CHORDIANT SOFTWARE INC
Form 10-K
December 09, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

PURSUANT TO SECTIONS 13 OR 15(d) OF THE

SECURITIES AND EXCHANGE ACT OF 1934

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

For the fiscal year ended September 30, 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: 000-29357

CHORDIANT SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**93-1051328**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer identification No.)**

20400 Stevens Creek Blvd., Suite 400

Cupertino, California 95014

(Address of principal executive offices, including zip code)

(408) 517-6100

(Registrant s telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock $.001 Par Value 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 x

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 x

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 **x** No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 Transition Report on Form 10-K or any amendment to this Form 10-K. ¨

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of March 31, 2005, the last business day of the registrant s most recently completed second fiscal quarter: $117,805,915.

As of October 31, 2005, there were 78,593,498 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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CHORDIANT SOFTWARE, INC.

ANNUAL REPORT ON FORM 10-K

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PART I

FORWARD-LOOKING INFORMATION

Except for the historical information contained herein, this Annual Report contains certain information that is forward-looking in nature. This information is based on our current expectations, assumptions, estimates and projections about our business and our industry, and involves known and unknown risks, uncertainties and other factors that may cause our or our industry s results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied in, or contemplated by the forward-looking statements. Words such as believe, anticipate, expect, intend, plan, will, may, should, estima guidance, potential, continue or the negative of such terms or other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors more fully described under the caption Risk Factors and those discussed elsewhere in this document. These and many other factors could affect the future financial and operating results of Chordiant. Chordiant undertakes no obligation to update any forward-looking statement to reflect events after the date of this report.

ITEM 1. BUSINESS

Restatement of Prior Quarters Financial Statements

In the course of preparing its 2005 financial results for the year ended September 30, 2005, the Company and its independent registered public accounting firm, BDO Seidman, LLP, identified certain errors in the Company s 2005 interim financial statements for the quarters ended December 31, 2004, March 31, 2005, and June 30, 2005. These errors are more fully described in Note 19 to the Consolidated Financial Statements contained in this Annual Report on Form 10-K. On December 6, 2005, management concluded that the Company should restate the Company s interim financial statements for the quarters ended December 31, 2004, March 31, 2005, and June 30, 2005 due to such errors. On December 6, 2005, senior management of the Company met with the Audit Committee of the Board of Directors of the Company to discuss management s conclusion. The Audit Committee concurred with management s conclusion. All financial information contained in this Annual Report on Form 10-K gives effect to these restatements.

Change in Year End and Prior Restatement of Financial Statements

On December 29, 2004, the Board of Directors of Chordiant approved a change in Chordiant s fiscal year end from December 31st to September 30th. In the course of preparing the 2004 financial results for the new fiscal year ended September 30, 2004, the Company identified certain errors relating to expense and revenue timing, the valuation of a guarantee, prepaid account balances, estimates used to compute stock offering costs, warrant valuations and stock based compensation in the interim financial statements for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004. Due to the aggregate number of errors identified in the previously issued interim financial statements and the relative percentages represented by those errors in the quarters, management concluded that the interim financial statements for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004 should be restated. The Audit Committee of the Board of Directors concurred with management s conclusion. As a result, Chordiant filed a Transition Report on Form 10-K/T for the transition period from January 1, 2004 to September 30, 2004 to reflect the change in fiscal year and the related restatement for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004. All financial information contained in this Annual Report on Form 10-K gives effect to this restatement.

Overview

We are an enterprise software company that provides process-driven software applications to global consumer companies to deliver strategies for revenue growth, operational efficiency and compliance with regulations. We concentrate on serving global customers in retail financial services, communications and other consumer direct industries. We focus on the largest consumer markets in the world North America and large European countries.

We believe our solutions add business value and a return-on-investment for our customers by reducing operational costs, increasing employee productivity and revenue growth. These improvements are realized by automating key business processes associated with servicing, selling, marketing and fulfilling customer requests throughout the customer s enterprise. We offer a complete customer solution that includes software applications, business processes, tools and services that enable businesses to integrate their customer information and corporate systems to produce a real-time view of customers across multiple customer channels. We believe our solutions offer businesses the flexibility to set their business policies and processes to control the quality of servicing, fulfillment and marketing to their customers. We believe that we are leaders in providing business process driven applications for consumer management.

Our software and architecture are based on leading industry standards that are widely adopted by business customers in the industries we serve. We provide the foundation for contemporary distributed computing environments required by global business-to-consumer enterprises.

On December 21, 2004, we acquired KiQ Limited, a privately held United Kingdom software company (KiQ), for an aggregate purchase price of approximately $20 million, which was comprised of $9.7 million in cash, $9.3 million in our common stock and approximately $0.9 million in associated transaction costs. Through this transaction, we acquired a decision management system that advances the state of analytics by exploiting the power of predictive data mining, analytical modeling, and strategy formulation into real-time decision management and execution. Products and patent-pending technology acquired by us in this transaction enable organizations to significantly increase the accuracy of marketing offers for retention, up-selling, cross selling, and to model risk scenarios such as customer churn and likelihood to default on payments. With the addition of KiQ s products and patent-pending technology we are able to deliver a range of applications for real-time recommendation, retention, risk management and recruitment.

As a result of the transaction, Chordiant added 14 new customers primarily in financial services and telecommunications industries. Customers include: O2, Orange and T-Mobile in the telecommunications sector and Fortis Banking and Insurance Group, DSB Bank, and SNS Bank, in the European financial services sector. A total of 20 KiQ employees, including two founders and 15 engineering and technical staff, joined us as employees in December 2004.

Product Solutions

Our products are designed for global enterprises seeking to optimize decision analysis, marketing, selling and servicing efforts. We have designed our products to integrate customer information from different data sources, generate business processes based on a customer s specific profile and requests, and provide uniform service and data to customers across multiple communication channels. Our products are designed to enable companies to deliver appropriate offers and information to a targeted customer at the time of customer need.

Our solutions are designed to address the enterprise requirements of global consumer companies serving millions of individual customers across multiple business channels integrating multiple lines of business. The solution suite is typically licensed as an integrated set of software products that include: applications, business processes, the enterprise platform and software tools. The complete solution is based on open systems software standards that are widely adopted by our industry and capable of deployment throughout a customer s information technology infrastructure. We generally segregate our solutions into two product families that are application solutions and enterprise solutions which can be licensed and implemented separately from each other or in combination, depending on our customers needs. The application solutions include multiple applications providing decision management solutions, marketing solutions and vertical or industry specific solutions. These are sold and licensed as Chordiant 5 Applications.

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The enterprise solutions consist of our enterprise platform products and selling and services application products that are described as Chordiant 5 Enterprise Platform and Chordiant 5 Selling and Services. Customers must license Chordiant 5 Enterprise Platform as a prerequisite to licensing Chordiant 5 Selling and Services applications. The principal markets for our decision management solutions, marketing solutions, vertical solutions and our enterprise solutions are substantially the same. For a discussion of the dollar amount of revenue contributed by our decision analysis, marketing solutions and our enterprise solutions, we incorporate by reference the information located under the headings Results of Operations Comparison of the Year Ended September 30, 2005 to the Year Ended September 30, 2004 Revenues and Results of Operations Comparison of the Nine Months Ended September 30, 2004 to the Nine Months Ended September 30, 2003 Revenues in Item 7. Management s Discussion and Analysis of Financial Condition of Results of Operations. This integrated suite includes the following products:

Chordiant 5 Applications

Chordiant 5 Decision Management Solutions. Chordiant 5 Decision Management is a suite of active decision management software products designed to allow marketing professionals and management to make better decisions during customer interactions and as part of marketing campaigns. Chordiant 5 Decision Management enables business users to develop decision strategies that predict customer behavior, develop customer strategies, add intelligence to decision management, make real time recommendations to frontline representatives, and offers business performance analysis. Chordiant 5 Decision Management Solutions include the following products:

Chordiant Data Preparation Director Chordiant Data Preparation Director allows non-IT users to combine, manipulate and aggregate customer data using an easy to use visual interface. By reducing the IT bottleneck, it gives business users more control and higher throughput, decreasing time to market.

Chordiant Predictive Analytics Director Chordiant Predictive Analytics Director provides marketing professionals functionality which enables in-depth analysis of significant amounts of customer information using data-mining and predictive analytical capabilities. It offers a streamlined business oriented process to quickly and accurately develop accurate and reliable models of the analysis.

Chordiant Strategy Director Chordiant Strategy Director allows users to design customer interaction strategies and marketing offers based on decisions and rules that reflect customer behavior, preferences, legislation, corporate policies and the desired business outcome. The resulting decision logic is executed in our campaign management solution for outbound communication or executed in real-time in multiple channels of communication.

Chordiant Decision Monitor Chordiant Decision Monitor provides management with insight into the business results, measures the data analysis effectiveness, and allows an organization to continuously learn from the current and future data models. It is a software module in which all decisions are automatically logged and stored in a monitoring database together with the relevant data as well as subsequent customer information and behavior. This module can be integrated and analyzed by many third party business intelligence tools.

Chordiant Deployment Manager Chordiant Deployment Manager provides the administrative function to prepare available data in the operational environment and implement the decision logic into the production campaigns, business processes and applications.

Chordiant Real-Time Decisioning Services Chordiant Real-Time Decisioning Server generates the decisioning service that can be hosted in industry-standard application servers.

Chordiant Database Decisioning Services The Chordiant Database Decisioning Server provides a user-friendly execution application for datamining, analysis, and modeling to create the optimal decision logic and the appropriate decisions outcomes.

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Chordiant 5 Marketing Solutions. Chordiant 5 Marketing automates the marketing processes required to plan, define, execute and optimize marketing campaigns across multiple product lines and channels of communication in global business-to-consumer enterprises. Chordiant 5 Marketing solution is an integrated set of applications designed to support a full range of marketing relationship management processes and serve the needs of corporate marketing departments and professionals. Chordiant 5 Marketing Solutions are comprised of the following applications:

Chordiant 5 Marketing Director provides the functionality for marketing professionals to plan, define, execute and optimize customer relationships and marketing campaigns across all traditional media channels: direct mail, telesales, and print and broadcast advertising and to schedule campaigns for real-time execution through communication channels such as; email, websites, wireless services, and call center and branch applications.

Chordiant 5 Online Marketing provides the execution server for web and e-mail based marketing campaigns.

Chordiant 5 Mobile Marketing provides the execution server for mobile devices such as cellular phones.

Chordiant 5 OneReporting provides real-time access to detailed marketing and customer information for creating reports, analysis and intelligent marketing decision-making.

Chordiant 5 Selling and Servicing. Chordiant 5 Selling & Servicing provides role-based application interfaces that optimize real-time, process driven interactions between a company and its customers. These applications provide a company s representatives who interact with customers and business partners a series of role-based interfaces for matching a company s unique business policies and processes to individual customers to optimize customer interactions, case management and work management between front office and back office operations. These applications automate a company s business policies, and processes which in turn accelerates customer servicing, improves marketing offers and sales cycles, improves customer interactions and gains consistent customer interactions. Chordiant 5 Selling & Servicing applications enable companies to increase the effectiveness of sales or service offerings by matching customer profiles and contact histories with appropriate offers to increase cross-sell effectiveness and opportunities. Chordiant 5 Selling & Servicing applications are comprised of the following application products:

Chordiant 5 Branch Advisor is a web browser-based application that allows customer information and application functionality to be broadly shared within and outside a company. Chordiant 5 Branch Advisor helps a company s employees and partners optimize customer selling and servicing interactions through a company s branch, back-office and partner/retail operations.

Chordiant 5 Call Center Advisor is a web browser-based application designed to provide a full set of servicing and selling business processes for high volume transactional call centers. The desktop environment is completely browser-based and utilizes server-side computer telephony integration provided in Chordiant 5 Enterprise Platform for call handling, queuing, routing and sequencing customer communications, application processes and work fulfillment. The environment is designed to meet the significant performance and time-dependency requirements supporting high-volume transaction and business processes common to enterprise contact centers.

Chordiant 5 Industry Solutions

In 2004 Chordiant introduced a series of applications for retail financial services that automate industry specific business processes in retail banking and credit card servicing. Chordiant 5 Industry Solutions include:

Chordiant 5 Teller (Financial Transactions) Solution. Chordiant 5 Teller (Financial Transactions) is a browser-based teller application driven by a high performance transactional business process management system provided in Chordiant 5 Enterprise Platform. A number of application versions of Chordiant 5 Teller Solution are offered based on the role and functionality required in branch operations. Chordiant 5 Teller

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Solution integrates to the retail banks multiple lines of businesses and transactional systems providing a customer centric approach to service delivery and selling in branch operations. The solution utilizes the strength of Chordiant 5 Enterprise Platform providing company-wide case management, customer history, work management between front office and back office operations and may be deployed as an integral part of the retail bank s multichannel network and architecture.

Chordiant 5 Card Servicing Solution. Chordiant 5 Card Servicing Solution consists of complete customer servicing application and Chordiant Dispute & Chargeback modules. The card servicing application provides complete customer profile, history, case management and automates work management within the multiple functions of a card issuer. The Card Dispute & Chargeback modules are a series of business processes and the policies that orchestrate the dispute and chargeback function from customer initiation through resolution integrating roles, functions and systems that support these processes. The Chordiant 5 Card Servicing Solution streamlines and automates these complex processes providing consistent means of arbitration, appeal and compliance procedures. The Chordiant 5 Card Servicing Solution utilizes the strength of Chordiant 5 Enterprise Platform providing company-wide case management, customer history, work management between front office and back office operations and is deployed as an integral part of the card issuer and bank s multichannel network and architecture.

Chordiant 5 Enterprise Solutions

Chordiant 5 Enterprise Platform. Chordiant 5 Enterprise Platform includes a number of software servers for managing a company s business to consumer policies, processes, profiles and integration interfaces and connections to legacy systems. Chordiant 5 Enterprise Platform includes Chordiant 5 Foundation Server and a set of optional Chordiant 5 Enterprise Server products and tools.

Chordiant 5 Enterprise Platform is a process-based architecture that provides a rich set of integration services, system services and application components. Customers can configure and customize these services and components as unique applications for their individual business processes and policies. It is a flexible and open web services-based platform for building and supporting enterprise-class process-driven business applications that integrate multiple channels and provide a consistent, real-time customer view.

Chordiant 5 Enterprise Platform is developed on the industry standard J2EE, XML and Web-Services software standards and is designed to process tens of millions of customer interactions, with real-time integration of customer, account, order, and product information across numerous enterprise data sources and applications. It includes Chordiant Foundation Server and Chordiant Tools that enable customers and system integrators to integrate with existing systems and configure the unique business processes and policies consistently across multiple channels of communications. Chordiant 5 Enterprise Platform includes the following products:

Chordiant 5 Foundation Server provides the software infrastructure to allow companies to access multiple data resources residing within a company s transaction systems and fulfillment systems while integrating with many existing enterprise back-office applications. Chordiant 5 Foundation Server integrates and communicates with telephony equipment, legacy systems and transactional applications. Chordiant 5 Foundation Server provides the functionality to integrate our customers data sources into a cohesive architecture that leverages this information through business processes to provide a universal desktop for representatives servicing, selling and fulfilling customers inquiries for a consistent customer experience. It provides support for electronic communications, telephony systems and switches, relational databases, back-office business applications and legacy data warehouses. The Chordiant 5 Foundation Server includes a business process server, an integration server, an integrated set of application components and integrated tool environment for application customization and deployment.

Chordiant 5 Connectors are connectivity applications that allow a business to access information and communications systems for maintaining persistent, real-time connections between information technology systems.

Chordiant 5 Collaboration Server is a Web-based interaction server that includes functionality for online chat, Web page publishing, synchronized co-browsing, and provides support for advanced Web applications.

Chordiant 5 Rules Server is a configurable business policy server that allows companies to implement policies specific to their customer profiles, offers and business processes.

Chordiant 5 Knowledge Server is a knowledge based server designed to provide intelligent responses to customer requests that are based on customer profiles, offerings of interest and an optimized set of similar inquiries.

Chordiant 5 Interaction Server is an interaction server for delivering complicated interactions to a web browser at the user interface such as smart forms, answer checking, and guided interactions.

Strategic Direction

The Company is undertaking a new approach to its enterprise software business across its chosen vertical markets of financial services, telecommunication and media. Chordiant anticipates that it will increasingly deliver business-focused applications based on an open and adaptable core information technology (IT) infrastructure that provides high levels of business agility and fast ROI for enterprises by allowing rapid changes to their IT systems. Chordiant s applications can be configured to provide competitive advantage by responding more directly and agilely to business needs.

Chordiant Mesh

Developed to exploit the open architecture provided through Service Oriented Architecture (SOA), Chordiant has developed a new collaborative development model called Chordiant Mesh which allows the Company to react to customer technology and solution requirements swiftly and in co-operation with the customer.

With the Chordiant Mesh, Chordiant will provide organizations with the ability to bind together a wide range of tools and components through an open, interworking infrastructure layer focused on customer processing and interaction systems. This allows organizations to quickly integrate and deploy applications into their systems. Built around the SOA approach, Chordiant Mesh is an infrastructure layer that allows the organization to bind together a wide range of components and tools. It consists of a variety of adapters, plug-ins and configuration tools that are open and able to integrate the other parts of the technology infrastructure. The Chordiant Mesh allows Chordiant customers and potentially third party application companies and system integrators in the future to more rapidly build new customer processing and interaction applications into their infrastructure.

Chordiant Mesh aims at solving the problem organizations face in being able to rapidly build and deploy new solutions while managing an increasing speed of change within their infrastructure. It provides flexibility to allow the enterprise to customize both the underlying architecture and applications to meet specific business needs. The new collaborative development approach means that such changes can be more effectively reviewed and supported by Chordiant.

Chordiant Mesh empowers organizations to work jointly with Chordiant and its partners to develop new classes of applications on a shared technology platform using modern tools for organizational collaboration. The end results is that Chordiant customers can more rapidly build new customer processing and interaction applications and deploy them into their infrastructure.

Through this collaborative development approach, the Chordiant Mesh will be continually developed and evolved for the benefit of Chordiant, its customers and partners. Chordiant Mesh enables a Chordiant to deliver increased value to Chordiant customers through greater speed of innovation, supported by a network of implementation partners and independent software vendors (ISVs) that are committed to Chordiant solutions.

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Key benefits of the Chordiant Mesh are believed to be:

- Greater speed of core innovation in technology and applications.
- A fabric for the maintenance of infrastructure level code and reduction of customization and cost of ownership.
- A set of tools and methodologies for building applications collaboratively with Chordiant and its partners.
- Enabling and enhancing the IT systems grid to better support high value SOA based applications;
- Providing IT departments with additional levels of support, control and flexibility to leverage their Chordiant investment.
- By leveraging open-source development models, Chordiant will take code revisions submitted by community members customers, partners and Chordiant itself and allow these to be incorporated into its products when appropriate.

The collaborative development approach will put Chordiant in closer collaboration with customers which the Company with the expectation that this will improve that relationship by enhancing the value its software brings in this model, Chordiant empowers a larger community of developers and thus creates more compelling value for customers.

Applications Development

Chordiant provides technology that enables businesses to engage with customers concerning their individual needs across multiple channels and across the enterprise. Chordiant s position in this space is underlined by the fact that it has completed implementations with major North American and European consumer companies.

Many businesses today recognize the need to have relationship management technology that enables high quality interaction with the customer to both maximize revenue opportunities and customer satisfaction and crucially, to provide differentiation within the marketplace.

It is the combination of predictive modeling with adaptive modeling, processes and business rules that drives sophisticated decisioning logic to create more intimate customer relationships and enhance customer loyalty and profitability. Chordiant enables automated decisions to be made across the organization and across different customer channels which are in turn backed up by automated, intelligent processes which deliver consistent organizational behavior and implement policy.

This approach has many advantages:

Inbound marketing businesses will be able to initiate individual customer-centric conversations through tailored, personal targeting that entices the individual to engage with the organization.

Integrated multi-channel experience the ability to converse with the customer seamlessly across multiple channels and especially across the growing self-service environments.

Executive real-time monitoring business executives can have real-time dynamic control through a console interface of more of what is going on in the business and are able to move away from post-event static reports and managing by memo as they will have greater ability to change the course of the business.

Business control the business user will be able to control and manipulate the decisioning logic directly without needing specialist IT help.

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Customers

We target global market leaders in business-to-consumer industries, particularly companies in the financial services and telecommunications industries. Our customers include: ING, Wachovia, HSBC, O2, Time Warner Cable, Covad Communications, 21st Century Insurance, USAA, T-Mobile, Lloyds TSB Bank, Bank of Ireland, The Royal Bank of Scotland plc, Metropolitan Life Insurance Company, Signal Iduna, Deutsche Bank, Canadian Tire Financial Services, Barclay s Bank, Direct Line, Canadian Imperial Bank of Commerce, HBOS plc, Nokia, British Telecom and British Sky Broadcasting (BskyB). For the year ended September 30, 2005, Capital One accounted for 18% of our total revenues. David A. Weymouth, a director of ours since January 2005, was the corporate responsibility director of Barclay s Group, an affiliate of Barclay s Bank, through June 2005.

Technology

Chordiant s solutions and core technology are implemented using industry standard software that includes J2EE, XML, and Web Services. This industry standard set of development specifications leverages the strengths of the Java programming language to enable software applications that are easier to develop, configure and integrate with legacy and third-party information technology systems. Our software architecture that was pioneered in 2000 and internally developed core technology is named Chordiant JX Architecture. This architecture is designed for supporting enterprise-class process-driven business applications that integrate multiple channels and provide a unified, real-time customer view.

Chordiant JX Architecture leverages J2EE and Web Services extensively to provide a services oriented architecture for use by Chordiant applications and other systems. The business services and related business components use a data persistence foundation with built-in support for Oracle and DB2 databases as well as IBM WebSphere MQ messaging. The persistence layer is fully extensible to other data sources, including those built on the Java Connector Architecture (JCA).

Chordiant s web browser technology delivers consistent self-service and agent-driven customer interaction processes using a rich web-based application platform that provides desktop interface behavior in a browser-based technology with high performance, low maintenance costs, and flexibility to meet the differing demands of a diverse user population.

Certain of our products use technology modules from third-party technology providers including IBM, BEA Systems, Sun Microsystems, Ingenieria de Software Bancario, S.L. (ISBAN) and certain other non-public entities. Our enterprise platform solutions support industry standard J2EE application servers including IBM WebSphere and BEA WebLogic. Our server software runs on UNIX server platforms from Sun Microsystems, IBM and Linux. In 2004, Chordiant announced support and certification for the IBM Grid Computing environment.

Sales and Marketing

We license our solutions and sell services primarily through a direct sales organization that is complemented by selling and support efforts through business alliance partners such as IBM, Capgemini and Accenture, systems integrators and technology vendors. Our market focus is the business-to-consumer segment of the economy with a targeted effort on leading consumer focused industries and companies using multiple channels as the means of conducting business and serving customers. We target our sales and marketing efforts, together with our product design efforts, on industries such as retail banking, insurance, consumer financial services, telecommunications and consumer direct industries.

The sales process generally ranges from three to twenty-four months depending on the level of knowledge that prospective customers need about the use and benefits of our solutions and the involvement of systems integrators. During the sales process, we typically approach the senior management teams of the business and information technology departments of a prospective customer s organization. We utilize sales teams consisting of sales and technical professionals who work with our systems integration partners to create company specific

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proposals, presentations and demonstrations that address the needs of the business and its technology requirements.

In the United States we have sales offices in the greater metropolitan areas of Boston, Massachusetts; Charlotte, North Carolina; and Manchester, New Hampshire. Our corporate offices are located in Cupertino, California. Outside the United States, we have offices in the greater metropolitan areas of London, Paris, Amsterdam, Frankfurt, and Munich.

Our Services

We offer a comprehensive set of customer services including professional consulting services and product support and training services. We believe that providing high quality customer service is critical to achieving rapid product implementation and customer success.

Professional Services

We provide implementation consulting and customer support services to licensed customers through our worldwide professional services organization. Our professional services consulting teams assist customers and systems integrator partners in the design and implementation of our software solutions.

Our professional services organization deploys consultants as part of the project team alongside systems integration partners and members of the customer s internal team to provide technical knowledge, business engineering, project guidance and quality assessments during project implementation. In the design stage, we provide a variety of professional services that help determine a customer s business processes and the technical requirements of the solutions implementation. In the implementation stage, we use a delivery methodology to assist customers and integration partners in planning and managing the implementation. Typically, systems integrators, supported by our consultants, manage the overall project and implement the products with a customer s existing communications, applications, databases and transaction systems. In the final phases of an implementation, the systems integrators provide deployment services to enable a customer s internal team to implement the system, train internal users and provide first-level end-user support.

Although our primary strategy is to leverage our strategic systems integration partners for implementations, our internal professional services organization is often integral in implementing our enterprise platform software solutions for our customers. We believe that our consulting services enhance the use and administration of our software solutions, facilitate the implementation of our solutions and result in sharing best business practices with client and systems integrator project teams. In addition to implementing our software, our professional services organization works closely with our internal research and development organization to enhance existing, and design our new, software solutions.

In addition to our internal professional services organization, in 2003 we entered into an agreement with Ness Technologies Inc., Ness Global Services, Inc. and Ness Technologies India, Ltd. (collectively, Ness), to provide our customers with technical product support, a sustaining engineering function, product testing services, and product development services through. Ness is an independent contracting company with global technical resources and an operations center in Bangalore, India. The agreement with Ness is for a term of three years and may be extended for additional one year terms at our discretion.

We provide our customers with support and maintenance services including telephone support, web-based support and updates to our products and documentation. We believe that providing a high level of technical support is critical to customer satisfaction. We also offer training programs to our customers and other companies with which we have relationships to accelerate the implementation and adoption of our solutions by the users within a company. Fees for our training services are typically charged separately from our software license, maintenance and consulting fees.

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Customer Support

Our customers have a choice of support and maintenance options depending on the level of service desired. Our technical support services are available to clients by telephone, over the web, by e-mail and on-site. Additionally, we provide product enhancement releases to all customers as part of our support and maintenance contracts. We use a customer service automation system to track each customer inquiry until it is resolved. We also make use of our website and a secured customer forum to provide product information and technical support information worldwide 24 hours a day, seven days a week.

Since fiscal year 2003, our agreement with Ness provides for the independent contractor, at our direction, to attract, train, assimilate and retain sufficient highly qualified personnel to perform technical support and certain sustaining engineering functions.

Educational Services

We provide educational services through an outsourced arrangement to train and enable our systems integrators and customers to use our products. Our training partners offer a comprehensive series of training modules to provide the knowledge and skills to successfully deploy, use and maintain our products. These training courses focus on the technical aspects of our products as well as business issues and processes. Training courses can be provided on-site for a custom session for a fee and through classroom and lab instruction.

Product Development

We have made substantial investments in research and development through internal development, acquisitions and technology licensing. Our product development efforts are focused on extending our enterprise software solutions, application components, industry specific processes and business process functionality, and continued integration of industry-specific transaction systems and services. Our product development organization is responsible for new software products, product architecture, core technologies, product testing, quality assurance and ensuring the compatibility of our products with third-party hardware and software platforms.

Our product development resources are organized into a number of development teams including:

- Enterprise Platform and Tools development;
- Applications, including our Decision Management, Marketing, Selling and Servicing applications and industry specific processes;
- Documentation; and
- Product Test and Release Management.

Our product development teams have extensive experience in enterprise and distributed computing, J2EE and object oriented development, data management, process and workflow engineering, transaction system interfaces, Internet and Web-Services technologies. Our research and development expenditures were $19.4 million and $13.2 million for the year ended September 30, 2005 and the nine months ended September 30, 2004, respectively.

Strategic Partnerships

Establishing partnerships and alliances with third parties that provide additional services and resources for implementing our solutions to enhance our sales and service organizations productivity is an important element of our strategy. These relationships and alliances fall into the following categories:

Consulting and System Integration Relationships. To enhance the productivity of our sales and service organizations, we have established relationships with systems integrators, complementary technology providers

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and alternative service providers. We have established relationships and trained professionals at a number of systems integrators including: Accenture, Capgemini, IBM Global Services, Ness Technologies and Infogain. We plan to expand these relationships to increase our capacity to license and implement our products. We have trained consultants in these organizations for the implementation and support of our solutions. We believe that expanding our relationships with systems integrators and independent consulting firms will enable us to gain a greater share of our target markets.

Technology Partnerships. We make extensive use of industry platforms and embrace a number of core technologies in our solution offerings. We have formed partnerships with vendors of software and hardware technology platforms. We currently maintain technology relationships with vendors such as Avaya/Lucent, Alcatel/Genesys, BEA Systems, Cisco Systems, IBM, Oracle, ISBAN and Sun Microsystems. Many of these companies voluntarily provide us with early releases of new technology platforms, education related to those platforms and limited access to their technical resources to facilitate adoption of their technology.

Competition

The market for our products is competitive, rapidly evolving, and can be affected by new product introductions and other market activities of industry participants. The competitive landscape is quickly evolving to address the need for enterprise-wide integration of IT assets and the convergence of customer interaction applications, back-office systems and business processes. The most significant competition we face is from customers internal development efforts, custom system integration, as well as other software providers that offer integration and development platforms.

Internal Development

Many of our customers and potential customers have in the past attempted to develop customer service, call center and customer relationship management systems in-house or with the help of systems integrators. Internal information technology departments have staffed projects to build their own systems utilizing a variety of tools. The cost of internal development and total cost-of-ownership has risen to become a primary concern of the business and management. We expect that internal development will continue to be a significant source of competition.

Custom System Integration Projects

Another source of competition results from systems integrators engaged to build a custom development application. The competitive factors in this area require that we demonstrate to the customer the cost savings and advantages of configurable, upgradeable and commercially supported software products developed by a dedicated professional software organization.

We frequently rely on system consulting and systems integration firms for implementation and other global services, as well as recommendations of our products during the evaluation stage of the purchase process. Many of these third parties have similar and often more established relationships with our competitors. We cannot assure that these third parties, many of whom have significantly greater resources than us, will not market software products in competition with us.

Application Software Competitors

Our primary competition is from internal development at our customers and potential customers as discussed. However, other competitors include providers of traditional, first-generation customer relationship management, enterprise resources planning, call center, marketing automation software and sales force automation software. These vendors include, among others, companies such as: PeopleSoft, Inc. (acquired by Oracle Corporation), E.piphany, Inc. (acquired by SSA Global Technologies), Fidelity Systems, S1 Corporation, Amdocs, and Siebel Systems, Inc., which has signed an agreement to be acquired by Oracle Corporation.

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Some of these companies have longer operating histories, greater financial, marketing and other resources, greater name recognition in other markets and a larger base of customers than we do. In addition, some companies have well-established relationships with our current and potential customers. As a result, these competitors may be able to devote greater resources to the development, promotion and sale of their products than we can.

We believe that we compete favorably in the industries we serve based on the following competitive advantages: process-driven solutions for servicing and selling; real-time and transactional processes; real-time decision management and vertical processes implemented in a Multichannel architecture. The technology advantages are equally important to our customers and include: Chordiant JX Architecture providing an open services oriented architecture providing for integration with multiple legacy systems, third-party applications and communication channels and advanced browser based application environment for high volume call center, mid-office and branch operations.

There is no one competitor, nor are there a small number of competitors that are dominant in our market. There are many factors that may increase competition in the enterprise customer relationship management market, including (i) entry of new competitors, (ii) mergers and alliances among existing competitors, (iii) consolidation in the software industry and (iv) technological changes or changes in the use of the Internet. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which could materially and adversely affect our business, operating results and financial condition. We cannot assure that we will be able to compete successfully against current and future competitors or that competitive pressure faced by us will not materially and adversely affect our business, operating results and financial condition.

Intellectual Property and Proprietary Rights

Our success is in part dependent upon our ability to develop and protect proprietary technology and intellectual proprietary rights. We rely primarily on a combination of contractual provisions, confidentiality procedures, patents pending, trade secrets, and copyright and trademark laws to protect our intellectual property and proprietary rights.

We license our products through non-exclusive license agreements that impose restrictions on customers ability to utilize the software. In addition, we seek to avoid disclosure of our trade secrets, including requiring employees, customers and others with access to our proprietary information to execute confidentiality agreements with us and restricting access to our source code. We also seek to protect our rights in our products, documentation and other written materials under trade secret and copyright laws. Due to rapid technological change, we believe factors such as the technological and creative skills of our personnel, new product developments and enhancements to our existing products are more important than the various legal protections of our technology to establishing and maintaining a technology leadership position.

We integrate third party software into our products. Costs associated with integrated technology provided by third parties historically accounts for approximately 3% to 7% of total license revenues. The third party software may not continue to be available on commercially reasonable terms or at all. If we cannot maintain licenses to key third party software, shipments of our products could be delayed until equivalent software is developed or licensed and integrated into our products. Moreover, although we are generally indemnified against claims if technology licensed from third parties infringes the intellectual property and proprietary rights of others, this indemnification is not always available for all types of intellectual property and proprietary rights and in some cases the scope of this indemnification is limited. There can be no assurance that infringement or invalidity claims arising from the incorporation of third-party technology or claims for indemnification from our customers resulting from these claims will not be asserted or prosecuted against us. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources, in addition to potential product redevelopment costs and delays.

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Despite our efforts to protect our proprietary rights, existing laws afford only limited protection. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. There can be no assurance that we will be able to protect our proprietary rights against unauthorized third party copying or use. Use by others of our proprietary rights could materially harm our business. Furthermore, policing the unauthorized use of our products is difficult and expensive litigation may be necessary in the future to enforce our intellectual property rights.

It is also possible that third parties will claim that we have infringed their current or future products. We expect that software developers will increasingly be subject to infringement claims as the number of products in different industry segments overlap. Any claims, with or without merit, could be time-consuming, result in costly litigation, prevent product shipment, cause delays, or require us to enter into royalty or licensing agreements, any of which could harm our business. Patent litigation in particular has complex technical issues and inherent uncertainties. If an infringement claim against us was successful and we could not obtain a license on acceptable terms, license a substitute technology or redesign to avoid infringement, our business would be harmed.

Employees

As of September 30, 2005, we employed 280 full time employees. Of that total, 68 were primarily engaged in product development, engineering or systems engineering, 94 were engaged in sales and marketing, 68 were engaged in professional services and 50 were engaged in operational, financial and administrative functions.

None of our employees are represented by a labor union and we have never experienced a work stoppage. We believe that our relations with our employees are good. We believe our future success will depend in part on our continued ability to recruit and retain highly skilled technical, finance, management and marketing personnel.

Financial Information About Geographic Areas

For a detailed description of our sales by geographic region, we incorporate by reference the information in Note 17 to our consolidated financial statements contained in Item 8 of this Form 10-K. For information relating to the risks attendant to our foreign operations, we incorporate by reference the information under the headings Risk Factors If we fail to adequately address the difficulties of managing our international operations, our revenues and operating expenses will be adversely affected and Risk Factors Fluctuations in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets and could negatively affect our operating results and cash flows.

Available Information

We were incorporated in California in March 1991 and were reincorporated in Delaware in October 1997.

We maintain a site on the world-wide web at www.chordiant.com; however, information found on our website is not incorporated by reference into this Annual Report on Form 10-K. We make available free of charge on or through our website our filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

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ITEM 1A. RISK FACTORS

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

We incurred losses of $19.5 million for the year ended September 30, 2005. We incurred losses of $0.4 million for the nine months ended September 30, 2004. We incurred losses of $16.4 million for the year ended December 31, 2003. As of September 30, 2005, we had an accumulated deficit of $208.9 million. We may continue to incur losses and cannot be certain that we can achieve or generate sufficient revenues to achieve profitability. Continued losses may leave many customers reluctant to enter into new large value license transactions without some assurance that we will operate profitably. If we fail to enter into new large value license transactions due to lack of vendor profitability and or viability concerns, our revenues will decline, which would further adversely affect our operating results.

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

We derive a significant portion of our license and service revenues from a limited number of customers. The loss of a major customer could cause a decrease in revenues and net income. For the year ended September 30, 2005, Capital One accounted for 18% of our total revenues. For the nine months ended September 30, 2004, Barclays, Time Warner Cable, and the Canadian Imperial Bank of Commerce accounted for 11%, 11% and 10% of our total revenues, respectively. While our customer concentration has fluctuated, we expect that a limited number of customers will continue to account for a substantial portion of our revenues. As a result, if we lose a major customer, or if a contract is delayed or cancelled or we do not contract with new major customers, our revenues and net loss would be adversely affected. In addition, customers that have accounted for significant revenues in the past may not generate revenues in any future period, causing our failure to obtain new significant customers or additional orders from existing customers to materially affect our operating results.

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

For the year ended September 30, 2005, international revenues were $42.0 million or approximately 50% of our total revenues. For the nine months ended September 30, 2004, international revenues were $32.0 million or approximately 52% of our total revenues. For the year ended December 31, 2003, international revenues were $52.4 million or approximately 77% of our total revenues. While we expect North American revenues to increase as a percentage of our overall revenues, international revenues will continue to represent a significant portion of our total revenues in future periods. We have faced, and will continue to face, difficulties in managing international operations which include:

- Difficulties in hiring qualified local personnel;
- Seasonal fluctuations in customer orders;
- Longer accounts receivable collection cycles;

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

- Economic downturns and political uncertainty in international economies.

- Expectations of European economic growth that are lower than for the US.

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

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Product Backlog

An increasingly material portion of our revenues has been derived from large orders, as major customers deployed our products. We define backlog as non-cancelable contractual commitments by our customers through purchase orders or contracts. Backlog is comprised of current software license orders which have not been accepted by customers or have not otherwise met all of the required criteria for revenue recognition, deferred revenue from customer support contracts, and deferred consulting and education orders for services not yet completed or delivered. Backlog is not necessarily indicative of revenues to be recognized in a specified future period. There are many factors that would impact Chordiant s filling of backlog, such as Chordiant s progress in completing projects for its customers and Chordiant s customers meeting anticipated schedules for customer-dependent deliverables. Chordiant provides no assurances that any portion of its backlog will be filled during any fiscal year or at all or that its backlog will be recognized as revenues in any given period. In addition, it is possible that customers from whom we expect to derive revenue from backlog will default and as a result we may not be able to recognize expected revenue from backlog.

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

A significant portion of our sales and operating expenses result from transactions outside of the United States, often in foreign currencies. These currencies include the United Kingdom Pound Sterling, the Euro and Canadian Dollars. Our international sales comprised 50% of our total sales for the year ended September 30, 2005. Our international sales comprised 52% of our total sales for the nine months ended September 30, 2004. Our international sales comprised 77% of our total sales for the year ended December 31, 2003. Our future operating results will continue to be subject to fluctuations in foreign currency rates, especially if international sales grow as a percentage of our total sales, and we may be negatively impacted by fluctuations in foreign currency rates in the future. For the year ended September 30, 2005, we had a foreign currency translation loss of approximately $0.6 million. We do not engage in any currency hedging activities.

Geopolitical concerns could make the closing of license transactions with new and existing customers difficult.

Our revenues will decrease in fiscal year 2006 if we are unable to enter into new large-scale license transactions with new and existing customers. The current state of world affairs and geopolitical concerns have left many customers reluctant to enter into new large value license transactions without some assurance that the economy both in the customer s home country and worldwide will have some economic and political stability. Geopolitical instability will continue to make closing large license transactions difficult. In addition, we cannot predict what effect the U.S. military presence overseas or potential or actual political or military conflict have had or are continuing to have on our existing and prospective customers decision-making process with respect to licensing or implementing enterprise-level products such as ours. Our ability to enter into new large license transactions also directly affects our ability to create additional consulting services and maintenance revenues, on which we also depend.

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

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

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

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Custom systems integration projects: we compete with large systems integrators who may develop custom solutions for specific companies which may reduce the likelihood that they would purchase our products and services.

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

In addition, recent consolidation in the software industry may indicate that we will face new competitors in the future. In August 2005, Oracle announced that it will acquire a majority interest in i-flex solutions, a banking software maker headquartered in Mumbai, India. In August 2005, IBM announced that it had signed an agreement to acquire DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In August 2005, SSA Global Technologies announced that it had signed an agreement to acquire E.piphany, Inc., a maker of customer relationship management software products. In September 2005, Oracle announced that it signed an agreement to acquire Siebel Systems, Inc., a maker of customer relationship management software products. While we do not believe that either i-flex or DWL have been significant competitors of Chordiant in the past, the acquisition of these companies by Oracle and IBM may indicate that we will face increased competition from significantly larger and more established entities in the future.

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

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

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

- Size and timing of individual license transactions;
- Delay or deferral of customer implementations of our products and subsequent impact on revenues;
- Lengthening of our sales cycle;
- Potential additional deterioration and changes in domestic and foreign markets and economies;
- Success in expanding our global services organization, direct sales force and indirect distribution channels;
- Timing of new product introductions and product enhancements;
- Appropriate mix of products licensed and services sold;

Levels of international transactions;

Activities of and acquisitions by competitors;

Product and price competition; and

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

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

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

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

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

Our development, marketing and distribution strategies rely on our ability to form and maintain long-term strategic relationships with systems integrators, in particular, our existing business alliance partners, IBM and Accenture. These business relationships often consist of joint marketing programs, technology partnerships and resale and distribution arrangements. Although most aspects of these relationships are contractual in nature, many important aspects of these relationships depend on the continued cooperation between the parties. Divergence in strategy, change in focus, competitive product offerings or potential contract defaults may interfere with our ability to develop, market, sell, or support our products, which in turn could harm our business. If either IBM or Accenture were to terminate their agreements with us or our relationship were to deteriorate, it could have a material adverse effect on our business, financial condition and results of operations. In many cases, these parties have extensive relationships with our existing and potential customers and influence the decisions of these customers. A number of our competitors have stronger relationships with IBM and Accenture and, as a result, these systems integrators may be more likely to recommend competitors products and services. In addition, in August 2005, IBM announced that it had signed an agreement to acquire DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. While we do not believe that DWL has been a direct competitor of Chordiant in the past, IBM s acquisition of DWL may indicate that IBM will become a competitor of ours in the future.

If systems integrators fail to properly implement our software, our business, reputation and financial results may be harmed.

We are increasingly relying on systems integrators to implement our products, and this trend may continue. As a result, we have less quality control over the implementation of our software with respect to these transactions and are more reliant on the ability of our systems integrators to correctly implement our software. If these systems integrators fail to properly implement our software, our business, reputation and financial results may be harmed.

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

The period between initial contact with a prospective customer and the implementation of our products is unpredictable and often lengthy, ranging to date from three to twenty-four months. Thus, revenue and cash

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receipts could vary significantly from quarter to quarter. Any delays in the implementation of our products could cause reductions in our revenues. The licensing of our products is often an enterprise-wide decision that generally requires us to provide a significant level of education to prospective customers about the use and benefits of our products. The implementation of our products involves significant commitment of technical and financial resources and is commonly associated with substantial implementation efforts that may be performed by us, by the customer or by third-party systems integrators. Customers generally consider a wide range of issues before committing to purchase our products, including product benefits, ability to operate with existing and future computer systems, vendor financial stability and longevity, ability to accommodate increased transaction volume and product reliability.

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

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our business could be harmed. We are a complex company with complex accounting issues and thus subject to related risks of errors in financial reporting which may cause problems in corporate governance, the costs of which may outweigh the costs of the underlying errors themselves. For example, in the course of preparing its 2005 financial results for the year ended September 30, 2005, the Company and its independent registered public accounting firm, BDO Seidman, LLP, identified certain errors in the Company s 2005 interim financial statements for the quarters ended December 31, 2004, March 31, 2005, and June 30, 2005 and management concluded that as a result of these errors, the Company should restate the Company s interim financial statements for these quarters. These errors are more fully described in Note 19 to the Consolidated Financial Statements contained in this Annual Report on Form 10-K. As a result of this need to restate interim financial statements, management and the Audit Committee determined that material weaknesses in our internal control over financial reporting existed. These material weaknesses have contributed to increased expenses and efforts required for our financial reporting. If we are not successful in implementing effective internal controls over financial reporting, customers may delay purchasing decisions or we may lose customers, create investor uncertainty, face litigation and the market price of our common stock may decline. For more information, please refer to the discussion below under the heading Item 9A. Controls and Procedures.

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

In fiscal year 2003, we entered into an agreement with an independent contracting company with global technical resources and an operations center in Bangalore, India and other locations. The agreement provides for the independent contractor, at our direction, to attract, train, assimilate and retain sufficient highly qualified personnel to perform staffing for consulting projects, technical support, product test and certain sustaining engineering functions. As of September 30, 2005, we use the services of approximately 99 persons through our independent contractor. In addition, as a result of the 10% reduction in our workforce that took place in July 2005, we are now more dependent on this agreement. The expansion of this organization is an important component of our strategy to address the business needs of our customers and manage our expenses. The success of this operation will depend on our ability and our independent contractor s ability to attract, train, assimilate and retain highly qualified personnel in the required periods. A disruption of our relationship with the independent contractor could adversely affect our operations. Failure to effectively manage the organization and operations will harm our business and financial results.

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

Since our initial public offering in February 2000, the price of our common stock has fluctuated widely. During the year ended September 30, 2005, the price of our common stock on the NASDAQ National Market ranged from a low of $1.38 to a high of $3.50 per share. We believe that factors such as the risks described herein

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or other factors could cause the price of our common stock to continue to fluctuate, perhaps substantially. In addition, recently, the stock market in general, and the market for high technology stocks in particular, has experienced extreme price fluctuations, which have often been unrelated to the operating performance of the affected companies. Such fluctuations could adversely affect the market price of our common stock.

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

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

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

Beginning in July 2001, Chordiant and certain of our officers and directors were named as defendants in several class action shareholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, In re Chordiant Software, Inc. Initial Public Offering Securities Litigation, Case No. 01-CV-6222. In the amended complaint, the plaintiffs allege that Chordiant, certain of our officers and directors and the underwriters of our initial public offering (IPO) violated Section 11 of the Securities Act of 1933, as amended, based on allegations that Chordiant s registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, the IPO underwriters. The complaint also contains a claim for violation of Section 10(b) of the Securities Exchange Act of 1934, as amended, based on allegations that this omission constituted a deceit on investors. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies that conducted IPOs of their common stock in the late 1990s. In June 2004, Chordiant and almost all of the other issuers entered into a formal settlement agreement with the plaintiffs. On February 15, 2005, the Court issued a decision certifying a class action for settlement purposes, and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. In addition, the settlement is still subject to statutory notice requirements as well as final judicial approval. If the settlement is not finalized as proposed, then this action may divert the efforts and attention of our management and, if determined adversely to us, could have a material impact on our business, results of operations, financial condition or cash flows.

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

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

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

Errors may be found from time-to-time in our new, acquired or enhanced products. Any significant software errors in our products may result in decreased revenues, decreased sales, and injury to our reputation and/or

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increased warranty and repair costs. Although we conduct extensive product testing during product development, we have in the past discovered software errors in our products as well as in third-party products, and as a result have experienced delays in the shipment of our new products.

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

If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or fail to reach expected levels of productivity, our ability to develop and market our products will be weakened. Our success depends largely on the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel. Because of the dependency on a small number of large deals, we are uniquely dependent upon the talents and relationships of a few executives and have no guarantee of their retention. We have been targeted by recruitment agencies seeking to hire our key management, finance, engineering, sales and marketing and professional services personnel. In addition, in July 2005 we reduced the size of our workforce by approximately 10%, which may have a negative effect on our ability to attract and retain qualified personnel.

To date, our sales have been concentrated in the financial services, telecommunications and retail markets, and if we are unable to continue sales in these markets or successfully penetrate new markets, our revenues may decline.

Sales of our products and services in three large markets financial services, telecommunications and retail markets accounted for approximately 94% and 90% of our total revenues for the year ended September 30, 2005 and the nine months ended September 30, 2004, respectively. We expect that revenues from these three markets will continue to account for a substantial portion of our total revenues for the foreseeable future. If we are unable to successfully increase penetration of our existing markets or achieve sales in additional markets, or if the overall economic climate of our target markets deteriorates, our revenues may decline.

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

Our services revenues have had lower gross margins than our license revenues. Service revenues comprised 62% and 61% of our total revenues for the year ended September 30, 2005 and the nine months ended September 30, 2004, respectively. Gross margin on service revenues was 43% and 42% for the year ended September 30, 2005 and the nine months ended September 30, 2004, respectively. Service revenues comprised 61% of our total revenues for the year ended December 31, 2003 and gross margin on service revenues was 41% in that year. License revenues comprised 38% and 39% of our total revenues for the year ended September 30, 2005 and the nine months ended September 30, 2004, respectively. License revenues comprised 39% of our total revenues for the year ended December 31, 2003. Gross margins on license revenues were 97% and 95% for the year ended September 30, 2005 and the nine months ended September 30, 2004, respectively. Gross margins on license revenues were 95% for the year ended December 31, 2003.

As a result, an increase in the percentage of total revenues represented by services revenues, or an unexpected decrease in license revenues, could have a detrimental impact on our overall gross margins. To increase services revenues, we would expand our services organization, successfully recruit and train a sufficient number of qualified services personnel, enter into new implementation projects and obtain renewals of current maintenance contracts by our customers. This expansion could further reduce gross margins in our services revenues.

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

In July 2005, we reduced the size of our workforce by approximately 10%. In the event that demand for our products increases, we may need to rebuild our workforce or increase outsourced functions to companies based in foreign jurisdictions and we may be unable to hire, train or retain qualified personnel in a timely manner, which

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may weaken our ability to market our products in a timely manner, negatively impacting our operations. Our success depends largely on ensuring that we have adequate personnel to support our platform of products as well as the continued contributions of our key management, finance, engineering, sales and marketing and professional services personnel.

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

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

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

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

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

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

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

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

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

If our products fail to satisfy advancing technological requirements of our customers and potential customers, the market acceptance of these products could be reduced. We currently serve a customer base with a

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wide variety of constantly changing hardware, software applications and networking platforms. Customer acceptance of our products depends on many factors such as:

- Our ability to integrate our products with multiple platforms and existing or legacy systems;
- Our ability to anticipate and support new standards, especially Internet and enterprise Java standards; and
- The integration of additional software modules and third party software applications with our existing products.

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

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

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

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

In particular, if we were sued for patent infringement by a patent holding company, one which has acquired large numbers of patents solely for the purpose of bringing suit against alleged infringers rather than practicing the patents, it may be costly to defend such suit. If any of our products were found to infringe such patent, the patent holder could seek an injunction to enjoin our use of the infringing product. This would have an extremely detrimental effect on our business. If we were required to settle such claim, it could be extremely costly. A patent infringement claim could have a material adverse effect on our business, operating results and financial condition.

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

Although we attempt use standardized license agreements designed to meet current revenue recognition criteria under generally accepted accounting principles, we must often negotiate and revise terms and conditions of these standardized agreements, particularly in multi-product transactions. At the time of entering

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into a transaction, we assess whether any services included within the arrangement require us to perform significant implementation or customization essential to the functionality of our products. For contracts involving significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenues using the percentage-of-completion method using labor hours incurred as the measure of progress towards completion. The application of the percentage of completion method of accounting is complex and involves judgments and estimates, which may change significantly based on customer requirements. This complexity combined with changing customer requirements could result in delays in the proper determination of our percentage of completion estimates and revenue not being recognized as we expect.

We may be subject to an investigation by the SEC or litigation by private parties in connection with the restatement of our interim financial statements for the fiscal quarters ended March 31, 2004, June 30, 2004, September 30, 2004, December 31, 2004, March 31, 2005, and June 30, 2005.

In March 2005, we concluded that our interim financial statements for the fiscal quarters ended March 31, June 30, and September 30, 2004 should no longer be relied upon because of various errors in such financial statements. We restated those financial statements, which were reported in our Transition Report on Form 10-K/T. Additionally, in the course of preparing our 2005 financial results for the year ended September 30, 2005, the Company and its independent registered public accounting firm, BDO Seidman, LLP, identified certain errors in the Company s 2005 interim financial statements for the quarters ended December 31, 2004, March 31, 2005, and June 30, 2005 and management concluded that as a result of these errors, the Company should restate the Company s interim financial statements for these quarters. These errors are more fully described in Note 19 to the Consolidated Financial Statements contained in this Annual Report on Form 10-K. As a result, the SEC may choose to begin an investigation or we may be subject to litigation, which could require significant management and financial resources which could otherwise be devoted to the operation of our business. If we are subject to an SEC investigation or litigation, we could be required to pay penalties or damages or have other remedies imposed upon us. In addition, we could become the target of expensive securities litigation related to other matters in the future. Any SEC investigation or litigation could adversely affect our business, results of operations, financial position or cash flows.

We may continue to encounter unexpected delays in implementing the requirements relating to internal control over financial reporting and we expect to incur additional expenses and diversion of management s time as a result of performing future system and process evaluation, testing and remediation required to comply with future management assessment and auditor attestation requirements.

In connection with the initial testing of internal controls certain material weaknesses were identified. In future periods we will continue to document our internal controls to allow management to report on, and our independent registered public accounting firm to attest to, our internal controls, as required by Section 404 of SOX, within the time frame required by Section 404. We may encounter unexpected delays in implementing the requirements relating to internal controls, therefore, we cannot be certain about the timing of the completion of our evaluation, testing and remediation actions or the impact that these activities will have on our operations. We also expect to incur additional expenses and diversion of management s time as a result of performing the system and process evaluation, testing and remediation required to comply with management s assessment and auditor attestation requirements. If we are not able to timely comply with the requirements set forth in Section 404 in future periods, we might be subject to sanctions or investigation by the regulatory authorities. Any such action could adversely affect our business or financial results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

Our headquarters are located in offices that are approximately 31,000 square feet in Cupertino, California pursuant to an office lease expiring in December 2008. We also lease office space in Mahwah New Jersey; Charlotte, North Carolina; and Manchester, New Hampshire. Outside of the United States, we have offices in the greater metropolitan areas of London, Paris, Amsterdam, Frankfurt and Munich. We believe our existing facilities meet our current needs and that we will be able to obtain additional commercial space as needed.

ITEM 3. LEGAL PROCEEDINGS

Beginning in July 2001, we and certain of our officers and directors (Individuals) were named as defendants in a series of class action shareholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, *In re Chordiant Software, Inc. Initial Public Offering Securities Litigation*, Case No. 01-CV-6222. In the amended complaint, filed in April 2002, the plaintiffs allege that we, the Individuals, and the underwriters of our initial public offering (IPO) violated section 11 of the Securities Act of 1933 and section 10(b) of the Exchange Act of 1934 based on allegations that the our registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, our IPO underwriters. The complaint also contains claims against the Individuals for control person liability under Securities Act section 15 and Exchange Act section 20. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies (Issuers) that conducted IPO s of their common stock in the late 1990s or in the year 2000 (collectively, the IPO Lawsuits).

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

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

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

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On September 27, 2005, our Annual Meeting of Stockholders was held in Cupertino, California. Of the 77,584,298 shares outstanding and entitled to vote as of the record date of August 4, 2005, 70,413,880 shares were present or represented by proxy at the meeting. At the meeting, stockholders were asked to vote with respect to (i) the election of two (2) directors to hold office until the 2008 Annual Meeting of Stockholders or until such time as their respective successors are elected and qualified; (ii) the ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm for our fiscal year ending September 30, 2005 and (iii) the approval of our 2005 Equity Incentive Plan.

The following nominees were elected as class II directors, each to hold office until the 2008 Annual Meeting of Stockholders or until such time as their respective successors are elected and qualified, by the vote set forth below:

Nominee	Votes For	Withheld	Broker Non-votes
Stephen P. Kelly	68,309,574	2,104,306	0
Steven R. Springsteel	67,482,624	2,931,256	0

In addition to the directors elected above, William J. Raduchel, Ph.D., Samuel T. Spadafora, David A. Weymouth, Charles E. Hoffman and David R. Springett continued to serve as directors after the annual meeting.

The selection of BDO Seidman, LLP as our independent registered public accounting firm for our fiscal year ended September 30, 2005 was ratified by the vote set forth below:

Votes For	Votes Against	Abstentions	Broker Non-votes
70,311,752	26,557	75,571	0

The approval of the 2005 Equity Incentive Plan was approved by the vote set forth below:

Votes For	Votes Against	Abstentions	Broker Non-votes
34,939,198	8,859,800	967,272	25,647,610

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq National Market under the symbol CHRD. The following table shows, for the periods indicated, the high and low per share sales prices of our common stock, as reported by the NASDAQ National Market. The prices appearing in the tables below reflect over-the-counter market quotations, which reflect inter-dealer prices, without retail mark-up, markdown or commission and may not necessarily represent actual transactions.

	High	Low
Year Ended September 30, 2005		
First Quarter (October 1 December 31)	$ 3.50	$ 1.78
Second Quarter (January 1 March 31)	$ 2.35	$ 1.64
Third Quarter (April 1 June 30)	$ 2.16	$ 1.38
Fourth Quarter (July 1 September 30)	$ 3.00	$ 2.15
Nine Months Ended September 30, 2004*		
First Quarter (January 1 March 31)	$ 6.10	$ 4.51
Second Quarter (April 1 June 30)	$ 5.48	$ 3.12
Final Quarter (July 1 September 30)	$ 4.55	$ 2.05

* We changed our fiscal year end date to September 30, effective in 2004. Accordingly, our fiscal period ended September 30, 2004 was comprised of three fiscal quarters.

As of October 31, 2005, there were approximately 248 holders of record of our common stock who together held approximately 5,983,000 shares of our common stock. The remainder of our shares outstanding are held by brokers and other institutions on behalf of stockholders. We have never paid or declared any cash dividends. We currently expect to retain earnings for use in the operation and expansion of our business and therefore do not anticipate paying any cash dividends.

In response to the SEC s adoption of Rule 10b5-1 under the Securities Exchange Act of 1934, we approved amendments to our insider trading policy on July 20, 2001 to permit our directors, executive officers and certain key employees to enter into trading plans or arrangements for systematic trading in our securities. We have been advised that certain of our directors, officers and key employees have entered into trading plans for selling shares in our securities. As of September 30, 2005, the directors and executive officers who have entered into trading plans include Stephen P. Kelly, Samuel T. Spadafora and Robert U. Mullen. We anticipate that, as permitted by Rule 10b5-1 and our insider trading policy, some or all of our directors, executive officers and employees may establish trading plans at some date in the future.

Securities Authorized for Issuance Under Equity Compensation Plans

For information relating to securities authorized for issuance under our equity compensation plans, please refer to the information under the heading, Equity Compensation Plan Information in Item 12 of this Form 10-K.

Recent Sales of Unregistered Securities

None.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected financial data in conjunction with our consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-K. The consolidated statement of operations data for the year ended September 30, 2005 and the nine months ended September 30, 2004 and for the year ended December 31, 2003 and the consolidated balance sheet data as of September 30, 2005 and 2004 are derived from the audited consolidated financial statements included in this Form 10-K. The consolidated statement of operations data for the years ended December 31, 2002 and 2001 and the balance sheet data as of December 31, 2003, 2002, and 2001 are derived from audited consolidated financial statements not included in this Form 10-K. The diluted net loss per share computation excludes potential shares of common stock (restricted stock, options and warrants to purchase common stock), since their effect would be anti-dilutive. See the notes to our consolidated financial statements for a detailed explanation of the determination of the shares used to compute basic and diluted net loss per share. Our historical results are not necessarily indicative of results to be expected for future periods.

	Year Ended September 30,	Nine Months Ended September 30,	Year Ended December 31,		
	2005	2004	2003	2002	2001
	(amounts in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenues	$ 83,725	$ 61,023	$ 68,266	$ 73,851	$ 77,464
Net loss	(19,540)	(443)	(16,403)	(32,321)	(42,262)
Net loss per share basic and diluted	$ (0.26)	$ (0.01)	$ (0.28)	$ (0.59)	$ (0.86)
Weighted average shares used in computing basic and diluted net loss per share	74,449	69,761	59,353	55,055	49,252

	September 30,		December 31,		
	2005	2004	2003	2002	2001
	(amounts in thousands, except per share data)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 38,546	$ 55,748	$ 36,218	$ 30,731	$ 27,068
Working capital	24,133	46,560	19,576	20,569	39,731
Total assets	107,250	115,340	83,811	90,759	114,865
Current and long term portion of capital lease obligations	309	508			
Short-term and long-term borrowings				1,250	75
Short-term and long-term deferred revenue	26,197	20,581	18,396	18,594	26,863
Stockholders equity	$ 65,557	$ 76,176	$ 48,446	$ 50,811	$ 71,300

No dividends have been paid or declared since our inception. Effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142 (SFAS 142), Goodwill and Other Intangible Assets, and ceased amortizing goodwill balances.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Safe Harbor

The following discussion and analysis contains forward-looking statements. These statements are based on our current expectations, assumptions, estimates and projections about our business and our industry, and involve known and unknown risks, uncertainties and other factors that may cause our or our industry s results, levels of activity, performance or achievement to be materially different from any future results, levels of activity, performance or achievements expressed or implied in or contemplated by the forward-looking statements. Words such as believe, anticipate, expect, intend, plan, will, may, should, estimate, predict, guidance, potential, continue or the r other similar expressions, identify forward-looking statements. Our actual results and the timing of events may differ significantly from those discussed in the forward-looking statements as a result of various factors, including but not limited to, those discussed in Item 1 of this Form 10-K under the caption Risk Factors and those discussed elsewhere in this Annual Report and in our other filings with the Securities and Exchange Commission. Chordiant undertakes no obligation to update any forward-looking statement to reflect events after the date of this report.

Overview

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

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

Beginning in the latter part of 2003, economic conditions began to show signs of improvement, which were reflected in increases in various economic indicators such as productivity, labor statistics and consumer confidence. This trend has continued through our fiscal year 2005 and appears to have a favorable impact, specifically in information technology spending. For the year ended September 30, 2005 and the nine months ended September 30, 2004, we were able to grow total revenues on a year over year basis.

Software Industry Consolidation and Possible Increased Competition

The software industry in general is undergoing a period of consolidation, and there has been recent consolidation in sectors of the software industry in which we operate. In August 2005, Oracle announced that it will acquire a majority interest in i-flex solutions, a banking software maker headquartered in Mumbai, India. In August 2005, IBM announced that it had signed an agreement to acquire DWL, a provider of middleware to companies in the banking, insurance, retail and telecommunications industries. In August 2005, SSA Global Technologies announced that it had signed an agreement to acquire Epiphany, Inc., a maker of customer relationship management software products. In September 2005, Oracle announced that it signed an agreement to acquire Siebel Systems, Inc., a maker of customer relationship management software products. While we do not believe that either i-flex or DWL are competitors of Chordiant, the acquisition activity of these large corporations of software providers to the industries we target may indicate that we will face increased competition from significantly larger and more established entities in the future.

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Financial Trends

Backlog. An increasingly material portion of our revenues has been derived from large orders, as major customers deployed our products. As of September 30, 2005, we had approximately $33 million in backlog, which we define as non-cancelable contractual commitments by our customers through purchase orders or contracts. Backlog is comprised of:

- current software license orders which have not been accepted by customers or have not otherwise met all of the required criteria for revenue recognition. This component includes both unbilled amounts plus billed amounts classified as deferred revenue;
- deferred revenue from customer support contracts;
- consulting service orders representing the unbilled remaining balances of consulting contracts not yet completed or delivered, plus deferred consulting revenue; and
- education orders for services not yet completed or delivered.

Backlog is not necessarily indicative of revenues to be recognized in a specified future period and is generally recognizable as revenue within a twelve month period. There are many factors that would impact Chordiant s conversion of backlog as recognizable revenue, such as Chordiant s progress in completing projects for its customers, Chordiant s customers meeting anticipated schedules for customer-dependent deliverables and customers increasing the scope or duration of a contract causing license revenue to be deferred for a longer period of time.

Chordiant provides no assurances that any portion of its backlog will be recognized as revenue during any fiscal year or at all or that its backlog will be recognized as revenues in any given period. In addition, it is possible that customers from whom we expect to derive revenue from backlog will default and as a result we may not be able to recognize expected revenue from backlog.

Gross margins. Management focuses on license and service gross margin in evaluating our financial condition and operating performance. Gross margins on license revenues were 97% and 94% for the twelve months ended September 30, 2005 and 2004, respectively. Gross margins on license revenues were 95% for both the nine months ended September 30, 2004 and 2003. Gross margins on license revenues were 95% for the year ended December 31, 2003. We expect license gross margin on current products to range from 93% to 97% in the foreseeable future. The margin will fluctuate with the mix of products sold, with certain of the enterprise solution products having higher associated royalties payable to third parties and the marketing solution and decision management products having minimal associated royalties. The banking product that was developed during the year ended September 30, 2005 will also have higher royalties than our existing products. Gross margins on service revenues were 43% and 42% for the twelve months ended September 30, 2005 and 2004, respectively. Gross margin on service revenues was 42% for both the nine months ended September 30, 2004 and 2003. Gross margin on service revenues was 41% for the year ended December 31, 2003.

Service revenues. Service revenues as a percentage of total revenues were 62% and 59% for the twelve months ended September 30, 2005 and 2004, respectively. Service revenues as a percentage of total revenues were 61% and 65% for the nine months ended September 30, 2004 and 2003, respectively. Service revenues as a percentage of total revenues were 61% for the year ended December 31, 2003. We expect that service revenues will continue to represent over 50% of our total revenues in the foreseeable future.

Revenues from international customers versus North America revenues. For all periods presented, revenues were principally derived from customer accounts in North America and Europe. For the twelve months ended September 30, 2005 and 2004, international revenues were $42.0 million and $45.3 million, or approximately 50% and 56% of our total revenues, respectively. For the nine months ended September 30, 2004 and 2003, international revenues were $32.0 million and $37.0 million, or approximately 52% and 76% of our total revenues, respectively. For the year ended December 31, 2003, international revenues were $52.4 million, or

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approximately 77% of our total revenues. We believe international revenues will continue to represent a significant portion of our total revenues in future periods.

For the twelve months ended September 30, 2005 and 2004, North America revenues were $41.7 million and $30.2 million, or approximately 50% and 37% of our total revenues, respectively. For the nine months ended September 30, 2004 and 2003, North America revenues were $29.0 million and $11.7 million, or approximately 48% and 24% of our total revenues, respectively. For the year ended December 31, 2003, North America revenues were $15.8 million, or approximately 23% of our total revenues. As the U.S. economy has strengthened, we have seen an increase in North America revenues. We believe North America revenues will continue to represent an increasing portion of our total revenues in future periods.

Acquisition of KiQ Limited. On December 21, 2004, we acquired KiQ Limited, a privately-held United Kingdom software company with branch offices in the Netherlands (KiQ), specializing in the development and sales of decision management systems. The year ended September 30, 2005 includes the revenues and expenses of KiQ for more than nine months. The acquisition resulted in an increase to our headcount of approximately 20 employees as of the acquisition date. The majority of these individuals are in the Cost of Service and Research and Development areas, accordingly personnel costs are now higher in these categories for the year ended September 30, 2005. KiQ operations have been integrated into the financial operations and the decision management products are actively being marketed to customers across all regions.

Costs related to compliance with the Sarbanes-Oxley Act of 2002. For the year ended September 30, 2005, general and administrative expenses include significant professional services costs relating with efforts to comply with the Sarbanes-Oxley Act of 2002. We expect these costs to continue for the first quarter of fiscal year 2006. While these costs are expected to decline during the remainder of fiscal year 2006, the level of decline is uncertain.

Reduction in workforce. In July 2005, we undertook an approximate 10% reduction in our workforce. In connection with this action, we incurred a one-time cash charge of approximately $1.0 million in the fourth quarter ended September 30, 2005 for severance benefits. As a result of this reduction in force, we expect to realize aggregate internal cost savings of approximately $1.1 million per quarter. Such savings will primarily be in the areas of Sales and Marketing and Research and Development. We anticipate a full offset to this savings attributable to increased sales commissions, a new marketing campaign and outsourced development expenses associated with new product deliverables.

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

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, we evaluate the estimates, including those related to our allowance for doubtful accounts, valuation of goodwill and intangible assets, valuation of deferred tax assets, restructuring costs, contingencies, vendor specific objective evidence (VSOE) of fair value in multiple element arrangements and the estimates associated with the percentage-of-completion method of accounting for certain of our revenue contracts. We base our estimates on historical experience and on various other assumptions that are believed to

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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 judgments and estimates are used in the preparation of our consolidated financial statements:

- Revenue recognition, including estimating the total estimated time required to complete sales arrangements involving significant implementation or customization essential to the functionality of our products;
- Estimating valuation allowances and accrued liabilities, specifically the allowance for doubtful accounts, and assessment of the probability of the outcome of our current litigation;
- Accounting for income taxes;
- Valuation of long-lived and intangible assets and goodwill;
- Restructuring costs; and
- Determining functional currencies for the purposes of consolidating our international operations.

Revenue recognition.

We derive revenues from licenses of our software and related services, which include assistance in implementation, customization and integration, post-contract customer support, training and consulting. The amount and timing of our revenue is difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in increased operating losses. The accounting rules related to revenue recognition are complex and are affected by interpretation of the rules and an understanding of industry practices, both of which are subject to change. Consequently, the revenue recognition accounting rules require management to make significant judgments.

Software license revenue is recognized in accordance with Statement of Position No. 97-2 Software Revenue Recognition, as amended by Statement of Position No. 98-9 Software Revenue Recognition with Respect to Certain Arrangements (collectively SOP 97-2).

For arrangements with multiple elements, we recognize revenue for services and post-contract customer support based upon VSOE of fair value of the respective elements. VSOE of fair value for the services element is based upon the standard hourly rates we charge for the services when such services are sold separately. The VSOE of fair value for annual post-contract customer support is generally established with the contractual future renewal rates included in the contracts when the renewal rate is substantive and consistent with the fees when support services are sold separately. When contracts contain multiple elements and VSOE of fair value exists for all undelivered elements, we account for the delivered elements, principally the license portion, based upon the residual method as prescribed by SOP 97-2. In multiple element transactions where VSOE is not established for an undelivered element, we recognize revenue upon the establishment of VSOE for that element or when the element is delivered.

At the time we enter into a transaction, we assess whether any services included within the arrangement require us to perform significant implementation or customization essential to the functionality of our products.

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

For contracts that involve significant implementation or customization essential to the functionality of our products, we recognize the license and professional consulting services revenue using either the percentage-of-completion method or the completed contract method as prescribed by Statement of Position No. 81-1, Accounting for Performance of Construction-Type and Certain Product-Type Contracts (SOP 81-1).

The percentage-of-completion method is applied when we have the ability to make reasonable dependable estimates of the total effort required for completion using labor hours incurred as the measure of progress towards completion. The progress toward completion is measured based on the go-live date. We define the go-live date as the date the essential product functionality has been delivered or the application enters into a production environment or the point at which no significant additional Chordiant supplied professional services resources are required. Estimates are subject to revisions as the contract progresses to completion. We account for the changes as changes in accounting estimates when the information becomes known. Information impacting estimates obtained after the balance sheet date but before the issuance of the financial statements is used to update the estimates. Provisions for estimated contract losses, if any, are recognized in the period in which the loss becomes probable and can be reasonably estimated. When we sell additional licenses related to the original licensing agreement, revenue is recognized upon delivery if the project has reached the go-live date, or if the project has not reached the go-live date, revenue is recognized under the percentage-of-completion method. We classify revenues from these arrangements as license and service revenues based upon the estimated fair value of each element.

The completed contract method is applied when we are unable to obtain reasonable dependable estimates of the total effort required for completion. Under the completed contract method, all revenue and related costs of revenue are deferred and recognized upon completion.

We recognize revenue for post-contract customer support ratably over the support period which ranges from one to three years.

Our training and consulting services revenues are recognized as such services are performed on an hourly or daily basis for time and material contracts. For consulting services arrangements with a fixed fee, we recognize revenue on the proportional performance method.

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

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

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

Allowance for doubtful accounts. We must make estimates of the uncollectability of our accounts receivables. We specifically analyze accounts receivable and analyze historical bad debts, customer concentrations, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Generally, we require no collateral from our customers. Our accounts receivable balance was $19.2 million with an allowance for doubtful accounts of $0.2 million as of September 30, 2005. Our accounts receivable balance was $20.3 million with an allowance for doubtful accounts of $0.1 million as of

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September 30, 2004. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required.

Accounting for income taxes. As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations.

We have recorded a valuation allowance of $79.9 million as of September 30, 2005, due to uncertainties related to our ability to utilize our net deferred tax assets, primarily consisting of certain net operating losses carried forward and foreign tax credits. This valuation allowance offsets 100% of the deferred tax asset at September 30, 2005. Deferred tax assets have been fully reserved for in all periods presented. In the event that actual results differ from these estimates or we adjust these estimates in future periods we may need to establish an additional valuation allowance which could materially impact our financial position and results of operations.

Valuation of long-lived and intangible assets and goodwill. We assess the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Furthermore, we assess the impairment of goodwill annually. Factors we consider important which could trigger an impairment review include the following:

- Significant underperformance relative to expected historical or projected future operating results;
- Significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- Significant negative industry or economic trends;
- Significant decline in our stock price for a sustained period;
- Market capitalization declines relative to net book value; and
- A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

When one or more of the above indicators of impairment occurs we estimate the value of long-lived assets and intangible assets to determine whether there is impairment. We measure any impairment based on the projected discounted cash flow method, which requires us to make several estimates including the estimated cash flows associated with the asset, the period over which these cash flows will be generated and a discount rate commensurate with the risk inherent in our current business model. These estimates are subjective and if we made different estimates, it could materially impact the estimated fair value of these assets and the conclusions we reached regarding an impairment. To date, we have not identified any triggering events which would require us to perform this analysis.

We are required to perform an impairment review of our goodwill balance on at least an annual basis. This impairment review involves a two-step process as follows:

Step 1 We compare the fair value of our reporting units to the carrying value, including goodwill, of each of those units. For each reporting unit where the carrying value, including goodwill, exceeds the unit s fair value, we proceed on to Step 2. If a unit s fair value exceeds the carrying value, no further work is performed and no impairment charge is necessary.

Step 2 We perform an allocation of the fair value of the reporting unit to our identifiable tangible and non-goodwill intangible assets and liabilities. This derives an implied fair value for the reporting unit s goodwill. We then compare the implied fair value of the reporting unit s goodwill with the carrying amount of the reporting unit s goodwill. If the carrying amount of the reporting unit s goodwill is greater than the implied fair value of its goodwill, an impairment charge would be recognized for the excess.

We determined that we have one reporting unit. We completed a goodwill impairment review for the period including September 30, 2005 and performed Step 1 of the goodwill impairment analysis required by Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, and concluded that goodwill was not impaired as of September 30, 2005 using the methodology described above. Accordingly, Step 2 was not performed. We will continue to test for impairment on an annual basis and on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting units below their carrying amount.

Restructuring costs. During the quarter ended September 30, 2005, we undertook an approximate 10% reduction in our workforce. Charges incurred related to severance payments in both North America and Europe.

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

During fiscal years 2004 and 2003, we implemented cost-reduction plans as part of our continued effort to streamline our operations to reduce ongoing operating expenses. These plans resulted in restructuring charges related to, among others, the consolidation of excess facilities. These charges relate to facilities and portions of facilities we no longer utilize and either seek to terminate early or sublease. Lease termination costs and brokerage fees for the abandoned facilities were estimated for the remaining lease obligations and were offset by estimated sublease income. Estimates related to sublease costs and income are based on assumptions regarding the period required to locate and contract with suitable sub-lessees and sublease rates which can be achieved using market trend information analyses provided by a commercial real estate brokerage retained by us. Each reporting period we review these estimates and to the extent that these assumptions change due to new agreements with landlords, new subleases with tenants, or changes in the market, the ultimate restructuring expenses for these abandoned facilities could vary by material amounts.

Determining functional currencies for the purpose of consolidation. We have several foreign subsidiaries that together account for a significant portion of our revenues, expenses, assets and liabilities.

In preparing our consolidated financial statements, we are required to translate the financial statements of the foreign subsidiaries from the currency in which they keep their accounting records, generally the local currency, into United States dollars. This process results in exchange gains and losses which, under the relevant accounting guidance are either included within the statement of operations or as a separate part of our net equity under the caption accumulated other comprehensive income (loss). Under the relevant accounting guidance the treatment of these translation gains or losses is dependent upon our management s determination of the functional currency of each subsidiary. The functional currency is determined based on management s judgment and involves consideration of all relevant economic facts and circumstances affecting the subsidiary. Generally, the currency in which the subsidiary conducts a majority of its transactions, including billings, financing, payroll and other expenditures would be considered the functional currency but any dependency upon the parent and the nature of the subsidiary s operations must also be considered.

If any subsidiary s functional currency were deemed to be the local currency, then any gain or loss associated with the translation of that subsidiary s financial statements would be included in cumulative translation adjustments. However, if the functional currency were deemed to be the United States dollar then any gain or loss associated with the translation of these financial statements would be included within our statement of operations. If we dispose of any of our subsidiaries, any cumulative translation gains or losses would be recognized in our statement of operations. If we determine that there has been a change in the functional currency of a subsidiary to the United States dollar, any translation gains or losses arising after the date of change would be included within our statement of operations.

Based on our assessment of the factors discussed above, we consider the relevant subsidiary s local currency to be the functional currency for each of our international subsidiaries. Accordingly, we had a foreign currency translation loss of approximately $0.6 million for the year ended September 30, 2005 and a foreign currency translation gain of less than $0.1 million, which were included as part of accumulated other comprehensive income within our balance sheet at September 30, 2005 and 2004, respectively.

The magnitude of these gains or losses is dependent upon movements in the exchange rates of the foreign currencies in which we transact business against the United States dollar. These currencies include the United Kingdom Pound Sterling, the Euro and Canadian Dollars. Any future translation gains or losses could be significantly higher than those noted in each of these years. In addition, if we determine that a change in the functional currency of one of our subsidiaries has occurred at any point in time we would be required to include any translation gains or losses from the date of change in our statement of operations.

Prior to June 30, 2005 the settlement of accumulated intercompany loans and advances was not planned or anticipated. Loans and advances made subsequent to this date are anticipated as cash balances may need to be transferred between entities. Exchange gains or losses on these intercompany balances are reflected in the statement of operations.

Recent Accounting Pronouncements

In June 2005, the FASB issued Statement No. 154 (FAS 154), Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. We do not believe the adoption of SFAS 154 will have a material effect on our consolidated financial position, results of operations or cash flows.

In March 2005, the FASB issued Financial Interpretation No. 47 (FIN 47), Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143. FIN 47 requires asset retirement obligations to be recorded when a legal obligation exists even though the timing and/or method of the settlement of such obligations is conditional on a future event. FIN 47 is effective for fiscal years beginning after December 15, 2005. The Company is currently evaluating the effect that the adoption of FIN 47 will have on its financial condition and results of operations but does not believe that the adoption will have a material impact.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107), Share-Based Payment, providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123R, and the disclosures in Management s Discussion and Analysis of Financial Condition and Results of Operations subsequent to the adoption. The Company will provide SAB 107 required disclosures upon adoption of SFAS 123R. The Company has not yet determined the method of adoption or the effect, however expects the adoption of SFAS 123R to have a material adverse effect on its financial statements.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) (SFAS 123R), Share-Based Payment. This standard requires expensing of stock options and other share-based payments and supersedes

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SFAS 123, which had allowed companies to choose between expensing stock options or showing pro forma disclosure only. On April 14, 2005, the standard was delayed to the first interim period after the Company s fiscal year, accordingly, effective October 1, 2005, the Company will be required to apply the standard to all awards granted, modified, cancelled or repurchased after that date as well as the unvested portion of prior awards. SFAS 123R permits public companies to adopt its requirements using one of two methods:

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

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

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

In December 2004, the FASB issued FASB Staff Position No. FSP 109-2 (FSP 109-2), Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004. FSP 109-2 provides guidance under FASB Statement No. 109 (SFAS 109), *Accounting for Income Taxes,* with respect to recording the potential impact of the repatriation provisions of the American Jobs Creation Act of 2004 (the Jobs Act) on enterprises income tax expense and deferred tax liability. The Jobs Act was enacted on October 22, 2004. FSP 109-2 states that an enterprise is allowed time beyond the financial reporting period of enactment to evaluate the effect of the Jobs Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB 109. FSP 109-2 is effective for fiscal years after December 15, 2005. The Company has not yet completed evaluating the impact of the repatriation provisions, however it does not anticipate the adoption will have a material impact on its consolidated financial statements. Accordingly, as provided for in FSP 109-2, we have not adjusted our tax expense or deferred tax liability to reflect the repatriation provisions of the Jobs Act.

Results of Operations

On December 29, 2004, Chordiant s Board of Directors approved a change in the Company s fiscal year end from December 31 to September 30. The nine-month results reported by the Company relate to the transitional period ended September 30, 2004. The financial information for the year ended September 30, 2004 and the nine months ended September 30, 2003 is unaudited and is presented for comparative purposes.

The following table sets forth, in dollars (in thousands) and as a percentage of total revenues, consolidated statements of operations data for the periods indicated. This information, except for the year ended September 30, 2004 and the nine months ended September 30, 2003, has been derived from the consolidated financial statements included elsewhere in this Annual Report.

	Year Ended September 30,				**Nine Months Ended September 30,**				**Year Ended December 31,**	
	2005		**2004**		**2004**		**2003**		**2003**	
			(unaudited)				**(unaudited)**			
Statements of Operations Data:										
Revenues:										
License	$ 31,678	38%	$ 32,909	41%	$ 23,661	39%	$ 17,266	35%	$ 26,514	39%
Service	52,047	62	47,714	59	37,362	61	31,400	65	41,752	61
Total revenues	83,725	100	80,623	100	61,023	100	48,666	100	68,266	100
Cost of revenues:										
License	1,079	1	1,836	2	1,262	2	847	2	1,421	2
Service	29,438	35	27,746	35	21,510	35	18,356	38	24,593	36
Stock-based compensation (benefit)	633	1	601	1	(75)		1,121	2	1,797	3
Amortization of intangible assets	1,068	1	1,838	2	1,044	2	2,377	5	3,171	4
Total cost of revenues	32,218	38	32,021	40	23,741	39	22,701	47	30,982	45
Gross profit	51,507	62	48,602	60	37,282	61	25,965	53	37,284	55
Operating expenses:										
Sales and marketing	28,517	34	23,459	29	17,763	29	15,728	32	21,423	31
Research and development	19,405	23	17,329	21	13,153	22	12,075	25	16,251	24
General and administrative	18,008	22	8,008	10	6,717	11	4,942	10	6,233	9
Stock-based compensation (benefit)	2,211	3	2,389	3	(282)		3,927	8	6,598	10
Amortization of intangible assets	117		222		126		294	1	390	1
Restructuring expense	1,052	1	1,200	2	172		1,161	2	2,189	3
Purchased in-process research and development	1,940	2								