Systems will be obligated to pay the Section 16 officer certain compensation and benefits. If a termination event occurs, an officer would be entitled to one year of the officer’s base salary that would be paid in equal semi-monthly installments over a one year period following a termination event. Such officer will also be entitled to other benefits as described in Article III of the Amended and Restated Change of Control Agreement. This discussion is qualified in its entirety by SumTotal Systems’ Current Report on Form 8-K filed by us on August 17, 2006. In addition to this change of control agreement, the terms of SumTotal Systems’ Senior Vice President, Field Operations employment offer letter provides that if his employment is terminated prior to December 31, 2008, other than for cause or good reason, he would be entitled to be paid his base salary for the remainder of 2008, a pro rata portion of his annual bonus and other benefits as described in his offer letter. This discussion is qualified in its entirety by the Current Report on Form 8-K filed by SumTotal Systems on November 1, 2007.

From time to time, third parties assert patent infringement claims against SumTotal Systems in the forms of letters, litigation, or other forms of communication. In addition, without limitation, from time-to-time, SumTotal Systems is subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights, employment claims and general contract or other claims. SumTotal Systems’ management does not believe that any of the foregoing claims are likely to have a material adverse effect on its financial position, results of operations or cash flows. However, SumTotal Systems’ analysis of whether a claim may proceed to litigation cannot be predicted with certainty, nor can a claim proceed to litigation, nor can the results of litigation be predicted with certainty. Defending each of these actions, regardless of the outcome, may be costly and time consuming and may distract management personnel and have a negative effect on SumTotal Systems’ business. An adverse outcome in any of these actions, including a judgment or settlement, may cause a material adverse effect on SumTotal Systems’ future business, operating results and/or financial condition.

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For information regarding indemnifications, refer to Note 8, *Guarantees, Warranties and Indemnification*, in the Notes to Consolidated Condensed Financial Statements.

Effective January 1, 2007, SumTotal Systems adopted the provisions of FIN No. 48 which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* . Refer to Note 2, *Summary of Significant Accounting Policies – Adoption of Accounting Standards* , in the Notes to the Condensed Consolidated Financial Statements.

As part of its ongoing business, SumTotal Systems does not participate in material transactions that constitute relationships that are considered off-balance sheet arrangements.

NOTE 8: GUARANTEES, WARRANTIES AND INDEMNIFICATION

SumTotal Systems has adopted FIN No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* . FIN No. 45 provides expanded accounting guidance surrounding liability recognition and disclosure requirements related to guarantees. In the ordinary course of business, SumTotal Systems is not subject to potential obligations under guarantees that fall within the scope of FIN No. 45 except for standard indemnification and warranty provisions that are contained within many of its customer license and service agreements and give rise only to the disclosure requirements prescribed by FIN No. 45 .

Indemnification and warranty provisions contained within SumTotal Systems' customer license and service agreements are generally consistent with those prevalent in the industry. The duration of product warranties are generally between 90 to 365 days following delivery of the products. Significant obligations under customer indemnification or warranty provisions have not been incurred historically and are not expected in the future. Accordingly, accruals for potential customer indemnification or warranty-related obligations are not maintained.

SumTotal Systems has entered into indemnification agreements with its directors and certain of its officers that will require SumTotal Systems, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. SumTotal Systems has also agreed to indemnify certain former officers, directors and employees of acquired companies in connection with the acquisition of such companies. SumTotal Systems maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its directors and officers and former directors, officers and employees of acquired companies, in certain circumstances.

NOTE 9: SEGMENT INFORMATION

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, requires that companies report separately in the financial statements certain financial and descriptive information about operating segments profit or loss, certain specific revenue and expense items and segment assets. The method for determining what information is reported is based on the way that management organizes the operating segments for making operational decisions and assessments of financial performance. SumTotal Systems' chief operating decision maker is considered to be the Chief Executive Officer ("CEO"). The CEO reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. The consolidated financial information reviewed by the CEO is similar to the information presented in the accompanying unaudited condensed consolidated financial statements of operations. Currently, management does not use product line financial performance as a basis for business operating decisions. Therefore, SumTotal Systems has determined that it operates in a single reportable segment.

Revenue by international region is based on the direct billing location of the customer and is as follows (in thousands, except percentages):

	Three-Months Ended June 30,			
	2008		2007	
	Revenue	Percent of Revenue	Revenue	Percent of Revenue
United States	$24,745	77.5%	$23,540	77.9%
Other Americas	1,823	5.7%	1,745	5.8%
Total Americas	26,568	83.2%	25,285	83.7%
Europe	4,248	13.3%	3,234	10.7%
Asia/Pacific	1,129	3.5%	1,707	5.6%
Total revenue	$31,945	100.0%	$30,226	100.0%

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	Six-Months Ended June 30, 2008 Revenue	2008 Percent of Revenue	2007 Revenue	2007 Percent of Revenue
United States	$52,268	76.9%	$47,221	79.7%
Other Americas	4,147	6.1%	3,017	5.1%
Total Americas	56,415	83.0%	50,238	84.8%
Europe	9,154	13.5%	6,471	10.9%
Asia/Pacific	2,368	3.5%	2,567	4.3%
Total revenue	$67,937	100.0%	$59,276	100.0%

Long-lived assets, which represent property, plant and equipment, other assets and goodwill and intangible assets, net of accumulated depreciation and amortization, by geographic location are as follows (in thousands):

	June 30, 2008	December 31, 2007
United States	$84,443	$ 87,781
Europe	253	279
India	2,002	2,300
Asia/Pacific	158	139
Total long-lived assets	$86,856	$ 90,499

NOTE 10: LEGAL PROCEEDINGS

From time-to-time, SumTotal Systems is involved in legal proceedings or threats of legal proceedings arising in the ordinary course of business. SumTotal Systems is not currently a party to any litigation or other legal proceeding that, in the opinion of management, is reasonably likely to have a material adverse effect on its business, operating results and financial condition.

SumTotal Systems may, from time to time, also be subject to various legal or government claims, disputes or investigations. Such matters may include, but not be limited to, claims, disputes or investigations related to warranty, refund, breach of contract, employment, intellectual property, government regulation or compliance or other matters such as a subpoena SumTotal Systems received on April 30, 2008 from the U.S. Department of Defense, Office of the Inspector General. The subpoena requests documents related to SumTotal Systems' sale of products and services to the Department of Defense as well as other related documents. SumTotal Systems is cooperating with the government's request and is in the process of responding to the subpoena.

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

Forward-Looking Statements

The following discussion and analysis should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and related Notes contained elsewhere within this document. Operating results for the three-months ended June 30, 2008 are not necessarily indicative of the results that may be expected for any future periods, including the full fiscal year. Reference should also be made to the Annual Consolidated Financial Statements, Notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors contained in the SumTotal Systems Annual Report on Form 10-K for the year ended December 31, 2007.

This Quarterly Report includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. This Act provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information so long as they identify these statements as forward-looking and provide meaningful cautionary statements identifying important factors that could cause actual results to differ from the projected results. All statements other than statements of historical fact we make in this Quarterly Report are forward-looking. Such forward-looking statements including the words "may", "plans", "expects", "anticipates", "intends", "targets", "goals", "seeks", "believes", "potential", "continue", "predict", "could", "will", "estimate" and similar language, including variations of such words and include, but are not limited to, statements regarding the following: our belief that our available cash resources, combined with cash flows generated from revenues, will be sufficient to meet our presently *anticipated working capital, capital expense and business expansion requirements for at least the next 12 months; our belief that any current disputes will not result in litigation, but if they do, they will not have a material adverse effect on our business, operating results and/or financial condition; statements about future business operations, including future product launches; marketing statements; industry leadership; internal controls and procedures; statements about our product, SumTotal 8 Series; revenue recognition; continued growth in our revenues from our professional service organization; financial performance including, but not limited to, estimated revenues, bookings, operating expenses, gross margins, and profit, and market conditions that include risks and uncertainties are based on information that is available to us at the date of this Quarterly Report on Form 10-Q and reflects management's then current expectations, estimates, beliefs, assumptions and goals and objectives, and are subject to uncertainties that are difficult, if not impossible, to predict. Our actual results may differ significantly from those projected in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to those discussed in the section "Management's Discussion and Analysis of Financial Condition and Results of Operations —Factors That May Affect Future Results of Operations." You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.*

Executive Summary

Overview

We are a global provider of learning, performance, and talent management solutions. Our offerings include learning, performance and compensation management software and services. Our markets are worldwide and include a broad range of industries. We are the global market share leader in learning management systems based on revenue, according to a 2007 study by Bersin & Associates, an independent market research firm. Our solutions automate the talent management processes within organizations including aligning individuals' goals with business objectives, developing the individual's skills and competencies, assessing the individual's performance, providing succession planning and setting compensation based on performance. We sell our solutions to organizations primarily through our direct sales force, complemented by sales through our domestic and international partners. We offer our solutions on a subscription or perpetual license basis. Our solutions can be provided on an on-demand basis or deployed at the customer's site. We have more than 1,500 customers worldwide across a variety of industries, including education, energy, financial services, government, healthcare, manufacturing, retail, services and utilities.

In the three-months and six-months ended June 30, 2008, we continued to execute against our growth strategy. Highlights with respect to operations include:

- delivered SumTotal 8.0, the industry's only unified Talent Development Suite, bringing a unified approach to the critical components needed to successfully address business' talent development challenges;
- continued penetration into our customer base by selling additional licenses and modules;
- acquired new enterprise customers as enterprises increasingly standardize on one Learning Management System ("LMS") platform;
- continued growth in international regions;
- continued our sales into the small and medium business ("SMB") market through our on-demand solutions;
- expanded our performance management customer base through new customers and selling into our existing customer base;
- continued the deployment of our products in a hosted or on-demand model which has enabled us to increase our subscription and support revenue, which includes on-demand and hosting subscriptions, term licenses and maintenance; and
- continued innovation in the learning and talent management market with first-to-market release of solutions such as integration with SkillSoft's Open Learning Services Architecture and our new ToolBook Instructor release which includes the ability to rapidly create learning and interactive content for the Apple iPhone™.

Total revenue increased to $31.9 million in the three-months ended June 30, 2008 from $30.2 million in the comparable period in 2007. We generated a net income of $0.5 million in the six-months ended June 30, 2008, an increase from our net loss of $3.3 million in the comparable period in 2007. Further, we generated $7.7 million in cash from operating activities in the six-months ended June 30, 2008.

Critical Accounting Policies and Estimates

Certain of our accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments reflect practices, information provided by our customers and other assumptions that we believe are reasonable under the circumstances. Our estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period in which they are determined to be necessary. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies and estimates include:

- revenue recognition;

- allowances for sales returns and doubtful accounts;
- recoverability evaluation of our goodwill and intangible assets;
- valuation allowance for deferred tax assets;
- business combinations; and
- stock-based compensation.

Our senior management has reviewed these critical accounting policies and related disclosures with our Disclosure Committee and the Audit Committee of our Board of Directors. The Notes to the Condensed Consolidated Financial Statements, contained elsewhere in this Report, contain additional information regarding our accounting policies and other disclosures required by generally accepted accounting principles.

We have made no significant changes in our critical accounting policies and estimates since our previous filing on our Annual Report on Form 10-K, as filed with the SEC on March 13, 2008.

Comparison of Financial Data for the Three-Months Ended June 30, 2008 and 2007

Results of Operations

The following table presents our results of continuing operations as a percentage of total revenue for the three-months ended June 30, 2008 and 2007:

	2008	2007
Revenue:		
Subscriptions and support	54.4%	50.0%
Service	27.3	26.4
License	18.3	23.6
Total revenue	100.0	100.0
Cost of revenue:		
Subscriptions and support	19.8	17.1
Service	19.4	18.6
License	0.2	0.7
Amortization of intangible assets	4.3	6.8
Total cost of revenue	43.7	43.2
Gross margin	56.3	56.8
Operating expenses:		
Research and development	17.4	17.4
Sales and marketing	27.0	29.6
General and administrative	15.3	14.6
Restructuring	0.1	—
Total operating expenses	59.8	61.6
Loss from operations	(3.5)	(4.8)
Other income (expense), net	0.4	—
Loss before provision for income taxes	(3.1)	(4.8)
Provision for income taxes	(0.0)	0.2
Net loss	(3.1)%	(5.0)%

Revenue

Revenue for the three-months ended June 30, 2008 and 2007 was as follows (in thousands, except percentages):

	Three-Months Ended June 30,		Variance in	Variance in
	2008	2007	Dollars	Percent
Subscriptions and support	$17,361	$15,104	$ 2,257	14.9%
Percentage of net revenue	*54.4 %*	*50.0 %*		
Service	8,735	7,979	756	9.5%
Percentage of net revenue	*27.3 %*	*26.4 %*		
License	5,849	7,143	(1,294)	(18.1)%
Percentage of net revenue	*18.3 %*	*23.6 %*		
Total revenue	$31,945	$30,226	$ 1,719	5.7%

Our total revenues increased in the three-months ended June 30, 2008 to $31.9 million as compared to $30.2 million in the comparable period in 2007. The increase was primarily the result of growth in subscription and support revenues and growth in services revenues in the three months ended June 30, 2008 compared to same period in 2007, which was partially offset by a decrease in license revenue.

We attribute the revenue growth to a number of factors, including the shift in our business focus and strategy to our on-demand offering and increased investments in our sales and marketing efforts in international markets. Subscription and support revenues were also positively affected by the increase in the number of on-demand customers. The decrease in our license revenues and increase in recurring subscription and support revenues reflected the shift in our business emphasis and strategy from our perpetual license offering to on-demand subscriptions.

Subscriptions and support revenue. The increase in subscriptions and support revenue in the three-months ended June 30, 2008 over the comparable period in 2007 was as follows (in thousands, except percentages):

	Three-Months Ended June 30,		Variance in	Variance in
	2008	2007	Dollars	Percent
Hosting subscriptions	$ 3,993	$ 3,757	$ 236	6.3%
Term license rental arrangements	1,784	1,409	375	26.6%
On-demand subscriptions	2,099	1,216	883	72.6%
Total subscriptions	7,876	6,382	1,494	23.4%
Support maintenance	9,485	8,722	763	8.7%
Total subscriptions and support revenue	$17,361	$15,104	$ 2,257	14.9%

The increase in subscriptions and support revenue in the three-months ended June 30, 2008 over the comparative period in 2007 was the result of increased on-demand subscription sales to customers and from subscription and support contract sales to new and existing customers related to the SumTotal 8 Series and legacy product suites. These results reflect increased interest in on-demand solutions as a way for our global customers to manage costs effectively, and demonstrate continued growth within our installed base, and broad market interest in on-demand solutions for both Learning Management and Performance Management.

Changes to the components of subscriptions and support revenue were as follows:

- the increase in hosting subscriptions revenue was the result of $0.2 million in increased sales of hosting contracts to new and existing customers related to the SumTotal 8 Series and legacy products;
- the increase in term license rental arrangements revenue was the result of a $0.4 million increase in contract sales to new and existing customers related to the SumTotal 8 Series and legacy products;
- the increase in on-demand subscriptions revenue was the result of $0.9 million from increased on-demand subscription sales to new customers; and
- the increase in support maintenance revenue was the result of $0.8 million from increased contract sales to customers related to the SumTotal 8 Series and legacy products.

Price changes in subscription and support had no material effect on our revenue in the three-months ended June 30, 2008 over the comparative period.

Service revenue. The increase in professional services was attributed to a higher demand for upgrade services and from implementation services for new customers.

Price changes in service had no material effect on our revenue in the three-months ended June 30, 2008 over the comparative period in 2007.

License revenue. We have shifted our business focus and strategy from perpetual licenses to our on-demand offering. This shift has been reflected in the decline of our license revenues compared to the growth in subscription and support revenues as discussed above.

Price changes in license had no material effect on our revenue in the three-months ended June 30, 2008 over the comparative period in 2007.

Geographic Region. We sell our product in three geographic regions: Americas; Europe; and Asia/Pacific. Net sales for each region, which include product and service revenue, are summarized in the following table (in thousands, except percentages):

	Three-Months Ended June 30,		Variance in	Variance in
	2008	2007	Dollars	Percent
United States	$24,745	$23,540	$ 1,205	5.1%
Percentage of net revenue	*77.5 %*	*77.9 %*		
Other Americas	1,823	1,745	78	4.5%
Percentage of net revenue	*5.7 %*	*5.8 %*		
Total Americas	26,568	25,285	1,283	5.1%
Percentage of net revenue	*83.2 %*	*83.7 %*		
Europe	4,248	3,234	1,014	31.4%
Percentage of net revenue	*13.3 %*	*10.7 %*		
Asia/Pacific	1,129	1,707	(578)	(33.9)%
Percentage of net revenue	*3.5 %*	*5.6 %*		
Total revenue	$31,945	$30,226	$ 1,719	5.7%

The increase in total revenue for the three-months ended June 30, 2008 over the comparable period in 2007 was primarily due to increased sales of our software products in the Americas, including $2.1 million in revenue as we met certain revenue recognition criteria which allowed us to recognize previously deferred revenue from a large sale and installation of an enterprise-wide solution for one of our global retail customers. Revenue in Europe increased as a result of our investment in 2007 to expand the European markets. Revenue in Asia/Pacific decreased $0.6 million primarily due to revenue recognized from one large license sale in Japan in the second quarter of 2007.

Price changes had no material effect on our revenue in any region or revenue type in the three-months ended June 30, 2008 over the comparable period in 2007.

No customer accounted for greater than 10% of total revenue in the three-months ended June 30, 2008 or 2007, respectively.

Cost of Revenue

The following table is a summary of cost of revenue between license, service and maintenance, and amortization of intangible assets (in thousands, except percentages):

	Three-Months Ended June 30,		Variance in	Variance in
	2008	2007	Dollars	Percent
Subscriptions and support	$ 6,330	$ 5,166	$ 1,164	22.5%
Percentage of total revenue	*19.8 %*	*17.1 %*		
Service	6,205	5,636	569	10.1%
Percentage of total revenue	*19.4 %*	*18.6 %*		
License	54	200	(146)	(73.0)%
Percentage of total revenue	*0.2 %*	*0.7 %*		
Amortization of intangible assets	1,385	2,051	(666)	(32.5)%
Percentage of total revenue	*4.3 %*	*6.8 %*		
Total cost of revenue	$13,974	$13,053	$ 921	7.1%

Cost of subscriptions and support. The increase in cost of subscriptions and support for the three-months ended June 30, 2008 over the comparable period in 2007 was primarily due to a $0.5 million increase for additional employees in the U.S. and India, a $0.2 million increase in equipment and software depreciation costs resulting from prior software subscription increases due to an expanded user base and a $0.5 million increase in costs related to outside services needed to support our growing infrastructure. We expect cost of subscriptions and support to continue to increase in 2008 to support our growing customer base.

Cost of services. The increase in the cost of services for the three-months ended June 30, 2008 over the comparable period in 2007 was partially attributable to a $0.4 million increase in employee related expenses from added headcount. The remaining increase was due to a $0.3 million increase in the use of outside services and consultants to support an increase in revenue coming primarily from international operations completed in the three-months ended June 30, 2008. We expect cost of services to continue to increase in 2008 to support the on-going business and large project orders received.

Cost of license. The decrease in the cost of license for the three-months ended June 30, 2008 over the comparable period in 2007 is due to reduced usage of third party content preparation combined with a decrease in revenue-related royalty payments in Asia/Pacific. We expect the cost of license to remain at a similar level to 2007 throughout the remainder of 2008.

Amortization of intangible assets . The decrease in amortization of intangible assets for the three-months ended June 30, 2008 over the comparable period in 2007 is attributable to $0.3 million in amortization of certain intangibles recorded from the Docent acquisition which became fully amortized in 2007 and a decrease of $0.3 million in the amortization of intangibles from Pathlore and other prior acquisitions.

Gross Margin

The following table is the summary of gross margin between license and amortization of intangible assets, and service and maintenance (in thousands, except percentages):

	Three-Months Ended June 30,	
	2008	2007
Gross margin		
Subscriptions and support	$11,031	$ 9,938
Percentage of subscriptions and support revenue	*63.5 %*	*65.8 %*
Services	2,530	2,343
Percentage of services revenue	*29.0 %*	*29.4 %*
License	5,795	6,943
Percentage of license revenue	*99.1 %*	*97.2 %*
Amortization of intangible assets	(1,385)	(2,051)
Percentage of license revenue	*(23.7)%*	*(28.7)%*
Total gross margin	$17,971	$17,173
Percentage of net revenue	*56.3 %*	*56.8 %*

Gross margin percent for subscriptions and support in the three-months ended June 30, 2008 decreased over the comparable period in 2007. The decrease is attributed to a lower overall margin percent of our Total Performance product caused by additional investments in staff and support costs being made to expand the business while additional depreciation expenses were also incurred as we invested in our hosting infrastructure to satisfy the increase in demand for on-demand subscriptions.

Gross margin percent for services in the three-months ended June 30, 2008 decreased over the comparable period in 2007 due to investments in additional headcount and third party support which were offset by the increases in service and consulting revenue.

Gross margin percent for license, exclusive of amortization of intangible assets, in the three-months ended June 30, 2008, improved slightly over the comparable period in 2007 due to the reduced usage of third party licenses and content. Gross margin percent for license, including amortization of intangible assets improved on lower revenue due to cost reductions in license cost and a decrease in the amortization of intangibles as described above.

Operating Expenses

The following table is a summary of research and development, sales and marketing, general and administrative and restructuring charges (in thousands, except percentages):

	Three-Months Ended June 30,		Variance in	Variance in
	2008	2007	Dollars	Percent
Research and development	$ 5,565	$ 5,258	$ 307	5.8%
Percentage of net revenue	*17.4 %*	*17.4 %*		
Sales and marketing	8,617	8,954	(337)	(3.8)%
Percentage of net revenue	*27.0 %*	*29.6 %*		
General and administrative	4,885	4,414	471	10.7%
Percentage of net revenue	*15.3 %*	*14.6 %*		
Restructuring charge	37	—	37	100.0%
Percentage of net revenue	*0.1 %*	*— %*		
Total operating expenses	$19,104	$18,626	$ 478	2.6%
Percentage of net revenue	*59.8 %*	*61.6 %*		

Research and development . The increase in research and development expense in the three-months ended June 30, 2008 over the comparable period in 2007 was primarily due to $0.2 million in additional employee and related costs and $0.1 million in additional facility and equipment expenses related to our investment in Performance Management and on-demand subscription projects for future releases. We expect research and development expense to increase in 2008 due to continued investment in future versions of our SumTotal product series for LMS and Performance Management.

Sales and marketing. The decrease in sales and marketing expense in the three-months ended June 30, 2008 over the comparable period in 2007 was due to a decrease of $0.3 million net commission and management incentive costs primarily related to a large retail transaction in the comparable period, a $0.3 million decrease in travel expense, a $0.1 million increase in other miscellaneous expenses, a $0.1 million increase in marketing programs and a $0.1 million increase in stock-based compensation expense. We expect sales and marketing expenses to increase in 2008 to support increased revenue expectations.

General and administrative. The increase in general and administrative expense in the three-months ended June 30, 2008 over the comparable period in 2007 was due to a $0.3 million increase in performance related management incentive costs and $0.1 million in incremental legal fees. We expect a small increase in general and administrative expenses for 2008.

Restructuring charge. During the three-months ended June 30, 2008, we recorded a restructuring charge of $37,000 in employee severance and other related costs. Employee severance and other related costs consist of severance and other benefits resulting from our fourth quarter 2007 reduction-in-force.

Stock-based compensation expense. The following table summarizes stock-based compensation expense related to employee stock options, shares issued pursuant to the employee stock purchase plan and restricted stock units under SFAS No. 123R for the three months ended June 30, 2008 and June 30, 2007 which was allocated as follows (in thousands):

	Three-Months Ended June 30, 2008	Three-Months Ended June 30, 2007
Stock-based compensation expense:		
Subscriptions and support	$ 72	$ 60
Service	143	128
Research and development	193	141
Sales and marketing	367	257
General and administrative	482	503
Total stock-based compensation expense	$1,257	$1,089

Non-Operating Income (Expense), Net

The following table is a summary of interest expense, interest income and other expense, net (in thousands, except percentages):

	Three-Months Ended June 30, 2008	Three-Months Ended June 30, 2007	Variance in Dollars	Variance in Percent
Interest expense	$(178)	$(364)	$ 186	(51.1)%
Percentage of net revenue	*(0.6)%*	*(1.2)%*		
Interest income	344	379	(35)	(9.2)%
Percentage of net revenue	*1.1 %*	*1.3 %*		
Other income (expense), net	(17)	(34)	17	(50.0)%
Percentage of net revenue	*(0.1)%*	*(0.1)%*		
Total non-operating expenses	$ 149	$ (19)	$ 168	(884.2)%
Percentage of net revenue	*0.5 %*	*(0.0)%*		

Interest expense. The decrease in interest expense was attributable to lower principal balance and interest rates on the Wells Fargo Foothill credit facility. We expect this expense to continue over the term of the credit facility; however, it will vary based on the changes in the principal balance and interest rates.

Interest income. Interest income decreased in the three-months ended June 30, 2008 over the comparable period in 2007 due to lower interest rates during the quarter, which was partially offset by higher average cash balances during the quarter. We expect interest income to continue at comparable levels, subject to interest rate fluctuations, as we maintain cash balances to meet our loan covenant requirements.

Other income expense, net. The increase in other income in the three-months ended June 30, 2008 was primarily due to lower net foreign exchange expense due to better results from our forward exchange hedging program. We continued our forward exchange hedging program for the USD and GBP contracts, which we believe will minimize future fluctuations related to changes in exchange rates.

Provision for income taxes. The tax provision for the three-months ended June 30, 2008 was $5,000 against a pre-tax net loss of $984,000 due to a decrease in alternative minimum taxes for the quarter offset by a FIN No. 48 adjustment and other contingencies booked in the quarter.

Comparison of Financial Data for the Six-Months Ended June 30, 2008 and 2007

Results of Operations

The following table presents our results of continuing operations as a percentage of total revenue for the six-months ended June 30, 2008 and 2007:

	2008	2007
Revenue:		
Subscriptions and support	51.5%	49.8%
Service	27.1	27.4
License	21.4	22.8
Total revenue	100.0	100.0
Cost of revenue:		
Subscriptions and support	18.1	16.7
Service	19.3	18.9
License	0.2	0.5
Amortization of intangible assets	4.5	7.3
Total cost of revenue	42.1	43.4
Gross margin	57.9	56.6
Operating expenses:		
Research and development	16.8	17.4
Sales and marketing	25.5	28.4
General and administrative	14.8	15.9
Restructuring	0.2	—
Total operating expenses	57.3	61.7
Income (loss) from operations	0.6	(5.1)
Other income (expense), net	0.7	(0.4)
Income (loss) before provision for income taxes	1.3	(5.5)
Provision for income taxes	0.5	0.1
Net income (loss)	0.8%	(5.6)%

Revenue

Revenue for the six-months ended June 30, 2008 and 2007 was as follows (in thousands, except percentages):

	Six-Months Ended June 30, 2008	Six-Months Ended June 30, 2007	Variance in Dollars	Variance in Percent
Subscriptions and support	$34,988	$29,572	$ 5,416	18.3%
Percentage of net revenue	*51.5 %*	*49.8 %*		
Service	18,407	16,212	2,195	13.5%
Percentage of net revenue	*27.1 %*	*27.4 %*		
License	14,542	13,492	1,050	7.8%
Percentage of net revenue	*21.4 %*	*22.8 %*		
Total revenue	$67,937	$59,276	$ 8,661	14.6%

Our total revenues increased in the six-months ended June 30, 2008 to $67.9 million as compared to $59.3 million in the comparable period in 2007. The increase was primarily the result of growth in subscription and support revenues and growth in services revenues. We attribute the revenue growth to a number of factors, including the shift in our business focus and strategy to our on-demand offering and increased investments in our sales and marketing efforts in international markets.

Subscriptions and support revenue. The increase in subscriptions and support revenue in the six-months ended June 30, 2008 over the comparable period in 2007 was as follows (in thousands, except percentages):

	Six-Months Ended June 30,		Variance in	Variance in
	2008	2007	Dollars	Percent
Hosting subscriptions	$ 7,951	$ 7,272	$ 679	9.3%
Term license rental arrangements	3,506	2,347	1,159	49.4%
On-demand subscriptions	3,974	2,644	1,330	50.3%
Total subscriptions	15,431	12,263	3,168	25.8%
Support maintenance	19,557	17,309	2,248	13.0%
Total subscriptions and support revenue	$34,988	$29,572	$ 5,416	18.3%

The increase in subscriptions and support revenue in the six-months ended June 30, 2008 over the comparative period in 2007 was the result of increased sales from increased on-demand subscription sales to customers and from subscription and support contract sales to new and existing customers related to the SumTotal 8 Series and legacy product suites. These results reflect increased interest in on-demand solutions as a way for our global customers to manage costs effectively, and demonstrate continued growth within our installed base, and broad market interest in on-demand solutions for both Learning Management and Performance Management.

Changes to the components of subscriptions and support revenue were as follows:

- the increase in hosting subscriptions revenue was the result of $0.7 million in increased sales of hosting contracts to new and existing customers related to the SumTotal 8 Series and legacy products;
- the increase in term license rental arrangements revenue was the result of a $1.2 million increase in contract sales to new and existing customers related to the SumTotal 8 Series and legacy products;
- the increase in on-demand subscriptions revenue was the result of $1.3 million from increased on-demand subscription sales as new customers purchased our subscription offering rather than the perpetual products we sold historically; and
- the increase in support maintenance revenue was the result of $2.2 million from increased contract sales to customers related to the SumTotal 8 Series and legacy products, including $0.9 million in revenue from one of our global retail customers as we met certain revenue recognition criteria which allowed us to recognize previously deferred revenue.

Price changes in subscription and support had no material effect on our revenue in the six-months ended June 30, 2008 over the comparative period.

Service revenue. The increase in service revenue in the six-months ended June 30, 2008 over the comparable period in 2007 was primarily due to a $1.3 million increase in consulting revenue recognized from one of our global retail customers as we met certain revenue recognition criteria which allowed us to recognize previously deferred revenue. The increase also included a $0.9 million increase from higher demand for upgrading services and from an increased number of new subscriptions and customers.

Price changes in service had no material effect on our revenue in the six-months ended June 30, 2008 over the comparative period in 2007.

License revenue. The increase in license revenue in the six-months ended June 30, 2008 over the comparable period in 2007 was primarily due to $5.5 million in license revenue recognized from one of our global retail customers as we met certain revenue recognition criteria which allowed us to recognize previously deferred revenue. The increase was partially offset by a $4.4 million decrease in sales of our perpetual license products as new customers purchased our subscription offerings rather than the perpetual products we sold historically.

Price changes in licenses had no material effect on our revenue in the six-months ended June 30, 2008 over the comparative period in 2007.

Geographic Region. We sell our product in three geographic regions: Americas; Europe; and Asia/Pacific. Net sales for each region, which include product and service revenue, are summarized in the following table (in thousands, except percentages):

	Six-Months Ended June 30, 2008	Six-Months Ended June 30, 2007	Variance in Dollars	Variance in Percent
United States	$52,268	$47,221	$ 5,047	10.7%
Percentage of net revenue	*76.9 %*	*79.7 %*		
Other Americas	4,147	3,017	1,130	37.5%
Percentage of net revenue	*6.1 %*	*5.1 %*		
Total Americas	56,415	50,238	6,177	12.3%
Percentage of net revenue	*83.0 %*	*84.8 %*		
Europe	9,154	6,471	2,683	41.5%
Percentage of net revenue	*13.5 %*	*10.9 %*		
Asia/Pacific	2,368	2,567	(199)	(7.8)%
Percentage of net revenue	*3.5 %*	*4.3 %*		
Total revenue	$67,937	$59,276	$ 8,661	14.6%

The increase in total revenue for the six-months ended June 30, 2008 over the comparable period in 2007 was primarily due to increased sales of our software products in the Americas, including $7.9 million in revenue as we met certain revenue recognition criteria which allowed us to recognize previously deferred revenue from a large sale and installation of an enterprise-wide solution for one of our global retail customers. Revenue in Europe increased as a result of our 2007 investment in and continued efforts towards expanding the European markets. Revenue in Asia/Pacific decreased $0.2 million primarily due to revenue recognized from one large license sale in Japan in the second quarter of 2007.

Price changes had no material effect on our revenue in any region or revenue type in the six-months ended June 30, 2008 over the comparable period in 2007.

One of our global retail customers accounted for 11.6% of total revenue in the six-months ended June 30, 2008 and no customer accounted for greater than 10% of total revenue in the six-months ended June 30, 2007.

Cost of Revenue

The following table is a summary of cost of revenue between license, service and maintenance, and amortization of intangible assets (in thousands, except percentages):

	Six-Months Ended June 30, 2008	Six-Months Ended June 30, 2007	Variance in Dollars	Variance in Percent
Subscriptions and support	$12,291	$ 9,912	$ 2,379	24.0%
Percentage of total revenue	*18.1 %*	*16.7 %*		
Service	13,096	11,226	1,870	16.7%
Percentage of total revenue	*19.3 %*	*18.9 %*		
License	118	292	(174)	(59.6)%
Percentage of total revenue	*0.2 %*	*0.5 %*		
Amortization of intangible assets	3,069	4,301	(1,232)	(28.6)%
Percentage of total revenue	*4.5 %*	*7.3 %*		
Total cost of revenue	$28,574	$25,731	$ 2,843	11.0%

Cost of subscriptions and support. The increase in cost of subscriptions and support for the six-months ended June 30, 2008 over the comparable period in 2007 was primarily due to a $1.5 million increase for additional employees in the U.S. and India, including $0.3 million for performance related management incentives, a $0.3 million increase in equipment and software depreciation costs resulting from prior software subscription increases due to an expanded user base and a $0.5 million increase in costs related to outside services needed to support our growing infrastructure. We expect cost of subscriptions and support to continue to increase in 2008 to support our growing customer base.

Cost of services. The increase in the cost of services for the six-months ended June 30, 2008 over the comparable period in 2007 was partially attributable to a $0.7 million increase in employee related expenses from added headcount. The remaining increase was due to $1.2 million for third-party support primarily related to international projects. We expect cost of services to continue to increase in 2008 to support the on-going business and large project orders received.

Cost of license. The decrease in the cost of services for the six-months ended June 30, 2008 over the comparable period in 2007 is due to reduced usage of third party content preparation combined with a decrease in royalty payments. We expect the cost of license to remain at a similar level to 2007 throughout the remainder of 2008.

Amortization of intangible assets . The decrease in amortization of intangible assets for the six-months ended June 30, 2008 over the comparable period in 2007 is attributable to $0.3 million in amortization of certain intangibles recorded from prior acquisitions which became fully amortized in 2007 and a decrease of $1.5 million in the amortization of intangibles from prior acquisitions.

Gross Margin

The following table is the summary of gross margin between license and amortization of intangible assets, and service and maintenance (in thousands, except percentages):

	Six-Months Ended June 30,	
	2008	2007
Gross margin		
Subscriptions and support	$22,697	$19,660
Percentage of subscriptions and support revenue	*64.9 %*	*66.5 %*
Services	5,311	4,986
Percentage of services revenue	*28.9 %*	*30.8 %*
License	14,424	13,200
Percentage of license revenue	*99.2 %*	*97.8 %*
Amortization of intangible assets	(3,069)	(4,301)
Percentage of license revenue	*(21.1)%*	*(31.9)%*
Total gross margin	$39,363	$33,545
Percentage of net revenue	*57.9 %*	*56.6 %*

Gross margin percent for subscriptions and support in the three-months ended June 30, 2008 decreased over the comparable period in 2007. The decrease is attributed to a lower overall margin percent of our Total Performance product caused by additional investments in staff and support costs being made to expand the business while additional depreciation expenses were also incurred as we invested in our hosting infrastructure to satisfy an increase in demand.

Gross margin percent for services in the six-months ended June 30, 2008 decreased over the comparable period in 2007 due to investments in additional headcount and third party support which were partially offset by the increases in service and consulting revenue.

Gross margin percent for license, exclusive of amortization of intangible assets, in the three-months ended June 30, 2008, improved slightly over the comparable period in 2007 due to the reduced usage of third party licenses and content. Gross margin percent for license, including amortization of intangible assets improved on lower revenue due to cost reductions in license cost and a decrease in the amortization of intangibles as described above.

Operating Expenses

The following table is a summary of research and development, sales and marketing, general and administrative and restructuring charges (in thousands, except percentages):

	Six-Months Ended June 30,		Variance in	Variance in
	2008	2007	Dollars	Percent
Research and development	$11,395	$10,297	$ 1,098	10.7%
Percentage of net revenue	*16.8 %*	*17.4 %*		
Sales and marketing	17,345	16,857	488	2.9%
Percentage of net revenue	*25.5 %*	*28.4 %*		
General and administrative	10,061	9,420	641	6.8%
Percentage of net revenue	*14.8 %*	*15.9 %*		
Restructuring charge	122	—	122	100.0%
Percentage of net revenue	*0.2 %*	*— %*		
Total operating expenses	$38,923	$36,574	$ 2,349	6.4%
Percentage of net revenue	*57.3 %*	*61.7 %*		

Research and development . The increase in research and development expense in the six-months ended June 30, 2008 over the comparable period in 2007 was primarily due to $0.8 million in additional employee and related costs, $0.3 million in additional facility and equipment expenses related to our investment in Performance Management and on-demand subscription projects for future releases and a $0.1 million increase in stock-based compensation expense, offset by a $0.1 million decrease in travel expense. We expect research and development expense to increase in 2008 due to continued investment in future versions of our SumTotal product series for LMS and Performance Management.

Sales and marketing. The increase in sales and marketing expense in the six-months ended June 30, 2008 over the comparable period in 2007 was due to an increase of $0.1 million in employee and related costs and commissions related to international and SMB personnel, a $0.4 million decrease in travel expense, a $0.4 million increase in other miscellaneous expenses, a $0.2 million increase in marketing programs and a $0.2 million increase in stock-based compensation expense. We expect sales and marketing expenses to increase in 2008 to support increased revenue expectations.

General and administrative. The increase in general and administrative expense in the six-months ended June 30, 2008 over the comparable period in 2007 was due to a $0.9 million increase in expenses relating to general and administrative personnel, offset by a $0.2 million decrease related to facility and other expenses and a $0.1 million decrease in stock-based compensation expense. We expect a small increase in general and administrative expenses for 2008.

Restructuring charge. During the six-months ended June 30, 2008, we recorded a restructuring charge of $122,000 in employee severance and other related costs. Employee severance and other related costs consists of severance and other benefits resulting from our fourth quarter 2007 reduction-in-force.

Stock-based compensation expense. The following table summarizes stock-based compensation expense related to employee stock options, shares issued pursuant to the employee stock purchase plan and restricted stock units under SFAS No. 123R for the six months ended June 30, 2008 and June 30, 2007 which was allocated as follows (in thousands):

	Six-Months Ended June 30,	
	2008	**2007**
Stock-based compensation expense:		
Subscriptions and support	$ 142	$ 120
Service	293	265
Research and development	368	279
Sales and marketing	722	532
General and administrative	951	945
Total stock-based compensation expense	$2,476	$2,141

Non-Operating Income (Expense), Net

The following table is a summary of interest expense, interest income and other expense, net (in thousands, except percentages):

	Six-Months Ended June 30,		Variance in	Variance in
	2008	**2007**	**Dollars**	**Percent**
Interest expense	$(400)	$(743)	$ 343	(46.2)%
Percentage of net revenue	*(0.6)%*	*(1.2)%*		
Interest income	837	541	296	54.7%
Percentage of net revenue	*1.2 %*	*0.9 %*		
Other income (expense), net	4	(43)	47	(109.3)%
Percentage of net revenue	*0.0 %*	*(0.1)%*		
Total non-operating expenses	$ 441	$(245)	$ 686	(280.0)%
Percentage of net revenue	*0.6 %*	*(0.4)%*		

Interest expense. The decrease in interest expense was attributable to lower principal balance and interest rates on the Wells Fargo Foothill credit facility. We expect this expense to continue over the term of the credit facility; however, it will vary based on the changes in the principal balance and interest rates.

Interest income. Interest income increased in the six-months ended June 30, 2008 over the comparable period in 2007 due to higher average cash balances during the six-months ended June 30, 2008, offset partially by lower interest rates during the six-months ended June 30, 2008. We expect interest income to continue at comparable levels, subject to interest rate fluctuations, as we maintain cash balances to meet our loan covenant requirements.

Other income expense, net. The increase in other income in the six-months ended June 30, 2008 was primarily due to lower net foreign exchange expense due to better results from our forward exchange hedging program. We continued our forward exchange hedging program for the USD and GBP contracts, which we believe will minimize future fluctuations related to changes in exchange rates.

Provision for income taxes. The effective tax rate for the six-months ended June 30, 2008 was 16.57% due to our taxable income in the six-months ended June 30, 2008 and our forecasted fiscal 2008 taxable income, partially offset by the utilization of certain federal and state net operating loss ("NOL") tax credit carryforwards. Effective tax rates differ from the federal statutory rate of 34% due to state taxes, foreign losses for which no tax benefit is provided, amortization of intangible assets and non-deductible stock-based compensation expense.

Liquidity and Capital Resources

At June 30, 2008, our principal sources of liquidity were $45.5 million of cash and cash equivalents, $5.1 million of short-term investments and a revolving credit facility with Wells Fargo Foothill to a maximum of $5.0 million, adjusted as described in the following paragraph, to meet the working capital requirements of the business. Our short-term investment portfolio declined from $30.1 million at December 31, 2007 to $5.1 million at June 30, 2008 primarily as a result of re-investing maturities of short-term investments during the quarter into cash and cash equivalents of higher credit quality in light of current financial markets instability.

In July 2006, under our revolving credit facility (the "Revolver") with Wells Fargo Foothill, we entered into an agreement with Wells Fargo Foothill in which we will enter into forward foreign exchange contracts to mitigate certain foreign exchange exposures we have related to foreign trade receivables. As part of this agreement, the credit facility provides for a 5% reserve against the Revolver. As a result of the 5% reserve requirement, we have $250,000 less in funds available for use from the Revolver including debt covenant compliance and, accordingly, only $4,750,000 was available for borrowings at June 30, 2008.

On June 1, 2006, we filed a universal shelf registration statement on Form S-3 with the SEC which was declared effective October 2, 2006. Our shelf registration statement allows us to offer and sell an aggregate of $75.0 million in debt and equity securities, the terms of which will be established at the time of the offering by means of a written prospectus or prospectus supplement.

On May 23, 2007, we completed the sale of approximately $35.1 million of our common stock in a registered direct offering, in which approximately 5.4 million shares of common stock were sold at a purchase price of $6.50 per share through a prospectus supplement to our shelf registration statement. The shares were sold to accredited institutional investors with RBC Capital Markets Corporation acting as sole placement agent for the transaction. The net proceeds raised from the offering provide us with greater working capital and will be used for general corporate purposes, to potentially repay or prepay our debt, and/or investments and acquisitions. As of June 30, 2008, there was approximately $39.9 million in debt and equity securities remaining eligible to be sold through the shelf registration statement.

On August 20, 2007, our Board of Directors authorized the repurchase up to $15.0 million of our outstanding shares of common stock. Stock repurchases will be made in the open market, in block purchase transactions, or in structured Rule 10b5-1 share repurchase plans, and may be made from time to time or in one or more larger repurchases. We intend to conduct the repurchase in compliance with Rule 10b-18 of the Securities Exchange Act of 1934. The program does not obligate us to acquire any particular amount of common stock and the program may be modified, suspended or terminated any time at in the discretion of the Board of Directors.

We believe that our available cash resources, combined with cash flows generated from operations will be sufficient to meet our presently anticipated working capital and capital expense requirements for at least the next year. We have borrowing capacity available to us in the form of our credit facility with Wells Fargo Foothill that expires in 2009. We may also consider raising additional capital in the public markets as a means to meet our capital needs and to invest in our business. Our future liquidity and capital requirements will depend on numerous factors, including our future revenue, the timing and extent of spending to support product development efforts and expansion of sales and marketing and general and administrative activities, the success of our existing and new product and service offerings and competing technological and market developments. Although we may need to return to the capital markets, establish new credit facilities, or raise capital in private transactions in order to meet our capital requirements, we can offer no assurances that we will be able to access these potential sources of funds on terms acceptable to us, or at all.

Six-months ended June 30, 2008

Net cash provided by operating activities was $7.7 million during the six-months ended June 30, 2008. The cash provided during the period primarily relates to our net income of $0.5 million, collections of our trade receivables resulting in a net decrease in accounts receivable of $1.5 million and reductions in prepaid expenses and other current assets and other accrued liabilities of $0.4 million and $0.4 million, respectively. Offsetting these increases in operating cash are decreases in other accrued compensation and benefits, accounts payable and deferred revenue of $0.6 million, $0.6 million and $1.7 million, respectively. The decline in accrued compensation and benefits is primarily associated with year-end sales commissions, bonuses and severance payments which were paid in the six-months ended June 30, 2008. The decline in accounts payable is associated with the timing of aged invoices and payables check runs at quarter-end versus year-end. The decline in deferred revenue is associated with the release of deferred revenue recognized in the first quarter of 2008 principally from one large deal. Also included in cash provided by operating activities are adjustments to net income for non-cash items which included intangible asset amortization of $3.1 million, stock-based compensation of $2.5 million and depreciation and amortization of $2.4 million.

Net cash provided by investing activities was $23.4 million in the six-months ended June 30, 2008. The cash provided during the period primarily relates to short-term investment maturities of $31.6 million in the six-months ended June 30, 2008, which was partially offset by purchases of $6.3 million of short-term investments and $1.8 million in purchases of property and equipment to increase our infrastructure. At June 30, 2008, short-term investments had a carrying value of $5.1 million.

Net cash used by financing activities includes a repayment of indebtedness under the Wells Fargo Foothill credit facility of $2.2 million, a payment of $0.6 million for notes payable related to our settlement with IpLearn and $2.3 million for purchases of treasury stock. Offsetting these uses was $0.4 million in net proceeds from the issuance of common stock through our employee stock purchase plan and exercises of common stock options.

Commitments

We lease office space and certain equipment under non-cancelable operating leases expiring in years through 2015. Rent expense under operating leases was approximately $709,000 and $658,000 during the three-months ended June 30, 2008 and 2007, respectively and approximately $1,413,000 and $1,340,000 during the six-months ended June 30, 2008 and 2007, respectively.

Future payments under operating lease obligations at June 30, 2008 are presented in the table below (in thousands):

	Payments Due by Period						
	Total	Remainder of 2008	2009	2010	2011	2012	Thereafter
Operating leases	$11,807	$ 1,324	$2,871	$2,003	$1,747	$1,754	$ 2,108

On February 14, 2008, we entered into an additional amendment of our lease for the Bellevue, Washington facility which will extend the lease for an additional five years after the original lease expiration date of December 31, 2008 occurs. Included in the table above are aggregate base rent payments of approximately $7.5 million for the five year period ended December 31, 2013.

In connection with the MindSolve acquisition in November 2006, we have change of control payments to be made to certain employees of MindSolve who are now our employees. These contractual change of control payments and are being expensed ratably over the contractual performance period. Total remaining future obligations amount to $588,000 and are scheduled to be paid in the fourth quarter of 2008.

Contingencies

On August 16, 2006, the Compensation Committee approved and adopted the form of Amended and Restated Change of Control Agreement for each of SumTotal Systems' Section 16 officers. In the event of a change of control and the subsequent termination of a Section 16 officer in a manner defined in the agreement as a termination event, we will be obligated to pay the Section 16 officer certain compensation and benefits. If a termination event occurs, an officer would be entitled to one year of the officer's base salary that would be paid in equal semi-monthly installments over a one year period following a termination event. Such officer will also be entitled to other benefits as described in Article III of our Amended and Restated Change of Control Agreement. This discussion is qualified in its entirety by our Current Report on Form 8-K filed on August 17, 2006. In addition to this change of control agreement, the terms of our Senior Vice President, Field Operations' employment offer letter provides that if his employment is terminated prior to December 31, 2008, other than for cause or good reason, he would be entitled to be paid his base salary for the remainder of 2008, a pro rata portion of his annual bonus and other benefits as described in his offer letter. This discussion is qualified in its entirety by our Current Report on Form 8-K filed on November 1, 2007.

From time-to-time, third parties assert patent infringement claims against us in the forms of letters, litigation, or other forms of communication. In addition, without limitation from time-to-time, we are subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights, employment claims and general contract or other claims. Management does not believe that any of the foregoing claims are likely to have a material adverse effect on our financial position, results of operations or cash flows. However, our analysis of whether a claim may proceed to litigation cannot be predicted with certainty, nor can a claim proceed to litigation, nor can the results of litigation be predicted with certainty. Defending each of these actions, regardless of the outcome, may be costly, time-consuming, distract management personnel and have a negative effect on our business. An adverse outcome in any of these actions, including a judgment or settlement, may cause a material adverse effect on our future business, operating results and/or financial condition.

For information regarding indemnifications, refer to Note 8, *Guarantees, Warranties and Indemnification*, in the Notes to Consolidated Condensed Financial Statements.

Effective January 1, 2007, we adopted the provisions of FIN No. 48 which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* . Refer to Note 2, *Summary of Significant Accounting Policies – Adoption of Accounting Standards* , in the Notes to the Condenses Consolidated Financial Statements.

As part of our ongoing business, we do not participate in material transactions that constitute relationships that are considered off-balance sheet arrangements.

Equity Incentive Awards

Our equity incentive plan is a key component of the compensation package we provide to attract and retain talented employees and we believe equity awards, such as stock options and other equity grants, provide our employees a strong link to our long term performance and the interests of our stockholders. The trading price of our common stock has been and is likely to continue to be highly volatile. As a result of this volatility, the trading price of our common stock may be lower than the exercise price of options held by some of our employees or the value of our common stock may decline from the value of such stock at the time of grant of other equity awards. Additionally, the effectiveness of our equity incentive plan may be adversely impacted. For example, at June 30, 2008, 65% of our outstanding stock options had exercise prices in excess of the current market price of our common stock.

Recent Accounting Pronouncements

Refer to the discussion of recent accounting pronouncements in Note 2, *Summary of Significant Accounting Policies*, in the Notes to the Condensed Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Rate Risk. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes. We held no auction-rate securities as of June 30, 2008 and December 31, 2007.

Interest Rate Risk. We hold our assets primarily in cash and cash equivalents, such as short-term marketable debt securities, money market funds and other cash equivalents and short-term investments such as commercial paper, publicly traded common stock and treasury notes. We minimize risk by investing in financial instruments with original maturities of less than one year. As a result, if market interest rates were to increase immediately and uniformly by 10% from levels at June 30, 2008, the fair value of cash and cash equivalents and short-term investments would not change by a material amount.

Concurrent with the closing of the Pathlore acquisition on October 4, 2005, we entered into a credit facility with Wells Fargo Foothill, principally to fund a portion of the acquisition price, and to provide for our ongoing working capital requirements. Under the terms of the facility, Wells Fargo Foothill loaned us $17.5 million to complete the acquisition of Pathlore and provided a revolving credit facility to a maximum of $5.0 million to meet the working capital requirements of the business. Prior to the amendment of the credit facility on June 19, 2007, outstanding loan balances would bear interest at Wells Fargo Foothill's base rate plus 2%, unless SumTotal Systems elected to be charged at the London Intrabank Offered Rate ("LIBOR") rate plus 3.5%. On June 19, 2007, SumTotal Systems entered into an amendment of its credit facility in which, among other things, the determination of the interest rate was changed from the description above to a scalable schedule of the base rate, based on earnings before interest, taxes, depreciation and amortization, as defined in the agreement. As of June 30, 2008, our interest rate under the credit facility was the contractual 6.0% minimum rate, versus a calculated LIBOR rate of 2.6838% plus 2.25%, resulting in a total calculated interest rate of 4.9338%. If market interest rates were to increase immediately and uniform by 10% from current levels at June 30, 2008, our interest payments on the credit facility over the term of the loan would not change by a material amount.

Foreign Currency Exchange Risk. We have foreign currency risk as a result of sales by our foreign subsidiaries denominated in currencies other than the United States dollar. In the three-months and six-months ended June 30, 2008, international revenue from our foreign subsidiaries accounted for approximately 23% and 23% of total revenue, respectively, up from 22% and 20% in the comparable periods in 2007, respectively. All foreign subsidiaries use the local currency as their functional currency.

Our exposure to foreign exchange rate fluctuations arises in part from inter-company accounts in which costs incurred in the U.S. are charged to the foreign subsidiaries. These inter-company accounts are typically denominated in the functional currency of the foreign subsidiary in order to centralize foreign exchange risk with the parent company in the U.S. We are also exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated in U.S. dollars in consolidation. As exchange rates vary, certain transaction gains and losses may vary from expectations and adversely impact overall expected profitability. In addition, during the third quarter 2006, we began entering into 30 day forward contracts for USD and GBP to hedge anticipated cash flows from our U.K. subsidiary. On June 26, 2008, we entered into a forward contract and sold approximately 2.5 million GBP, equivalent $5.0 million USD, with a maturity date of July 31, 2008, for which a hypothetical 10% appreciation of the GBP to USD would result in a $0.5 million gain and a hypothetical 10% depreciation of GBP to USD would result in a $0.5 million loss.

The effect of foreign exchange rate fluctuations accounted for in accumulated other comprehensive income for the three-months and six-months ended June 30, 2008 was a foreign translation loss of approximately $331,000 and a loss of $272,000, respectively, as compared to a foreign translation loss of approximately $16,000 and a gain of $2,000, in the comparable prior year periods, respectively. Due to the substantial volatility of currency exchange rates, among other factors, we cannot predict the effect of exchange rate fluctuations on our future operating results.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures.

Our management, with the participation of our chief executive officer and our chief financial officer, evaluated the effectiveness of 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 (the "Exchange Act")) as of the end of the period covered by this quarterly report on Form 10-Q.

A control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within the company have been detected. These inherent limitations include the reality that judgments in decision-making can be incorrect, and that breakdowns can occur because of simple errors or mistakes. The design of any control system is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a control system, misstatements due to error or fraud may occur and not be detected.

Based upon their evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

Changes in internal controls.

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter 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

From time-to-time, we are involved in legal proceedings or threats of legal proceedings arising in the ordinary course of business. We are not currently a party to any litigation or other legal proceeding that, in the opinion of management, is reasonably likely to have a material adverse effect on our business, operating results and financial condition.

We may, from time to time, also be subject to various legal or government claims, disputes or investigations. Such matters may include, but not be limited to, claims, disputes or investigations related to warranty, refund, breach of contract, employment, intellectual property, government regulation or compliance or other matters such as a subpoena we received on April 30, 2008 from the U.S. Department of Defense, Office of the Inspector General. The subpoena requests documents related to our sale of products and services to the Department of Defense as well as other documents related to us. We are cooperating with the government's request and are in the process of responding to the subpoena.

Item 1A. Risk Factors

Factors That May Affect Future Results of Operations

Set forth below and elsewhere in this report and in other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this report. These risks and uncertainties may not be the only ones facing us. Furthermore, new risks and uncertainties arise from time to time, and we cannot predict those events or how they may affect us. All forward-looking statements included in this document are based on information available to us on the date hereof. We assume no obligation to update any forward-looking statement.

We have a history of losses and we may not achieve profitability under generally accepted accounting principles on a consistent basis.

We expect to continue to derive substantially all of our revenue from the licensing of our learning, performance and talent management solutions, the recently introduced SumTotal 8 Series, as well as our predecessor products and related services, including without limitation, maintenance, professional services, on-demand subscriptions and hosting. Although we were profitable for the first quarter of 2008, historically and for the quarter ended June 30, 2008, we have not been profitable under accounting principles generally accepted in the U.S. ("GAAP") and may not consistently achieve or sustain GAAP profitability. If we fail to generate adequate revenue from the SumTotal 8 Series, predecessor products and related services, we will continue to incur losses.

Furthermore, we have taken actions to reduce our operating expenses, including the elimination of a number of positions, in the fourth quarter of 2007. While we believe the full benefit of the savings of these actions commenced in the first quarter of 2008, there can be no guarantee that these cost reductions will enable us to be profitable in 2008 or subsequent periods.

In the future, we expect to continue to incur additional non-cash expenses relating to the amortization of purchased intangible assets that will contribute to our net losses. In addition, charges related to stock-based compensation awards, including grants of stock options, are recorded as an expense in our reported results of operations in accordance with SFAS No. 123R, which has the result of increasing our reported expenses and our GAAP losses. We expect to incur additional GAAP expenses related to stock based compensation awards for the foreseeable future and these future expenses will adversely impact our ability to achieve profitability on a GAAP basis.

We are currently increasing our emphasis on subscription-based, on-demand offerings, which could slow our short term revenue growth and affect our revenue derived from perpetual license sales.

While we continue to offer and support our software on a perpetual license model, we are in the process of increasing our emphasis on a subscription revenue model by offering our products as on-demand subscriptions. We anticipate that our future financial performance and revenue growth will depend upon the acceptance and growth of our on-demand products. Offering on-demand subscription products represents a significant departure from traditional software delivery strategies. The relatively short history and continued evolution of this business model makes our business operations and prospects difficult to evaluate. As we increase our focus on offering our products on-demand, we may incur a reduction in our traditional perpetual software license revenues, which may not be offset by our on-demand revenues. Moreover, our short term financial results could be affected by upfront investments required to grow our on-demand offerings.

Additionally, we recognize revenue for our on-demand products over the term of the agreement instead of in the quarter in which the agreement is signed, as is typically the case with our perpetual software licenses. As a result, our operating results may not immediately reflect any increases or decreases in sales of our on-demand offerings, and our short term financial results could be impacted if customers choose our on-demand products instead of our perpetual software offerings. Furthermore, continued revenue from these services requires our customers to renew such subscriptions. Unexpected customer cancellations or low renewal rates of subscriptions could adversely impact our financial results.

Undetected product defects may require us to halt sales or shipments of our products, delay introduction of new products, or account for warranty claims.

Our products are highly technical and complex and have contained and may contain undetected errors, bugs, security vulnerabilities or defects, some of which may only be discovered after a product has been installed and used by customers. Our product offerings, both current and future and including our recently introduced SumTotal 8 Series, are complex and often contain undetected errors or bugs, despite internal and third-party testing. New product offerings, such as SumTotal 8 Series, contain new features and functionality which result in a greater likelihood of errors, bugs, security vulnerabilities and frequently these are undetected until the period immediately following introduction and initial shipment of new products or enhancements to existing products. For example in SumTotal 7 Series, our predecessor product, although we attempted to discover and resolve all such defects in our product line that we believed would be considered serious by our customers before shipment to them, the SumTotal 7 Series was not error-free and some customers notified us that they considered some of the defects to be serious. In addition, our products include third-party software, and any defects in third-party software that we incorporate into our products may compromise our products. It may be difficult for us to determine the source of the problem and correct any errors in third-party software because such software is not within our control.

Any bugs, errors, defects or security vulnerabilities discovered in our products after commercial release could result in loss of revenue or delay in revenue recognition, loss of customers and increased service and warranty costs, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort or breach of warranty, including claims relating to changes to our products made by our channel partners. Our contracts with customers contain provisions relating to warranty disclaimers and liability limitations, which may not be upheld. Defending a lawsuit, regardless of its merit, is costly and may divert management’s attention and adversely affect the market’s perception of us and our products. In addition, if our business liability insurance coverage proves inadequate or future coverage is unavailable on acceptable terms or at all, our business, operating results and financial condition could be adversely impacted.

If we fail to manage successfully our product transition, adapt to rapidly changing technology and evolving industry standards, or deploy upgrades to our products successfully and on a timely basis, our business and financial results will be harmed.

The learning, performance and talent management markets are characterized by rapidly changing technologies, frequent new product and service introductions, short development cycles and evolving industry standards. The introduction of new products and services embodying new technologies and the emergence of new industry standards may render our products and services obsolete. Additionally, although our software products can be licensed for use with a variety of popular industry standard relational database management system platforms, specific operating systems, or other combinations of licensed software, there may be existing or future platforms or user interfaces that achieve popularity in the marketplace which may not be architecturally compatible with our software product design. Our success depends on our ability to adapt to a rapidly changing landscape, to offer new products and services to address our customers' changing demands and to develop and maintain consistent software product performance characteristics across different combinations of licensed software. We may also experience difficulties that delay or prevent the successful design, development, introduction or marketing of our products and services, which may harm our ability to attract new customers and retain existing customers.

Since the formation of SumTotal Systems in 2004, we have introduced major product upgrades in December 2004, April 2005, June 2006, December 2006, and June 2007. In addition, in June 2008, we released SumTotal 8 Series and plan to launch subsequent product releases. We face numerous risks relating to product transitions and introductions, including customers delaying their purchasing decision until they have confidence in our new product and until we have proven we can successfully install and implement new products or upgrades. Due to the product transition, we may be unable to forecast revenue from product sales and related services accurately, the number and severity of defects and increased support requirements due to the complexity of the new product. In order to market and sell the product successfully, we must ensure broad-based cooperation from and coordination between multiple departments, including engineering and marketing, and from multiple geographic regions, including Bellevue, Washington; Mountain View, California; Gainesville, Florida; and Hyderabad, India. In addition, our implementations may be very complicated and require more time and resources than originally forecasted. As a result, we may not be able to complete the requisite work necessary in order to gain customer acceptance, which may delay or prevent us from recognizing revenue on deals we have signed. If we fail to manage the transition to new product offerings successfully, our business and financial results may be adversely affected, which may cause a decline in the price of our common stock.

Further, we have plans to discontinue supporting certain legacy products and encourage customers of these products to upgrade to a newer version of our software. However, if these customers chose not to upgrade or there are delays or complications in such upgrades causing a decrease in customer satisfaction with our products, our financial results may be harmed.

Our operating results may fluctuate significantly from quarter to quarter and year to year and are difficult to predict, which could negatively affect the value of your investment.

We have experienced substantial fluctuations in operating results on a quarterly and annual basis and expect these fluctuations to continue in the future. Our operating results may be affected by a number of other factors, including, but not limited to:

- the size and timing of product orders and the timing and execution of professional services engagements;
- the mix of revenue from products and services;
- our increased focus on offering our products as on-demand subscriptions;
- our ability to meet customer project milestones;
- market acceptance of our products and services, especially the SumTotal 8 Series and predecessor products, related services and our on-demand subscriptions;
- our ability to complete fixed-price professional services engagements within budget, on time and to our customers' satisfaction;
- the timing of revenue and expense recognition, including the recognition of a significant portion of revenue or expenses in a single quarter from large and/or long-term contracts;
- industry consolidation among both our competitors and our customers;
- recognition of impairment of existing assets; and
- our ability to execute on our strategy and operating plans.

Our limited operating history with performance management and compensation management solutions, and the rapidly evolving nature of our market make prediction of future revenue and expenses difficult. Expense levels are based, in part, on expectations as to future revenue and are essentially fixed in the short-term. To the extent our future revenue is difficult to predict, we may not be able to adjust spending in response to revenue shortfalls. Other expenses, as a result of changes in the law or otherwise, such as expenses related to litigation or compliance with government regulations, may also increase and cause us to fall short of our forecasts. Failure to meet our forecasts would likely cause a decline in the price of our common stock.

Our sales cycles in our traditional perpetual license business line are lengthy, making the timing of sales difficult to predict and also requiring considerable resources and expense with no assurance that such sales will occur.

For our traditional perpetual license business line, the period between our initial contact with a potential customer and a customer's purchase of our products and services is lengthy and often extends over several fiscal quarters or a fiscal year. To sell our products and services successfully, we generally must educate our potential customers regarding the use and benefits of our products and services, which typically requires significant time, capital and other resources. Also, as we offer both on-demand solutions and perpetual licenses, this might create customer confusion regarding our offerings, which may delay purchases of our perpetual licensed products and lengthen our sales cycle. The delay or failure to complete sales in a particular quarter could reduce our revenue for that quarter, as well as subsequent quarters over which revenue for the sale would likely be recognized. If the sales cycle unexpectedly lengthens in general or for one or more large orders, it would negatively affect the timing of a significant portion of our revenue, and our revenue growth would be harmed. Many of our potential customers for perpetual licenses are large organizations which generally take more time to make significant business decisions, and the formation and execution of even a relatively small number of large contracts with these large organizations may have a significant impact on our revenue. In addition, we must expend and allocate resources prior to completing a sales transaction, with no guarantee that such transaction will result in an actual sale. Furthermore, the lengthening of our sales cycles may create increased difficulties in negotiating such sales on terms favorable to us. This may result in a delay or failure to generate revenue from our sales efforts and may adversely affect our stock price.

Adverse economic conditions, including reduced information technology spending or increased unemployment may adversely impact our business.

Our business depends on the overall demand for learning, performance and talent management systems solutions, and on the economic health of our current and prospective customers. The purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. To the extent that the budgets for technology spending are reduced, demand for our products and services will also decrease. Furthermore, the market for our products and services may be disproportionately affected by weakness in general economic conditions or the broader market for information technology. Moreover, if the unemployment rate increases materially and training and retention of employees becomes less critical, our existing and potential clients may no longer consider improvement of their learning, performance, and talent management systems a priority. Weak economic conditions, or a reduction in information technology spending even if economic conditions remain stable, would likely adversely impact our business, operating results and financial condition in a number of ways, including longer sales cycles, lower prices, or possible delays or cancellations of purchases, for our products and services and reduced sales.

We rely on partnerships, alliances and other relationships to conduct our business, including internationally, and our business may be adversely affected if they do not perform as expected.

Our business relies on a variety of partnerships, alliances and other relationships, such as those with content partners, resellers, original equipment manufacturers, solution integrators, human resource outsourcers and technology partners, to develop, market and sell our products and solutions, including in many foreign countries. We also use independent third parties to provide engineering services, including customer implementation and product development, including customer implementation and product development. As our business grows and evolves, through adding new products and solutions or possible third party or product acquisitions, we have relied, and in the future, we may rely more heavily, on these types of partnerships globally. As a result, we have had to, and may in the future, have to renegotiate or terminate existing relationships. There can be no assurance that we will be able to enter into new contracts, or amend or terminate our existing contracts on favorable terms, or at all. In addition, if we amend or terminate any of our contracts, our former partners may become our competitors in the future. These former partners may be unhappy with their new relationships, and may, as a result, commence litigation against us, regardless of the merits of such litigation. Litigation is expensive to defend, and even the threat of legal proceedings diverts resources, and management attention from operating our business and causes increases in our expense levels, all of which may negatively affect the price of our common stock.

Moreover, our success in international markets will depend to a large degree on the success of these independent partners, with whom we have a limited working experience and over whom we have little control. If they are unwilling or unable to dedicate sufficient resources to our relationships, our international operations will suffer so our future success will depend in part on our ability to attract, train and motivate new distributors, resellers, alliance partners and systems integrators and expand our relationships with current independent partners.

Our lack of product diversification, and our reliance on the SumTotal 8 Series and its predecessor products, means that any decline in price or demand for our products and services would seriously harm our business.

We expect the SumTotal 8 Series and predecessor products and related services to continue to account for a significant majority of our revenue for the foreseeable future. Consequently, a decline in the price of, or demand for, the SumTotal 8 Series and predecessor products or services, or their failure to achieve broad market acceptance, would seriously harm our business and would likely result in a decline in the price of our common stock.

The anticipated benefits of our entry into the Performance Management industry may be delayed or may not be realized as we integrate products and employees and adapt to a new market with different competitors.

We expect to continue to enhance our position in the performance management industry through the further integration of our performance and compensation management technologies, products, services, partnerships, and customer contacts into our current product offerings. Nevertheless, we may not realize all of the anticipated benefits associated with our entry into the performance management market in a timely manner or at all. Additionally, we had limited experience competing in this space and now face new and different competitors with more experience selling and delivering such software and services. If we are unable to generate greater growth and acceptance of our performance management offering, our business and financial results may be harmed.

Third parties have claimed, and may claim in the future, that we are infringing their intellectual property which could diminish the value of our products and services or deter customers from purchasing our products regardless of whether these claims are successful.

From time-to-time, we are involved in legal proceedings or threats of legal proceedings. Litigation is expensive to defend and even the threat of legal proceedings, regardless of their merit, diverts management attention from operating our business and causes increases in our expense levels. We have received, and may in the future receive, threatening letters and notice of claims of infringement of other parties' proprietary rights. In addition, there are patent-holding companies, entities that do not make or sell products, which may threaten or bring claims against us alleging that our products infringe upon their proprietary rights. Such claims could result in costly litigation and could divert management and technical resources. They could also delay product shipment, deter potential customers from purchasing our products and services, or require us to develop non-infringing technology or enter into royalty or licensing agreements, which agreements may not be available on reasonable terms, or at all. In the event of an adverse judgment against us (including a judgment or settlement which may impose adverse conditions on us), we may be required to cease shipping, to pay damages, to license technology on terms that may not be favorable to us or to alter our technology, website or software products, any of which may adversely affect our operating results and cause us to miss our forecasts or industry analysts' forecasts, thereby causing a possible decline in the price of our common stock.

If third parties infringe our intellectual property or if we are unable to secure and protect our intellectual property, we may expend significant resources enforcing our rights or suffer competitive harm.

Our success depends in large part on our proprietary technology. We rely on a combination of copyrights, trade secret and trademark laws, contractual restrictions, restrictions on disclosure and other methods to protect our proprietary technology. In addition, our "Drag and Drop" patent is part of our performance management offering and, as a result, patent protection may become a more important component of the methods we use to protect our proprietary technology. These legal protections afford only limited protection for our technology. Furthermore, effective protection of intellectual property rights is unavailable or limited in certain foreign countries. It may also be possible for third parties to copy or otherwise obtain and use our intellectual property or trade secrets without our authorization and it may be possible for third parties to independently develop substantially equivalent intellectual property. We cannot assure that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our products and services or design around any patents or other intellectual property rights we hold. Consequently the value of our products and services to our customers could diminish substantially.

Our products include third-party technology, the loss of which could materially harm our business.

We use licensed third-party technology components in our products. Future licenses to this technology may not be available to us on commercially reasonable terms, or at all. The loss of or inability to obtain or maintain any of these technology licenses could result in delays in the introduction of new products or could force us to discontinue offering portions of our learning, performance, and talent management solutions until equivalent technology, if available, is identified, licensed and integrated.

Our credit facility requires compliance with certain restrictive covenants, and if we breach the covenants, we will be in default and the lender could demand immediate repayment and foreclose on the loan.

Our credit facility with Wells Fargo Foothill requires compliance with certain restrictive covenants. These covenants include, but are not limited to, earnings before interest, taxes, depreciation and amortization levels, leverage ratios, and restrictions related to capital expenditures, indebtedness, distributions, investments and changes of control. If we breach any of these covenants, Wells Fargo Foothill could demand repayment of the outstanding debt, which as of June 30, 2008 was approximately $6.6 million. These covenants may adversely affect our ability to finance future operations, potential acquisitions or capital needs or to engage in other business activities. As a result of the credit facility, we may have more debt than some of our competitors, which could place us at a competitive disadvantage and make us more susceptible to downturns in our business in the event our cash flow is not sufficient to cover our debt service requirements. Even if we repay the debt, the credit facility provides for penalties for making pre-payments that would otherwise save us substantial future interest payments. The forced premature repayment of the loan would reduce our cash position. Each of these risks may cause concern among our customers or investors and therefore cause a decrease in our revenue or the price of our common stock.

We may need additional financing in the future, which we may be unable to obtain on favorable terms or at all.

Even though in the second quarter of 2007 we closed on a registered direct offering of our common stock, raising over $32 million after fees and expenses, if our business does not generate the cash needed to finance our operations or growth, including potential business acquisitions, we may need to obtain additional financing or take steps to restrict our operations in order to conserve existing cash. In addition, poor financial results or unanticipated expenses could give rise to additional financing requirements. We may be unable to obtain financing on terms favorable to us or at all. Further, it may be more difficult to obtain additional financing because of our credit facility. Further, our ability to utilize our Revolver credit facility expires in 2009. Unless waived by Wells Fargo Foothill, upon the sale or issuance by us of any shares of our capital stock, the credit facility requires us to prepay the outstanding principal amount of the term loan in an amount equal to 75% of the proceeds received by us in connection with such sale. If we do sell or issue additional shares of our capital stock, we may be able to obtain a waiver from Wells Fargo Foothill. If we need to obtain financing and adequate funds are not available or are not available on acceptable terms, or we are not able to obtain a waiver from Wells Fargo Foothill, we may be required to make further expense reductions, which could significantly restrict our operations and limit our ability to enhance our products, fund expansion, respond to competitive pressures or take advantage of business opportunities, thereby resulting in a decrease in our revenue and stock price.

Any future acquisitions we make, or attempt to make, will need to be integrated into our business and require significant time and effort from our management team, which may disrupt our business and harm our operating results or financial condition.

We have made and may continue to make acquisitions of businesses and technologies to enhance our existing business. Acquisitions involve numerous risks, including problems combining the purchased operations and key employees, technologies or products, unanticipated costs, diversion of management's attention from our core business, adverse effects on existing business relationships with suppliers and customers, risks associated with entering markets in which we have no or limited prior experience and potential loss of key employees. The integration of businesses that we have acquired or that we may acquire in the future into our business has been and will continue to be a complex, time consuming and expensive process. Failure to operate as a combined organization utilizing common information and communication systems, operating procedures, financial controls and human resources practices could adversely impact the success of any business combination as evidenced in previous combination and acquisition transactions. For example, although we completed the acquisition of Pathlore in October 2005, the related difficulty in integrating the financial controls and procedures resulted in a material control weakness to our accounting for business combinations in fiscal year 2005 and contributed to our filing an extension to file our Annual Report on Form 10-K for the fiscal year ended December 31, 2005. Moreover, the integration of the products, product roadmap, and operations from the acquisition of Pathlore, MindSolve and any other company we may acquire is a continuing activity and will be for the foreseeable future.

Our operating results may suffer because of acquisition-related expenses, amortization of intangible assets and impairment of acquired goodwill or intangible assets. Furthermore, we may have to incur debt or issue equity securities to pay for any future acquisitions, or to provide for additional working capital requirements, the issuance of which could be dilutive to our existing shareholders.

There can be no assurance that we will be able consummate or expand future business combinations, if any, on favorable terms or on a timely basis, or that we will be able to integrate successfully businesses, products, technologies or personnel that we might acquire. Failure to do so may negatively affect our financial results, customer, employee and investor confidence, and ultimately, the price of our common stock. Further, we might be required to invest significant additional resources in order to expand these relationships, and the cost of this investment may exceed the revenue generated from this investment.

Security and privacy breaches could subject us to litigation and liability.

We host certain of our customers' learning, performance, and talent management software implementations and provide access to that software using the Internet and also use the Internet to deliver our on-demand subscription services to our customers. Computer viruses could be introduced into our systems or those of our customers which could disrupt the operation of our hosting systems or make them inaccessible to users. We also depend on third parties to provide key components of our networks and systems and Internet service providers and telecommunications companies and the efficient operation of their computer networks and other computer equipment to enable customers to access and use hosted software implementations.

We could become subject to litigation and liability if third parties penetrate security for our hosting systems or otherwise misappropriate our users' confidential information or personal data, or if customers are unable to access and use hosted software implementations. Advances in computer capabilities, new discoveries in the field of cryptography or other technological events or developments could result in compromises or breaches of our security systems. Anyone who circumvents our security measures could misappropriate proprietary information or personal data, or could cause interruptions in our services or operations. We may be required to expend significant capital and other resources to protect against the threat of security breaches or service interruptions or to alleviate problems caused by breaches or service interruptions. Each of our key third-party networks and systems component providers, Internet service providers and telecommunications companies partners have experienced significant outages in the past and could, in the future, experience outages, delays and other difficulties due to system failures unrelated to our systems, which could require us to pay service level credits to our customers or cause our customers to believe we were at fault and withhold payments due to us or sue us for breach of contract, which would result in decreased revenue and a possible decline in the price of our common stock.

Our disaster recovery plan might be insufficient if a major interruption occurs, and a disaster could severely damage our operations.

Our disaster recovery plan does not include redundant back-up computer systems at an alternate site. A disaster could severely harm our business because our computer systems could be interrupted for an indeterminate length of time. Our operations, including software solutions we host for some of our customers, depend on our ability to maintain and protect the computer systems needed for our day-to-day operations. For instance, a number of these computer systems are located in Mountain View, California on or near known earthquake fault zones and flood plains, or in Hyderabad, India where the infrastructure is not as robust as in the United States. Although these systems are designed to be fault tolerant, they are vulnerable to damage from fire, floods, earthquakes, power loss, telecommunications failures and other events. Any damage to our facility could lead to interruptions in the services we provide to our customers and loss of customer information, and could impair our ability to operate our business, leading us to pay service level credits or customers to withhold payments due to us and decreased revenue. The business interruption insurance we maintain may not be adequate to cover our losses resulting from disasters or other business interruptions, which would result in increased expenses and a possible decline in the price of our common stock.

The learning, performance and talent management systems market is highly competitive, and we may be unable to compete successfully.

The market for our products and services is intensely competitive, dynamic and subject to rapid technology change. Our competitors vary in size, scope and the breadth of products and services offered. We face competition from:

- other developers of learning, performance and talent management systems;
- providers of other learning, performance and talent management systems solutions;
- vendors of other enterprise software applications that are beginning to offer products with learning, performance and talent management functionality;
- large professional consulting firms and in-house information technology departments; and
- developers of web authoring tools.

Additionally, companies may choose to develop their own learning, performance, and talent management software internally rather than acquiring it from third parties.

There are relatively low barriers to entry in the learning, performance and talent management systems market, and we expect the intensity of competition to increase in the future. Additionally, some of our existing and potential competitors, such as Oracle Corporation and SAP AG, have longer operating histories and significantly greater financial, technical, marketing and other resources. These companies not only have more resources to develop their own products and technologies internally but can also use such resources to acquire competing products and technologies through acquisitions or other strategic transactions and quickly enter the learning, performance and talent management market and compete with us on both product offerings and pricing. Increased competition may result in price reductions, reduced gross margins or loss of market share, any of which would seriously harm our business and financial results.

Our core offering, the SumTotal 8 Series and predecessor products, integrates solutions addressing the learning management, performance management and compensation management segments of our market; however, our performance management solution was acquired in our acquisition of MindSolve and has only recently been integrated into our offering. Additionally, we had limited experience competing in the performance management space prior to our acquisition of MindSolve and now face new and different competitors with more experience selling and delivering performance management software and services. Furthermore, our compensation management offering is not as fully developed and does not have the same market acceptance as the other modules of the SumTotal 8 Series and predecessor products. As a result, we may have difficulty competing against companies which focus on these segments rather than the entire learning, performance, and talent management market, or selling to customers who only need solutions in a specific segment.

The learning, performance and talent management systems software markets may not grow to a sufficient size or at a sufficient rate to sustain our business.

Corporate training and education historically have been conducted primarily through classroom instruction and performance management solutions have traditionally been done using paper-based systems, desktop applications, spreadsheets, classroom settings, and human resource management systems. Although technology-based training applications have been available for many years, they currently account for only a small portion of the overall corporate learning market. Accordingly, our success depends on the extent to which companies implement learning, performance and talent management software solutions for the design, development, delivery and management of their corporate learning needs and performance management solutions for rating, reviewing, evaluating, developing and compensating individuals.

Many companies that have already invested substantial resources in traditional training methods may be reluctant to adopt a new strategy that may limit or compete with their existing investments. Even if companies implement learning, performance and talent management software solutions or performance management solutions, they may still choose to develop such solutions internally. If the use of learning, performance and talent management software does not become widespread, or if companies choose to develop such software or solutions internally rather than acquiring them from third parties, then our learning, performance and talent management software and solutions will not be commercially successful.

Our operating results could be harmed by economic, political, regulatory and other risks associated with international sales and operations.

We, as well as our customers and our partners, are increasingly doing business outside of the United States. Accordingly, our business is subject to a number of risks inherent in international operations, including:

- difficulties and costs of recruiting and retaining qualified personnel in our offices outside of the United States;
- difficulties managing a geographically dispersed workforce and sales organization with different learning styles and cultures;
- export controls, import tariffs and other barriers to trade;
- changes in laws or regulatory requirements, including tax laws;
- reduced protection of intellectual property rights;
- political and economic instability;
- reliability of infrastructure;
- potential difficulties in collecting accounts in foreign countries; and
- fluctuations in currency exchange rates.

While we sell our products worldwide and we have experienced international partners, we have limited experience with sales and marketing in some countries, such as China, where we opened a representative office in 2007. There can be no assurance that we will be able to market and sell our products in all of our targeted international markets. If our international efforts are not successful, our business and results of operations could be harmed.

Due to our significant operations in India, which has a rapidly growing technology market, our business is subject to certain risks that are not typically experienced to the same degree in the United States or elsewhere abroad.

We rely significantly on our research and development, professional services and technical support operations in Hyderabad, India to enable us to develop new products, complete customer implementation projects and new releases of our products on time and within established budgets and provide technical support. In recent years, increased growth and development of the technology market in general, and in Hyderabad specifically, has made it more difficult for us to hire and retain qualified technical employees and other personnel. In addition, it may be difficult to acquire additional space to support future growth.

Our efforts in Hyderabad are subject to a number of risks inherent in international operations. However, certain risks are particularly acute in India, such as:

- employee turnover;
- increasing salaries;
- increased expenses due to fluctuations in currency exchange rates; and
- less reliable infrastructure.

If our India operations fail, for any reason, to provide adequate and timely product enhancements, updates and fixes to us or customer implementations, our ability to fix defects in our SumTotal 8 Series, our ability to develop new versions of our SumTotal 8 Series and successor products, and our ability to respond to customer or competitive demands would be harmed and we would lose sales opportunities and customers and might negatively impact our customer satisfaction.

In addition, our engineering efforts are based primarily out of three offices: Bellevue, Washington; Gainesville, Florida and Hyderabad, India. If the offices fail to work together successfully, we may experience delays in fixing defects in our products, customer implementations, or in developing and releasing future versions of our product.

Our stock price has been and may continue to be volatile.

The trading price of our common stock has been and is likely to continue to be highly volatile. Our stock price is subject to continued fluctuations in response to a number of factors, including:

- actual or anticipated variations in our operating results;
- changes in the estimates of our operating results or changes in recommendations by securities analysts;

- changes in conditions or trends in the learning, performance, and talent management market;
- announcements by us or our competitors of significant customer wins, technological innovations, new products or services, significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- our growing emphasis on selling subscription-based, on-demand solutions;
- fluctuations in demand for our products, including due to seasonality;
- additions or departures of key personnel;
- foreign currency, interest rate, and fixed income risks; and
- market conditions in our industry, the industries of our customers and the economy as a whole.

Fluctuations in the price and trading volume of our common stock may prevent stockholders from selling their shares above the price at which they purchased their shares.

In addition, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation, and we may be the target of this type of litigation in the future. Securities litigation, like other litigation against us could result in substantial costs, negative publicity and divert our management's attention, which could seriously harm our business and stock price.

We have experienced and may continue to experience turnover of senior management and key personnel, which could harm our business or operations.

Our success depends to a significant degree on the performance of the senior management team and other key employees, and there is no guarantee that such officers or key employees will remain employed with us. We do not have employment agreements other than offer letters with any key employee, and we do not maintain key person life insurance. As a result of the departure of any of our other employees, there is a risk that we would be unable to effectively manage the Company and successfully meet operational and other challenges, which could harm our business. If the Company's senior management team, including any new hires, fail to work effectively together and execute the Company's plans and strategies, our business could be harmed.

Our success also depends on our ability to attract, integrate, motivate and retain highly skilled technical, sales and marketing and professional services personnel. Competition for qualified personnel in the software industry, particularly engineering and other technical personnel, is intense and is increasing, and there can be no assurance that we will be able to attract and retain highly skilled employees in sufficient numbers to sustain our current business or to support future growth.

In addition, we announced a restructuring in the fourth quarter of 2007 which included the termination of employment of a number of our employees. While most of the terminated employees signed release agreements, there is no assurance that such employees or any other former employee will not sue us for wrongful termination or other employment related claims. Even if such suits are meritless, such suits may divert management resources and will be costly to defend. The results of such litigation, if any, may be difficult to predict, and a judgment or settlement may adversely affect our operating results, which may result in a lower stock price.

Our internal controls and procedures may not be adequate to prevent or detect misstatements or errors.

A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Our management does not expect that our internal controls and procedures will prevent all errors and all fraud, if any, because, in addition to resource constraints, there are inherent limitations of all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls and procedures can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of a control or procedure. The design of any system of controls and procedures is also based in part on certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a control system, misstatements due to error or fraud may occur and not be detected. In such event, we may not be able to recognize revenue we expected to recognize; we may not be able to meet our forecasts or industry analysts' projections; or we may be the subject of litigation, each of which would likely harm our financial results and may result in a decline in the price of our common stock.

Standards for compliance with Sarbanes-Oxley Section 404 are burdensome and uncertain, and if we fail to comply in a timely manner, our business could be harmed and our stock price could decline.

Pursuant to Sarbanes-Oxley Section 404, our management is required to report on and our independent registered public accounting firm to attest to, the effectiveness of our internal controls over financial reporting, at least annually. The rules governing the standards that must be met for management to assess our internal controls over financial reporting are new, complex and subject to proposed changes. Currently, the rules require significant documentation, testing and possible remediation of our internal controls over financial reporting. The process of reviewing, documenting and testing our internal controls over financial reporting will likely continue to result in increased expenses and the devotion of significant management and other internal resources. We may encounter problems or delays in completing the implementation of any changes necessary to retain a favorable assessment of our internal controls over financial reporting during fiscal 2008. If we are unable to effectively remediate any future material weaknesses identified by us or our independent registered public accounting firm, we will be unable to assert that our internal controls are effective, and we may not be able to timely file, or file at all, our periodic financial reports. Even if we are able to file such reports, there may be a loss of stockholder confidence, leading to an adverse effect on the price of our stock.

Future changes in securities laws and regulations may increase our expenses.

Past changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and the listing standards of the Nasdaq Global Market, have increased our expenses as we devote resources to respond to the requirements. Although recent changes to the Sarbanes-Oxley Act of 2002 are intended to reduce the costs of compliance, compliance is costly due to the necessity of hiring additional personnel and external consultants and our independent registered public accounting firm. The securities laws and regulations may also make it more difficult and more expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. Further, our directors and executive officers could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified directors and executive officers, which could adversely affect our business.

Our operating expenses may be negatively affected by the impairment of goodwill and the impairment and amortization of intangible assets.

Goodwill represents the excess of costs over the net fair value of net identifiable assets acquired in a business combination. Goodwill is not amortized, but is instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* . Intangible assets with estimable useful lives are amortized over their respective estimated useful lives using straight-line and accelerated methods designed to match the amortization to the benefits received where applicable. They are reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* . Recoverability of goodwill is measured by a comparison of the carrying amount of a reporting unit, which is a component representing a segment or one level below a segment, to the estimated undiscounted future cash flows expected to be generated by the reporting unit. If the carrying amount of a reporting unit, after any adjustments required for other long-lived assets, exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the unit exceeds its fair value.

Purchased intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset group exceeds the fair value of the asset group.

Any significant adverse changes to the key assumptions about acquired businesses and their prospects or an adverse change in market conditions could result in a change to the estimation of fair value that could result in an impairment charge. Given the significance of the intangible assets as a percent of our total asset balance, an adverse change to the estimated fair value of intangible assets could result in an impairment charge that would be material to our reported assets and results of operations.

Finally, a sustained decline in our stock price could help trigger an impairment analysis for the value of our goodwill and intangible assets, which then might result in an impairment based not only on stock price but other factors. The carrying value of our goodwill and intangible assets on June 30, 2008 was $68.5 million and $9.9 million, respectively.

Changes in accounting regulations and related interpretations and policies, particularly those related to revenue recognition and income taxes could cause us to recognize lower revenue or to report lower earnings per share.

While we believe that we are in compliance with the accounting rules and guidance provided by AICPA and FASB, these bodies continue to issue implementation guidelines for their standards and the accounting profession continues to discuss a wide range of potential interpretations of such rules and guidance. Additional implementation guidelines, and changes in interpretations of such guidelines, could lead to unanticipated changes in our current revenue accounting practices that could cause us to recognize lower revenue. In addition, policies, guidelines and interpretations related to accounting for acquisitions, income taxes, allowance for doubtful accounts and other financial reporting matters require different judgments on complex matters that are often subject to multiple sources of authoritative guidance. If our determination of these matters is subsequently changed or updated, such changes or updates could result in an adverse impact on our financial statements.

Adverse litigation, disputes or investigations could affect our business.

We may, from time to time, be subject to various legal or government claims, disputes or investigations. Such matters may include, but not be limited to, claims, disputes or investigations related to warranty, refund, breach of contract, employment, intellectual property, government regulation or compliance or other matters such as the subpoena we received on April 30, 2008 from the U.S. Department of Defense, as described in the section "Legal Proceedings". These matters can be lengthy, expensive, and disruptive to our operations and results cannot be predicted with certainty. An adverse decision could result in monetary damages or injunctive relief that could affect our business, operating results or financial condition. Even if such matters do not result in litigation or such matters are resolved in our favor, such matters and the time and resources necessary to resolve or litigate them, could have a material adverse impact on our financial condition, results of operations, our reputation, or the market value of our common stock.

We may be limited in our use of net operating losses carry forwards.

Our ability to benefit from our deferred tax assets depends on us having sufficient future earnings to utilize our net operating loss ("NOL") carryforwards before they expire. We have established a valuation allowance against the future tax benefit for our federal and state NOL carryforwards. We could be required to record an additional valuation allowance against our foreign or U.S. deferred tax assets if market conditions change materially and, as a result, our future earnings are, or are projected to be, significantly less than we currently estimate. Our NOL carryforwards are subject to review and potential disallowance upon audit by the tax authorities of the jurisdictions where the NOLs were incurred.

As of December 31, 2007, we had federal and state NOL and research and development tax credit carry-forwards available to offset future taxable income. Our ability to utilize net operating losses and credits may be subject to a substantial limitation due to the change in ownership, as defined in the Internal Revenue Code Section 382 and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

We may become subject to government regulation and legal uncertainties that could result in liability or increase the cost of doing business, thereby adversely affecting our financial result.

We are not currently subject to direct regulation by any domestic or foreign governmental agency, other than regulations applicable to businesses generally, such as export control laws. However, due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may become applicable to us or may be adopted in the future with respect to the Internet covering issues such as taxation, user privacy, content, right to access personal data, copyrights, distribution and characteristics and quality of services.

The applicability of existing laws governing issues such as taxation, property ownership, copyrights, and other intellectual property issues, encryption, libel, export or import matters and personal privacy to the Internet is uncertain. The vast majority of these laws were adopted prior to the broad commercial use of the Internet and related technologies. As a result, they do not contemplate or address the unique issues of the Internet and related technologies. Changes to these laws, including some recently proposed changes, could create uncertainty in the Internet marketplace. Such uncertainty could reduce demand for our services or increase the cost of doing business due to increased costs of litigation or increased service delivery costs.

In addition, we could be liable for the misuse or unauthorized disclosure of personal data. The Federal Trade Commission, the European Union and certain state and local authorities have been investigating certain Internet companies regarding their use of personal information. Further, the European Union has adopted various data protection regulations related to the confidentiality of personal data. While we are certified under the European Union Safe Harbor which regulates the collection, disclosure and use of personal data, failure to comply with these various regulations could subject us to fines, and cause customers to lose confidence in our software products and related services, thereby negatively affecting our revenue and expense.

Terrorism and United States military actions may adversely affect our business.

In light of recent terrorist activity, political and military instability, and existing and possible United States military actions, significant instability and uncertainty in the world may continue to have a material adverse effect on world financial markets, including financial markets in the United States. In addition, such adverse political effects may have an adverse impact on economic conditions in the United States. Unfavorable economic conditions in the United States may have an adverse effect on our business operations including, but not limited to, our ability to expand the market for our products, obtain financing as needed, enter into strategic relationships and compete effectively in the learning, performance, and talent management markets. Such consequences may lead to a decrease in demand for our products and services and as a result our stock price may suffer.

Anti-takeover provisions in our charter documents could make the sale of the company more difficult.

Our certificate of incorporation and bylaws contain provisions that could make it harder for a third party to acquire us without the consent of our board of directors. For example, no potential acquirer would be able to call a special meeting of stockholders to remove our board of directors. A potential acquirer would also not be able to act by written consent without a meeting. In addition, our board of directors has staggered terms that make it difficult to remove all directors at once. The acquirer would also be required to provide advance notice of its proposal to remove directors at an annual meeting. The acquirer would not be able to cumulate votes at a meeting, which would require the acquirer to hold more shares to gain representation on our board of directors than if cumulative voting were permitted. In addition, our certificate of incorporation authorizes our Board of Directors, without stockholder approval, to issue up to 5,000,000 shares of undesignated preferred stock, which could be used to dilute the stock ownership of a potential hostile acquirer.

Subject to its fiduciary duties, our board of directors may in the future adopt a stockholder rights plan. If the board adopts a stockholder rights plan, it may discourage a merger or tender offer involving our securities that is not approved by our board of directors by increasing the cost of effecting any such transaction and, accordingly, could have an adverse impact on stockholders who may want to vote in favor of such merger or participate in such tender offer.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

***Purchases of Equity Securities* .** On August 20, 2007, our Board of Directors authorized the repurchase up to $15 million of our outstanding shares of common stock. Stock repurchases will be made in the open market, in block purchase transactions, or in structured Rule 10b5-1 share repurchase plans, and may be made from time to time or in one or more larger repurchases. We intend to conduct the repurchase in compliance with Rule 10b-18 of the Securities Exchange Act of 1934. The program does not obligate us to acquire any particular amount of common stock and the program may be modified, suspended or terminated at any time at our discretion. As of June 30, 2008, we have purchased 1,162,314 shares of common stock for an aggregate cost of approximately $5.7 million as follows:

Period	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Average Price Paid Per Share	Total Dollar Value of Shares Purchased as Part of Publicly Announced Plans or Programs (in thousands)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Programs (in thousands)
Through March 31, 2008	803,461	$ 4.98	$ 3,999	$ 11,001
April 1-30, 2008	2,000	3.93	8	10,993
May 1-31, 2008	210,731	4.74	999	9,994
June 1-30, 2008	146,122	4.68	684	9,310
Total	1,162,314	$ 4.90	$ 5,690	$ 9,310

Item 4. Submission of Matters to a Vote of Securities Holders

The Annual Meeting of Stockholders of SumTotal Systems, Inc. was held on Friday, June 6, 2008 at the Company's Corporate Headquarters in Mountain View, California. The results of the voting on the matters submitted to the stockholders are as follows:

1. To elect two (2) Class III Directors to hold office until the 2011 Annual Meeting of Stockholders or until their successors are duly elected and qualified or until such directors' death, resignation or removal. Voting results were as follows:

Name	Votes For	Votes Withheld
Jack Acosta	26,519,389	74,622
Vijay Vashee	26,043,637	550,374

The Company's Class II Directors continuing in office until the 2009 Annual Meeting are John Coné, Donald Fowler and Ali Kutay. The Company's Class III Directors continuing in office until the 2010 Annual Meeting are Sally Narodick and Kevin Oakes.

2. To ratify the selection of BDO Seidman, LLP as the independent registered public accounting firm for the Company for the fiscal year ending December 31, 2008. Voting results were as follows:

For	Against	Abstain
26,475,995	100,556	17,460

3. To approve the amended and restated 2004 Equity Incentive Plan.

For	Against	Abstain
12,257,387	5,799,757	40,013

4. To approve the amended and restated Employee Stock Purchase Plan.

For	Against	Abstain
17,878,129	182,472	36,556

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Item 6. **Exhibits**

(a) **Exhibits**

3.1	Amended and Restated Certificate of Incorporation, filed with the Secretary of State of Delaware on March 18, 2004 (incorporated by reference to Form 8-K filed on March 19, 2004)
3.2	Amended and Restated Bylaws (incorporated by reference to Form 8-K filed on December 6, 2007)
4.1	Registration Rights Agreement dated as of November 15, 2001 by and between Click2learn and various investors (incorporated by reference to Click2learn's Current Report on Form 8-K dated November 15, 2001)
4.2	Form of Warrant to Purchase Common Stock dated as of November 20, 2001 from Click2learn to various investors (incorporated by reference to Click2learn's Current Report on Form 8-K dated November 15, 2001)
4.3	Registration Rights Agreement dated as of June 20, 2003 by and between Click2learn and various investors (incorporated by reference to Click2learn's Current Report on Form 8-K dated June 20, 2003)
4.4	Form of Warrant to Purchase Common Stock dated as June 20, 2003 from Click2learn to various investors (incorporated by reference to Click2learn's Current Report on Form 8-K dated June 20, 2003)
4.5	Registration Rights Agreement between SumTotal, Inc. and certain stockholders of Pathlore Software Corporation dated August 3, 2005 (incorporated by reference to Exhibit 4.5 to Form 10-K filed March 28, 2006)
10.1*	Amended and Restated SumTotal Systems, Inc. 2004 Equity Incentive Plan (incorporated by reference to Appendix A of the Company's definitive Proxy Statement on Schedule 14A, filed on April 29, 2008)
10.2*	Amended and Restated SumTotal Systems, Inc. Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.2 for Registatation Statement on Form S-8 (No. 333-152687))
31.1	Certifications of Chief Executive Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certifications of Chief Financial Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Each exhibit marked with a (*) is a compensatory contract, plan or other arrangement in which one or more directors and/or executive officers are eligible to participate.

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SIGNATURES

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

SUMTOTAL SYSTEMS, INC.

August 4, 2008	/s/ NEIL J. LAIRD
Date	Neil J. Laird Chief Financial Officer (Duly Authorized Officer and Chief Financial and Chief Accounting Officer)

Exhibit Index

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Exhibit 31.1

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a),
AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

I, Donald E. Fowler, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SumTotal Systems, Inc.;

2. Based on my knowledge, 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 such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15 (f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2008

/s/ DONALD E. FOWLER
Donald E. Fowler
Chief Executive Officer and Director

Exhibit 31.2

CERTIFICATIONS OF CHIEF FINANCIAL OFFICER PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Neil J. Laird, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SumTotal Systems, Inc.;

2. Based on my knowledge, 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 such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2008

/s/ NEIL J. LAIRD
Neil J. Laird
Chief Financial Officer

Exhibit 32.1

**CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald E. Fowler, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of SumTotal Systems, Inc. on Form 10-Q for the fiscal quarter ended June 30, 2008 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of SumTotal Systems, Inc.

/s/ DONALD E. FOWLER
Donald E. Fowler
Chief Executive Officer and Director
Date: August 4, 2008

I, Neil J. Laird, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of SumTotal Systems, Inc. on Form 10-Q for the fiscal quarter ended June 30, 2008 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of SumTotal Systems, Inc.

/s/ NEIL J. LAIRD
Neil J. Laird
Chief Financial Officer
Date: August 4, 2008