



Know your Customer.

Know the Answer.

Knova Software.

Letter to Shareholders

From Bruce Armstrong, President and CEO

2005 was a pivotal year for our company that began with the successful merger of Kanisa and ServiceWare and the re-branding of the combined company as Knova Software. Over the course of 2005, Knova successfully integrated the two companies, grew revenue to \$23.4 million and reduced costs of the combined company by 60%.

This strong performance reflects the success of the merger, Knova's product and sales momentum, and the business value our solutions deliver to our customers. In 2005, Knova welcomed 25 new customers including market leaders such as Autodesk, Business Objects, Express Scripts and Trend Micro. At the same time, Knova also secured 90 follow-on deals in 2005 for software and services with existing customers. This large number of follow-on deals reflects the confidence our existing customers have in the combined company and our product direction.

In 2005, Knova made two key additions to its management team:

- Tom Muise, former executive at Tandem Computers and Synopsis, joined Knova in June as chief financial officer, and
- Richard Stouffer, former executive at PeopleSoft and Accenture, joined Knova in November as vice president of global services.

We are delighted to have Tom and Richard join the Knova team and believe that our customers, investors and employees will benefit from their extensive knowledge and experience.

In 2005, Knova also rolled out version 6.5 of its application suite for Service Resolution Management. Released in the second quarter, Knova 6.5 was highlighted by a new version of Knova's powerful natural language search engine, and enhanced content management and internationalization capabilities. Knova 6.5 remains the first and only fully integrated solution with applications for self-service, assisted service and peer support forums.

As a result of Knova's innovative products, patented technologies, competitive wins and successful deployments, Knova continued to earn recognition from the industry's top analysts including Gartner, Forrester, Patricia Seybold Group and Basex. Most notably, Knova was positioned as "Visionary" by Gartner in its Magic Quadrant report for Enterprise Search for the second consecutive time, and received the top rating in its Marketscope report for Self-Service for the second consecutive time. Knova was the only vendor to receive these ratings in both Gartner reports.

Looking ahead to 2006, we expect the demand for our software to remain strong as enterprises seek to automate the costly, labor-intensive customer service process of resolving customer cases, incidents and questions. According to IDC, the customer relationship management (CRM) market will reach \$11.5 billion in 2006 while the knowledge management (KM) market will reach nearly \$6.4 billion. Targeting the intersection of these two large markets, Knova's opportunity is clear and compelling. Built on a next-generation search and

(continued)

knowledge management platform, Knova's suite of knowledge-empowered customer service applications automate the resolution process across multiple channels including contact centers, help desks, email and self-service sites. Customers inundated with high call volumes and pressure to cut costs are now deflecting tens of thousands of calls more than with previous knowledge management and search applications while simultaneously improving customer satisfaction.

Our continued success in addressing this market opportunity is based on our ability to innovate and execute faster than our competitors. We believe our product leadership will continue with the next major release of our product. Knova 7.0 will feature a new unified platform, integrating both Kanisa and ServiceWare technologies, as well as a range of new and powerful capabilities for personalized and adaptive customer service across multiple channels. Knova 7.0 will enhance Knova's ability to further penetrate key markets, including high technology, telecommunications, financial services and enterprise help desks.

In 2006, our direct sales force will continue to leverage our channel partnerships with system integrators such as Capgemini and EDS, as well as technology vendors such as HP and Amdocs. In both Europe and the U.S., our partner channels continue to bring us a steady stream of large deals in our target sectors. We will continue to strengthen and develop these existing partnerships in the U.S. and abroad while also pursuing additional strategic alliances.

Without question, 2006 will be an exciting year for us as we plan to introduce new products, acquire new customers and deliver successful deployments. Armed with a strong and capable organization, solid financial footing and a powerful and innovative product suite, we are well positioned to take advantage of the significant market opportunity ahead. As always, we will rely on the financial discipline, commitment to customers and market innovation that have guided us thus far. We look forward to sharing another excellent year with our customers, partners, employees and shareholders.

Sincerely,

A handwritten signature in black ink, appearing to be 'Bruce Armstrong', followed by a horizontal line extending to the right.

Bruce Armstrong
President and CEO

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2005

OR

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

For the transition period from _____ **to** _____

Commission file number 000-30277

Knova Software, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

*(State or Other Jurisdiction of
Incorporation or Organization)*

25-1647861

*(I.R.S. Employer
Identification No.)*

**10201 Torre Avenue, Suite 350
Cupertino, CA**

(Address of Principal Executive Offices)

95014

(Zip Code)

Registrant's telephone number, including area code:

(408) 863-5800

(Former name or former address, if changed since last report.)

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

Title of Each Class

Name of Each Exchange on Which Registered

None

Not applicable

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

Common Stock, par value \$.01 per share

(Title of Class)

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of common equity held by non-affiliates of the registrant as of June 30, 2005, the last business day of the registrant's most recently completed second quarter, was \$18,981,403, computed by reference to the price at which the common equity was last sold on the Over the Counter Bulletin Board on June 30, 2005, as reported in *The Wall Street Journal*. This figure has been calculated by excluding shares owned beneficially by directors and executive officers as a group from total outstanding shares solely for the purpose of this response.

The number of shares of the registrant's Common Stock outstanding as of the close of business on March 13, 2006 was 8,744,116.

DOCUMENTS INCORPORATED BY REFERENCE

Not Applicable

EXHIBITS INDEX IS LOCATED ON PAGE 66

KNOVA SOFTWARE, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2005

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PART I

Item 1. Business

Overview

On February 8, 2005, ServiceWare Technologies, Inc. combined with Kanisa Inc. (“Kanisa”) through the merger of a wholly owned subsidiary of ours with and into Kanisa. Upon the consummation of the merger, we relocated our headquarters to Kanisa’s offices in Cupertino, California. Our company was renamed “Knova Software, Inc.” in May 2005.

As used in this report, the terms “we”, “us”, “our”, “our company” and “Knova” mean Knova Software, Inc. and its subsidiaries.

We are a provider of customer relationship management (CRM) software applications, specifically applications that enable customer service organizations to more effectively resolve service requests and answer questions. Built on knowledge management and search technologies, our service resolution management (SRM) applications optimize the resolution process across multiple service channels, including contact centers, self-service websites, help desk, email and chat. Our SRM applications complement, integrate with, and enhance traditional CRM, contact center, and help desk applications by providing patented knowledge management solutions that improve service delivery. Our customers include some of the largest companies in the world and our products enable them to reduce operating and service delivery costs, improve customer satisfaction, and increase revenues.

We are principally engaged in the design, development, marketing and support of software applications and services. Substantially all of our revenues are derived from a perpetual license of our software products, the related professional services and the related customer support, otherwise known as maintenance. We license our software in arrangements in which the customer purchases a combination of software, maintenance and/or professional services, such as our training and implementation services. Maintenance, which includes technical support and product updates, is typically sold with the related software license and is renewable at the option of the customer on an annual basis after the first year. Our professional services and technical support organizations provide a broad range of implementation services, training, and technical support to our customers and implementation partners. Our service organization has significant product and implementation expertise and is committed to supporting customers and partners throughout every phase of their adoption and use of our solutions.

Products

During 2005, we announced our new identity, Knova Software, and began selling a single product line of Knova software applications.

By streamlining processes and providing customer service and technical support personnel, as well as customers and employees, with complete access to enterprise knowledge and content, Knova applications enable organizations to increase customer satisfaction and reduce operating and service delivery costs. For example,

- Customer service organizations can increase service-agent productivity and customer retention while decreasing service costs, training costs and resolution time.
- Customer service organizations can ensure consistent service and customer interactions across channels by providing a unified view of knowledge, enforcing consistent resolution processes in the contact center, and providing seamless escalation with CRM systems.
- Enterprises can provide customer self-service that reduces service costs, improves customer satisfaction, and facilitates sales and marketing of products and services.
- Information technology organizations can increase the effectiveness of employee help desk operations while decreasing internal technical support costs.

- Enterprises can preserve and enhance their existing deployments of traditional call center, CRM and help desk applications, as well as content management, knowledge management and workflow tools.

The following is a description of our products.

Knova Application Suite

The Knova Application Suite is a suite of knowledge powered service resolution management applications designed to enable companies to better service and retain their customers and employees. Specifically, we believe our Knova Application Suite enables companies we service to improve employee productivity, improve customer service, and increase customer satisfaction and revenue.

The Knova Application Suite consists of the following business applications:

- **Knova Contact Center** is an assisted-service application for customer service and help desk agents that enables them to resolve customer issues and questions more effectively. Knova Contact Center integrates a sophisticated knowledge management system with additional features such as search, collaboration, interview scripting, email response, and knowledge authoring. Knova Contact Center features business process support integrated with customer relationship management systems that can tailor the resolution experience based on the customer's or employee's issue or question.
- **Knova Self-Service** is a self-service application that enables customers and employees to resolve their own issues and questions on an enterprise website. Knova Self-Service provides a wide range of features, including guided search and business process support that can provide a personalized and guided resolution experience based on the issue or question the customer or employee has.
- **Knova Forums** is an application for online customer communities and forums that enables customers to discuss and collaborate on topics of interest, including an enterprise's products and services. Knova Forums enables customers and employees to assist each other, reducing service delivery costs and providing valuable insight to the enterprise.
- **Knova Field Service** is a mobile support application that enables field technicians and service professionals to search the knowledge base and resolve problems at the customer site. Knova Field Service runs on a disconnected laptop computer and synchronizes via a network connection with the Field Service application server to update the knowledge base content.
- **Knova Knowledge Desk** is a packaged knowledge management solution for service and help desks to resolve questions, author knowledge, and manage repositories of intellectual capital. Knova Knowledge Desk is integrated with traditional service and help desk applications from companies such as Remedy and Hewlett Packard ("HP"). It is based on a patented self-learning search technology that is designed to improve with usage. Knova Knowledge Desk features application modules for different user types and functions.

Knova Knowledge Platform

The Knova Application Suite is built on and deployed with the Knova Knowledge Platform, a next-generation search and knowledge management platform. The Knova Knowledge Platform features several core technology components and capabilities accessed by Knova applications and used by customers. These include:

- A knowledge auto-classification engine that automatically tags and organizes disparate knowledge sources, including unstructured documents, transaction data, experts, and authored support content.
- A natural language processing (NLP) search engine that enables users to find the knowledge they require based on their query, intent, and goal. This search engine also provides a guided search experience based on a patented approach to knowledge management that enables users to narrow search results by dynamic parameters and drill-down options.

- A patented self-learning search and knowledge management technology called the Cognitive Processor that enables organizations to capture and manage repositories of intellectual capital and knowledge. The Cognitive Processor uses patented algorithm technology based on neural network and Bayesian statistical principles that enable learning and improvement from past transactions.
- The Resolution Flow business process engine is a rules-based engine that guides users through a designed service experience based on the context of their query, profile, or case.
- Application Programming Interfaces (APIs) and pre-built adaptors for integrating the Knova Application Suite with complementary business applications from vendors such as Siebel, Amdocs, PeopleSoft, Remedy, HP and others, using industry-standard protocols and approaches.

Technology and Architecture

We employ industry-standard technologies to create an object-based open architecture for all of our applications. The architecture is based on the Java 2 Enterprise Edition (J2EE) framework that includes components specifically designed to take advantage of the modern web environment. We also have provided some of our applications based on Microsoft's .NET framework.

Our solutions run on leading operating systems and databases and we are continually updating our software to run on common environments. Currently we support existing customers on Windows, Solaris and NT operating environments and a wide range of J2EE-compliant application servers.

Our technology is also based on the popular Extensible Markup Language (XML) and Simple Object Access Protocol (SOAP) framework. The use of XML and SOAP standards enable our products to be more easily integrated with enterprise systems and web services.

Strategy

Our objective is to become the leading provider of service resolution management applications that enable our customers to reduce service and operating costs, improve customer satisfaction, and thereby increase revenues. To achieve our goal, we intend to:

- *Support Successful Customer Implementations.* Our success depends on our customers' successful implementations of Knova applications. To this end, we actively support the customer's deployment efforts by providing Internet and telephone technical support, instructor-led training, and account management teams.
- *Maintain and Extend Our Advanced Technology Position.* We intend to broaden our position in the knowledge management and customer service and support solutions market by continuing to increase the performance, functionality, and scalability of our solutions. We plan to continue to devote resources to the development of new and innovative technologies and products, to increase efficiencies, to offer immediate answers, and to minimize service response time. We intend to expand our current offerings to incorporate advances in knowledge acquisition, business process support, and multi-channel interactions.
- *Expand Strategic Alliances.* To broaden our market presence, enter new geographic and vertical markets, and increase adoption of our solutions, we plan to strengthen existing and pursue additional strategic alliances with consultants, systems integrators, value-added resellers, and independent software vendors of complementary products. We intend to use these relationships to increase our sales by taking advantage of these organizations' industry expertise, business relationships, and sales and marketing resources.
- *Further Develop International Presence.* To capitalize on international opportunities for our SRM applications and knowledge management solutions, we intend to expand our international presence through global offices as well as local distributors, including Merlin Information Systems in the United Kingdom.

Services

Professional Services. Our professional services team provides our customers with pre- and post-sales services. Pre-sales consulting services include our business impact analysis, which applies analytical methodologies and an understanding of business processes to help organizations make an informed decision regarding the choice of service resolution management and knowledge management solutions. Post-sales implementation, integration, and knowledge management consulting services allow our customers to deploy our customer service and support solutions effectively. In addition, our professional services team offers education and training to enable our customers' internal teams to understand how to use our products, support the implementation, and maintain our solutions.

Customer Support. All customers under a maintenance agreement have access to our technical support engineers by telephone, fax or e-mail. In addition, we provide self-service support to our customers on a 24/7 basis through our website.

Account Management and Technical Support. We are dedicated to providing quality customer service and technical support to our customers. Our customers have access to our skilled support agents and engineers and are assigned an account manager. Account managers are responsible for overall customer satisfaction and work with all relevant parts of our organization (sales, support, services) to ensure that customer expectations are met and exceeded. Account managers meet with our customers during the initial implementation and later become the primary customer point of contact and relationship manager when the Knova system is rolled into production.

Customers

We maintain a referenceable and active customer list of over 160 customers. We have traditionally marketed our products and services to Global 2000 call centers and help desks in a wide range of vertical industries. No customer accounted for greater than 10% of total revenues in 2005. The following is a partial list of our customers.

Technology	Trend Micro Incorporated	Healthcare & Biotech
Business Objects	Vision Solutions	Allina Hospitals & Clinics
EBay Inc.	VMWare, Inc.	Aventis Pharmaceuticals, Inc.
First Data Corporation		Express Scripts, Inc.
Genesys Telecommunications Laboratory	Services	GE Healthcare
Hewlett Packard	C3i, Inc.	McKesson Provider Technologies
Intersystems Corporation	Circle Company Associates, Inc.	Omniceil
Intuit, Inc.	Electronic Data Systems Corporation	United Health Technologies
Invensys Systems, Inc.	SEI Information Technology, Inc.	University of Utah Vanderbilt University Medical Center
McAfee, Inc.	Telecommunications	Government/Public Sector
Mercury Interactive	Aastra Intecom (EADS)	Northeastern University
Novell	Cingular Wireless LLC	State of Washington
Partech, Inc.	Qualcomm, Inc.	United States Navy
Plato, Inc.	SaskTel	U.S. Patent & Trademark Office
Qlogic Corporation	U.S. Cellular Corporation	The University of Iowa
Sage Software, Inc.		
Softbrands	Automotive	
Tellabs North America, Inc.	Ford Motor Company	
Texas Instruments, Inc.		
Toshiba America		

Financial Services

Aegon Equity Group
 AmSouth Bank
 Dow Jones & Company, Inc.
 Fifth Third Bank
 H&R Block, Inc.
 Prudential Insurance Company of America
 Reuters Limited
 The Travelers Indemnity Company
 Wachovia
 Wausau Financial Systems

Retail/Consumer Goods

Jack in the Box, Inc.
 Mattel, Inc.
 Nestle Waters NA, Inc.
 Sharp Electronics
 Staples, Inc.
 Tommy Hilfiger USA, Inc.

Industrial/Manufacturing

Eaton Electrical
 Hughes Supply, Inc.
 Johnson Controls, Inc.
 Pactiv Corporation

Sales & Marketing

We sell our solutions primarily through our direct sales force. We have sales personnel throughout the United States and in the United Kingdom. Our direct sales activity is supplemented by several channel relationships, including relationships with Amdocs, HP, Capgemini, eVergance, and Merlin Information Systems.

To increase the effectiveness of our direct selling efforts and our penetration of the knowledge management solutions market, we build brand awareness of Knova Software and our solutions through marketing programs. These programs include print and web advertisements, direct mailings, public relations activities, seminars and other major industry/partner events, market research and our website.

Our marketing organization creates materials to support the sales process, including brochures, data sheets, case studies, presentations, white papers and demonstrations. In addition, our marketing group helps identify and develop key strategic alliance opportunities and channel distribution relationships.

Strategic Alliances

We have established strategic alliances in several categories to extend our market reach, to augment our sales and marketing initiatives, to supplement our implementation and deployment capabilities, and enhance our product capabilities. Alliance categories include:

- **Resellers and Distributors:** We have active reseller relationships with Amdocs Software Systems Limited and Hewlett Packard, which provide complementary CRM and service desk solutions, as well as Capgemini Technologies, LLC, eVergance Partners, LLC, and Merlin Information Systems, which provide consulting and implementation services.
- **Complementary Software Partners:** We participate in several alliance programs of vendors who provide complementary business applications and software. These include Siebel Systems, Inc., Amdocs Software Systems Limited, Remedy, Hewlett Packard, and Genesys Telecommunications Laboratory.
- **Consulting and System Integration Partners:** We work closely with leading system integration, consulting and outsourcing firms, and has established alliances with Capgemini Technologies, LLC, Electronic Data Systems Corporation, eVergance Partners, LLC, Stratacom, Inc., Hewlett Packard, and Merlin Information Systems.
- **Technology Partners:** To deploy our software effectively across varied IT environments, we maintain technology partnerships with Inxight Software, Inc., Business Objects, and WebMethods, Inc. In addition, our software is developed on and tested against platform software from providers of database, operating system and application server software.

Research and Development

Our internal research and development team, based in Cupertino, California, together with our outside development resources develop our product and service offerings. In conjunction with our outside development resources, we continue to enhance the features and performance of our existing products and services. In addition, we are continuing to develop our products and services to meet our customers' expectations of ongoing innovation and enhancement within our suite of products and services. In 2001, we entered into an agreement with EPAM Systems of Princeton, New Jersey, and Minsk, Belarus, to augment our research and development capabilities. This relationship gives us access to approximately 500 developers in what we believe to be a cost effective offshore model. EPAM Systems is ISO 9001 certified and has completed complicated projects for major international corporations including Fortune 500 companies. This relationship has allowed us to streamline operating costs and increase productivity. Research and development is conducted by way of a clearly defined process that is a subset of industry standard Rational Unified Process.

We renewed our agreement with EPAM Systems on April 1, 2002. This agreement states that consulting services will be provided in accordance with specific work orders. Payment for these services is billed as the work is incurred or at a fixed fee agreed upon for the work order. As of December 31, 2005, the agreement was terminated, but we continued to use services under the same terms and conditions. We renewed our agreement on February 28, 2006 under similar terms and conditions.

Our ability to meet our customers' expectations depends on a number of factors, including our ability to identify and respond to emerging technological trends in our target markets, develop and maintain competitive products, enhance our existing products and services by adding features and functionality that differentiate them from those of our competitors and bring products and services to market on a timely basis and at competitive prices. Consequently, we have made, and we intend to continue to make, investments in research and development.

For a description of our research and development related expenses, see the Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Form 10-K.

Competition

Competition in our marketplace is rapidly evolving and intense, and we expect competition to intensify further in the future as current competitors expand their product offerings and new competitors enter the market. Current competitors include in-house developed applications and providers of commercially available CRM, e-Service, search and knowledge management solutions, including eGain Communications, Inqira, Inc., KANA Software, RightNow Technologies, SupportSoft, and Art Technology Group.

We believe that the principal competitive factors affecting our market include referenceable customers, the breadth and depth of a given solution, product quality and performance, customer service, core technology, product scalability and reliability, product features and the ability to implement solutions and respond quickly to customer needs.

Although we believe that we currently compete favorably with respect to the principal competitive factors in our market, we may not be able to maintain our competitive position against current and potential competitors, especially those with significantly greater financial, marketing, service, support, technical and other resources. It is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share. We also expect that competition will increase as a result of industry consolidation.

Intellectual Property

Our success and ability to compete effectively depends, in part, upon our proprietary rights. We rely on a combination of patent, copyright, trade secret, and trademark laws, confidentiality procedures and contractual provisions to establish and protect our proprietary rights in our software, documentation, and other written materials. These legal protections afford only limited protections for our proprietary rights and may not

prevent misappropriation of our technology or deter third parties from developing similar or competing technologies.

We seek to avoid disclosure of our intellectual property by generally entering into confidentiality or license agreements with our employees, consultants and companies with which we have alliances, and we generally control access to, and distribution of, our software, documentation, and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology or to develop products with the same functionality as our products.

Policing unauthorized use of our proprietary information is difficult, and we may be unable to determine the extent of unauthorized copying or use of our products or technology. Further, third parties who have been granted certain limited contractual rights to use our proprietary information may improperly use or disclose such proprietary information. In addition, certain components of our product suite require us to have licenses from third parties for use. These licenses may be subject to cancellation or non-renewal. In this event, we will be required to obtain new licenses for use of these products, which may not be available on commercially reasonable terms, if at all, and could result in product shipment delays and unanticipated product development costs.

Employees

As of February 28, 2006, we had 95 full time employees consisting of 24 in sales, 35 in professional services and support, 20 in research and development, 8 in marketing, and 8 in general and administration. We strive to maintain a work environment that fosters professionalism, excellence, and cooperation among our employees.

Forward-looking Statements

Certain statements contained in this annual report on Form 10-K constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different than any expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expects", "plans", "anticipates", "believes", "estimates", "predicts", "potential", "continue", "intends", or the negative of these terms or other comparable terminology.

We often use these types of statements when discussing:

- Our plans and strategies,
- Our anticipation of profitability or cash flow from operations,
- The development of our business,
- The expected market for our services and products,
- Other statements contained in this report regarding matters that are not historical facts.

These forward-looking statements are only predictions and estimates regarding future events and circumstances. Actual results could differ materially from those anticipated as a result of factors described in Item 1A "Risk Factors" or as a result of other factors. We may not be able to achieve the future results reflected in these statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report might not transpire.

Although we believe that the expectations in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

Internet Address and SEC Reports

We maintain a website with the address www.knova.com. We have not incorporated by reference into this Annual Report on Form 10-K the information on our website, and the information on our website should not be considered to be a part of this document. Our website address is included in this document for reference only. We make available free of charge (other than an investor's own Internet access charges) through our website our Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, through a link to the EDGAR database, as soon as reasonably practicable after we electronically file, or furnish material to the Securities and Exchange Commission (the "SEC"). We also include on our website our corporate governance guidelines and the charters for each of the major committees of our board of directors. In addition, we intend to disclose on our website any amendments to, or waivers from, our code of business conduct and ethics that are required to be publicly disclosed pursuant to rules of the SEC.

Business History

We were initially incorporated as a Pennsylvania corporation in January 1991 as ServiceWare, Inc. In July 1999, we acquired the Molloy Group, Inc., a provider of knowledge powered software for strengthening customer relationships, including its rights to the Cognitive Processor. In May 2000, we changed our name to ServiceWare Technologies, Inc. and reincorporated as a Delaware corporation. In August 2000, we closed our initial public offering. Prior to July 2001, we had two reportable business segments: software and content. In July 2001, we completed the sale of our content business. In response to poor financial performance and the economic downturn, during 2001 we announced strategic corporate restructuring programs pursuant to which we significantly reduced costs and focused our business exclusively on revenue growth opportunities in our software business. As part of the restructuring plans, approximately 180 employees were laid off during 2001.

In February 2005, we combined with Kanisa, Inc., a privately held company based in Cupertino, California. Kanisa is a provider of service resolution management applications that automate the problem resolution process across multiple customer service channels. Kanisa was founded in 1997. In 2002, Kanisa acquired the assets of Quiq Inc., a provider of software solutions for customer communities and peer-support forums. In July 2003, Kanisa acquired Jeeves Solutions, the enterprise search division of Ask Jeeves (Nasdaq: ASKJ). We changed our name to "Knova Software, Inc." in May 2005.

Financial information regarding revenues and long lived assets attributable to the United States versus international operations is found in Note 15 to our consolidated financial statements in Item 8 below.

Item 1A. Risk Factors

Before you invest in shares of our securities, you should be aware of various risks, including the risks described below. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The risks and uncertainties described below or elsewhere in this report are not the only ones facing us. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also adversely affect our business and operations. If any of the matters included in the following risks were to occur, our business, financial condition, results of operations, cash flows or prospects could be materially adversely affected. In such case, you could lose all or part of your investment.

We may not be able to reverse our history of losses.

As of December 31, 2005, we had an accumulated deficit of \$83.3 million. We incurred a net loss of \$5.1 million for the year ended December 31, 2005. We will need to increase our revenues and control expenses to avoid continued losses. In addition, our history of losses may cause some of our potential customers to question our viability, which might hamper our ability to make sales.

We may need additional capital to fund continued business operations and we cannot be sure that additional financing will be available when and if needed.

Although we presently have adequate cash resources for our near term needs, our ability to continue as a business in our present form will ultimately depend on our ability to generate sufficient revenues or to obtain additional debt or equity financing. From time to time, we consider and discuss various financing alternatives and expect to continue such efforts to raise additional funds to support our operational plan as needed. However, we cannot be certain that additional financing will be available to us on favorable terms when required, or at all.

If we are not able to obtain capital when needed, we may need to dramatically change our business strategy and direction, including pursuing options to sell or merge our business.

In the past, we have funded our operating losses and capital expenditures through proceeds from equity offerings and debt. Changes in equity markets within the past several years have adversely affected our ability to raise equity financing and have adversely affected the markets for debt financing for companies with a history of losses such as ours. If we raise additional funds through the issuance of equity, equity-linked or debt securities, those securities may have rights, preferences or privileges senior to those of the rights of our common stock and, in light of our current market capitalization, our stockholders may experience substantial dilution. Further, the issuance of debt securities could increase the risk or perceived risk of our company. If we are not able to obtain necessary capital, we may need to dramatically change our business strategy and direction, including pursuing options to sell or merge our business.

Our cash flow may not be sufficient to permit repayment of our debt when due.

As of December 31, 2005, we had \$3.6 million of outstanding debt through a line of credit with Silicon Valley Bank. We may need to, in the future, raise additional money through bank financing or debt instruments. Our ability to retire or to refinance our indebtedness will depend on our ability to generate cash flow in the future. Our cash flow from operations may be insufficient to repay this indebtedness at scheduled maturity. If we are unable to repay or refinance our debt when due, we could be forced to dispose of assets under circumstances that might not be favorable to realizing the highest price for the assets or to default on our obligations with respect to this indebtedness.

We may not succeed in attracting and retaining the personnel we need for our business.

Our business requires the employment of highly skilled personnel, especially experienced software developers. The inability to recruit and retain experienced software developers in the future could result in delays in developing new versions of our software products or could result in the release of deficient software products. Any such delays or defective products would likely result in lower sales. We may also experience difficulty in hiring and retaining sales personnel, product managers and professional services employees.

A significant percentage of our product development is performed by a third party internationally, the loss of which could substantially impair our product development efforts.

A significant percentage of our product development work, and some of our implementation services, is performed by a third-party development organization located in Minsk, Belarus. Unpredictable developments in the political, economic and social conditions in Belarus, or our failure to maintain or renew our business relationship with this organization on terms similar to those which exist currently, could reduce or eliminate product development and implementation services. If access to these services were to be unexpectedly eliminated or significantly reduced, our ability to meet development objectives vital to our ongoing strategy would be hindered or we may be required to incur significant costs to find suitable replacements, and our business could be seriously harmed.

It is difficult to draw conclusions about our future performance based on our past performance due to significant fluctuations in our quarterly operating results.

We manage our expense levels based on our expectations regarding future revenues and our expenses are relatively fixed in the short term. Therefore, if revenue levels are below expectations in a particular quarter, operating results and net income are likely to be disproportionately adversely affected because our expenses are relatively fixed. In addition, a significant percentage of our revenues is typically derived from large orders from a limited number of customers, so it is difficult to estimate accurately the timing of future revenues. Our revenues are unpredictable and in our last eight quarters have fluctuated up and down between a low of \$1.8 million in first quarter 2004 and a high of \$6.8 million in fourth quarter 2005.

Our historical results for periods prior to February 2005 may not be indicative of future performance as a result of the significant changes to our business from the merger with Kanisa.

Our quarterly results are also impacted by our revenue recognition policies. Because we generally recognize license revenues upon installation, sales orders from new customers in a quarter might not be recognized during that quarter. Delays in the implementation and installation of our software near the end of a quarter could also cause recognized quarterly revenues and, to a greater degree, results of operations to fall substantially short of anticipated levels. We often recognize revenues for existing customers in a shorter time frame because installation can generally be completed in significantly less time than for new customers. However, we may not be able to recognize expected revenues at the end of a quarter due to delays in the receipt of expected orders from existing customers.

Revenues in any given quarter are not indicative of revenues in any future period because of these and other factors and, accordingly, we believe that certain period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indicators of future performance.

The markets for knowledge management and service resolution management are evolving and, if they do not grow rapidly, our business will be adversely affected.

The markets for knowledge management and service resolution management solutions are emerging industries, and it is difficult to predict how large or how quickly they will grow, if at all. Customer service historically has been provided primarily in person or over the telephone with limited reference materials available for the customer service representative. Our business model assumes that companies which provide customer service over the telephone will find value in aggregating institutional knowledge by using our software and will be willing to access our content over the Internet. Our business model also assumes that companies will find value in providing some of their customer service over the Internet rather than by telephone. Our success will depend on the broad commercial acceptance of, and demand for, these knowledge management and service resolution management solutions.

We currently have one core product family. If the demand for this line of products declines, our business will be adversely affected.

Our knowledge powered service resolution management application, Knova Application Suite, includes our Knova Contact Center, Knova Self-Service, Knova Forums, and Knova Knowledge Desk software products. Our past and expected future revenues consist primarily of license fees for these software solutions and fees for related services. Factors adversely affecting the demand for these products and our products in general, such as competition, pricing or technological change, could materially adversely affect our business, financial condition, operating results, and the value of our stock price. Our future financial performance will substantially depend on our ability to sell current versions of our entire suite of products and our ability to develop and sell enhanced versions of our products.

Due to the lengthy sales cycles of our products and services, the timing of our sales is difficult to predict and may cause us to miss our revenue expectations.

Our products and services are typically intended for use in applications that may be critical to a customer's business. In certain instances, the purchase of our products and services involves a significant commitment of resources by prospective customers. As a result, our sales process is often subject to delays associated with lengthy approval processes that accompany the commitment of significant resources. For these and other reasons, the sales cycle associated with the licensing of our products and subscription for our services averages six months and is subject to a number of significant delays over which we have little or no control. While our customers are evaluating whether our products and services suit their needs, we may incur substantial sales and marketing expenses and expend significant management effort. We may not realize forecasted revenues from a specific customer in the quarter in which we expend these significant resources, or at all, because of the lengthy sales cycle for our products and services.

We may not be able to expand our business internationally, and, if we do, we face risks relating to international operations.

Our business strategy includes efforts to attract more international customers. By doing business in international markets we face risks, such as unexpected changes in tariffs and other trade barriers, fluctuations in currency exchange rates, political instability, reduced protection for intellectual property rights in some countries, seasonal reductions in business activity during the summer months in Europe and certain other parts of the world, and potentially adverse tax consequences, any of which could adversely impact our international operations.

If we are not able to keep pace with rapid technological change, sales of our products may decrease.

The software industry is characterized by rapid technological change, including changes in customer requirements, frequent new product and service introductions and enhancements and evolving industry standards. If we fail to keep pace with the technological progress of our competitors, sales of our products may decrease.

We depend on technology licensed to us by third parties, and the loss of this technology could delay implementation of our products, injure our reputation or force us to pay higher royalties.

We rely, in part, on technology that we license from a small number of software providers for use with our products. After the expiration of these licenses, this technology may not continue to be available on commercially reasonable terms, if at all, and may be difficult to replace. The loss of any of these technology licenses could result in delays in introducing or maintaining our products until equivalent technology, if available, is identified, licensed and integrated. In addition, any defects in the technology we may license in the future could prevent the implementation or impair the functionality of our products, delay new product introductions or injure our reputation. If we are required to enter into license agreements with third parties for replacement technology, we could be subject to higher royalty payments.

Problems arising from the use of our products with other vendors' products could cause us to incur significant costs, divert attention from our product development efforts and cause customer relations problems.

Our customers generally use our products together with products from other companies. As a result, when problems occur in a customer's systems, it may be difficult to identify the source of the problem. Even when our products do not cause these problems, they may cause us to incur significant warranty and repair costs, divert the attention of our technical personnel from our product development efforts and cause significant customer relations problems.

If third parties cease to provide open program interfaces for their customer relationship management software, it will be difficult to integrate our software with theirs. This may decrease the attractiveness of our products.

Our ability to compete successfully also depends on the continued compatibility and interoperability of our products with products and systems sold by various third parties, specifically including CRM software sold by Siebel Systems, Amdocs, Peoplesoft/Oracle, SAP, Remedy, Hewlett Packard, and Peregrine. Currently, these vendors have open applications program interfaces, which facilitate our ability to integrate with their systems. If any one of them should close their programs' interface or if they should acquire one of our competitors, our ability to provide a close integration of our products could become more difficult, or impossible, and could delay or prevent our products' integration with future systems. Inadequate integration with other vendors' products could make our products less desirable and could lead to lower sales.

We face intense competition from both established and recently formed entities, and this competition may adversely affect our revenues and profitability because we compete in the emerging markets for knowledge management and service resolution management solutions.

We compete in the emerging markets for knowledge management and service resolution management solutions and changes in these markets could adversely affect our revenues and profitability. We face competition from many firms offering a variety of products and services. In the future, because there are relatively low barriers to entry in the software industry, we expect to experience additional competition from new entrants into the knowledge management and service resolution management solutions market. It is also possible that alliances or mergers may occur among our competitors and that these newly consolidated companies could rapidly acquire significant market share. Greater competition may result in price erosion for our products and services, which may significantly affect our future operating margins.

If our software products contain errors or failures, sales of these products could decrease.

Software products frequently contain errors or failures, especially when first introduced or when new versions are released. In the past, we have released products that contained defects, including software errors in certain new versions of existing products and in new products after their introduction. In the event that the information contained in our products is inaccurate or perceived to be incomplete or out-of-date, our customers could purchase our competitors' products or decide they do not need knowledge management or service resolution management solutions at all. In either case, our sales would decrease. Our products are typically intended for use in applications that may be critical to a customer's business. As a result, we believe that our customers and potential customers have a great sensitivity to product defects.

We could incur substantial costs as a result of product liability claims because our products are critical to the operations of our customers' businesses.

Our products may be critical to the operations of our customers' businesses. Any defects or alleged defects in our products entail the risk of product liability claims for substantial damages, regardless of our responsibility for the failure. Although our license agreements with our customers typically contain provisions designed to limit our exposure to potential product liability claims, these provisions may not be effective under the laws of some jurisdictions. In addition, product liability claims, even if unsuccessful, may be costly and divert management's attention from our operations. Software defects and product liability claims may result in a loss of future revenue, a delay in market acceptance, the diversion of development resources, damage to our reputation or increased service and warranty costs. We have not had any product liability claims in the past.

If our customers' system security is breached and confidential information is stolen, our business and reputation could suffer.

Users of our products transmit their and their customers' confidential information, such as names, addresses, social security numbers and credit card information, over the Internet. In our license agreements with our customers, we typically disclaim responsibility for the security of confidential data and have

contractual indemnities for any damages claimed against us. However, if unauthorized third parties are successful in illegally obtaining confidential information from users of our products, our reputation and business may be damaged, and if our contractual disclaimers and indemnities are not enforceable, we may be subject to liability.

We may acquire or make investments in companies or technologies that could hurt our business.

In the future, we may pursue mergers or acquisitions to obtain complementary businesses, products, services or technologies. Entering into a merger or acquisition entails many risks, any of which could adversely affect our business, including, but not limited to:

- failure to integrate the acquired assets and/or companies with our current business;
- the price we pay may exceed the value we eventually realize;
- potential loss of share value to our existing stockholders as a result of issuing equity securities as part or all of the purchase price;
- potential loss of key employees from either our current business or the acquired business;
- entering into markets in which we have little or no prior experience;
- diversion of management's attention from other business concerns;
- assumption of unanticipated liabilities related to the acquired assets; and
- the business or technologies we acquire or in which we invest may have limited operating histories and may be subject to many of the same risks we are.

Any of these outcomes could prevent us from realizing the anticipated benefits of any additional acquisitions. To pay for an acquisition, we might use stock or cash or, alternatively, borrow money from a bank or other lender. If we use our stock, our stockholders would experience dilution of their ownership interests. If we use cash or debt financing, our financial liquidity would be reduced. We may be required to capitalize a significant amount of intangibles, including goodwill, which may lead to significant amortization charges. In addition, we may incur significant, one-time write offs and amortization charges. These amortization charges and write offs could decrease our future earnings or increase our future losses.

We may not be able to protect our intellectual property rights, which may cause us to incur significant costs in litigation and an erosion in the value of our brands and products.

Our business is dependent on proprietary technology and the value of our brands. We rely primarily on patent, copyright, trade secret and trademark laws to protect our technology and brands. Our patents may not survive a legal challenge to their validity or provide meaningful protection to us. Litigation to protect our patents could be expensive and the loss of our patents would decrease the value of our products. Defending against claims of patent infringement would also be expensive and, if we are unsuccessful, we could be forced to redesign our products, pay royalties, or cease selling them. In addition, effective trademark protection may not be available for our trademarks. The use by other parties of our trademarks would dilute the value of our brands.

Notwithstanding the precautions we have taken, a third party may copy or otherwise obtain and use our software or other proprietary information without authorization or may develop similar software independently. Policing unauthorized use of our technology is difficult, particularly because the global nature of the Internet makes it difficult to control the ultimate destination or security of software or other transmitted data. Further, we have granted certain third parties limited contractual rights to use proprietary information, which they may improperly use or disclose. The laws of other countries may afford us little or no effective protection of our intellectual property. The steps we have taken may not prevent misappropriation of our technology, and the agreements entered into for that purpose may not be enforceable. The unauthorized use of our proprietary technologies could also decrease the value of our products.

We may initiate lawsuits to protect or enforce our patents. Lawsuits may be expensive and, depending on the verdict, we may lose some, if not all, of our intellectual property rights, and this may impair our ability to compete in the market.

We believe that some companies, including direct and indirect competitors, may be infringing upon our patents. In order to protect or enforce our patent rights, we may initiate patent litigation suits against third parties, such as infringement suits or interference proceedings. Lawsuits that we may file are likely to be expensive, may take significant time and could divert management's attention from other business concerns. Litigation also places our patents at risk of being invalidated or interpreted narrowly. Lawsuits may also provoke these third parties to assert claims against us. Patent law relating to the scope of claims in the technology fields in which we operate is still evolving and, consequently, patent positions in our industry are generally uncertain. We may not prevail in any suits we may bring, the damages or other remedies that may be awarded to us may not be commercially valuable and we could be held liable for damages as a result of counterclaims.

The success of our software products depends on its adoption by our customers' employees. If these employees do not accept the implementation of our products, our customers may fail to renew their service contracts and we may have difficulty attracting new customers.

The effectiveness of our products depends in part on widespread adoption and use of our software by our customers' customer service personnel and on the quality of the solutions they generate. Resistance to our software by customer service personnel and an inadequate development and maintenance of the system's knowledge resources, business rule, and other configurations may make it more difficult to attract new customers and retain old ones.

Some of our customers have found that customer service personnel productivity initially drops while customer service personnel become accustomed to using our software. If an enterprise deploying our software has not adequately planned for and communicated its expectations regarding that initial productivity decline, customer service personnel may resist adoption of our software.

We depend on increased business from our new customers and, if we fail to grow our client base or generate repeat business, our operating results could be adversely affected.

Some of our customers initially make a limited purchase of our products and services for pilot programs. If these customers do not successfully develop and deploy such initial applications, they may choose not to purchase complete deployment or development licenses. Some of our customers who have made initial purchases of our software have deferred or suspended implementation of our products due to slower than expected rates of internal adoption by customer service personnel. If more customers decide to defer or suspend implementation of our products in the future, we will be unable to increase our revenue from these customers from additional licenses or maintenance agreements, and our financial position will be seriously harmed.

In addition, as we introduce new versions of our products or new products, our current customers may not need our new products and may not ultimately license these products. Any downturn in our software licenses revenues would negatively impact our future service revenues because the total amount of maintenance and service fees we receive in any period depends in large part on the size and number of licenses that we have previously sold. In addition, if customers elect not to renew their maintenance agreements, our service revenues could be significantly adversely affected.

A decline in information technology spending could reduce the sale of our products.

The license fees for our products often represent a significant expenditure of information technology ("IT") capital for our customers. Any slowdown in the national or global economy or increased uncertainty resulting from acts of terrorism or war could cause existing and potential customers to reduce or reassess their planned IT expenditures. Such reductions in or eliminations of IT spending could cause us to be unable to

maintain or increase our sales volumes, and therefore, have a material adverse effect on our revenues, operating results, ability to generate positive cash flow and stock price.

Increasing government regulation of the Internet could harm our business.

As knowledge management, service resolution management, and the Internet continue to evolve, we expect that federal, state and foreign governments will adopt laws and regulations tailored to the Internet addressing issues like user privacy, taxation of goods and services provided over the Internet, pricing, content and quality of products and services. If enacted, these laws and regulations could limit the market for knowledge management and service resolution management services and, therefore, the market for our products and services. Additionally, Internet security issues could deter customers from using the Internet for certain transactions or from implementing customer support websites.

The Telecommunications Act of 1996 prohibits certain types of information and content from being transmitted over the Internet. The prohibition's scope and the liability associated with a violation of the Telecommunications Act's information and content provisions are currently unsettled. The imposition of potential liability upon us and other software and service providers for information carried on or disseminated through our applications could require us to implement measures to reduce our exposure to this liability. These measures could require us to expend substantial resources or discontinue certain services. In addition, although substantial portions of the Communications Decency Act, the act through which the Telecommunications Act of 1996 imposes criminal penalties, were held to be unconstitutional, similar legislation may be enacted and upheld in the future. It is possible that new legislation and the Communications Decency Act could expose companies involved in Internet liability, which could limit the growth of Internet usage and, therefore, the demand for knowledge management and service resolution management solutions. In addition, similar or more restrictive laws in other countries could have a similar effect and hamper our plans to expand overseas.

We may become involved in securities class action litigation, which could divert management's attention and harm our business.

In recent years, the common stocks of technology companies have experienced significant price and volume fluctuations. These broad market fluctuations may cause the market price of our common stock to decline. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. We may become involved in that type of litigation in the future. Litigation is often expensive and diverts management's attention and resources, which could harm our business and operating results.

Our stock price may be adversely affected since our stock is not listed on an exchange or The Nasdaq Stock Market.

As our stock is traded on the OTC Bulletin Board, investors may find it more difficult to dispose of or obtain accurate quotations as to the market value of the securities. In addition, we are subject to a rule promulgated by the Securities and Exchange Commission that, if we fail to meet criteria set forth in such rule, various practice requirements are imposed on broker-dealers who sell securities governed by the rule to persons other than established customers and accredited investors. For these types of transactions, the broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transactions prior to purchase. Consequently, the rule may deter broker-dealers from recommending or purchasing our common stock, which may further affect the liquidity of our common stock.

Our failure to be listed on an exchange or Nasdaq makes trading our shares more difficult for investors. It may also make it more difficult for us to raise additional capital. Further, we may also incur additional costs under state blue sky laws in connection with any sales of our securities.

Shares available for future sale could adversely affect our stock price.

Future sales of a substantial number of shares of our common stock in the public market, or the perception that such sales may occur, could adversely affect trading prices of our common stock from time to time. As of the time of this filing, 8,744,116 shares of our common stock are outstanding. Virtually all of the shares outstanding prior to the Kanisa merger (approximately 5,252,245 shares) are freely tradable without restriction or further registration under the Securities Act, except for any shares which are owned by an affiliate of ours as that term is defined in Rule 144 under the Securities Act. The shares of our common stock issued in the merger with Kanisa and the shares of our common stock owned by our affiliates are restricted securities, as that term is defined in Rule 144, and are eligible to be sold under the Securities Act to the extent permitted by Rule 144 or any applicable exemption under the Securities Act.

Our business could be harmed if we lose the services of our key personnel.

Our business depends upon the efforts of our chief executive officer, Bruce Armstrong, and a small number of management and operating personnel. We do not maintain key-man life insurance on Mr. Armstrong or our other executive officers. We may have difficulty replacing management or other key personnel who leave and, therefore, the loss of the services of any of these individuals could harm our business.

Our management owns a significant percentage of our company and will be able to exercise significant influence over our actions.

Our officers and directors and related entities, who in the aggregate directly or indirectly control more than 50% of our outstanding common stock and voting power, control us. These stockholders collectively will likely be able to control our management policy, decide all fundamental corporate actions, including mergers, substantial acquisitions and dispositions, and elect our board of directors.

Voting agreements in place assure election of our current directors for 2006.

Certain of our stockholders owning more than 50% of our voting stock have entered into voting agreements to vote in favor of the current board members up for election in 2006. This could negatively affect the ability of any third party to gain control of our company.

Terrorist attacks and other attacks or acts of war may adversely affect the markets on which our common stock trades, our financial condition and our results of operations.

Acts of terrorism in the United States or elsewhere could cause instability in the United States and other financial markets. Armed hostilities or further acts of terrorism could cause further instability in financial markets and could directly impact our financial condition and our results of operations.

The regulatory environment surrounding accounting and corporate governance subjects us to certain legal uncertainties in the operation of our business and may increase the cost of doing business.

We will face increased regulatory scrutiny associated with the highly publicized financial scandals and the various accounting and corporate governance rules promulgated under the Sarbanes-Oxley Act of 2002 and related regulations. Our management will review and will continue to monitor our accounting policies and practices, legal disclosure and corporate governance policies under the new legislation, including those related to relationships with our independent auditors, enhanced financial disclosures, internal controls, board and board committee practices, corporate responsibility and executive officer loan practices. We intend to fully comply with these laws. Nevertheless, the increased scrutiny and penalties involve risks to both us and our executive officers and directors in monitoring and ensuring compliance. A failure to properly navigate the legal disclosure environment and implement and enforce appropriate policies and procedures, if needed, could harm our business and prospects, including our ability to recruit and retain skilled officers and directors. In addition, we may be adversely affected as a result of new or revised legislation or regulations imposed by the Securities and Exchange Commission, other U.S. or foreign governmental regulatory authorities or self-regulatory organizations that supervise the financial markets. We also may be adversely affected by changes in the

interpretation or enforcement of existing laws and rules by these governmental authorities and self-regulatory organizations.

Item 1B. Unresolved Staff Comments

Not Applicable.

Item 2. Properties

We own no real property. Following our combination with Kanisa, we changed our corporate headquarters from Pittsburgh, Pennsylvania to Cupertino, California. In Cupertino, we lease approximately 16,800 square feet of office space pursuant to a lease that expires in 2007. We also maintain approximately 10,400 square feet of office space in Pittsburgh, Pennsylvania pursuant to a lease that expires in 2009. We believe that our current offices are adequate to support our existing operations. If necessary, however, we believe that we will be able to obtain suitable additional facilities on commercially reasonable terms, when needed.

Item 3. Legal Proceedings

Under our patent enforcement program, from time to time we may enter into litigation to protect our rights under one or more of our patents. The result of any such future litigation is inherently unpredictable and is likely to be expensive, may take significant time and could divert management's attention from other business concerns. Litigation also places our patents at risk of being invalidated or interpreted narrowly. Lawsuits may also provoke these third parties to assert claims against us. We may not prevail in any suits we may bring, the damages or other remedies that may be awarded to us may not be commercially valuable and we could be held liable for damages as a result of counterclaims.

From time to time, we engage in litigation in the ordinary course of business. The result of current or future litigation is inherently unpredictable; however, we do not believe any asserted or pending litigation will have a material adverse effect on our results of operations or financial condition.

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

Not Applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Market for our common stock

Our common stock is traded on the over the counter bulletin board, a regulated service that displays real-time quotes, last sale prices and volume information in over-the-counter securities. On March 10, 2006, the last sale price of our common stock was \$2.50 per share. The following table sets forth the range of high and low sale prices for our common stock for the periods indicated. All prices have been adjusted retroactively to reflect the 1 for 10 reverse split, which was effective February 4, 2005. Our stock traded under the symbol

“SVCW” until the reverse stock split at which time, the symbol was changed to “SVWN”. As of May 27, 2005, our trading symbol was changed to “KNVS” in conjunction with our name change.

	<u>High</u>	<u>Low</u>
2004		
First Quarter	\$8.90	\$5.80
Second Quarter	\$6.80	\$5.20
Third Quarter	\$5.90	\$3.20
Fourth Quarter	\$5.40	\$3.60
2005		
First Quarter	\$6.80	\$3.87
Second Quarter	\$4.50	\$3.00
Third Quarter	\$4.25	\$3.20
Fourth Quarter	\$3.60	\$2.50

As of March 10, 2006, there were approximately 400 holders of record of our common stock. We believe that a substantially larger number of beneficial owners hold shares of our common stock in depository or nominee form.

Dividend Policy

We do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain any future earnings to finance the expansion of our business.

Item 6. Selected Financial Data

The following financial information for each of the five years ended December 31 has been derived from our consolidated financial statements. You should read the selected consolidated financial data set forth below along with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes. Our financial performance for 2005 and subsequent years is not comparable to prior years since the financial information in the following table does not include any financial performance of Kanisa, prior to the date of merger on February 8, 2005.

	<u>For the Year Ended December 31,</u>				
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
	(In thousands, except per share data)				
STATEMENT OF OPERATIONS DATA					
Total revenues	\$23,595	\$12,502	\$11,511	\$10,158	\$ 12,427
Net loss from continuing operations	(5,095)	(1,694)	(2,979)	(6,825)	(31,486)
Net income (loss) per common share, basic and diluted:					
Continuing operations	(0.61)	(0.33)	(1.23)	(2.85)	(13.00)
Discontinued operations	—	—	—	—	0.73
Net loss per share	<u>\$ (0.61)</u>	<u>\$ (0.33)</u>	<u>\$ (1.23)</u>	<u>\$ (2.85)</u>	<u>\$ (12.27)</u>

	<u>As of December 31,</u>				
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
	(In thousands)				
Balance Sheet Data					
Total assets	\$38,992	\$16,953	\$8,084	\$8,735	\$13,886
Long term debt	306	384	599	109	443

Until July 2001, we had two reportable business segments: software and content. In July 2001, we completed the sale of our content segment. The content segment is reported as a discontinued operation in our 2001 consolidated statement of operations.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes.

Overview

On February 8, 2005, we combined with Kanisa Inc. through the merger of a wholly owned subsidiary of ours with and into Kanisa. As a result, Kanisa became our wholly owned subsidiary. Upon the consummation of the merger, we relocated our headquarters to Kanisa's offices in Cupertino, California. Kanisa was founded in 1997 and has pioneered the use of a knowledge management platform for customer services applications. Prior to the merger, Kanisa was a privately held organization and its technology had resulted in broad industry recognition and awards for its products and performance.

We are a provider of customer relationship management (CRM) software applications, specifically applications that enable customer service organizations to more effectively resolve service requests and answer questions. Built on knowledge management and search technologies, our service resolution management (SRM) applications optimize the resolution process across multiple service channels, including contact centers, self-service websites, help desk, email and chat. Our SRM applications complement, integrate with, and enhance traditional CRM, contact center, and help desk applications by providing patented knowledge management solutions that improve service delivery. Our customers include some of the largest companies in the world and our products enable them to reduce operating and service delivery costs, improve customer satisfaction, and increase revenues.

We are principally engaged in the design, development, marketing and support of software applications and services. Substantially all of our revenues are derived from a perpetual license of our software products, the related professional services and the related customer support, otherwise known as maintenance. We license our software in arrangements in which the customer purchases a combination of software, maintenance and/or professional services, such as our training and implementation services. Maintenance, which includes technical support and product updates, is typically sold with the related software license and is renewable at the option of the customer on an annual basis after the first year. Our professional services and technical support organizations provide a broad range of implementation services, training, and technical support to our customers and implementation partners. Our service organization has significant product and implementation expertise and is committed to supporting customers and partners throughout every phase of their adoption and use of our solutions. Most of our professional service arrangements are billed on a time and materials basis. Payment terms for our arrangements are negotiated with our customers and determined based on a variety of factors, including the customer's credit standing and our history with the customer.

We continually explore opportunities available to us to increase our customer base and service offerings through merger and/or acquisition transactions that we would expect to be accretive to shareholder value. We believe there will be consolidation in our industry and we intend to participate as a buyer or a seller. We will, however, continue to be disciplined in our approach and only evaluate opportunities that are beneficial to our shareholders.

Description of Statement of Operations

Revenues

We market and sell our products primarily in North America through our direct sales force and outsourcers. Indirect revenues were 4% of total revenues in 2005 and approximately 8% of total revenues in 2004. Internationally, we market our products through value-added resellers, software vendors and system integrators. International revenues were 4% of total revenues in 2005 and 9% of total revenues in 2004. We derive our revenues from licenses for software products and from providing related services, including installation, training, consulting, customer support and maintenance contracts. License revenues primarily represent fees for perpetual licenses. Service revenues contain variable fees for installation, training and

consulting, reimbursements for travel expenses that are billed to customers, as well as fixed fees for customer support and maintenance contracts.

Cost of Revenues

Cost of license revenues consists primarily of the expenses related to royalties and amortization of purchased technology. Cost of service revenues consists of the salaries, benefits, direct expenses and allocated overhead costs of customer support and services personnel, reimbursable expenses for travel that are billed to customers, fees for sub-contractors, and the costs associated with maintaining our customer support site.

Operating Costs

We classify our core operating costs into four general categories: sales and marketing, research and development, general and administrative, and intangible assets amortization based upon the nature of the costs. Special one-time charges, such as restructuring costs, are presented separately to enable the reader to determine core operating costs. We allocate the total costs for overhead and facilities, based upon headcount, to each of the functional areas that benefit from these services. Allocated charges include general overhead items such as building rent, equipment-leasing costs, telecommunications charges and depreciation expense. Sales and marketing expenses consist primarily of employee compensation for direct sales and marketing personnel, travel, public relations, sales and other promotional materials, trade shows, advertising and other sales and marketing programs. Research and development expenses consist primarily of expenses related to the development and upgrade of our proprietary software and other technologies. These expenses include employee compensation for software developers and quality assurance personnel and third-party contract development costs. General and administrative expenses consist primarily of compensation for personnel and fees for outside professional advisors. Intangible assets amortization expense consists of the amortization of intangible assets, including intangible assets acquired through our acquisition of Kanisa Inc. in 2005. These assets (other than goodwill) are amortized on a straight line basis over their respective estimated useful lives. Restructuring charges consist of costs incurred for restructuring plans and other costs related to the separation of senior executives.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to allowance for doubtful accounts and intangible assets. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

We recognize revenues on license fees after a non-cancelable license agreement is signed, the product is delivered, the fee is fixed or determinable and collectible, and there is vendor-specific objective evidence to support the allocation of the total fee to elements of a multiple-element arrangement using the residual method. We recognize revenues on installation, training and consulting primarily on a time-and-material basis. Customer support and maintenance contracts are recognized over the life of the contract.

Our revenue recognition policy is governed by Statement of Position (SOP) 97-2, "Software Revenue Recognition", issued by the American Institute of Certified Public Accountants (AICPA), as amended by SOP 98-9 "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transac-

tions”. These statements provide guidance on applying generally accepted accounting principles in recognizing revenue on software and services transactions. In addition, the AICPA and its Software Revenue Recognition Task Force continue to issue interpretations and guidance for applying the relevant standards to a wide range of sales contract terms and business arrangements that are prevalent in the software industry. Also, the Securities and Exchange Commission (SEC) has issued Staff Accounting Bulletin No. 104 “Revenue Recognition in Financial Statements,” which provides guidance related to revenue recognition based on interpretations and practices followed by the SEC, and the Emerging Issues Task Force of the Financial Accounting Standards Board continues to issue additional guidance on revenue recognition. Future interpretations of existing accounting standards or changes in our business practices could result in future changes in our revenue accounting policies that could have a material effect on our financial condition and results of operations.

Accounts Receivable

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. If the financial condition of these customers were to deteriorate, resulting in an impairment of their ability to make payments, we may be required to increase our allowance of doubtful accounts or to defer revenue until we determine that collectibility is probable. We perform a quarterly analysis to determine the appropriate allowance for doubtful accounts. This analysis includes a review of specific individual balances in our accounts receivable, our history of collections, as well as the overall economic environment.

Intangible Assets and Goodwill

Goodwill is assessed for impairment at least annually and as triggering events occur. In making this assessment, we rely on a number of factors including operating results, business plans, economic projections, anticipated future cash flows and our current market value. There are inherent uncertainties related to these factors and management’s judgment in applying them to the analysis of goodwill impairment. Since our judgment is involved in performing goodwill valuation analyses, there is risk that the carrying value of our goodwill may be misstated. During 2005, we performed the required impairment tests of goodwill and indefinite lived intangible assets as of December 31, 2005 and determined that we did not have an impairment loss.

Income Taxes

We record valuation allowances to reduce deferred tax assets to the amount more likely than not to be realized. When assessing the need for valuation allowances, we consider future taxable income and ongoing prudent and feasible tax strategies. Should a change in circumstances lead to a change in judgment about the reliability of deferred tax assets in future years, we would adjust the related valuation allowances in the period in which the change in circumstances occurs, along with a corresponding increase in or charge to income.

Results of Operations

The following table sets forth consolidated statement of operations data:

	For the Year Ended December 31,					
	2005		2004		2003	
Revenues:						
Licenses	\$ 8,957,479	38.0%	\$ 5,243,910	41.9%	\$ 4,934,345	42.9%
Services	<u>14,637,476</u>	<u>62.0</u>	<u>7,258,217</u>	<u>58.1</u>	<u>6,577,090</u>	<u>57.1</u>
Total revenues	<u>23,594,955</u>	<u>100.0</u>	<u>12,502,127</u>	<u>100.0</u>	<u>11,511,435</u>	<u>100.0</u>
Cost of revenues:						
Cost of licenses	892,576	3.8	412,972	3.3	270,325	2.3
Cost of services	<u>8,711,239</u>	<u>36.9</u>	<u>4,372,888</u>	<u>35.0</u>	<u>2,923,355</u>	<u>25.4</u>
Total cost of revenues..	<u>9,603,815</u>	<u>40.7</u>	<u>4,785,860</u>	<u>38.3</u>	<u>3,193,680</u>	<u>27.7</u>
Gross margin	13,991,140	59.3	7,716,267	61.7	8,317,755	72.3
Operating expenses:						
Sales and marketing	8,122,507	34.4	4,781,641	38.2	5,116,062	44.5
Research and development	5,664,487	24.0	2,197,588	17.6	1,961,959	17.0
General and administrative	3,939,076	16.7	2,402,891	19.2	2,119,126	18.4
Intangible assets amortization	256,850	1.1	—	0.0	146,746	1.3
Restructuring charges	<u>1,355,350</u>	<u>5.7</u>	<u>—</u>	<u>0.0</u>	<u>(20,000)</u>	<u>(0.2)</u>
Total operating expenses	<u>19,338,270</u>	<u>81.9</u>	<u>9,382,120</u>	<u>75.0</u>	<u>9,323,893</u>	<u>81.0</u>
Loss from operations	(5,347,130)	(22.6)	(1,665,853)	(13.3)	(1,006,138)	(8.7)
Other income (expense), net....	<u>252,309</u>	<u>1.1</u>	<u>(28,399)</u>	<u>(0.2)</u>	<u>(1,973,167)</u>	<u>(17.1)</u>
Net loss	<u>\$(5,094,821)</u>	<u>(21.5)%</u>	<u>\$(1,694,252)</u>	<u>(13.5)%</u>	<u>\$(2,979,305)</u>	<u>(25.8)%</u>

The above financial information does not include any financial performance of Kanisa prior to the date of merger on February 8, 2005. Our historical operating results prior to February 8, 2005 may not be reflective of future operating results because of the material changes in our business structure that have resulted from our merger with Kanisa. Similarly, operating results for 2005 and prior years are not necessarily comparable since Kanisa operating results prior to February 8, 2005 are not included.

Years Ended December 31, 2005 and 2004

Revenues

Total revenues increased 88.7% to \$23.6 million in 2005 from \$12.5 million in 2004. The increase was principally due to the increase in our maintenance installed base due to the merger and an increase in newly licensed products.

License revenues increased 70.8% to \$9.0 million in 2005 from \$5.2 million in 2004. The increase in license revenues was due to the offering of our new product line acquired in our merger with Kanisa, the Knova Application Suite.

Service revenues increased 101.7% to \$14.6 million in 2005 from \$7.3 million in 2004. The increase was due to an increased combined install base after the merger with Kanisa.

Cost of Revenues

Cost of revenues increased to \$9.6 million in 2005 from \$4.8 million in 2004. Cost of revenues as a percentage of revenues increased to 40.7% from 38.3%. Cost of license revenues increased to \$0.9 million in 2005 from \$0.4 million in 2004. As a percentage of revenues, the cost of license revenues increased to 3.8% from 3.3%. The increase in the cost of license revenues was primarily attributable to the amortization of core technology acquired from Kanisa.

Cost of service revenues increased to \$8.7 million in 2005 from \$4.4 million in 2004. As a percentage of revenues, the cost of service revenues increased to 36.9% from 35.0%. The increase was primarily due to a 50.0% increase in employee headcount (allocable to cost of revenues) and the increased use of a third party implementation partner after the merger.

Operating Expenses

Sales and Marketing. Sales and marketing expenses increased to \$8.1 million, or 34.4% of revenues, in 2005 from \$4.8 million, or 38.2% of revenues, in 2004. The increase is primarily attributable to costs associated with our merger with Kanisa, which includes a 54.5% increase in employee headcount (allocable to sales and marketing) to 34 at December 31, 2005, of which 9 were quota carrying representatives, compared to 22 at December 31, 2004. In addition, we increased our investment in discretionary marketing programs during 2005 in order to market ourselves as a combined company and to seek to strengthen our sales pipeline for future periods.

Research and Development. Research and development expenses increased to \$5.7 million, or 24.0% of revenues, in 2005 from \$2.2 million, or 17.6% of revenues, in 2004. The increase was primarily due to the costs associated with our merger with Kanisa, which includes recognizing the expense for acquired in-process research and development of approximately \$421,000. In addition, the increase was a result of a 260% increase in employee headcount (allocable to research and development) to 18 at December 31, 2005 compared to 5 at December 31, 2004 and an increased use of third party contractors for the year ended December 31, 2005.

General and Administrative. General and administrative expenses increased to \$3.9 million, or 16.7% of revenues in 2005 from \$2.4 million, or 19.2% of revenues in 2004. The increase resulted from costs associated with our merger with Kanisa, including increases in facility costs to maintain two locations, costs of contractors associated with integration of the two companies, legal and accounting fees relating to public filings, Sarbanes Oxley 404 compliance costs and recruiting fees associated with the hiring of our new chief financial officer.

Intangible Assets Amortization. Intangible assets amortization of \$257,000 or 1.1% of revenues was recorded in 2005 as a result of intangible assets acquired through our acquisition of Kanisa. There was no intangible assets amortization in 2004 as our intangible assets at that time had been fully amortized prior to 2004.

Restructuring charges. During the first quarter 2005, in connection with the integration of our acquisition of Kanisa, we approved a plan to streamline our operations. The workforce reduction of 21 employees consisted of one executive, three from general and administrative, nine from research and development, three from professional services and five from sales. During the quarter ended March 31, 2005, we recorded restructuring charges of approximately \$1.4 million, including stock based compensation of \$242,000 for one executive. As of December 31, 2005, \$261,000 in severance costs remain to be paid to terminated employees over the next year.

Other income (expense), net. Other income (expense), net consists primarily of interest income received from short-term investments, interest expense and amortization expense related to our convertible notes and bank borrowings. Other income increased to \$252,000 in 2005 from \$28,000 of expense in 2004. The increase was primarily the result of interest income earned on higher cash balances post merger.

Years Ended December 31, 2004 and 2003

Revenues

Total revenues increased 8.6% to \$12.5 million in 2004 from \$11.5 million in 2003. The increase was due to the momentum being generated by Hewlett Packard's Managed Services Group, an upswing in services revenues generated by our Solution Services group, and an increase in our maintenance contract base as we added customers year over year, many of whom continue to renew.

License revenues increased 6.3% to \$5.2 million in 2004 from \$4.9 million in 2003. The increase in license revenues was due to the momentum being generated by our Hewlett Packard Managed Services Group, which generated approximately \$700,000 in license revenues in 2004.

Service revenues increased 10.4% to \$7.3 million in 2004 from \$6.6 million in 2003. The primary reason for the increase was the increase of our maintenance contract base. During 2004, our renewal rate remained consistent at approximately 95%.

Cost of Revenues

Cost of revenues increased to \$4.8 million in 2004 from \$3.2 million in 2003. Cost of revenues as a percentage of revenues increased to 38.3% from 27.7%. Cost of license revenues increased to \$0.4 million in 2004 from \$0.3 million in 2003. As a percentage of revenues, the cost of license revenues increased to 3.3% from 2.3%. The increase in the cost of license revenues was primarily attributable to a increase in product royalties payable to third parties.

Cost of service revenues increased to \$4.4 million in 2004 from \$2.9 million in 2003. As a percentage of revenues, the cost of service revenues increased to 35.0% from 25.4%. The increase in the cost of service revenues was principally the result of a 73.3% increase in customer support and services personnel to a high of 26 in 2004 from an average of 16 in 2003. In addition, there was an increased use of a third party contracting firm to support major services efforts.

Operating Expenses

Sales and Marketing. Sales and marketing expenses decreased to \$4.8 million, or 38.2% of revenues, in 2004 from \$5.1 million, or 44.4% of revenues, in 2003. The decrease is primarily attributable to the closing of our United Kingdom sales office in July 2003.

Research and Development. Research and development expenses increased to \$2.2 million, or 17.6% of revenues, in 2004 from \$2.0 million, or 17.0% of revenues, in 2003. The increase is primarily attributable to the use of an increased number of third party resources for development purposes.

General and Administrative. General and administrative expenses increased to \$2.4 million, or 19.2% of revenues in 2004 from \$2.1 million, or 18.4% of revenues in 2003. The increase resulted primarily from stock based compensation in the amount of \$241,195 recorded upon the issuance of restricted stock to executives and warrants issued in a lawsuit settlement in 2004.

Intangible Assets Amortization. Intangible assets amortization was \$0.1 million or, 1.3% of revenues in 2003. Intangible assets amortization consisted of the amortization expense for the intangible assets resulting from our acquisition of the Molloy Group in 1999. The components of our intangible assets were fully amortized in 2003. As such, there were no expenses for intangible asset amortization in 2004.

Other income (expense), net. Other income (expense), net consists primarily of interest income received from short-term investments, interest expense and amortization expense related to our convertible notes and bank borrowings. Other expense, net decreased to \$28,000 in 2004 from \$2.0 million in 2003. The decrease was primarily the result of other income of approximately \$1.3 million received in conjunction with the Primus lawsuit settlement. Offsetting interest expense of approximately \$1.3 million primarily represents amortization of the beneficial conversion feature, discount and debt issue costs recognized in conjunction with the issuance of our then outstanding convertible notes.

Liquidity and Capital Resources

Historically, we have satisfied our cash requirements primarily through private placements of convertible preferred stock and common stock, our initial public offering and incurrence of debt. For the year ended December 31, 2005, we incurred a net loss of \$5,094,821 and had negative cash flow from operations of \$4,997,983. Our ability to continue as a business in its present form is largely dependent on our ability to generate additional revenues, maintain our overall operating expenses, and achieve profitability and positive cash flows. We believe that we have the ability to do so and plan to fund 2006 operations through operating revenues, cash, cash equivalents and investment balances, and borrowings under our line of credit. As of December 31, 2005, we had \$12.2 million in cash, cash equivalents and investments compared to \$10.9 million at December 31, 2004.

In December 2005, we entered into a loan and security agreement with Silicon Valley Bank. The agreement allows for a revolving line of credit and an equipment loan of up to \$4.5 million. Borrowings under the loan agreement are collateralized by essentially all of our assets, excluding intangibles. At December 31, 2005, we had a \$3,600,000 balance outstanding under the revolving line of credit.

We incurred a net loss of \$5.1 million for 2005. Our ability to continue as a business in our present form is largely dependent on our ability to generate additional revenues, reduce overall operating expenses, and achieve profitability and positive cash flows. We believe that we have the ability to do so and plan to fund the remainder of the 2006 operations through operating revenue and our cash balances.

Net cash used for operating activities in 2005 is principally the result of our net loss and an increase in accounts receivable. Net cash provided by operating activities in 2004 was generated by reducing our net loss and accounts receivable while increasing our accruals and other liabilities since our non-cash expense items exceeded our net loss.

Net cash provided by investing activities in 2005 is primarily due to the cash received from the acquisition of Kanisa and proceeds from the sale of marketable securities. Net cash used in investing activities in 2004 was primarily attributable to the purchase of short-term investments. Net cash provided by investing activities in 2003 was primarily attributable to the sale of short-term investments offset by property and equipment acquisitions.

Net cash provided by financing activities in 2005 was primarily due to the proceeds of borrowing against our line of credit with Silicon Valley Bank. Net cash provided by financing activities in 2004 was primarily due to the proceeds from the equity funding reduced by the repayment of borrowings under a revolving line of credit, which is now terminated. Net cash used in financing activities in 2003 was primarily due to the repayment of borrowings under a revolving line of credit.

There can be no assurance that additional capital will be available to us on reasonable terms, if at all, when needed or desired. If we raise additional funds through the issuance of equity, equity-related or debt securities, such securities may have rights, preferences or privileges senior to those of the rights of our common stock. Furthermore, our stockholders may suffer significant additional dilution. Further, the issuance of debt securities could increase the risk or perceived risk of our company.

Contractual Obligations

As of December 31, 2005, we are obligated to make cash payments in connection with our capital leases, debt and operating leases. The effect of these obligations and commitments on our liquidity and cash flows in future periods are listed below. All of these arrangements require cash payments over varying periods of time. Some of these arrangements are cancelable on short notice and others require termination or severance

payments as part of any early termination. Included in the table below are our contractual obligations as of December 31, 2005:

	<u>Payments Due by Period</u>			
	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>4-5 Years</u>
	(In thousands)			
Line of credit borrowing	\$3,600	\$3,600	\$ —	\$ —
Capital lease obligations	80	43	37	—
Operating lease obligations	<u>1,191</u>	<u>561</u>	<u>528</u>	<u>102</u>
Total contractual obligations	<u>\$4,871</u>	<u>\$4,204</u>	<u>\$565</u>	<u>\$102</u>

Off-Balance Sheet Arrangements

We have no material off-balance sheet debt or other unrecorded obligations other than the items noted in the above table.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R) “Share-Based Payment” (“SFAS 123(R)”), a revision to SFAS 123. SFAS 123R addresses all forms of share-based payment (“SBP”) awards, including shares issued under the Employee Stock Purchase Plan, stock options, restricted stock, restricted stock units and stock appreciation rights. SFAS 123R will require us to record compensation expense for SBP awards based on the fair value of the SBP awards. Under SFAS 123R, restricted stock and restricted stock units will generally be valued by reference to the market value of freely tradable shares of our common stock. Stock options, stock appreciation rights and shares issued under the Employee Stock Purchase Plan will generally be valued at fair value determined through an option valuation model, such as a lattice model or the Black-Scholes model (the model that we currently use for our footnote disclosure). SFAS 123R is effective for annual periods beginning after June 15, 2005 and, accordingly, we must adopt the new accounting provisions effective January 1, 2006. We expect the adoption of SFAS 123(R) to result in stock based compensation expense for existing options of approximately \$1,243,000 in 2006.

In March 2005, the SEC issued Staff Accounting Bulletin (“SAB”) No. 107, “Share-Based Payment” (“SAB 107”), which provides interpretive guidance related to the interaction between SFAS 123R and certain SEC rules and regulations, as well as provides the SEC staff’s views regarding the valuation of share-based payment arrangements. We are currently assessing the impact of SAB 107 on our implementation and adoption of SFAS 123R.

In May 2005, the FASB issued SFAS No. 154 “Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3” (SFAS No. 154). SFAS No. 154 requires that all voluntary changes in accounting principles be recognized as a retroactive restatement of all periods presented except when retroactive restatement is impracticable. In addition, SFAS No. 154 also requires that a change in depreciation method be accounted for as a change in accounting estimate that is affected by a change in accounting principle, which would be accounted for in the period of change if the change affects that period only and also in future periods if the change affects both the period of change and future periods. SFAS No. 154 also eliminates paragraph 4 of APB 20, which specifies that APB 20 does not apply to changes made to comply with new pronouncements. This Statement will require that any change in an accounting principle made as a result of adopting a new pronouncement be reported following the same guidance as that for voluntary changes in accounting principles, unless the new pronouncement’s transition provisions require another method. SFAS No. 154 is effective for years beginning after December 15, 2005.

Forward Looking Statements

Under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we caution investors that statements contained in this report regarding our intentions, hopes, beliefs, expectations or

predictions of the future are forward-looking statements. We caution you that these forward-looking statements are not historical facts and are only estimates or predictions. Actual results may differ materially from those anticipated as a result of risks and uncertainties including, but not limited to, risks related to revenue expectations, our software strategy, fluctuations in customer demand, performance of outside distributors and resellers, use of the Web as a delivery vehicle for customer support solutions, risks resulting from new product introductions, integration of acquired products with current offerings, and customer acceptance of new products, rapid technological change, risks associated with competition, continued growth in the use of the Internet, our ability to retain and increase revenue from existing customers and to execute agreements with new customers, unforeseen expenses, our ability to attract and retain qualified personnel and to secure necessary financing for our operations and business development, and other market conditions and risks detailed from time to time in Item 1A "Risk Factors" or other filings that we may make with the Securities and Exchange Commission. We undertake no obligation to update publicly any forward-looking statements, whether as a result of future events, new information, or otherwise.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Nearly all of our revenues recognized to date have been denominated in United States dollars and are primarily from customers in the United States. We have a European distributor located in London, England. Revenues from international clients were 4% percent in 2005 and 9% in 2004. In the future, a portion of the revenues we derive from international operations may be denominated in foreign currencies. Furthermore, to the extent we engage in international sales denominated in United States dollars, an increase in the value of the United States dollar relative to foreign currencies could make our services less competitive in international markets. Although currency fluctuations are currently not a material risk to our operating results, we will continue to monitor our exposure to currency fluctuations and when appropriate, consider the use of financial hedging techniques to minimize the effect of these fluctuations in the future. Exchange rate fluctuations could potentially harm our business in the future. We do not currently utilize any derivative financial instruments or derivative commodity instruments.

Our interest income is sensitive to changes in the general level of United States interest rates, particularly because the majority of our investments are in short-term instruments. Our interest expense on our line of credit is sensitive to changes in the general level of United States interest rates, because the rate is not fixed.

Our current investment policy permits investment of temporarily idle funds with commercial banks, investment banks, savings and loan associations, securities dealers, and in money market mutual funds. We believe that default risk is minimized by investing only in securities rated A or better and by diversifying the portfolio. Market risk is minimized by ensuring that the cash flows of the portfolio securities are reasonably and conservatively matched to anticipate cash requirements.

Item 8. Financial Statements and Supplementary Data

The following consolidated financial statements as of December 31, 2005 and 2004 and for each of the three years in the period ended December 31, 2005 are included herein:

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Consolidated Statements of Stockholders' Equity	33
Consolidated Statements of Cash Flows	34
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Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of Knova Software, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Knova Software, Inc. at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Pittsburgh, Pennsylvania
February 9, 2006

Knova Software, Inc.
Consolidated Balance Sheets

	December 31,	
	2005	2004
ASSETS		
Current assets		
Cash and cash equivalents	\$ 6,730,766	\$ 1,672,305
Marketable securities	5,461,016	9,266,461
Accounts receivable, less allowance for doubtful accounts of \$126,111 at December 31, 2005 and \$94,588 at December 31, 2004	6,442,391	2,529,081
Prepaid expenses and other current assets	780,546	513,072
Total current assets	19,414,719	13,980,919
Non current assets		
Property and equipment		
Office furniture, equipment, and leasehold improvements	1,518,027	1,510,616
Computer equipment	5,165,969	4,830,356
Total property and equipment	6,683,996	6,340,972
Less accumulated depreciation	(6,318,897)	(5,890,323)
Property and equipment, net	365,099	450,649
Intangible assets, net of amortization of \$778,196 at December 31, 2005	4,603,995	—
Goodwill	14,484,947	2,323,791
Other noncurrent assets	123,111	197,611
Total noncurrent assets	19,577,152	2,972,051
Total assets	\$ 38,991,871	\$ 16,952,970
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	1,635,911	1,693,333
Accrued compensation and benefits	1,002,940	407,014
Deferred revenue — licenses	1,571,616	378,885
Deferred revenue — services	5,113,942	2,720,380
Accrued restructuring charges	261,252	—
Line of credit — short term	3,600,000	—
Current portion of capital lease obligations	39,636	34,211
Other current liabilities	794,942	571,919
Total current liabilities	14,020,239	5,805,742
Noncurrent deferred revenue	181,603	322,676
Other noncurrent liabilities	88,519	—
Capital lease obligations	35,454	60,961
Total liabilities	14,325,815	6,189,379
Commitments and Contingencies		
Stockholders' equity		
Common stock, \$0.01 par; 50,000,000 shares authorized, 8,770,296 and 5,268,896 shares issued and 8,744,112 and 5,252,241 shares outstanding at December 31, 2005 and December 31, 2004, respectively	561,766	526,890
Additional paid in capital	100,997,498	83,360,602
Treasury stock, 26,184 and 16,655 shares at December 31, 2005 and December 31, 2004, respectively	(150,554)	(62,166)
Deferred compensation	(5,453)	(161,682)
Warrants	6,549,347	4,765,479
Accumulated other comprehensive income (loss)	(12,436)	513,759
Accumulated deficit	(83,274,112)	(78,179,291)
Total stockholders' equity	24,666,056	10,763,591
Total liabilities and stockholders' equity	\$ 38,991,871	\$ 16,952,970

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

Knova Software, Inc.
Consolidated Statements of Operations

	Year Ended December 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Revenues			
License	\$ 8,957,479	\$ 5,243,910	\$ 4,934,345
Services	<u>14,637,476</u>	<u>7,258,217</u>	<u>6,577,090</u>
Total revenues	23,594,955	12,502,127	11,511,435
Cost of revenues			
Cost of licenses	892,576	412,972	270,325
Cost of services	<u>8,711,239</u>	<u>4,372,888</u>	<u>2,923,355</u>
Total cost of revenues	<u>9,603,815</u>	<u>4,785,860</u>	<u>3,193,680</u>
Gross margin	13,991,140	7,716,267	8,317,755
Operating expenses			
Sales and marketing	8,122,507	4,781,641	5,116,062
Research and development	5,664,487	2,197,588	1,961,959
General and administrative	3,939,076	2,402,891	2,119,126
Intangible assets amortization	256,850	—	146,746
Restructuring charges	<u>1,355,350</u>	<u>—</u>	<u>(20,000)</u>
Total operating expenses	<u>19,338,270</u>	<u>9,382,120</u>	<u>9,323,893</u>
Loss from operations	(5,347,130)	(1,665,853)	(1,006,138)
Other income (expense), net			
Interest expense	(9,763)	(1,277,961)	(1,951,326)
Other, net	<u>262,072</u>	<u>1,249,562</u>	<u>(21,841)</u>
Other income (expense), net	<u>252,309</u>	<u>(28,399)</u>	<u>(1,973,167)</u>
Net loss	<u><u>\$ (5,094,821)</u></u>	<u><u>\$ (1,694,252)</u></u>	<u><u>\$ (2,979,305)</u></u>
Net loss per common share, basic and diluted	\$ (0.61)	\$ (0.33)	\$ (1.23)
Shares used in computing per share amounts	8,341,426	5,140,378	2,419,750

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

Knova Software, Inc.

Consolidated Statements of Stockholders' Equity

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Treasury Stock Shares	Treasury Stock Amount	Deferred Compensation	Warrants	Accumulated Other Income (Loss) Gain	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2002	2,408,336	\$246,845	\$ 74,183,726	60,117	\$(223,351)	\$ (9,548)	\$ 1,414,564	\$ (36,819)	\$ (73,505,734)	\$ 2,069,683
Exercise of stock options	9,060	—	(8,479)	(9,060)	33,660	—	—	—	—	25,181
Beneficial conversion feature of convertible notes	—	—	906,799	—	—	—	—	—	—	906,799
Expiration of warrants	—	—	1,368,164	—	—	—	(1,368,164)	—	—	—
Amortization of warrants	—	—	—	—	—	9,548	—	—	—	9,548
Issuance of stock under Employee Stock Purchase Plan	15,105	—	(17,602)	(15,105)	56,123	—	—	—	—	38,521
Comprehensive (loss) income:										
Currency translation adjustment	—	—	—	—	—	—	—	36,819	(2,979,305)	36,819
Net loss	—	—	—	—	—	—	—	—	—	(2,979,305)
Total comprehensive (loss) income	—	—	—	—	—	—	—	—	—	(2,942,486)
Balance at December 31, 2003	2,432,501	246,845	76,432,608	35,952	(133,568)	—	46,400	—	(76,485,039)	107,246
Exercise of warrants and stock options	19,725	213	31,724	(17,600)	65,120	—	—	—	—	97,057
Beneficial conversion feature of convertible notes	—	—	232,672	—	—	—	—	—	—	232,672
Issuance of common stock and warrants, net of \$574,000 of issuance costs	1,230,769	123,077	2,681,865	—	—	—	4,614,154	—	—	7,419,096
Issuance of warrants for settlement of lawsuit	—	—	—	—	—	—	104,925	—	—	104,925
Issuance of common stock related to note conversion	1,535,386	153,539	3,684,928	—	—	—	—	—	—	3,838,467
Stock based compensation awards	32,163	3,216	294,736	—	—	(297,952)	—	—	—	—
Stock based compensation expense	—	—	—	—	—	136,270	—	—	—	136,270
Issuance of stock under Employee Stock Purchase Plan	1,697	—	2,069	(1,697)	6,282	—	—	—	—	8,351
Comprehensive (loss) income:										
Unrealized gain on short term investments	—	—	—	—	—	—	—	513,759	(1,694,252)	513,759
Net loss	—	—	—	—	—	—	—	—	—	(1,694,252)
Total comprehensive (loss) income	—	—	—	—	—	—	—	—	—	(1,180,493)
Balance at December 31, 2004	5,252,241	526,890	83,360,602	16,655	(62,166)	(161,682)	4,765,479	513,759	(78,179,291)	10,763,591
Exercise of stock options	2,140	—	(3,006)	(2,140)	10,970	—	—	—	—	7,964
Issuance of common stock for merger	3,501,400	35,014	17,261,902	—	—	—	—	—	—	17,296,916
Issuance of warrants for merger	—	—	—	—	—	—	1,759,153	—	—	1,759,153
Issuance of warrants to bank	—	—	—	—	—	—	24,715	—	—	24,715
Stock based compensation expense	—	—	382,549	—	—	121,392	—	—	—	503,941
Issuance of stock under Employee Stock Purchase Plan	2,115	—	(4,549)	(2,115)	10,841	—	—	—	—	6,292
Forfeiture of restricted stock	(13,784)	(138)	—	13,784	(110,199)	34,837	—	—	—	(75,500)
Comprehensive loss:										
Unrealized loss on short term investments	—	—	—	—	—	—	—	(239,778)	—	(239,778)
Reclassification adjustment for gains realized in net loss	—	—	—	—	—	—	—	(286,417)	—	(286,417)
Net loss	—	—	—	—	—	—	—	—	(5,094,821)	(5,094,821)
Total comprehensive loss	—	—	—	—	—	—	—	—	—	(5,621,016)
Balance at December 31, 2005	8,744,112	\$561,766	\$100,997,498	26,184	\$(150,554)	\$ (5,453)	\$ 6,549,347	\$ (12,436)	\$(83,274,112)	\$24,666,056

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

Knova Software, Inc.
Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2005	2004	2003
Cash flows from operating activities			
Net loss	\$(5,094,821)	\$ (1,694,252)	\$(2,979,305)
Adjustments to reconcile net loss to net cash (used in) provided by operations:			
Non cash items:			
Depreciation	430,353	316,267	801,195
Amortization of intangible assets	778,196	33,337	206,297
Cost of warrants issued	24,715	—	—
Cost of warrants in connection with lease settlement	—	104,925	—
Amortization of beneficial conversion feature related to convertible notes	—	1,162,150	1,429,603
Amortization of discount on convertible notes	—	50,196	115,341
Interest expense paid by issuing common stock	—	105,760	347,032
Provision for doubtful accounts	106,778	—	25,000
Stock based compensation	503,941	136,270	—
Forfeiture of restricted stock	(75,500)	—	—
Acquired in-process research and development	420,935	—	—
Other non-cash items	2,452	(7,362)	32,905
Non-cash portion of legal settlement	—	(850,000)	—
Gain on sale of investments	(286,417)	—	—
Changes in operating assets and liabilities, net of assets and liabilities acquired:			
Accounts receivable	(1,987,591)	819,198	(1,839,021)
Other assets	170,596	(230,132)	(7,354)
Accounts payable	(1,201,272)	594,355	(53,995)
Accrued compensation and benefits	(19,142)	132,576	114,440
Accrued restructuring charges	261,252	—	—
Deferred revenue	1,569,247	395,844	870,830
Other liabilities	(601,705)	116,156	(15,923)
Net cash (used in) provided by operating activities	(4,997,983)	1,185,288	(952,955)
Cash flows from investing activities			
Purchases of marketable securities	(5,748,734)	(13,227,702)	—
Proceeds from sale of marketable securities	9,314,401	5,325,000	500,080
Proceeds from sale of assets	1,050	1,460	12,153
Acquisition costs for Kanisa merger	(561,653)	—	—
Cash acquired from Kanisa merger	3,779,427	—	—
Increase in restricted cash	—	(61,000)	—
Property and equipment acquisitions	(261,449)	(207,814)	(94,558)
Net cash provided by (used in) investing activities	6,523,042	(8,170,056)	417,675
Cash flows from financing activities			
Repayments of principal of capital lease obligations	(80,854)	(32,332)	(38,500)
Proceeds from borrowings	3,600,000	—	250,000
Repayments of principal of revolving line of credit	—	(250,000)	(800,000)
Proceeds from equity funding, net of debt issuance costs	—	7,419,096	—
Proceeds from stock option exercises and employee stock purchase plan issuances	14,256	82,588	63,702
Net cash provided by (used in) financing activities	3,533,402	7,219,352	(524,798)
Effect of exchange rate changes on cash	—	—	36,598
Increase (decrease) in cash and cash equivalents	5,058,461	234,584	(1,023,480)
Cash and cash equivalents at beginning of year	1,672,305	1,437,721	2,461,201
Cash and cash equivalents at end of year	\$ 6,730,766	\$ 1,672,305	\$ 1,437,721
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 9,763	\$ 9,765	\$ 14,613
Supplemental disclosures of non-cash investing and financing activities:			
Conversion of convertible debt and accrued interest to common stock	\$ —	\$ 3,838,467	\$ —
Exercise of warrants by bank	—	22,820	—
Issuance of warrants	1,783,868	—	—
Assets acquired under capital lease obligations	—	31,689	—
Expiration of warrants at no consideration	—	—	1,368,164
Unrealized gain (loss) on investments	(12,436)	513,759	—
Kanisa acquisition (Note 17)	—	—	—

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

Knova Software, Inc.

**Notes to Consolidated Financial Statements
December 31, 2005**

Note 1. Organization of the Company

Knova Software, Inc. (the “Company”) is a provider of customer relationship management (CRM) software applications, specifically applications that enable customer service organizations to more effectively resolve service requests and answer questions. Built on knowledge management and search technologies, the Company’s service resolution management (SRM) applications optimize the resolution process across multiple service channels, including contact centers, self-service websites, help desk, email and chat. The Company’s SRM applications complement, integrate with, and enhance traditional CRM, contact center, and help desk applications by providing patented knowledge management solutions that improve service delivery. The Company’s customers include some of the largest companies in the world and the Company’s products enable them to reduce operating and service delivery costs, improve customer satisfaction, and thereby increase revenues.

The Company is principally engaged in the design, development, marketing and support of software applications and services. Substantially all of the Company’s revenues are derived from perpetual licenses of software products, the related professional services and the related customer support, otherwise known as maintenance. The Company licenses software in arrangements in which the customer purchases a combination of software, maintenance and/or professional services, such as training and implementation services. Maintenance, which includes technical support and product updates, is typically sold with the related software license and is renewable at the option of the customer on an annual basis after the first year. The Company’s professional services and technical support organizations provide a broad range of implementation services, training, and technical support to customers and implementation partners. The Company’s service organization has significant product and implementation expertise and is committed to supporting customers and partners throughout every phase of their adoption and use of the Company’s solutions.

On February 8, 2005, the Company combined with Kanisa Inc. (“Kanisa”) through the merger of a wholly owned subsidiary of the Company with and into Kanisa. Refer to Note 17.

Note 2. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries after elimination of all significant intercompany accounts and transactions.

Revenue Recognition

The Company’s revenue recognition policy is governed by Statement of Position (SOP) 97-2, “Software Revenue Recognition”, issued by the American Institute of Certified Public Accountants (AICPA), as amended by SOP 98-9 “Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions”. The Company derives its revenues from licenses for its products sold directly to end-users and indirectly through distributors as well as from providing related services, including installation and training, consulting, customer support and maintenance contracts. Revenues are recognized only if persuasive evidence of an agreement exists, delivery has occurred, all significant vendor obligations are satisfied, the fee is fixed or determinable, and collection of the amount due from the customer is deemed probable. Additionally, in sales contracts that have multi-element arrangements, the Company recognizes revenue using the residual method. The total fair value of the undelivered elements as indicated by vendor-specific objective evidence (price charged when the undelivered element is sold individually) is deferred and the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements. Additional revenue recognition criteria by revenue type are listed below.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

License revenues

License revenues include fees for perpetual and annual licenses. The Company recognizes revenues on perpetual license fees after a non-cancelable license agreement has been signed, the product has been delivered, the fee is fixed or determinable and collectible, and there is vendor-specific objective evidence to support the allocation of the total fee to elements of a multiple-element arrangement. Revenue for annual licenses and software lease licenses is recognized ratably over the period of the contract.

Services revenues

Services revenues are derived from variable fees for installation, training, consulting and building customized knowledge bases as well as from fixed fees for customer support and maintenance contracts.

Maintenance and support revenues are derived from the sale of maintenance and support contracts, which provide end-users with the right to receive maintenance releases of the licensed products, access to the support website and access to the customer support staff. Maintenance and support revenues are recognized on a straight-line basis over the term of the contract. Payments for maintenance and support revenues are normally received in advance and are nonrefundable.

Revenues for installation and training, implementation and system integration projects, and consulting services are primarily recognized as the services are performed.

Cost of revenues

Cost of licenses revenues consists primarily of the expenses related to royalties and amortization of purchased technology.

Cost of services revenues consists of direct and indirect costs related to service revenues which primarily include salaries, benefits, direct expenses and allocated overhead costs related to the customer support and services personnel, fees for subcontractors and the cost associated with maintaining the Company's customer support site.

Cash and Cash Equivalents

Cash and cash equivalents include cash and interest-bearing money market deposits with financial institutions having original maturities of thirty days or less. Cash equivalents are stated at cost, which approximates market value. The amounts held by major financial institutions may exceed the amount of insurance provided on such deposits. These deposits may generally be redeemed upon demand and, therefore, subject the Company to minimal risk.

Restricted Cash

The Company has included \$61,000 of restricted cash in other non-current assets. The restricted cash is held as a deposit for our Pittsburgh, Pennsylvania office lease.

Marketable securities, available for sale

The Company considers all marketable securities as available-for-sale. Accordingly, these securities are carried at fair value and unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of other comprehensive income (loss) until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. The securities consist of corporate bonds, government bonds, auction rate securities and common stock.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

The majority of the Company's investments are held in an account with an investment firm of which a Director of the Company is an affiliate. Refer to Note 16.

Accounts receivable and allowance for doubtful accounts

Trade accounts receivable are recorded at the invoice amount and do not bear interest. The Company provides credit to its customers in the normal course of business, performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses. The allowance for doubtful accounts related to trade receivables is determined based on an evaluation of specific accounts, which evaluation is conducted when information is available indicating that a customer may not be able to meet its financial obligations. Judgments are made in these specific cases based on available facts and circumstances, and a specific reserve for that customer may be recorded to reduce the receivable to the amount that is expected to be collected. These specific reserves are re-evaluated and adjusted as additional information is received that impacts the amount reserved. The collectibility of trade receivables could be significantly reduced if default rates are greater than expected or if an unexpected material adverse change occurs in a major customer's ability to meet its financial obligations.

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Computer equipment is amortized over two years, computer software over three years, and furniture and office equipment over five years. Leasehold improvements are amortized over the lesser of their useful lives or the remaining term of the lease. Amortization of assets recorded under capital leases is included in depreciation expense. Capital leases, which are for office equipment, are amortized over the term of the lease. Upon disposal, assets and related accumulated depreciation are removed from the Company's accounts and the resulting gains or losses are reflected in the consolidated statement of operations.

Impairment of long-lived assets

On an ongoing basis, when there are indicators of impairment such as declining revenues or recurring losses, the Company evaluates the carrying value of long-lived assets, including identifiable intangible assets resulting from business acquisitions. If such indicators are apparent, the Company compares the carrying value of the assets to the estimated future undiscounted cash flows expected to be generated over the remaining life of the assets. If the undiscounted cash flows are less than the carrying value of the assets, the cash flows will be discounted to present value and the assets will be reduced to this amount. There were no impairments for the years ended December 31, 2005, 2004 and 2003.

Internal Use Computer Software

The Company applies AICPA Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* ("SOP No. 98-1"). Accordingly, the Company capitalizes internal and external costs related to software and implementation services in connection with its internal use software systems.

Intangible Assets and Goodwill

Intangible assets consist of goodwill, core technology and customer relationships purchased from Kanisa in February 2005. The core technology and customer relationships are being amortized over periods from five to seven years using the straight-line method.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, effective January 1, 2002, and ceased amortization of goodwill. SFAS No. 142 requires that goodwill and intangible assets deemed to have an indefinite useful life be reviewed for impairment upon adoption of SFAS No. 142 and, at a minimum, annually thereafter. Under SFAS No. 142, goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds the estimated fair value. The Company performed an impairment review in the fourth quarters of 2005, 2004 and 2003 and concluded that no impairment loss was necessary.

Concentration of Credit Risk/Major Customers

Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of accounts receivable. The Company sells its products to end-users directly, and the Company's customer base is dispersed across many different geographic areas primarily throughout North America and parts of Europe. The Company believes it maintains adequate reserves for potential credit losses and to date, such losses have been minimal and within management's estimates.

During 2005, no customers accounted for greater than 10% of total revenues. At December 31, 2005, two customers represented 35% of total trade accounts receivable. During 2004, two customers accounted for 12% and 9% of total revenues and 0% and 8% of total accounts receivable at December 31, 2004. During 2003, two customers accounted for a total of 12% and 7% of total revenues.

Capitalized Software

Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Software development costs are capitalized beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers provided recoverability is reasonably assured. The Company follows the "working model" approach, whereby technological feasibility is established at the time the Company has a beta customer. The Company releases updated products periodically soon after technological feasibility has been established for new enhancements. For 2005, 2004, and 2003, costs which were eligible for capitalization were insignificant and, thus, the Company has charged its software development costs to research and development expense in the accompanying statements of operations.

Research and Development

Research and development costs are charged to expense when incurred.

Advertising Costs

Advertising and sales promotions are charged to expense during the period in which they are incurred. Total advertising and sales promotions expense for the years ended December 31, 2005, 2004, and 2003 were approximately \$211,000, \$157,000, and \$119,000, respectively.

Stock Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004) (SFAS No. 123R), *Share-Based Payment*. SFAS No. 123R will require the Company to expense share-based payments, including employee stock options, based on their fair value. SFAS No. 123R permits public companies to adopt its requirements using one of two methods. The first adoption method is a "modified prospective" method in which compensation cost is recognized beginning with the effective date (i) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (ii) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

date of SFAS No. 123R that remain unvested on the effective date. The second adoption method is a “modified retrospective” method, which includes the requirements of the modified prospective method described above, but also permits entities to restate, based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures, either (i) all prior periods presented or (ii) prior interim periods in the year of adoption.

The Company is required to adopt SFAS No. 123R effective as of January 1, 2006 and plans to utilize the modified prospective method of adoption, recognizing cost for all share-based payments granted after January 1, 2006. As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees under APB No. 25 using the intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R’s fair value method will have a significant impact on the Company’s results of operations, although it will have no impact on the Company’s overall financial position. The impact of adoption of SFAS No. 123R is expected to result in stock based compensation expense for existing options of approximately \$1,243,000 in 2006. However, had the Company adopted SFAS No. 123R in prior years, the impact of that adoption would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net earnings and pro forma earnings per share in the table below.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net loss, as reported	\$(5,094,821)	\$(1,694,252)	\$(2,979,305)
Add: stock based compensation expense included in reported net loss	503,941	136,270	—
Less: total stock based compensation expense under SFAS No. 123	<u>(2,151,953)</u>	<u>(576,003)</u>	<u>(1,809,000)</u>
Pro forma net loss	<u>\$(6,742,833)</u>	<u>\$(2,133,985)</u>	<u>\$(4,788,305)</u>
Weighted average shares basic and diluted	8,341,426	5,140,378	2,419,750
Net loss per share, basic and diluted	\$ (0.81)	\$ (0.42)	\$ (1.98)

The average fair value of the options granted is estimated at \$4.07 in 2005, \$5.80 in 2004 and \$3.60 in 2003, on the date of grant using the Black-Scholes pricing model with the following assumptions:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Volatility, annual rate	107%	150%	325%
Dividend yield	0.0%	0.0%	0.0%
Expected life, in years	6	3	3
Average risk-free interest rate	4.03%	2.82%	1.98%

Use of Estimates

The preparation of the Company’s financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the balance sheet dates and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

Net Loss Per Share

In accordance with SFAS No. 128, *Earnings Per Share*, basic and dilutive net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. All potentially dilutive securities have not been included in the calculation of net loss per share due to their anti-dilutive effect.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Other Comprehensive Income (Loss)

Other comprehensive income (loss) consists of net unrealized gains and losses from securities available-for-sale in 2005 and 2004 and foreign currency translation adjustments in 2003.

Impact of Recently Issued Accounting Standards

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, *Share-Based Payment* (“SAB 107”), which provides interpretive guidance related to the interaction between SFAS 123R and certain SEC rules and regulations, as well as provides the SEC staff’s views regarding the valuation of share-based payment arrangements. The Company is currently assessing the impact of SAB 107 on its implementation and adoption of SFAS 123R.

In May 2005, the FASB issued SFAS No. 154 *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* (SFAS No. 154). SFAS No. 154 requires that all voluntary changes in accounting principles be recognized as a retroactive restatement of all periods presented except when retroactive restatement is impracticable. In addition, SFAS No. 154 also requires that a change in depreciation method be accounted for as a change in accounting estimate that is affected by a change in accounting principle, which would be accounted for in the period of change if the change affects that period only and also in future periods if the change affects both the period of change and future periods. SFAS No. 154 also eliminates paragraph 4 of APB 20, which specifies that APB 20 does not apply to changes made to comply with new pronouncements. This Statement will require that any change in an accounting principle made as a result of adopting a new pronouncement be reported following the same guidance as that for voluntary changes in accounting principles, unless the new pronouncement’s transition provisions require another method. SFAS No. 154 is effective for years beginning after December 15, 2005.

Liquidity and Capital Resources

Historically, the Company has satisfied its cash requirements primarily through private placements of convertible preferred stock and common stock, an initial public offering and incurrence of debt. For the year ended December 31, 2005, the Company incurred a net loss of \$5,094,821 and had negative cash flow from operations of \$4,997,983. The Company’s ability to continue as a business in its present form is largely dependent on the Company’s ability to generate additional revenues, maintain its overall operating expenses and achieve profitability and positive cash flows. The Company believes that it has the ability to do so and plans to fund 2006 operations through operating revenues, cash, cash equivalents and investment balances and borrowings under its line of credit. As of December 31, 2005, the Company had \$12.2 million in cash, cash equivalents and investments.

Note 3. Fair Value of Financial Instruments

The carrying amounts of the Company’s financial instruments consisting principally of cash and cash equivalents, short term investments, accounts receivable, payables and debt approximate their fair values at December 31, 2005 and 2004.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Note 4. Accounts Receivable

Accounts receivable consist of the following:

	December 31,	
	2005	2004
Billed receivables	\$6,344,413	\$2,623,669
Unbilled receivables	224,089	—
	6,568,502	2,623,669
Allowance for doubtful accounts	(126,111)	(94,588)
Total receivables	6,442,391	2,529,081

Activity in the allowance for doubtful accounts is as follows:

	Balance
Balance December 31, 2002	\$170,998
Net charge to expense	25,000
Amounts written off	(95,998)
Balance December 31, 2003	100,000
Amounts written off	(5,412)
Balance December 31, 2004	94,588
Net charge to expense	106,778
Amounts written off	(75,255)
Balance December 31, 2005	\$126,111

Note 5. Intangible Assets and Goodwill

Intangible assets consist of goodwill, core technology and customer relationships purchased from Kanisa in February 2005.

Description	Amortization Period	December 31,					
		2005			2004		
		Amount	Accumulated Amortization	Net Amount	Amount	Accumulated Amortization	Net Amount
Kanisa core technology	7 years	\$3,981,190	\$521,346	\$ 3,459,844	\$ —	\$ —	\$ —
Kanisa customer relationships	5 years	1,401,001	256,850	1,144,151	—	—	—
Total intangible assets		\$5,382,191	\$778,196	\$ 4,603,995	\$ —	\$ —	\$ —
Goodwill				\$14,484,947			\$2,323,791

Amortization expense was \$778,196 and \$33,337 for 2005 and 2004, respectively. As of December 31, 2005, expected amortization expense on existing intangibles for the next five year is as follows:

2006	\$ 848,942
2007	848,942
2008	848,942
2009	848,942
2010	592,091

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Note 6. Debt

Credit Facilities

On December 21, 2005, the Company entered into a Loan and Security Agreement (the "Agreement") with Silicon Valley Bank (the "Bank"). The Agreement provides for the Bank to make advances to the Company until December 19, 2007, of up to \$4,000,000 in the aggregate, as a revolving facility and to provide an equipment loan of up to \$500,000. As part of the revolving loan, the Bank may issue up to \$3,000,000 in aggregate of letters of credit, provide cash management services and provide entry into foreign exchange forward contracts. Pursuant to the Agreement, the loans will bear interest at the prime rate plus one-half to one percent, depending on the Company's quick asset ratio. All loans under the Agreement will be due by December 19, 2007, unless accelerated or otherwise paid prior to that time. The Company's obligations under the Agreement are secured by certain assets of the Company (excluding its intellectual property) and the Company has agreed not to pledge its intellectual property rights during the term of the loan. The Company is subject to customary affirmative and negative covenants under the Agreement, including restrictions on the ability to incur additional indebtedness and maintenance of a minimum tangible net worth. The Agreement includes customary events of default, including bankruptcy events, entry of judgments against the Company and occurrence of material adverse changes. Upon the occurrence of an event of default, the Bank may cease to provide advances. As of December 31, 2005, there was \$3.6 million borrowed against the Agreement.

Convertible Notes

On April 1, 2002, the Company signed a binding commitment letter for the sale of convertible notes. The closing of the transaction took place in two tranches on May 6 and June 19, 2002 with total proceeds of \$2,975,000 being received, net of transaction costs of \$275,000.

The convertible notes were originally to mature 18 months from the closing date, bore interest at 10% per annum, and were convertible at any time at the option of the holder, into shares of the Company's common stock at a conversion price of \$3.00 per share. Interest was payable in cash or additional convertible notes, at the option of the Company. The convertible notes were senior unsecured obligations that ranked senior to all future subordinated indebtedness, *pari passu* to all existing and future senior, unsecured indebtedness and subordinated to all existing and future senior secured indebtedness. While the notes were outstanding, the Company was restricted from paying or declaring dividends on common stock, making any other distribution on common stock, or repurchasing or redeeming any shares of common stock.

In accordance with EITF 00-27, *Application of EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," to Certain Convertible Instruments*, the Company recognized in 2002 a beneficial conversion feature ("BCF") in the aggregate amount of \$2,225,000 as the difference between the market value of the Company's common stock on the commitment date and the conversion price of the convertible notes, reduced for the investors' transaction costs. The BCF was recorded as an increase in additional paid in capital and a discount on debt in the accompanying 2002 consolidated balance sheet. Additionally, the Company incurred total legal and other expenses of approximately \$54,000 related to the transaction, which was also recorded as a discount on debt. The aggregate discount was being amortized as interest expense over the 18 month term of the convertible notes.

On March 31, 2003, the noteholders agreed to an amendment to the original notes. The amendment reduced the conversion price from \$3.00 per share to \$2.50 per share and extended the term of the notes until July 15, 2004.

On October 31, 2003, April 30, 2003 and October 31, 2002, interest payments were due on the convertible notes and were paid by issuing additional convertible notes in the amounts of \$177,748, \$169,284 and \$135,681, respectively. These additional convertible notes had the same terms as the amended convertible

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

notes. The Company recognized additional BCF of \$232,672 and \$906,799 in 2004 and 2003, respectively, as a result of the amendment of the notes and payment of interest with additional convertible notes.

On February 10, 2004, the notes were converted into common stock as part of the terms of an equity funding discussed in Note 8. Additional interest of \$105,760 was paid in shares of stock in connection with the conversion.

Note 7. Restructuring Charges

During the first quarter 2005, in connection with the integration of its acquisition of Kanisa, the Company approved a plan to streamline its operations. The workforce reduction of 21 employees consisted of one executive, three from general and administrative, nine from research and development, three from professional services and five from sales. During the quarter ended March 31, 2005, the Company recorded restructuring charges of approximately \$1.4 million, including stock based compensation of \$242,000 for an executive. As of December 31, 2005, \$261,252 in severance costs remain to be paid to terminated employees over the next year.

Note 8. Capital Stock

Common Stock and Preferred Stock

The Company has two classes of capital stock consisting of common stock and preferred stock. As of December 31, 2005, a total of 50,000,000 shares were authorized for common stock and 5,000,000 shares were authorized for preferred stock.

The Company has reserved 3,158,799 shares of common stock as of December 31, 2005. Of this total, 2,090,514 shares are reserved for exercise of stock options and 1,068,285 shares are reserved for exercise of warrants.

There are no shares of preferred stock outstanding as of December 31, 2005.

Stock Split

At the Company's 2004 annual meeting of stockholders on December 7, 2004, the stockholders approved an amendment to the Company's Certificate of Incorporation to effect a reverse stock split of its common stock and to grant its board of directors the authority until June 30, 2006 to set the ratio for the reverse split or to not complete the reverse split. The board granted authority to effect a 1 for 10 reverse stock split, which was effective February 4, 2005. The split is reflected in all share and per share information found throughout the consolidated financial statements. In addition, on February 4, 2005, the number of authorized shares of common stock was decreased to 50,000,000 shares upon completion of the reverse stock split.

Stock offering

On January 30, 2004, the Company secured an additional \$7.5 million, net of expenses, in funding to finance its operations and the development of its business. The additional funding was raised through a private placement of equity securities consisting of 1,230,769 shares of common stock and five-year warrants to purchase 615,384 shares of common stock at \$7.20 per share.

On February 10, 2004, the Company's convertible notes were converted into common stock as part of the terms of the equity funding.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Note 9. Stock Option Plan

Effective April 2000, the Company's Board of Directors approved the ServiceWare Technologies, Inc. 2000 Stock Incentive Plan (the "Plan") which amended and restated the 1996 ServiceWare, Inc. Amended and Restated Stock Option Plan (the "1996 Plan"). The Plan is administered by the Board of Directors and provides for awards of stock options to employees, officers, directors, consultants and advisors. In May 2005, the Company's stockholders approved amendments to the 2000 Stock Incentive Plan to: (i) increase the maximum aggregate number of shares of common stock available for issuance thereunder from 1,240,817 to 2,453,387 shares and to reserve an additional 1,212,570 shares of common stock for issuance in connection with awards granted or to be granted under the Plan; (ii) approve an increase in the grant limit under the Plan from 100,000 to 500,000 shares per participant per fiscal year; and (iii) change the name of the Plan to "Knova Software, Inc. 2000 Stock Incentive Plan." The maximum aggregate number of shares of the Company's Common Stock that may be subject to grants made under the Plan is increased by any shares of Common Stock covered by any unexercised portion of stock options granted under the 1996 Plan that terminate after April 11, 2005, and also by an automatic annual increase on the first day of each fiscal year of the Company beginning on or after January 1, 2006 and ending on or before December 31, 2010 equal to the lesser of (i) 100,000 shares, (ii) 6.25% of the shares outstanding on the last day of the immediately preceding fiscal year, or (iii) such lesser number of shares as is determined by the Company's Board of Directors.

Management and the Board of Directors determined the exercise price of incentive stock options for the period from April 2000 through the Company's initial public offering in August 2000 ("IPO"). After the IPO, the exercise price of incentive stock options is the closing market price of the Company's Common Stock on the date of the grant. The Board of Directors also determines the exercise price of nonqualified options. Options generally vest over a four-year period, or over such other period as the Board of Directors determines, and may be accelerated in the event of certain transactions such as merger or sale of the Company. These options expire within ten years after the date of grant. During 2005 and 2004, the Company recorded \$503,941 and \$136,220 in stock based compensation expenses related to restricted stock grants to executives and granting options at less than market price.

The following table summarizes option activity for the years ended December 31, 2005, 2004, and 2003:

	<u>Options Outstanding</u>	<u>Option Price Range per Share</u>	<u>Weighted Average Exercise Price</u>
Options outstanding, December 31, 2002	556,830	\$2.40 - \$70.00	\$5.06
Options granted	97,046	\$2.60 - \$ 7.00	\$3.64
Options exercised	(9,060)	\$2.60 - \$ 4.50	\$3.62
Options forfeited	<u>(68,045)</u>	\$2.60 - \$25.00	\$4.39
Options outstanding, December 31, 2003	576,771	\$2.50 - \$70.00	\$4.71
Options granted	380,445	\$4.09 - \$ 8.19	\$5.79
Options exercised	(17,600)	\$2.60 - \$ 4.50	\$4.21
Options forfeited	<u>(72,567)</u>	\$2.60 - \$51.25	\$5.89
Options outstanding, December 31, 2004	867,049	\$2.50 - \$70.00	\$5.10
Options granted	1,550,190	\$2.75 - \$ 4.60	\$4.07
Options exercised	(2,140)	\$2.60 - \$ 3.80	\$3.72
Options forfeited	<u>(324,585)</u>	\$2.60 - \$ 6.99	\$4.67
Options outstanding, December 31, 2005	<u>2,090,514</u>	\$2.50 - \$70.00	\$4.37
Options exercisable, December 31, 2005	<u>880,009</u>	\$2.50 - \$70.00	\$4.81

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

The options outstanding as of December 31, 2005 have been segregated into ranges for additional disclosure as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding as of December 31, 2005	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable as of December 31, 2005	Weighted Average Exercise Price
\$0.000 - \$ 2.50	95,000	3.3	\$ 2.50	95,000	\$ 2.50
\$ 2.51 - \$ 3.50	271,885	7.8	\$ 3.09	108,944	\$ 2.91
\$ 3.51 - \$ 4.00	565,354	7.8	\$ 3.80	172,560	\$ 3.96
\$ 4.01 - \$ 5.90	980,202	8.4	\$ 4.54	343,331	\$ 4.75
\$ 5.91 - \$ 6.00	140,498	6.2	\$ 5.99	123,248	\$ 5.99
\$ 6.01 - \$ 6.90	800	6.3	\$ 6.63	800	\$ 6.63
\$ 6.91 - \$11.00	17,678	4.1	\$ 9.91	17,028	\$ 9.98
\$11.01 - \$28.00	10,838	3.4	\$19.81	10,838	\$19.81
\$28.01 - \$35.00	8,000	3.0	\$28.12	8,000	\$28.12
\$35.01 - \$70.00	259	2.9	\$49.12	260	\$49.08
	<u>2,090,514</u>	<u>7.7</u>	<u>\$ 4.37</u>	<u>880,009</u>	<u>\$ 4.81</u>

Employee Stock Purchase Plan

In May 2000, the Company adopted the Employee Stock Purchase Plan (ESPP). Under the terms of the ESPP, the Company is authorized to issue up to 50,000 shares of common stock, plus annual increases, as defined by the plan document. The ESPP enables employees to purchase shares of the Company's common stock at a discounted price through after-tax payroll deductions. Shares are offered to employees in six month offering periods. Eligible employees elect to have deducted from 1% to 15% of their base compensation. The amounts deducted can be used to purchase the Company's common stock at the lesser of 85% of the fair value on the first day of the offering period or 85% of the fair value on last day of the offering period (purchase date). As of December 31, 2005, the Company has discontinued the plan.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Note 10. Warrants

The following table summarizes warrant activity for the years ended December 31, 2005, 2004 and 2003:

	<u>Warrants Outstanding</u>	<u>Warrant Price Range per Share</u>
Balance, December 31, 2002	66,529	\$ 4.60 - \$90.00
Warrants granted	—	
Warrants exercised	—	
Warrants expired	<u>(50,047)</u>	\$15.00 - \$70.00
Balance, December 31, 2003	16,482	\$ 4.60 - \$37.50
Warrants granted	627,883	\$ 7.20 - \$ 8.39
Warrants exercised	(5,000)	\$ 4.59
Warrants expired	<u>(3,481)</u>	\$37.50
Balance, December 31, 2004	635,884	\$ 7.20 - \$37.50
Warrants granted	432,401	\$ 7.20
Warrants exercised	—	
Warrants expired	<u>—</u>	
Balance, December 31, 2005	<u>1,068,285</u>	\$ 7.20 - \$37.50

The valuation of warrants was calculated using the Black-Scholes pricing model. The holders of the warrants have the right to exercise their warrants for shares of the Company's common stock at anytime until the expiration of the warrant. Expiration dates of the warrants are as follows:

<u>Warrants Outstanding</u>	<u>Warrant Price per Share</u>	<u>Expiration Date</u>
1,047,785	\$ 7.20	1/30/09
8,000	\$37.50	12/10/06
<u>12,500</u>	\$ 8.40	1/16/07
<u>1,068,285</u>		

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Note 11. Capital and Operating Leases

The Company has several capital and operating leases covering office space and certain equipment. Future minimum lease payments due under noncancelable capital and operating leases are as follows:

<u>Year Ending December 31,</u>	<u>Capital Leases</u>	<u>Operating Leases</u>
2006	\$42,920	\$ 561,186
2007	18,996	285,975
2008	18,499	241,653
2009	—	102,137
Thereafter	<u>—</u>	<u>—</u>
Total minimum lease payments	\$80,415	<u>\$1,190,951</u>
Less amount representing interest	<u>5,325</u>	
Present value of capital lease obligations	75,090	
Less current maturities	<u>39,636</u>	
Non current capital lease obligations	<u>\$35,454</u>	

The current operating leases contain an escalation clause, which has been straight-lined over the life of the lease.

Total rent expense under all operating leases amounted to \$468,611, \$216,472 and \$295,922 in 2005, 2004 and 2003, respectively.

Note 12. Income Taxes

A reconciliation of the provision for income taxes computed by applying the U.S. federal statutory rate of 34% to the loss before income taxes is as follows:

	<u>Year Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Income tax benefit computed at statutory federal income tax rate	\$(1,732,239)	\$(576,046)	\$(1,012,964)
State income taxes, net of federal tax benefit	(302,632)	(100,639)	(176,971)
Other (principally meals and entertainment)	47,026	35,882	15,640
Research tax credit	166,337	75,790	75,790
Foreign loss	—	—	166,952
Deferred tax asset valuation allowance	<u>1,821,508</u>	<u>565,013</u>	<u>931,553</u>
Total benefit for income taxes	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31, are as follows:

	December 31,	
	2005	2004
Deferred tax assets (liabilities)		
Accounts receivable	\$ 50,000	\$ 38,000
Accrued vacation	118,000	—
Property and equipment	183,000	72,000
Intangible assets and goodwill	(1,790,000)	57,000
Deferred license revenue	(622,000)	(149,000)
Stock based compensation	201,000	—
Net operating loss carryforwards	35,513,000	26,490,000
Research tax credit carryforwards	1,326,000	1,049,000
Total net deferred tax assets	34,979,000	27,557,000
Valuation allowance	(34,979,000)	(27,557,000)
Net deferred tax asset	\$ —	\$ —

Management has recorded a valuation allowance against the net deferred tax asset until such time that the Company demonstrates an ability to generate taxable income on a consistent basis.

At December 31, 2005, the Company had net operating loss carryforwards for federal and state income tax purposes of approximately \$88,782,000, which expire between 2010-2025. Utilization of certain net operating loss carryforwards is subject to limitation under Section 382 of the Internal Revenue Code.

Note 13. Net Loss Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	2005	2004	2003
Numerator:			
Net loss	\$(5,094,821)	\$(1,694,252)	\$(2,979,305)
Denominator:			
Weighted average shares	8,341,426	5,140,378	2,419,750
Net loss per share, basic and diluted	\$ (0.61)	\$ (0.33)	\$ (1.23)

Dilutive securities include convertible notes, options and warrants as if converted. Potentially dilutive securities totaling 3,158,798, 1,502,931 and 2,076,460 shares for the years ended December 31, 2005, 2004 and 2003, respectively, were excluded from historical basic and diluted loss per share because of their antidilutive effect. The number of outstanding options to purchase common stock for which the option exercise price exceeded the average market price of the Company's common stock aggregated 1,398,126, 912,105, and 94,824 for the years ended December 31, 2005, 2004, and 2003 respectively.

Note 14. Retirement Plan

The Company has a 401(k) profit sharing plan (the "Plan") covering all of its employees subject to certain age and service requirements. Under provisions of the Plan, participants may contribute up to 15% of their eligible compensation to the Plan. The Company contributed \$42,465, \$78,995 and \$26,952 in matching contributions to the Plan in 2005, 2004 and 2003, respectively. The Company no longer matches contributions as of June 1, 2005.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Note 15. Segment Reporting

The Company has only one business segment.

Geographic Information

	Year Ended December 31,				
	2005		2004		2003
	Revenues(a)	Long-Lived Assets(b)	Revenues(a)	Long-Lived Assets(b)	Revenues(a)
United States	\$22,686,387	\$365,099	\$11,430,354	\$450,649	\$10,716,304
International	908,568	—	1,071,773	—	795,131
Total	\$23,594,955	\$365,099	\$12,502,127	\$450,649	\$11,511,435

(a) Revenues are attributed to the United States and International based on customer location.

(b) Long-lived assets include non-current tangible assets of the Company.

Note 16. Related Party Transactions

The Company's investments are held in an account with an investment firm that is related to a director of the Company and his affiliated entities, who collectively own more than 25% of the Company's stock. Also, as investments are purchased and sold, this investment firm may hold a cash balance. At December 31, 2005 and 2004, the cash balance with this investment firm was \$89,418 and \$64,926, respectively. The maximum balance in the cash and investment accounts during 2005 and 2004 was \$9,152,392 and \$9,331,387, respectively.

Marketable securities consist of investments in bond and stock mutual funds, and commercial paper. At December 31, 2005, the historical cost, gross unrealized gains and losses, and fair value of the securities were as follows:

	Historical Cost	Gross Unrealized Gains	Gross Unrealized Loss	Fair Value
Corporate bonds	\$1,210,815	\$—	\$ (4,936)	\$1,205,879
Government bonds	1,006,389	—	(7,500)	998,889
Auction rate securities	3,256,248	—	—	3,256,248
Total current available for sale securities	\$5,473,452	\$—	\$(12,436)	\$5,461,016

At December 31, 2004, the historical cost, gross unrealized gains and losses, and fair value of the securities were as follows:

	Historical Cost	Gross Unrealized Gains	Gross Unrealized Loss	Fair Value
Common stock	\$ 850,000	\$553,933	\$ —	1,403,933
Corporate bonds	815,550	—	(35,174)	780,376
Government bonds	1,005,111	—	(5,000)	1,000,111
Auction rate securities	6,082,041	—	—	6,082,041
Total current available for sale securities	\$8,752,702	\$553,933	\$(40,174)	\$9,266,461

Of the total amount of \$3,732,713 of convertible notes issued as of December 31, 2003, convertible notes with an aggregate principal amount of \$3,029,531 were owned by a director of the Company and his affiliated

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

entities, who collectively owned approximately 20% of the Company's stock prior to the acquisition of convertible notes. Refer to Note 6.

An investment firm that is related to a director of the Company served as one of the placement agents in connection with the private placement, which occurred in January 2004, of an aggregate of 1,230,769 shares of the Company's common stock and warrants to purchase up to an aggregate of 615,385 shares of common stock. In connection with the private placement, the investment firm received a placement fee of \$240,000. Affiliates of the investment firm purchased \$455,000 of units in the private placement. In addition, entities with respect to which the director has or shares voting power purchased \$162,500 of units in the private placement.

Note 17. Acquisition

On December 22, 2004, the Company entered into a business combination agreement with Kanisa Inc. under which Kanisa became a wholly-owned subsidiary of the Company through a merger with a newly created wholly-owned subsidiary of the Company. The merger was completed on February 8, 2005 pursuant to an Amended Merger Agreement. Bruce Armstrong, CEO of Kanisa, became CEO of the Company. The corporate headquarters of the Company following consummation of the merger is Cupertino, California.

In pursuing this merger, the Company determined that combining the technology, research and development resources, customer relationship and sales and marketing capabilities of the two companies would create a stronger and more competitive company, with the breadth and scale that the Company's market demands.

Pursuant to the Merger, the Kanisa stockholders received a total of 3,501,400 shares of \$.01 par value common stock of the Company, which represented 40% of post-merger common stock outstanding. Warrants to purchase an additional 423,923 shares of common stock at an exercise price of \$7.20 per share were issued to the Kanisa stockholders. These warrants will expire in January 2009. The fair value of each warrant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

Volatility	142.67%
Risk-free interest rate	3.4%
Dividend yield	—
Expected life	4 years

Based on this methodology, the warrants were valued at approximately \$4.13 each, resulting in a total value of approximately \$1,759,000.

The results of operations of Kanisa have been included in the Company's consolidated results from the date of acquisition, February 8, 2005.

The following table summarizes the allocation of the total purchase price (consisting of approximately \$17,297,000 for the common stock issued to Kanisa stockholders, approximately \$1,759,000 for the warrants

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

issued to the Kanisa stockholders and acquisition costs of approximately \$561,000) to the fair values of the assets acquired and liabilities assumed as of the date of the acquisition (in thousands):

Cash and cash equivalents	\$ 3,779
Accounts receivable	2,032
Prepaid expenses and other current assets	364
Equipment	87
Intangible assets:	
Core and developed technologies	3,981
Acquired in-process research and development	421
Customer contracts/customer relationships	1,401
Goodwill	12,161
Accounts payable	(1,144)
Accrued compensation and benefits	(614)
Other current liabilities	(913)
Deferred revenues	(1,876)
Capital lease obligations and other long term liabilities	<u>(62)</u>
Net assets acquired	<u>\$19,617</u>

The Company expensed the acquired in-process research and development in the first quarter of 2005. The core and developed technologies of \$4.0 million were assigned a useful life of 7 years and the customer contracts/customer relationships of \$1.4 million were assigned a useful life of 5 years. These intangible assets are being amortized using the straight-line method over their estimated useful lives.

An investment firm, of which a Director of the Company is an affiliate, received \$350,000 in consulting fees for assistance with the acquisition. These fees are included in the acquisition costs.

The merger contemplated a name change for the Company. Effective as of May 27, 2005, the Company's name was changed to "Knova Software, Inc."

Pro forma results

The following pro forma results of operations reflect the combined results of the Company and Kanisa as if the combination occurred at the beginning of each of the applicable periods. The information used for this pro forma disclosure was obtained from internal financial reports prepared by Kanisa for the periods January 1, 2005 through February 7, 2005 and the year ended December 31, 2004.

	<u>For the Year Ended December 31,</u>	
	<u>2005</u>	<u>2004</u>
Revenues	\$23,999,224	\$ 23,586,097
Net loss	\$(6,018,372)	\$(12,035,534)
Net loss per share	\$ (0.72)	\$ (1.38)
Shares used in per share calculation	8,341,426	8,720,094

The pro forma results are not necessarily indicative of what would have occurred if the acquisition had actually been completed as of the assumed dates and periods presented. The actual results for the year ended December 31, 2005 include the results for Kanisa from February 8, 2005 through December 31, 2005.

Knova Software, Inc.

Notes to Consolidated Financial Statements — (Continued)

Note 18. Quarterly Financial Data (unaudited)

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
Year ended December 31, 2005				
Revenues	\$ 3,699,843	\$7,341,560	\$5,719,254	\$6,834,299
Gross margin	1,908,980	4,864,260	3,306,777	3,911,123
Net (loss) income	(3,508,421)	63,757	(940,190)	(709,967)
Net (loss) income per common share, basic	(0.49)	0.01	(0.11)	(0.08)
Net (loss) income per common share, diluted	(0.49)	0.01	(0.11)	(0.08)
Year ended December 31, 2004				
Revenues	\$ 1,836,774	\$3,887,372	\$3,973,360	\$2,804,620
Gross margin	1,000,927	2,880,608	2,363,799	1,470,933
Net (loss) income	(2,709,705)	163,450	199,991	652,012
Net (loss) income per common share, basic	0.55	0.03	0.04	0.12
Net (loss) income per common share, diluted	—	0.03	0.04	0.12

On February 8, 2005, the Company combined with Kanisa, Inc. Refer to Note 17.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* As of the end of the period covered by this report, under the supervision and with the participation of our management, including our chief executive officer (“CEO”) and chief financial officer (“CFO”), we evaluated the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, or the “Exchange Act”). Based on this evaluation, our management, including our CEO and CFO, has concluded that our disclosure controls and procedures are designed, and are effective, to give reasonable assurance that the information we are required to disclose is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Based upon this evaluation, the CEO and CFO concluded that our disclosure controls and procedures are effective in providing reasonable assurance that information required to be disclosed in our reports filed with or submitted to the SEC under the Exchange Act is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

(b) *Changes in internal controls.* There were no changes in our internal control over financial reporting that occurred during the fourth quarter of our year ended December 31, 2005, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

The following table identifies our current executive officers and directors and their ages as of March 15, 2006:

<u>Name</u>	<u>Age</u>	<u>Capacities in which Served</u>
Bruce Armstrong	44	President, Chief Executive Officer and Director
Kent Heyman	50	Director (Chairman of the Board)
David Schwab	48	Director
Thomas Shanahan	59	Director
Thomas Unterberg	75	Director
Timothy Wallace	48	Director
Mark Angel	47	Chief Technology Officer
Thomas Muise	46	Chief Financial Officer and Treasurer
Frank Lauletta	36	General Counsel and Secretary

Bruce Armstrong joined our board of directors in February 2005. As a Class I director, Mr. Armstrong’s term as a director will expire in 2007. Mr. Armstrong was employed as our president and chief executive officer upon consummation of the merger with Kanisa in February 2005. Mr. Armstrong has served as president and chief executive officer of Kanisa since November 2002. Prior to joining Kanisa, Mr. Armstrong served as vice president of Internet Capital Group, a public holding company focused on internet-based businesses, from March 2000 until August 2002. His prior experience included serving as president and chief executive officer of CMPNET from 1999 to February 2000, as executive vice president of sales and marketing for Broadbase Software (now KANA) from 1996 to 1999, as vice president and general manager of the server products group of Sybase from 1995 to 1996 and as vice president and general manager of the enterprise

solutions division of AT&T/NCR (Teradata) from 1993 to 1995. Mr. Armstrong has a Bachelor's Degree in Computer Science from the University of California at Berkeley.

Kent Heyman joined our board of directors in February 2002. As a Class III director, Mr. Heyman's term as a director will expire in 2006. As of February 2005, Mr. Heyman serves as a non-executive chairman of the board. Mr. Heyman was employed as our president and chief executive officer from September 2001 until the consummation of the merger with Kanisa in February 2005. From June 1996 to December 2000, he served as senior vice president at Mpower Communications, a facilities-based communications provider. Prior to his tenure at Mpower, Mr. Heyman served as litigation department chairman and lead trial counsel for Dowling Magarian Aaron and Heyman, a law firm in Fresno, California. Mr. Heyman earned a doctor of law (J.D.) degree from the University of the Pacific's McGeorge School of Law, and received a bachelor's degree from California State University, Fresno.

David Schwab joined our board of directors in February 2005. As a Class II Director, Mr. Schwab's term in office will expire in 2008. Mr. Schwab is currently a general partner at Sierra Ventures, a private venture capital firm located in Menlo Park, California, which focuses its investments on early and pre-public communications, software and Internet related content and infrastructure companies. He serves on the boards of Micromuse, Inc. (NASDAQ: MUSE) and privately held Addamark, CrossLogix, Inc., Motiva, Inc., SeeCommerce, Inc., Tightlylink, Corp., and Ventaso. Mr. Schwab began his professional career in 1979 as a software engineer and engineering manager for five years at Lockheed Corporation. After attending Harvard Business School, from 1986 through 1991, he worked in sales and sales management at Sun Microsystems. Mr. Schwab co-founded Scopus Technology, Inc. (NASDAQ: SCOP) in 1991, a provider of client/server software systems for the customer information management market. During his five years at Scopus, Mr. Schwab served as vice president of sales and vice president of application development. Mr. Schwab holds an MBA degree from Harvard Business School, two graduate engineering degrees from Stanford University, and an undergraduate degree from UC San Diego.

Thomas P. Shanahan joined our board of directors in February 2005. As a Class III Director, Mr. Shanahan's term in office will expire in 2006. Mr. Shanahan has served as a general partner for Needham Capital Partners in Menlo Park, California since January 2002. Prior to Needham Capital Partners, Mr. Shanahan served as co-founder, chief financial officer and director for Agile Software Corporation, a provider of supply chain management software, from December 1997 to December 2001. From 1992 to 1997, he served as chief financial officer for several companies including Digital Generation Systems, Inc, a digital distribution services company, and Sherpa Corporation, a product data management software company. Mr. Shanahan holds an MBA degree from Harvard University and a B.A. from Stanford University. He currently is a member of the board of directors of diCarta, Inc.

Thomas Unterberg has served as a director since June 2001. As a Class I Director, Mr. Unterberg's term in office will expire in 2007. Mr. Unterberg is a co-founder and, from 1989 until November 2004, served as a chairman of C.E. Unterberg, Towbin, L.P., an investment banking firm. Mr. Unterberg currently serves on the boards of directors of Electronics for Imaging, Inc., PDL D (an analytical communications company), Reasoning (an automated software inspection company), Rumson-Fair Haven Bank & Trust Company, and Club One, LLC (a fitness club company). Mr. Unterberg is a graduate of Princeton University and received a master's degree in business administration from the Wharton School, University of Pennsylvania.

Timothy Wallace joined our board of directors in 1994. As a Class II Director, Mr. Wallace's term in office will expire in 2008. Mr. Wallace currently is the chairman and chief executive officer of Full Tilt Solutions, a business-to-business software company, which he joined in January 2000. Prior to Full Tilt, Mr. Wallace was the president and chief executive officer of Xerox Connect, a network integration technology company from May 1998 through December 1999. From 1996 until May 1998, Mr. Wallace was the president, chief executive officer and a director of XLConnect Solutions, which he founded. Xerox Connect acquired XLConnect in May 1998. From 1991 to 1996, Mr. Wallace was the vice president of professional services of The Future Now, a national systems integration company. Mr. Wallace received a Bachelor of Science degree in business administration from Indiana University of Pennsylvania and a master's degree in business administration from Miami University of Ohio.

Mark Angel was employed as our chief technology officer in February 2005, upon the consummation of the merger with Kanisa. Mr. Angel founded Kanisa in 1997, and served as its chief executive officer until 1999 and as its chief technology officer since then. Prior to Kanisa, Mr. Angel was a founder of Papyrus Technology, a provider of intelligent trading workstations from 1987 until 1996. Mr. Angel studied economics at the University of Chicago, and was a recipient of the Truman Scholarship in 1978.

Thomas Muise has served as our chief financial officer since June 2005. Mr. Muise was self-employed as a CFO consultant from October 2003 until June 2005. From February 2001 until September 2003, Mr. Muise was chief financial officer and vice president of operations of Embrace Networks, an enterprise software platform provider. From December 1999 until January 2001, he served as chief financial officer and vice president of finance of Solopoint, a provider of marketing technologies and communications services for the broadband market. Mr. Muise served as senior director, corporate financial planning, analysis and systems for Synopsys, a supplier of electronic design automation, from 1998 to 1999 and served in various finance positions for Tandem Computers, from 1986 to 1998, last serving as director of finance, nonstop software business unit from 1996 to 1998. Mr. Muise holds an MBA degree with distinction from the University of Michigan and a bachelor of science in economics from Bowling Green State University.

Frank Lauletta has served as our general counsel since September 2003 and our secretary since February 2004. Prior to joining us, Mr. Lauletta was a member in the corporate law department of the law firm of Cozen O'Connor where he concentrated his practice on the representation of high-technology companies in areas such as mergers and acquisitions, venture capital financing, intellectual property and other general corporate and securities law matters. From August 1999 to September 2001, Mr. Lauletta served as in-house counsel for eCal Corporation, a calendaring and scheduling software company. Prior to his tenure at eCal, Mr. Lauletta was an attorney in the corporate law department of the law firm Dilworth Paxson. Mr. Lauletta received his Juris Doctorate degree from Rutgers University School of Law in 1995 where he graduated with tax Honors.

Messrs. Armstrong, Schwab and Shanahan were elected to our board of directors and Mr. Heyman commenced service as non-executive chairman of the board pursuant to the terms of the merger agreement with Kanisa. Messrs. Armstrong and Angel were also elected to their respective offices in accordance with the terms of the merger agreement.

None of our executive officers or directors is related to any other executive officer or to any of our directors. Our executive officers are elected annually by our board of directors and serve until their successors are duly elected and qualified.

Our board of directors has designated Timothy Wallace as our "audit committee financial expert" and has determined that he is independent within the meaning of the rules of the SEC.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our directors and executive officers, and persons who own more than 10% of our equity securities, to file initial reports of ownership and reports of changes in ownership with the Securities and Exchange Commission. Such persons are required by the Exchange Act to furnish us with copies of all Section 16(a) forms they file.

Based on our review of the copies of such forms received by us with respect to transactions during 2005, or written representations from reporting persons, we believe that all filing requirements applicable to our directors, executive officers and persons who own more than 10% of our equity securities have been complied with on a timely basis except that our new chief financial officer, Thomas Muise, filed his initial Form 3 one day late.

Code of Ethics

We have adopted a Corporate Code of Conduct and Ethics (the "Code of Ethics") that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, as well as to other directors, officers and employees of ours. The Code of Ethics is posted on our website (www.knova.com) and is available in print free of charge to any shareholder who

requests a copy. Interested parties may address a written request for a printed copy of the Code of Ethics to: Frank Lauletta, Knova Software, Inc., 10201 Torre Avenue, Suite 350, Cupertino, CA 95014. We intend to satisfy the disclosure requirement regarding any amendment to, or a waiver of, a provision of the Code of Ethics for our principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions by posting such information on our website.

Item 11. Executive Compensation

The following table shows, for the fiscal years ended December 31, 2005, 2004, and 2003, the cash compensation paid by us, as well as certain other compensation paid or accrued for such year, to our chief executive officer and other executive officers during 2005. Such table also indicates all capacities in which they served.

<u>Name and Principal Position</u>	<u>Year</u>	<u>Annual Compensation</u>			<u>Long Term Compensation Awards</u>	
		<u>Salary (\$)</u>	<u>Bonus (\$)</u>	<u>Other Annual Compensation (\$)</u>	<u>Restricted Stock Awards (\$)</u>	<u>Options (#)</u>
Bruce Armstrong, president and chief executive officer(1)	<u>2005</u>	223,958	86,844	—	—	445,000
Thomas Muise, chief financial officer and treasurer(2)	<u>2005</u>	91,538	—	—	—	88,000
Mark Angel, chief technology officer(3)	<u>2005</u>	156,771	26,857	—	—	220,000
Frank Lauletta, general counsel and secretary(4)	<u>2005</u>	120,000	156,910	—	—	—
	<u>2004</u>			—	—	13,000
	<u>2003</u>			—	—	9,000
Kent Heyman, president and chief executive officer (5) and chairman of the board	<u>2005</u>	23,438	—	214,763	—	—
	<u>2004</u>	225,000	42,500	16,450	<u>147,115</u>	800,000
	<u>2003</u>	226,173	—	14,606	—	—

- (1) As Mr. Armstrong was first employed by us as of the merger with Kanisa on February 8, 2005, the compensation shown for him is for the period from and after February 8, 2005.
- (2) As Mr. Muise was first employed by us as of June 23, 2005, the compensation shown for him is for the period from and after June 23, 2005.
- (3) As Mr. Angel was first employed by us as of the merger with Kanisa on February 8, 2005, the compensation shown for him is for the period from and after February 8, 2005.
- (4) Mr. Lauletta’s bonus was related to the successful settlement of a patent infringement lawsuit.
- (5) Mr. Heyman served as our chief executive officer until the merger with Kanisa on February 8, 2005 and now serves as non-executive chairman of the board effective February 2005. All compensation paid after February 8, 2005 is listed as Other Annual Compensation, which represents compensation earned under his consulting agreement disclosed under “Employment Agreements and Change of Control Arrangements”.

None of the individuals listed above received perquisites or personal benefits during any of the years indicated in excess of the lesser of \$50,000 or 10% of his annual salary and bonus. The amount of such benefits to all executive officers as a group during any of the years indicated was less than 10% of their aggregate annual salaries and bonuses.

Compensation Committee Interlocks and Insider Participation

As of December 31, 2005, our compensation committee consisted of Thomas Shanahan, Thomas Unterberg and Timothy Wallace. None of the members of our compensation committee has ever been an officer or employee of our company. None of our executive officers has served or serves as a member of our compensation committee of any entity that has one or more executive officers on our board of directors or compensation committee. There are no, and during 2005 there were no, compensation committee interlocks.

Employment Agreements and Change of Control Arrangements

Bruce Armstrong — In connection with the merger with Kanisa on February 8, 2005, we assumed the employment agreement between Bruce Armstrong and Kanisa under which Mr. Armstrong is to serve as our president and chief executive officer. Under the provisions of Mr. Armstrong's employment agreement, Mr. Armstrong is entitled to a base salary of \$250,000 per year with a target bonus of \$100,000 per year. Mr. Armstrong receives monthly draws against his annual bonus up to \$75,000 for each year and the draws are recoverable only against bonus entitlements. Mr. Armstrong is also entitled to participate in all of our standard benefit plans. The employment agreement provides for employment at will. Under his employment agreement, if Mr. Armstrong's employment is terminated by us without cause or by Mr. Armstrong for good reason (as such terms are defined therein), Mr. Armstrong is entitled to a severance package equal to one year's base salary plus 100% of his annual bonus, all of Mr. Armstrong's stock options will vest and he will have 12 months following such termination to exercise his stock options.

Thomas Muise — On June 23, 2005, we entered into an employment agreement with Thomas J. Muise under which Mr. Muise is to serve as our chief financial officer. Under the provisions of Mr. Muise's employment agreement, Mr. Muise is entitled to a base salary of \$175,000 per year with a target bonus of \$52,500 per year. In addition, Mr. Muise has been granted options to purchase 88,000 shares of stock with vesting 25% after one year and monthly thereafter over 36 months. Mr. Muise is also entitled to participate in all of our standard benefit plans. The employment agreement provides for employment at will. Under his employment agreement, Mr. Muise is entitled to severance pay for six months or until he obtains other full-time employment, whichever comes first, if his employment is terminated by us without cause or by Mr. Muise for good reason.

Mark Angel — In connection with the merger with Kanisa on February 8, 2005, we assumed the employment agreement between Mark Angel and Kanisa under which Mr. Angel is to serve as our chief technology officer. Under the provisions of Mr. Angel's employment agreement, Mr. Angel is entitled to a base salary of \$175,000 per year with a target bonus of \$50,000 per year with bonus amounts payable quarterly. Mr. Angel is also entitled to participate in all of our standard benefit plans. The employment agreement provides for employment at will. Under his employment agreement, if Mr. Angel's employment is terminated by us without cause or by Mr. Angel for good reason (as such terms are defined therein), Mr. Angel is entitled to a severance package equal to one year's base salary plus 100% of his annual bonus, all of Mr. Angel's stock options will vest and he will have 12 months following such termination to exercise his stock options.

Kent Heyman — In connection with the merger with Kanisa on February 8, 2005, we entered into an agreement with Kent Heyman, replacing Mr. Heyman's previous employment agreement with us. Under the agreement, Mr. Heyman will serve as our non-executive chairman of the board until his resignation or removal. Mr. Heyman will receive his current salary of \$225,000 per year and benefits until December 31, 2006. Mr. Heyman will also receive an additional \$12,000 per year so long as the agreement remains in effect. In January 2006, Mr. Heyman was paid \$100,000, which represented his bonus commitment for 2005 and 2006. All of Mr. Heyman's stock options for the purchase of our common stock vested upon the execution of the agreement and Mr. Heyman will be entitled to exercise his stock options at any time during the term of the agreement. The consulting agreement expires on the second anniversary following Mr. Heyman's resignation or removal as a member of our board of directors.

Option Grants in Last Fiscal Year

The table below sets forth information regarding all stock options granted in the 2005 fiscal year under our stock option plans to our executive officers named in the Summary Compensation Table above.

	Number of Securities Underlying Options Granted	% of Total Options Granted to Employees in Fiscal Year	Exercise Price	Market Price or Fair Value on Date of Grant	Expiration Date	Potential Realized Value at Assumed Annual Rates of Stock Price Appreciation (1)	
Bruce Armstrong	270,000	17.4%	\$4.60	\$4.60	2/15/2015	\$781,087	\$1,979,428
Bruce Armstrong	175,000	11.3%	\$3.70	\$3.70	4/14/2015	\$407,209	\$1,031,948
Thomas Muise	88,000	5.7%	\$3.70	\$3.70	6/23/2015	\$204,768	\$ 518,923
Mark Angel	170,000	11.0%	\$4.60	\$4.60	2/15/2015	\$491,796	\$1,246,307
Mark Angel	50,000	3.2%	\$3.70	\$3.70	4/14/2015	\$116,346	\$ 294,842
Frank Lauletta	—	N/A	N/A	N/A	N/A	N/A	N/A
Kent Heyman	—	N/A	N/A	N/A	N/A	N/A	N/A

(1) The dollar amounts under these columns are the result of calculations at the 5% and 10% rates set by the Securities and Exchange Commission and therefore are not intended to forecast possible future appreciation, if any, of the price of our stock.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year End Option Values

The following table shows aggregate exercises of options during 2005 and the values of options held as of December 31, 2005, by our executive officers named in the Summary Compensation Table above.

	Shares Acquired on Exercise	Value Realized	Number of Unexercised Options December 31, 2005 Exercisable (E)/ Unexercisable (U)	Value of Unexercised In-The-Money Options December 31, 2005 Exercisable (E)/ Unexercisable (U)
Bruce Armstrong	—	—	112,500 E	\$ — E
			332,500 U	\$ — U
Thomas Muise	—	—	— E	\$ — E
			88,000 U	\$ — U
Mark Angel	—	—	70,833 E	\$ — E
			149,167 U	\$ — U
Frank Lauletta	—	—	12,250 E	\$ — E
			9,750 U	\$ — U
Kent Heyman	—	—	210,000 E	\$2,500 E
			— U	U

(1) Amounts shown are based upon the closing sale price for our common stock on December 31, 2005, which was \$2.55 per share.

Compensation of Directors

Our directors do not receive any cash compensation for their services as directors, but we reimburse directors for reasonable and necessary expenses incurred in connection with attendance at meetings of our board of directors and other company business. In December 2005, pursuant to our 2000 Stock Incentive Plan, we granted to one of our outside directors options to purchase 10,000 shares of our common stock. The exercise price of these options is \$3.05 per share, and vest over a period of 24 months.

From time to time, members of our board of directors have previously been granted options to purchase shares of our common stock. See “Security Ownership of Management and Certain Beneficial Owners” for disclosure of vested options held by each director.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth, as of March 17, 2006 (unless otherwise indicated in the footnotes), certain information with respect to our common stock owned beneficially by each director, by each executive officer named in the above compensation table, by all current executive officers and directors as a group and by each person known by us to be a beneficial owner of more than 5% of our outstanding common stock.

<u>Name and Address of Beneficial Owner</u>	<u>Number of Shares Beneficially Owned(1)</u>	<u>Percent of Shares Outstanding(2)</u>
(i) Certain Beneficial Owners:		
C.E. Unterberg Towbin Holdings, Inc. 350 Madison Avenue New York, NY 10017	1,966,918(3)	22.4%
Needham Capital Management, LLC 445 Park Avenue New York, NY 10022	1,859,927(4)	20.8%
Meritech Capital Partners II, L.P. 285 Hamilton Avenue, Suite 200 Palo Alto, CA 94301	565,149(5)	6.4%
Sierra Ventures 2884 Sand Hill Road, Suite 100 Menlo Park, CA 94025	475,842(6)	5.4%
(ii) Directors and executive officers:		
Bruce Armstrong, president, chief executive officer and director . . .	186,978(7)	2.1%
Kent Heyman, chairman of the board	228,379(8)	2.6%
David Schwab, director	—(9)	—
Thomas Shanahan, director	—(10)	—
Thomas Unterberg, director	332,603(11)	3.8%
Timothy Wallace, director	71,903(12)	*
Thomas Muise, chief financial officer and secretary	—(13)	—
Mark Angel, chief technology officer	106,249(14)	1.2%
Frank Lauletta, general counsel	18,750(15)	*
(iii) All directors and current executive officers as a group (9 persons)	944,862(16)	10.1%

* Less than 1%.

- (1) Except as set forth in the footnotes to this table and subject to applicable community property law, the person and entities named in the table have sole voting and investment power with respect to all shares.
- (2) Applicable percentage of ownership for each holder is based on 8,744,116 shares of common stock outstanding on March 17, 2006, plus any common stock equivalents and presently exercisable stock options or warrants held by each such holder, and options or warrants held by each such holder which will become exercisable within 60 days after the date of this report.
- (3) Information is based on information provided by the beneficial owner as of December 31, 2004, and assuming no changes in beneficial ownership since that time other than the purchase of shares of our common stock on the open market by C.E. Unterberg, Towbin, LLC as a market maker of our common stock. Includes warrants exercisable for 35,000 shares of our common stock and other shares of our

common stock owned by this beneficial owner or its affiliates. The warrants and shares referred to in the preceding sentence are held variously by the following entities with which C.E. Unterberg, Towbin Holdings, Inc. is affiliated: C.E. Unterberg, Towbin, LLC, C. E. Unterberg, Towbin Capital Partners, I, L.P.; C.E. Unterberg, Towbin Private Equity Partners II, L.P.; C.E. Unterberg, Towbin Private Equity Partners II-Q, L.P.; UT Technology Partners I, LP, UT Technology Partners II, LP and UT Technology Fund Ltd. C.E. Unterberg Towbin Holdings, Inc. disclaims beneficial ownership of shares of common stock and warrants owned by Mr. Thomas Unterberg.

- (4) Information is based on a Schedule 13D filed with the Securities and Exchange Commission on February 18, 2005, by Needham Capital Management, L.L.C. (“NCM”), Needham Capital Management (Bermuda), L.L.C. (“NCMB”), Needham Capital Management II, L.P. (“NCMII”), Needham Capital Partners III, L.P. (“NCPIII”), Needham Capital Partners IIIA, L.P. (“NCPIIIA”), Needham Capital Partners III (Bermuda), L.P. (“NCPIIIB”), Needham Capital SBIC III, L.P. (“NCSBICIII”), George A. Needham, Thomas P. Shanahan, John C. Michaelson and John J. Prior, Jr. As of the date of the filing, these persons may be deemed to beneficially own 1,659,060 shares of common stock and warrants exercisable for 200,867 shares of common stock. The shares and warrants are owned directly as follows: 908,370 shares and warrants to purchase 109,979 shares (for a total of 1,018,349 shares) by NCPIII, 367,526 shares and warrants to purchase 44,497 shares (for a total of 412,023 shares) by NCSBICIII, 131,327 shares and warrants to purchase 15,900 shares (for a total of 147,227 shares) by NCPIIIB and 251,837 shares and warrants to purchase 30,491 shares (for a total of 282,328 shares) by NCPIIIA. NCMII may be deemed to own beneficially the shares of common stock owned by NCSBICIII by virtue of its position as general partner of NCSBICIII. NCMII disclaims beneficial ownership of all of the reported shares of common stock owned by NCSBICIII. Each of George A. Needham, Thomas P. Shanahan, John C. Michaelson and John C. Prior, Jr. may be deemed to beneficially own and have shared power to direct the vote and disposition of (i) the common stock and warrants owned by NCPIII and NCPIIIA by virtue of his position as a manager of NCM, the general partner of NCPIII and NCPIIIA, (ii) the common stock and warrants owned by NCPIIIB by virtue of his position as a manager of NCMB, and (iii) the common stock and warrants owned by NCSBICIII by virtue of his position as a manager of NCMII. Messrs. Needham, Shanahan, Michaelson and Prior disclaim beneficial ownership of the shares of common stock and warrants owned by NCPIII, NCPIIIA, NCPIIIB and NCSBICIII. NCM may be deemed to own beneficially the common stock and warrants owned by NCPIII and NCPIIIA by virtue of its position as general partner of those persons. NCM disclaims beneficial ownership of all of the reported shares of common stock and warrants owned by NCPIII and NCPIIIA. NCMB may be deemed to own beneficially the common stock and warrants owned by NCPIIIB by virtue of its position as general partner of NCPIIIB. NCMB disclaims beneficial ownership of all of the common stock and warrants owned by NCPIIIB. NCM, the general partner of NCPIIIA, and NCPIIIA have shared power to direct the vote of the shares owned by NCPIIIA. NCMB, the general partner of NCPIIIB, and NCPIIIB have shared power to direct the vote and disposition of the shares owned by NCPIIIB. NCM, the general partner of NCPIII, and NCPIII have shared power to direct the vote and disposition of the shares owned by NCPIII. NCMII, the general partner of NCSBICIII, and NCSBICIII have shared power to direct the vote and disposition of the shares owned by NCSBICIII.
- (5) Information is based on a Schedule 13G filed with the Securities and Exchange Commission on February 24, 2005, by Meritech Capital Partners II L.P. (“MCP II”), MeriTech Capital Affiliates II L.P. (“MC AFF II”), MCP Entrepreneur Partners II L.P. (“MEP II”), MeriTech Capital Associates II L.L.C. (“MCA II”), MeriTech Management Associates II L.L.C. (“MMA II”), Paul Madera (“Madera”) and Michael Gordon (“Gordon”). MCA II is the general partner of MCP II, MC AFF II and MEP II, and may be deemed to have indirect beneficial ownership of shares directly owned by MCP II, MC AFF II and MEP II. MMA II is a managing member of MCA II and may be deemed to have indirect beneficial ownership of shares directly owned by MCP II, MC AFF II and MEP II. Madera and Gordon are managing members of MMA II and may be deemed to have indirect beneficial ownership of shares directly owned by MCP II, MC AFF II and MEP II. The shares and warrants are owned directly as follows: 487,832 shares and warrants to purchase 59,063 shares (for a total of

546,895 shares) by MCP II, 12,552 shares and warrants to purchase 1,520 shares (for a total of 14,072 shares) by MC AFF II and 3,730 shares and warrants to purchase 452 shares (for a total of 4,182 shares) by MEP II. MCA II and MMA II may each be deemed to have sole power to direct the vote and disposition of the shares owned by MCP II, MC AFF II and MEP II. Each of Madera and Gordon may be deemed to have shared power to direct the vote and disposition of the shares owned by MCP II, MC AFF II and MEP II.

- (6) Information is based on a Schedule 13G filed with the Securities and Exchange Commission on February 14, 2006, by Sierra Ventures VI, L.P., SV Associates VI, L.P., Sierra Ventures VII, L.P. and Sierra Ventures Associates VII, LLC. Sierra Ventures VI, L.P. holds 131,642 shares of common stock and warrants to purchase an additional 15,938 shares. SV Associates VI, L.P. is the general partner of Sierra Ventures, VI, L.P. Sierra Ventures VII, L.P. holds 292,811 shares of common stock and warrants to purchase an additional 35,451 shares. Sierra Ventures Associates VII, LLC is the general partner of Sierra Ventures VII, L.P.
- (7) Mr. Armstrong's shares consist of 186,978 shares of our common stock underlying options which are presently exercisable or which will become exercisable within 60 days after the day of this report.
- (8) Mr. Heyman's shares include 210,000 shares of our common stock underlying options which are presently exercisable.
- (9) Mr. Schwab is a general partner of SV Associates VI, L.P., which is the sole general partner of Sierra Ventures VI, L.P. Sierra Ventures VI, L.P. holds 131,642 shares of common stock and warrants to purchase an additional 15,938 shares. Mr. Schwab disclaims beneficial ownership of the shares of common stock held by Sierra Ventures VI, L.P. (and deemed beneficially owned by SV Associates VI, L.P.), except to the extent of any pecuniary interest therein. Mr. Schwab is a general partner of Sierra Ventures Associates VII, L.L.C., which is the sole general partner of Sierra Ventures VII, L.P. Sierra Ventures VII, L.P. holds 292,811 shares of common stock and warrants to purchase an additional 35,451 shares. Mr. Schwab disclaims beneficial ownership of the shares of common stock held by Sierra Ventures VII, L.P. (and deemed beneficially owned by Sierra Ventures Associates VII, L.L.C.), except to the extent of any pecuniary interest therein.
- (10) See footnote (4) above.
- (11) Information is based on information provided by the beneficial owner as of December 31, 2004, and assumes no changes in beneficial ownership since that time. Includes 117,028 shares (including warrants exercisable for 12,500 shares of our common stock) owned by the following entities with respect to which Mr. Unterberg has or shares voting power: Marjorie and Clarence E. Unterberg Foundation, Inc., Bella and Israel Unterberg Foundation, Inc., Ellen U. Celli Family Trust and Emily U. Satloff Family Trust. Mr. Unterberg disclaims beneficial ownership of shares of common stock and warrants owned by C.E. Unterberg Towbin, Holdings, Inc., other entities in which he is a member or partner and their affiliates except as to his proportionate interest in such entities. Includes options to purchase 40,162 shares owned by Mr. Unterberg. Excludes 1,250 shares of our common stock owned by Mr. Unterberg's wife, as to which Mr. Unterberg disclaims beneficial ownership.
- (12) Mr. Wallace's shares include 71,833 shares of our common stock underlying options which are presently exercisable or which will become exercisable within 60 days after the day of this report.
- (13) Mr. Muise will not have any vested interest in his options until June 2006.
- (14) Mr. Angel's ownership includes 106,249 shares of our common stock underlying options which are presently exercisable or which will become exercisable within 60 days after the day of this report.
- (15) Mr. Lauletta's shares include 18,750 shares of our common stock underlying options which are presently exercisable.
- (16) See Notes 7 through 15.

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information regarding options, warrants or other rights to acquire equity securities under our equity compensation plans as of December 31, 2005:

	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans
Equity compensation plans approved by security holders . .	2,090,514	\$4.3747	341,612
Equity compensation plans not approved by security holders . .	1,068,285	\$7.4351	N/A
Total	3,158,799	\$5.4097	341,612

The shares shown as being issuable under equity compensation plans not approved by our security holders include the warrants granted to our investors in the private placement completed in February 2004 and the warrants issued to the Kanisa stockholders in the merger completed in February 2005.

Item 13. Certain Relationships and Related Transactions

In February 2005, C.E. Unterberg, Towbin, LLC received a fee of \$350,000 in consideration for services rendered to us in connection with the merger with Kanisa. Our director, Thomas Unterberg, is an affiliate of C.E. Unterberg, Towbin, LLC.

Item 14. Principal Accountant's Fees and Services

Audit Fees

The aggregate fees billed by PricewaterhouseCoopers LLP for the audit of our annual financial statements, the reviews of our financial statements included in our quarterly reports on Form 10-Q and services that are normally provided by the accounting firm in connection with statutory and regulatory filings were approximately \$170,000 for the year ended December 31, 2005 and \$138,950 for the year ended December 31, 2004.

Audit-Related Fees

The aggregate fees billed by PricewaterhouseCoopers LLP for assurance and related services that were reasonably related to the performance of the audit and reviews referred to above was approximately \$84,750 for the year ended December 31, 2005 and \$24,225 for the year ended December 31, 2004. The fee for 2005 was primarily attributable to fees relating to the 8-K filing and other related accounting matters in relation to our merger with Kanisa. The fee for 2004 was attributable to S-1 filings.

Tax Fees

No fees were billed for tax compliance, tax advice and tax planning rendered by PricewaterhouseCoopers LLP during 2005 or 2004.

All Other Fees

There were no non-audit services rendered by PricewaterhouseCoopers LLP in 2005 or 2004.

All non-audit services require an engagement letter to be signed prior to commencing any services. The engagement letter must detail the fee estimates and the scope of services to be provided. The current policy of our audit committee is that the audit committee must be informed of the non-audit services in advance of the engagement and the audit committee's responsibilities in this regard may not be delegated to management.

PART IV

Item 15. Exhibits and Financial Statement Schedules

1. *Financial Statements and Supplementary Data.* The following consolidated financial statements of the Company are included in Part II, Item 8:

	<u>Page Number</u>
Report of Independent Registered Public Accounting Firm	30
Consolidated Balance Sheets	31
Consolidated Statements of Operations	32
Consolidated Statements of Stockholders' Equity	33
Consolidated Statements of Cash Flows	34
Notes to Consolidated Financial Statements	35

2. *Financial Statement Schedules.* Schedules are not submitted because they are not required or are not applicable, or the required information is shown in the consolidated financial statements or notes thereto.

3. *Exhibits.* The Exhibits listed below are filed or incorporated by reference as part of this Form 10-K. Where so indicated by footnote, exhibits which were previously filed are incorporated by reference.

<u>Exhibit Number</u>	<u>Description</u>
2.1	Amended Agreement and Plan of Merger, dated as of February 8, 2005, by and among the Company, Kanisa Inc. and SVCW Acquisition, Inc.(2)
3.1*	Third Amended and Restated Certificate of Incorporation of the Company.
3.2	Amended and Restated Bylaws of the Company.(2)
3.3	Certificate of Amendment of Third Amended and Restated Certificate of Incorporation. (reverse split)(3)
3.4	Certificate of Amendment of Third Amended and Restated Certificate of Incorporation. (name change)(4)
4.1	Amended and Restated Registration Rights Agreement dated June 2, 2000.(5)
4.2	Registration Rights Agreement dated as of May 6, 2002 between the Company and the purchasers of the 10% Convertible Notes.(6)
4.3	Form of Warrant issued to equity investors as of January 30, 2004.(7)
4.4	Form of Warrant issued to Kanisa stockholders as of February 8, 2005.(3)
4.5	Registration Rights Agreement, dated as of February 8, 2005, by and among ServiceWare Technologies, Inc. and stockholders of Kanisa Inc.(2)
10.1	Restatement and Amendment of 2000 Stock Incentive Plan of the Company.(1)(8)
10.2	Employee Stock Purchase Plan of the Company.(9)
10.3	Amended and Restated Stock Option Plan of the Company. (10)
10.4	License Agreement and Assignment, each dated July 23, 1999, between the Company and Bruce Molloy.(10)
10.5I	Master Alliance Agreement, dated June 30, 2000, between the Company and Electronic Data Systems Corporation.(11)
10.6I	Master Software License Agreement, dated June 30, 2000, between the Company and Electronic Data Systems Corporation.(11)
10.7	Common Stock Purchase Warrant of the Company in favor of Electronic Data Systems Inc.(11)
10.8	Warrant Purchase Agreement, dated June 2, 2000 between the Company and Electronic Data Systems.(11)
10.9	ServiceWare Technologies, Inc. Change of Control Benefit Plan.(12)

<u>Exhibit Number</u>	<u>Description</u>
10.10I	Software License and Maintenance Agreement dated December 13, 2001 between the Company and Cingular Wireless LLC.(13)
10.11	Restricted Stock Agreement dated January 26, 2004, between Kent Heyman and the Company.(1)(7)
10.12	Employment Agreement, effective as of February 8, 2005, by and between Kanisa Inc. and Bruce Armstrong.(1)(2)
10.13	Employment Agreement, effective as of February 8, 2005, by and between Kanisa Inc. and Mark Angel.(1)(2)
10.14	Agreement, effective as of February 8, 2005, by and between the Company and Kent Heyman.(1)(2)
10.15	Restricted Stock Agreement dated March 29, 2004, between Kent Heyman and the Company.(1)(14)
10.16	Employment Agreement dated June 23, 2005 between Thomas J. Muise and the Company.(1)(4)
23.1*	Consent of PricewaterhouseCoopers LLP.
24.1*	Power of Attorney (included on signature page hereto).
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
32*	Section 1350 Certifications.

I Portions of these exhibits have been omitted based on a grant of confidential treatment by the Commission. The omitted portions of the exhibits have been filed separately with the Commission.

- (1) Management contract or compensation plan or agreement required to be filed as an Exhibit to this Report on Form 10-K pursuant to Item 15(c) of Form 10-K.
- (2) Incorporated by reference to our Current Report on Form 8-K dated February 8, 2005.
- (3) Incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 2004.
- (4) Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.
- (5) Incorporated by reference to our Registration Statement on Form S-1, as amended, filed on August 18, 2000.
- (6) Incorporated by reference to our Registration Statement on Form S-3 filed on June 19, 2002.
- (7) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2003.
- (8) Incorporated by reference to definitive proxy statement filed with the Commission on May 5, 2005.
- (9) Incorporated by reference to our Registration Statement on Form S-1 filed on March 31, 2000.
- (10) Incorporated by reference to our Registration Statement on Form S-1, as amended, filed on April 7, 2000.
- (11) Incorporated by reference to our Registration Statement on Form S-1, as amended, filed on July 13, 2000.
- (12) Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2001.
- (13) Incorporated by reference to our Annual Report on Form 10-K for the fiscal year ended December 31, 2001.
- (14) Incorporated by reference to Pre-Effective Amendment to our Registration Statement on Form S-1 filed on June 8, 2004.

* * * * *

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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 in the City of Cupertino, State of California on March 31, 2006.

KNOVA SOFTWARE, INC.

By: /s/ Bruce Armstrong

BRUCE ARMSTRONG
Chief Executive Officer

Each person whose signature appears below hereby appoints Bruce Armstrong and Thomas Muise, and both of them, either of whom may act without the joinder of the other, as his true and lawful attorneys-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and all other documents in connection therewith, with the Commission, granting unto said attorneys-in-fact and agents full power and authority to perform each and every act and thing appropriate or necessary to be done, as fully and for all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or their substitute or substitutes may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Capacity</u>	<u>Date</u>
/s/ Bruce Armstrong Bruce Armstrong	President, Principal Executive Officer and Director	March 31, 2006
/s/ Thomas Muise Thomas Muise	Chief Financial Officer and Principal Financial Officer	March 31, 2006
/s/ Kelly Barefoot Kelly Barefoot	Controller and Principal Accounting Officer	March 31, 2006
/s/ Kent Heyman Kent Heyman	Director	March 31, 2006
_____ David Schwab	Director	March , 2006
/s/ Thomas Shanahan Thomas Shanahan	Director	March 31, 2006
_____ Thomas Unterberg	Director	March , 2006
/s/ Timothy Wallace Timothy Wallace	Director	March 31, 2006

INDEX TO EXHIBITS

The following exhibits are filed as part of this report.

<u>Exhibit Number</u>	<u>Description</u>
3.1	Third Amended and Restated Certificate of Incorporation
23.1	Consent of PricewaterhouseCoopers LLP
24.1	Power of Attorney (included on signature page hereto).
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certifications

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-44680 and 333-50498) of Knova Software, Inc. of our report dated February 9, 2006 relating to the financial statements, which appears in the Annual Report on Form 10-K.

PricewaterhouseCoopers LLP
Pittsburgh, Pennsylvania
March 31, 2006

Certifications

I, Bruce Armstrong, President and Principal Executive Officer of Knova Software, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of Knova Software, 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 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)) 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. 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
 - c. 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 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.

/s/ Bruce Armstrong

Title: President and Principal Executive Officer

Date: March 31, 2006

Certifications

I, Thomas Muise, Chief Financial Officer and Principal Financial Officer of Knova Software, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of Knova Software, 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 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)) 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. 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
 - c. 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 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.

/s/ Thomas Muise

Title: Chief Financial Officer and Principal
Financial Officer

Date: March 31, 2006

Certification

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of Knova Software, Inc., a Delaware corporation (the "Company"), does hereby certify that:

The Annual Report on Form 10-K for the year ended December 31, 2005 (the Form 10-K) of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Bruce Armstrong

Name: Bruce Armstrong

Title: President and Principal Executive Officer

Dated: March 31, 2006

/s/ Thomas Muise

Name: Thomas Muise

Title: Chief Financial Officer and Principal
Financial Officer

Dated: March 31, 2006

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished to the Securities and Exchange Commission as an exhibit to the Form 10-K and shall not be considered filed as part of the Form 10-K.

Corporate Offices

World Headquarters

10201 Torre Avenue, Suite 350
Cupertino, CA 95014

Tel: 800.572.5748

Tel: 408.863.5800

Fax: 408.863.5810

www.KNOVA.com

Board of Directors

Kent Heyman

Chairman of the Board

Bruce Armstrong

President and CEO

Thomas I. Unterberg

Chairman, C.E. Unterberg, Towbin

Thomas P. Shanahan

General Partner, Needham Capital Partners

Dave Schwab

Managing Director, Sierra Ventures

Tim Wallace

CEO and Director, FullTilt Solutions, Inc.

Independent Accountants

PricewaterhouseCoopers LLP

Transfer Agent and Registrar

American Stock Transfer & Trust Company
59 Maiden Lane



Knova Software is a leading provider of service resolution management applications that reduce service costs, increase revenues and improve customer satisfaction. Built on a next-generation search and knowledge management platform, Knova's suite of knowledge-empowered customer service applications automates the resolution process across multiple channels including contact centers, help desks, email and self-service sites. Industry leaders including EDS, Ford, HP, H&R Block, Novell, Merrill Lynch, McAfee, Reuters and QUALCOMM rely on Knova's award-winning solutions to deliver world-class customer service.

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