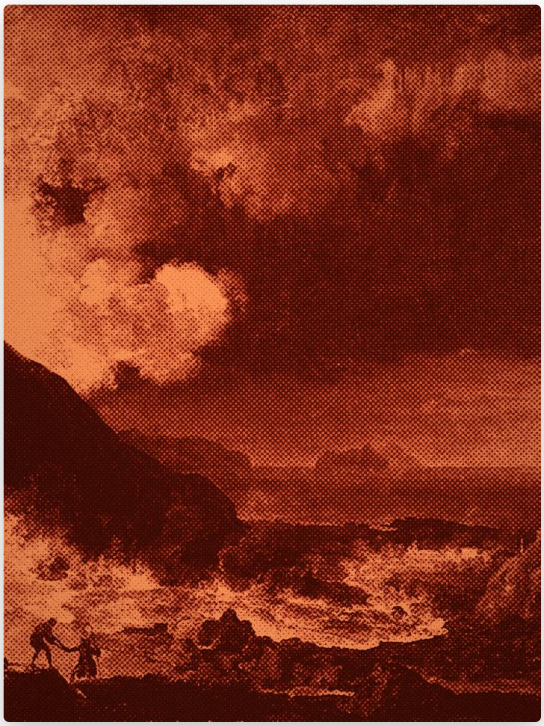
FORM S-1 · REGISTRATION STATEMENT

Caldera Systems Inc

IPO priced 2000-03-21 · $14.00 a share · CALD



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PAGEBREAK

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON SEPTEMBER 23, 2003

REGISTRATION NO. 333-

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

CALLIDUS SOFTWARE INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**7371**	**77-0438629**
(State or Other Jurisdiction of Incorporation or Organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

160 WEST SANTA CLARA STREET, SUITE 1500

SAN JOSE, CA 95113

(408) 808-6400

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

REED D. TAUSSIG

PRESIDENT, CHIEF EXECUTIVE OFFICER

AND CHAIRMAN OF THE BOARD OF DIRECTORS

Callidus Software Inc.

160 WEST SANTA CLARA STREET, SUITE 1500

SAN JOSE, CA 95113

(408) 808-6400

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent For Service) ***Copies to:***

Francis S. Currie, Esq. **Davis Polk & Wardwell 1600 El Camino Real Menlo Park, California 94025 (650) 752-2000**	**John D. Wilson, Esq.** **Shearman & Sterling LLP 1080 Marsh Road Menlo Park, California 94025 (650) 838-3600**

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. o If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title Of Each Class Of Securities To Be Registered	**Proposed Maximum Aggregate Offering Price(1)**	**Amount Of Registration Fee**
Common Stock, par value $0.001 per share	$75,000,000	$6,075

(1) Includes shares that the underwriters have the right to purchase to cover over-allotments. Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(o) under the Securities Act of 1933.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

PAGEBREAK The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED SEPTEMBER 23, 2003

PROSPECTUS

SHARES

COMMON STOCK

$ PER SHARE

We are selling shares of our common stock. We have granted the underwriters an option to purchase up to additional shares of common stock to cover over-allotments.

This is the initial public offering of our common stock. We currently expect the initial public offering price to be between $ and $ per share. We have applied to have the common stock included for quotation on the Nasdaq National Market under the symbol "CALD."

Investing in our common stock involves risks. See "Risk Factors" beginning on page 5.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public Offering Price		$ $
Underwriting Discount		$ $
Proceeds to Callidus Software (before expenses)		$ $

The underwriters expect to deliver the shares to purchasers on or about , 2003.

CITIGROUP

Lehman Brothers U.S. Bancorp Piper Jaffray

, 2003

Enterprise Incentive Management Solutions *Aligning Employee, Sales and Channel Incentives with Corporate Strategy and Shareholder Value.* **Solutions for the Strategic Enterprise™** SUMMARY RISK FACTORS FORWARD-LOOKING STATEMENTS USE OF PROCEEDS DIVIDEND POLICY CAPITALIZATION DILUTION SELECTED CONSOLIDATED FINANCIAL DATA MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS BUSINESS MANAGEMENT CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS PRINCIPAL STOCKHOLDERS DESCRIPTION OF CAPITAL STOCK SHARES ELIGIBLE FOR FUTURE SALE UNDERWRITING MATERIAL U.S. FEDERAL TAX CONSIDERATIONS FOR NON-U.S. HOLDERS OF COMMON STOCK LEGAL MATTERS EXPERTS WHERE YOU CAN FIND MORE INFORMATION INDEX TO CONSOLIDATED FINANCIAL STATEMENTS EXHIBIT 3.1 EXHIBIT 3.2 EXHIBIT 4.2 EXHIBIT 10.3 EXHIBIT 10.4 EXHIBIT 10.5 EXHIBIT 10.6 EXHIBIT 10.7 EXHIBIT 10.8 EXHIBIT 10.9 EXHIBIT 10.10 EXHIBIT 10.11 EXHIBIT 10.12 EXHIBIT 10.13 EXHIBIT 10.14 EXHIBIT 10.15 EXHIBIT 10.16 EXHIBIT 10.17 EXHIBIT 10.18 EXHIBIT 10.19 EXHIBIT 21.1 EXHIBIT 23.1 /TOC

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.

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Until , 2004 (25 days after the date of this prospectus), all dealers that effect transactions in our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

Callidus Software®, the Callidus Software logo and TrueComp® are registered trademarks of Callidus Software and TruePerformance™, TrueComp Grid™, TrueComp Manager™, TrueInformation™, TrueIntegration™, TrueResolution™ and TrueReferral™ are unregistered trademarks of Callidus Software. All trademarks, service marks and trade names of other companies that appear in this prospectus are the property of their respective holders.

Summary

This summary highlights information contained elsewhere in this prospectus. This summary does not contain all of the information that you should consider before deciding to invest in our common stock. You should read this entire prospectus carefully before making an investment decision, including the "Risk Factors" section and the consolidated financial statements and the notes to those statements. Unless otherwise indicated, references in this prospectus to "Callidus," the "Company," "we," "our" or "us" refer to Callidus Software Inc. and its subsidiaries.

Callidus Software Inc.

We are a leading provider of Enterprise Incentive Management (EIM) software systems to global companies across multiple industries. Large enterprises use EIM systems to model, administer, analyze and report on pay-for-performance plans, which are designed to align employee, sales and channel tactics with targeted business objectives, and thereby increase productivity, improve profitability and achieve competitive advantage. Our product suite is based on our proprietary technology and extensive domain expertise and provides the flexibility and scalability required to meet the dynamic EIM requirements of large, complex businesses across multiple industries. Our installed base of over 75 active customers includes industry leaders in the insurance, retail banking, telecommunications, distribution, and manufacturing and technology industries, such as Allstate, JP Morgan Chase, AT&T Wireless, Airborne Express and Apple Computer. Our revenues were $26.6 million for the year ended December 31, 2002 and $29.8 million for the six months ended June 30, 2003.

MARKET OPPORTUNITY

In today's competitive environment, pay-for-performance programs are increasingly recognized as important tools for companies to increase sales and productivity, gain market share and improve profitability. In 2001, AMR, a leading industry analysis firm, estimated that more than $1.5 trillion of pay-for-performance compensation is paid out annually by U.S. and European based companies. However, the management of pay-for-performance programs presents complex challenges due to the large numbers of potential payees, compensation transactions, incentive programs and corporate policies involved. Currently, the majority of large businesses administer these programs using manual methods or internally developed solutions that do not adequately address these challenges. Failure to effectively meet these challenges erodes the effectiveness of incentive compensation, impairs management's ability to adapt pay-for-performance programs to changing corporate objectives and results in costly errors. We believe that large enterprises are increasingly seeking dedicated EIM solutions to manage their pay-for-performance programs and, as a result, that the EIM market represents a substantial and growing new market opportunity.

THE CALLIDUS SOLUTION

We develop, market, install and support a suite of rules-based EIM products to address the complex challenges of pay-for-performance programs for large enterprises. We provide a transparent and reliable data resource for enterprises to plan and manage pay-for-performance programs and accurately allocate credit among a wide range of payees. Our product suite allows management to accurately calculate and coordinate the payment of incentive compensation based on a highly flexible and scalable software architecture. In addition, our reporting product enables management to accurately and systematically report incentive compensation results to payees on a timely basis. Our solution is designed to enable large enterprises to achieve competitive advantages by ensuring that employees, agents and business partners are focused on targeted business objectives, thereby increasing productivity and driving bottom line results. We believe we provide the most advanced EIM solution available for three principal reasons:

We Solve Complex Pay-for-Performance Problems. By focusing exclusively on solving the challenges and complexities inherent in pay-for-performance programs, we have developed a suite of EIM solutions designed to enable timely and accurate planning, calculation and management of variable, salary and management-by-objective (MBO) compensation, as well as dispute resolution, referral tracking and reporting.

We Address Key Vertical Market Requirements. We believe domain expertise is critical to designing a successful EIM system. We apply our domain expertise to build specific functionality into our products to address the key requirements of the insurance, retail banking, telecommunications, distribution, and manufacturing and technology industries.

We Have Superior Technology. Our products are based on our proprietary rules-based software and grid computing architecture. We believe this technology differentiates our products and offers superior performance, scalability and flexibility in an easy-to-use and reliable system, resulting in a lower total cost of ownership than manual methods and internally developed solutions.

Strategy

Our objective is to extend our leadership position in the EIM market for large businesses. To achieve this goal we are pursuing the following strategies:

Capitalize on Our Technological Leadership. We intend to leverage our early-mover advantage and our technological leadership in the EIM market by continuing to invest in research and development to expand our product line and increase our products' functionality, and thereby to capitalize on the EIM market opportunity.

Continue Our Focus on Vertical Markets and Develop Additional Referenceable Accounts. Our domain expertise enables our products to offer industry-specific advantages in functionality, implementation and deployment and allows us to achieve greater efficiency and effectiveness in our sales, marketing and product development efforts. We intend to add marquee customers in each of our vertical markets and to leverage these referenceable accounts to increase

penetration of our target markets.

Increase the Industry-Specific Modeling and Analytic Capabilities of Our Products. We are developing new products and product enhancements to provide customers with more extensive industry-specific modeling and analytic capabilities required in increasingly competitive marketplaces.

Continue to Build Loyalty Through Superior Customer Care. As we grow our installed base, we intend to increase our investment in customer care to further strengthen customer loyalty and referenceability.

COMPANY INFORMATION

Our principal executive offices are located at 160 West Santa Clara Street, Suite 1500, San Jose, California 95113 and our telephone number is (408) 808-6400. Our website address is http://www.callidussoftware.com. Our website and the information contained therein or connected thereto shall not be deemed to be incorporated into this prospectus or the registration statement of which it forms a part.

THE OFFERING

Common stock offered	shares
Common stock to be outstanding after this offering	shares
Use of proceeds	We anticipate that we will use the net proceeds of this offering for general corporate purposes, including working capital, capital expenditures and potential acquisitions of complementary businesses, products and technologies.
Dividend policy	We have never declared or paid any cash dividends on our capital stock. We currently expect to retain any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends on our common stock in the foreseeable future.
Proposed Nasdaq National Market symbol	CALD
Risk factors	See "Risk Factors" and the other information included in this prospectus for a discussion of the factors you should consider carefully before deciding to invest in our common stock.

The number of shares to be outstanding after the offering is based on 17,420,414 shares outstanding on June 30, 2003 and excludes:

- 4,201,026 shares of common stock issuable upon exercise of outstanding options at a weighted average exercise price of $1.43 per share as of June 30, 2003;
- 843,197 shares of common stock issuable upon exercise of outstanding warrants at a weighted average exercise price of $3.63 per share as of June 30, 2003; and
- 4,858,274 shares of common stock available for future issuance under our various stock plans, plus the annual increases in the number of shares authorized under each of our stock plans beginning July 1, 2004.

Unless otherwise noted, this prospectus:

- gives effect to a 3-for-5 reverse split of our common stock expected to take effect prior to the effectiveness of the registration statement of which this prospectus is a part and the conversion of all of our outstanding preferred stock into common stock effective upon the consummation of this offering; and
- assumes no exercise by the underwriters of their option to purchase additional shares of our common stock in this offering.

SUMMARY CONSOLIDATED FINANCIAL DATA

(in thousands, except per share data) The following table sets forth a summary of our consolidated financial data for the periods presented. This summary consolidated financial data should be read together with "Selected Consolidated Financial Data," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes contained elsewhere in this prospectus. The consolidated balance sheet data is set forth as of June 30, 2003 both on an actual basis and on an as adjusted basis to reflect our receipt of the estimated net proceeds from the sale of shares of common stock by us in this offering at an assumed initial public offering price of $ per share. See "Use of Proceeds" and "Capitalization."

	Year Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003
						(unaudited)	
Consolidated Statement of Operations Data:							
Revenues:							
License revenues	$—	$1,334	$8,879	$6,860	$9,820	$5,224	$16,603
Maintenance and service revenues	9	4,756	13,302	16,033	16,766	6,917	13,175
Total revenues	9	6,090	22,181	22,893	26,586	12,141	29,778
Gross profit	9	(1,196)	10,158	9,140	11,560	5,448	18,497
Operating expenses:							
Sales and marketing	3,349	8,684	16,115	12,003	13,527	6,062	8,764
Research and development	2,354	4,852	9,701	10,659	11,118	5,227	5,266
General and administrative	974	2,668	5,048	4,859	5,053	2,174	2,525
Stock-based compensation(1)	1,064	3,229	4,312	1,878	424	280	2,027
Total operating expenses	7,741	19,433	35,176	29,399	30,122	13,743	18,582
Loss from operations	(7,732)	(20,629)	(25,018)	(20,259)	(18,562)	(8,295)	(85)

Net loss	$(7,575)	$(20,536)	$(25,428)	$(20,844)	$(19,130)	$(8,576)	$(255)
Basic and diluted net loss per share	$(35.07)	$(28.72)	$(23.83)	$(17.24)	$(13.98)	$(6.35)	$(0.18)
Weighted-average shares used in computing basic and diluted net loss per share	216	715	1,067	1,286	1,368	1,350	1,422

						Six Months	
	Year Ended December 31,					**Ended June 30,**	
	1998	**1999**	**2000**	**2001**	**2002**	**2002**	**2003**
						(unaudited)	
(1) Stock-based compensation consists of:							
Cost of maintenance and service revenues	$90	$552	$619	$309	$95	$63	$534
Sales and marketing	363	1,471	2,185	726	73	52	815
Research and development	339	637	767	399	119	77	460
General and administrative	272	569	741	444	137	88	218
Total stock-based compensation	$1,064	$3,229	$4,312	$1,878	$424	$280	$2,027

	As of June 30, 2003	
	Actual	**As Adjusted**
	(unaudited)	
Consolidated Balance Sheet Data:		
Cash and cash equivalents	$13,289	
Working capital	3,547	
Total assets	27,961	
Total liabilities	23,467	
Total stockholders' equity	4,494	

Risk Factors

Risk Factors

An investment in our common stock involves a high degree of risk. You should consider the risks described below carefully and all of the information contained in this prospectus before deciding whether to purchase our common stock. If any of the adverse events described in the following risk factors actually occurs, our business, financial condition and results of operations may suffer significantly. As a result, the trading price of our common stock could decline, and you may lose all or part of your investment in our common stock.

Risks Related to Our Business

We have a history of losses, and we cannot assure you that we will achieve or sustain our profitability. If we fail to do so, our stock price may decline.

We incurred net losses of $25.4 million for 2000, $20.8 million for 2001 and $19.1 million for 2002. Taking account of the $2.0 million of stock-based compensation we recorded in the first half of 2003, we recorded a net loss of $255,000 in the six months ended June 30, 2003. After this offering, we expect to significantly increase our expenses in the near term in order to expand our business. In addition, based on stock options granted through June 30, 2003, we expect to amortize an aggregate of $678,000, $665,000 and $1.8 million of deferred stock-based compensation in the three months ending September 30, 2003, the three months ending December 31, 2003 and in 2004, respectively. These increased operating expenses and amortization charges will adversely affect our operating results and may result in or contribute to net losses in future periods and we cannot assure you that we will be able to achieve or sustain profitability on a quarterly or annual basis. Our results of operations will be harmed if our revenues do not increase at a rate equal to or greater than increases in our expenses or if our revenues are insufficient for us to achieve or sustain profitability. If we are not able to achieve or sustain profitability, our stock price may decline and we may require additional financing, which may not be available.

Our quarterly revenues and operating results can be difficult to predict and can fluctuate substantially, which may harm our results of operations.

Our revenues, particularly our license revenues, are difficult to forecast and are likely to fluctuate significantly from quarter to quarter due to a number of factors, many of which are outside of our control. These factors include:

- Competitive conditions in our industry, including new products, product announcements and special pricing offered by our competitors;
- varying size, timing and contractual terms of orders for our products, which may delay the recognition of revenues;
- the discretionary nature of our customers' purchase and budget cycles and changes in their budgets for software and related purchases;
- strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments or changes in business strategy;
- our ability to timely complete our service obligations related to product sales;
- general weakening of the economy resulting in a decrease in the overall demand for computer software and services;
- the utilization rate of our professional services personnel and the degree to which we use third-party consulting services;
- changes in our pricing policies;
- timing of product development and new product initiatives;

- our ability to hire, train and retain sufficient sales and professional services staff; and

- changes in the mix of revenues attributable to higher-margin product license revenues as opposed to substantially lower-margin service revenues.

Because our quarterly revenues are dependent upon a relatively small number of transactions, even minor variations in the rate and timing of conversion of our sales prospects into revenues could cause us to plan or budget inaccurately, and those variations could adversely affect our financial results. In particular, based upon the terms of our customer contracts, we recognize the bulk of our license revenues for a given sale either at the time we enter into the agreement and deliver the product, or over the period in which we perform any services that are essential to the functionality of the product. Unexpected changes in contractual terms late in the negotiation process or changes in the mix of contracts we enter into could therefore materially and adversely affect our license revenues in a quarter. Delays, reductions in amount or cancellations of customers' purchases would adversely affect our revenues, results of operations and financial condition.

In addition, we make assumptions and estimates as to the timing and amount of future revenues in budgeting our future operating costs and capital expenditures. Specifically, our sales personnel monitor the status of all proposals, including the estimated closing date and potential dollar amount of such transactions. We aggregate these estimates periodically to generate our sales forecasts and then evaluate the forecasts to identify trends in our business. Because our costs are relatively fixed in the short term and a substantial portion of our license revenue contracts are completed in the latter part of a quarter, we may be unable to reduce our expenses to avoid or minimize the negative impact on our quarterly results of operations if our estimates prove inaccurate and our anticipated revenues are not realized. As a result, our quarterly results of operations could be worse than anticipated, which could adversely affect our stock price.

Our products have long sales cycles, which make it difficult to plan our expenses and forecast our results.

The sales cycles for our products are generally between six and nine months for the majority of our sales, and in some cases can be a year or longer. It is therefore difficult to predict the quarter in which a particular sale will occur and to plan our expenditures accordingly. The period between our initial contact with a potential customer and its purchase of our products and services is relatively long due to several factors, including:

- The complex nature of our products;
- the need to educate potential customers about the uses and benefits of our products;
- the requirement that a potential customer invest significant resources in connection with the purchase and implementation of our products;
- budget cycles of our potential customers that affect the timing of purchases;
- customer requirements for competitive evaluation and internal approval before purchasing our products;
- potential delays of purchases due to announcements or planned introductions of new products by us or our competitors; and
- the lengthy approval processes of our potential customers, many of which are large organizations.

The delay or failure to complete sales in a particular quarter would reduce our revenues in that quarter, as well as any subsequent quarters over which revenues for the sale would likely be recognized. If our sales cycle unexpectedly lengthens in general or for one or more large orders, it would adversely affect the timing of our revenues. If we were to experience a delay on a large order, it could harm our ability to meet our forecasts for a given quarter.

Managing large-scale deployments of our products requires substantial technical implementation and support by us or third-party service providers. Failure to meet these requirements could cause a decline or delay in recognition of our revenues and an increase in our expenses.

Our customers may require large, enterprise-wide deployments of our products, which require a substantial degree of technical implementation and support. It may be difficult for us to manage the timeliness of these deployments and the allocation of personnel and resources by us or our customers. Failure to successfully manage this process could harm our reputation and cause us to lose existing customers, face potential customer disputes or limit the number of new customers that purchase our products, which could adversely affect our revenues and increase our technical support and litigation costs.

Our software license customers have the option to receive implementation, maintenance, training and consulting services from our internal professional services organization or from outside consulting organizations. If we are unable to expand our internal professional services organization to keep pace with sales, we will be required to increase our use of third-party service providers to help meet our implementation and service obligations. If we require a greater number of third-party service providers than we currently have available, we will be required to negotiate additional arrangements, which may result in lower gross margins for maintenance or service revenues.

If a customer selects a third-party implementation service provider and such implementation services are not provided successfully and in a timely manner, our customers may experience increased costs and errors, which may result in customer dissatisfaction and costly remediation and litigation, any of which could adversely impact our operating results and financial condition.

Our success depends upon our ability to develop new products and enhance our existing products.

The enterprise application software market is characterized by:

- Rapid technological advances in hardware and software development;
- evolving standards in computer hardware, software technology and communications infrastructure;
- changing customer needs; and
- frequent new product introductions and enhancements.

To keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance, we must enhance and improve existing products and we must also continue to introduce new products and services. If we are unable to successfully develop new products or enhance and improve our existing products or if we fail to position and/or price our products to meet market demand, our business and operating results

will be adversely affected. Accelerated product introductions and short product life cycles require high levels of expenditures for research and development that could adversely affect our operating results. Further, any new products we develop may not be introduced in a timely manner and may not achieve the broad market acceptance necessary to generate significant revenues.

A substantial majority of our revenues are derived from TrueComp and related products and services and a decline in sales of these products and services could adversely affect our operating results and financial condition.

We derive a substantial majority of our revenues from TrueComp and related products and services, and revenues from these products and services are expected to continue to account for a substantial portion of our revenues for the foreseeable future. Because we generally sell licenses to our products on a perpetual basis and deliver new versions and enhancements to customers who purchase maintenance contracts, our future license revenues are substantially dependent on sales to new customers. In addition, substantially all of our TrueInformation product sales have historically been made in connection with TrueComp sales. As a result of these factors, we are particularly vulnerable to fluctuations in demand for TrueComp. Accordingly, if demand for TrueComp and related products and services declines significantly, our business and operating results would be adversely affected.

Errors in our products could result in significant costs to us and could impair our ability to sell our products.

Our products are complex and, accordingly, they may contain errors, or "bugs," that could be detected at any point in their product life cycle. Errors in our products could materially and adversely affect our reputation, result in significant costs to us and impair our ability to sell our products in the future. Customers relying on our products to calculate and pay incentive compensation may have a greater sensitivity to product errors and security vulnerabilities than customers for software products in general. The costs incurred in correcting any product errors may be substantial and would adversely affect our operating margins. While we plan to continually test our products for errors and work with customers through our customer support services organization to identify and correct bugs, errors in our products may be found in the future.

Because our customers depend on our software for their critical business functions, any interruptions could result in:

- Lost or delayed market acceptance and sales of our products;
- product liability suits against us;
- lost sales revenues;
- diversion of development resources;
- injury to our reputation; and
- increased service and warranty costs.

While our software license agreements typically contain limitations and disclaimers that purport to limit our liability for damages for errors in our software, such limitations and disclaimers may not be enforced by a court or other tribunal or otherwise effectively protect us from such claims.

If we do not compete effectively with companies selling EIM software, our revenues may not grow and could decline.

We have experienced, and expect to continue to experience, intense competition from a number of software companies. We compete principally with vendors of EIM software, such as Centive, Motiva and Synygy, vendors of enterprise resource planning software, such as Oracle, PeopleSoft and SAP, and vendors of customer relationship management software, such as Siebel Systems. Our competitors may announce new products, services or enhancements that better meet the needs of customers or changing industry standards. Increased competition may cause price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on our business, results of operations and financial condition.

Many of our competitors and potential competitors have significantly greater financial, technical, marketing, service and other resources than we have. Many of these companies also have a larger installed base of users, have longer operating histories or have greater name recognition than we have. Some of our competitors' products may be more effective than our products at performing particular EIM system functions or may be more customized for particular customer needs in a given vertical market. Even if our competitors provide products with more limited EIM system functionality than our products, these products may incorporate other capabilities, such as recording and accounting for transactions, customer orders or inventory management data. A product that performs these functions, as well as some of the functions of our software solutions, may be appealing to some customers because it would reduce the number of different types of software used to run their business. Further, our competitors may be able to respond more quickly than we can to changes in customer requirements.

Our products must be integrated with software provided by a number of our existing or potential competitors. These competitors could alter their products in ways that inhibit integration with our products, or they could deny or delay access by us to advance software releases, which would restrict our ability to adapt our products to facilitate integration with these new releases.

If we are required to change our pricing models to compete successfully, our margins and operating results will be adversely affected.

The intensely competitive market in which we do business may require us to reduce our prices. If our competitors offer deep discounts on certain products or services in an effort to recapture or gain market share or to sell other software or hardware products, we may be required to lower prices or offer other favorable terms to compete successfully. Any such changes would be likely to reduce our margins and could adversely affect our operating results. Some of our competitors may bundle software products that compete with ours for promotional purposes or as a long-term pricing strategy or provide guarantees of prices and product implementations. These practices could, over time, limit the prices that we can charge for our products. If we cannot offset price reductions with a corresponding increase in the number of sales or with lower spending, then the reduced software license revenues resulting from lower prices would adversely affect our margins and operating results.

Potential customers that outsource their technology projects offshore may come to expect lower rates for professional services than we are able to provide profitably, which could impair our ability to win customers and achieve profitability.

Many of our potential customers have begun to outsource technology projects offshore to take advantage of lower labor costs, and we believe that this trend will continue. Due to the lower labor costs in some countries, these customers may demand lower hourly rates for the professional services we provide, which may erode our margins for our maintenance and services revenues or result in lost business.

Our maintenance and service revenues produce substantially lower gross margins than our license revenues, and an increase in service revenues relative to license revenues would harm our overall gross margins.

Our maintenance and service revenues, which include fees for consulting, implementation, maintenance and training, were 44% of our revenues for the six months ended June 30, 2003 and 63% of our revenues for 2002. Our maintenance and service revenues have substantially lower gross margins than our license revenues. An increase in the percentage of total revenues represented by maintenance and service revenues would adversely affect our overall gross margins.

Maintenance and service revenues as a percentage of total revenues have varied significantly from quarter to quarter due to fluctuations in licensing revenues, economic changes, change in the average selling prices for our products and services, our customers' acceptance of our products and our sales force execution. In addition, the volume and profitability of services can depend in large part upon:

- Competitive pricing pressure on the rates that we can charge for our professional services;
- the complexity of the customers' information technology environment;
- the resources directed by customers to their implementation projects; and
- the extent to which outside consulting organizations provide services directly to customers.

Any erosion of our margins for our maintenance and service revenues, or any adverse changes in the mix of our license versus maintenance and service revenues would adversely affect our operating results.

We will not be able to maintain our sales growth if we do not attract, train or retain qualified sales personnel.

We depend on our direct sales force for most of our sales and have made significant expenditures in recent years to expand our sales force. Our future success will depend in part upon the continued expansion and increased productivity of our sales force. To the extent we experience attrition in our direct sales force, we will need to hire replacements. We face intense competition for sales personnel in the software industry, and we cannot be sure that we will be successful in hiring, training or retaining these personnel in accordance with our plans. Even if we hire and train a sufficient number of sales personnel, we cannot be sure that we will generate enough additional revenues to exceed the cost of the new personnel.

Our business may be harmed if we do not successfully develop and maintain strategic relationships to implement and sell our products.

We have relationships with third-party consulting firms, systems integrators and software vendors. These third parties may provide us with customer referrals, cooperate with us in marketing our products and provide our customers with systems implementation services or overall program management. However, we do not have formal agreements governing our ongoing relationship with certain of these third-party providers and the agreements we do have generally do not include obligations with respect to generating sales opportunities or cooperating on future business. Should any of these third parties go out of business or choose not to work with us, we may be forced to increase the development of those capabilities internally, incurring significant expense and adversely affecting our operating margins. Any of our third-party providers may offer products of other companies, including products that compete with our products. We could lose sales opportunities if we fail to work effectively with these parties or they choose not to work with us.

Acquisitions and investments present many risks, and we may not realize the anticipated financial and strategic goals for any such transactions.

We may in the future acquire or make investments in complementary companies, products, services and technologies. Such acquisitions and investments involve a number of risks, including:

- We may find that the acquired company or assets do not further our business strategy, or that we overpaid for the company or assets, or that economic conditions change, all of which may generate a future impairment charge;
- we may have difficulty integrating the operations and personnel of the acquired business, and may have difficulty retaining the key personnel of the acquired business;
- we may have difficulty incorporating the acquired technologies or products with our existing product lines;
- there may be customer confusion where our products overlap with those of the acquired company;
- we may have product liability associated with the sale of the acquired company's products;
- our ongoing business and management's attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically and culturally diverse locations;
- we may have difficulty maintaining uniform standards, controls, procedures and policies across locations;
- the acquisition may result in litigation from terminated employees or third-parties; and
- we may experience significant problems or liabilities associated with product quality, technology and legal contingencies.

These factors could have a material adverse effect on our business, results of operations and financial condition or cash flows, particularly in the case of a larger acquisition or multiple acquisitions in a short period of time. From time to time, we may enter into negotiations for acquisitions or investments that are not ultimately consummated. Such negotiations could result in significant diversion of management time, as well as out-of-pocket costs.

The consideration paid in connection with an investment or acquisition also affects our financial results. If we were to proceed with one or more significant acquisitions in which the consideration included cash, we could be required to use a substantial portion of our available cash, including proceeds of this offering, to consummate any acquisition. To the extent we issue shares of stock or other rights to purchase stock, including options or other rights, existing stockholders may be diluted and earnings per share may decrease. In addition, acquisitions may result in the incurrence of debt, large one-time write-offs (such as of acquired in-process research and development costs) and restructuring charges. They may also result in goodwill and other intangible assets that are subject to impairment tests, which could result in future impairment charges.

For our business to succeed, we need to attract, train and retain qualified employees and manage our employee base effectively.

Our success depends on our ability to hire, train and retain qualified employees and to manage our employee base effectively. Competition for qualified personnel is intense, particularly in the San Francisco Bay area where our headquarters are located, and the high cost of living increases our recruiting and compensation costs. We cannot assure you that we will be successful in hiring, training or retaining qualified personnel. If we are unable to do so, our business and operating results will be adversely affected.

We have recently experienced changes in our senior management team and the loss of key personnel and any failure to successfully integrate replacement personnel could adversely affect our business.

In September 2002, we hired Ronald J. Fior as our Chief Financial Officer and in June 2003, we hired Bertram W. Rankin as our Senior Vice President of Worldwide Marketing. In addition, we continue to recruit additional senior management personnel to support our growing operations. Our success will depend to a significant extent on our ability to assimilate these changes in our leadership team and to retain the services of our executive officers, including Reed D. Taussig, our President and Chief Executive Officer, and our other key employees. If we lose the services of one or more of our executives or key employees, or if one or more of our executives or key employees decides to join a competitor or otherwise compete directly or indirectly with us, this could harm our business and could affect our ability to successfully implement our business plan.

If we fail to adequately protect our proprietary rights and intellectual property, we may lose valuable assets, experience reduced revenues and incur costly litigation to protect our rights.

We rely on a combination of copyrights, trademarks, service marks, trade secret laws and contractual restrictions to establish and protect our proprietary rights in our products and services. We will not be able to protect our intellectual property if we are unable to enforce our rights or if we do not detect unauthorized use of our intellectual property. Despite our precautions, it may be possible for unauthorized third parties to copy our products and use information that we regard as proprietary to create products and services that compete with ours. Some license provisions protecting against unauthorized use, copying, transfer and disclosure of our licensed programs may be unenforceable under the laws of certain jurisdictions and foreign countries. Further, the laws of some countries do not protect proprietary rights to the same extent as the laws of the United States. To the extent that we engage in international activities, our exposure to unauthorized copying and use of our products and proprietary information will increase.

We enter into confidentiality or license agreements with our employees and consultants and with the customers and corporations with whom we have strategic relationships and business alliances. No assurance can be given that these agreements will be effective in controlling access to and distribution of our products and proprietary information. Further, these agreements do not prevent our competitors from independently developing technologies that are substantially equivalent or superior to our products. Litigation may be necessary in the future to enforce our intellectual property rights and to protect our trade secrets. Litigation, whether successful or unsuccessful, could result in substantial costs and diversion of management resources, either of which could seriously harm our business.

Our results of operations may be adversely affected if we are subject to a protracted infringement claim or one that results in a significant damage award.

From time to time, we receive claims that our products or business infringe or misappropriate the intellectual property of third parties. Our competitors or other third parties may challenge the validity or scope of our intellectual property rights. We believe that software developers will be increasingly subject to claims of infringement as the functionality of products in our market overlaps. A claim may also be made relating to technology that we acquire or license from third parties. If we were subject to a claim of infringement, regardless of the merit of the claim or our defenses, the claim could:

- Require costly litigation to resolve;
- absorb significant management time;
- cause us to enter into unfavorable royalty or license agreements;
- require us to discontinue the sale of our products;
- require us to indemnify our customers or third-party systems integrators; or
- require us to expend additional development resources to redesign our products.

We may also be required to indemnify our customers and third-party systems integrators for third-party products that are incorporated into our products and that infringe the intellectual property rights of others. Although many of these third parties are obligated to indemnify us if their products infringe the rights of others, this indemnification may not be adequate.

In addition, from time to time there have been claims challenging the ownership of open source software against companies that incorporate open source software into their products. We use a limited amount of open source software in our products and may use more open source software in the future. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software. Any of this litigation could be costly for us to defend, have a negative effect on our results of operations and financial condition or require us to devote additional research and development resources to change our products.

We depend on technology of third parties licensed to us for our TruePerformance product, our rules engine and the analytics and web viewer functionality for our products and the loss or inability to maintain these licenses or errors in such software could result in increased costs or delayed sales of our products.

We distribute our TruePerformance product under license from the independent contractor that developed the product. In addition, we license technology from several software providers for our rules engine, analytics and web viewer. 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. Some of the products we license from third parties could be difficult to replace, and implementing new software with our products could require six months or more of design and engineering work. The loss of any of these technology licenses could result in delays in the license of our products until equivalent technology, if available, is developed or identified, licensed and integrated. In addition, our products depend upon the successful operation of third-party products in conjunction with our products, and therefore any undetected errors in these products could prevent the implementation or impair the functionality of our products, delay new product introductions and/or injure our reputation. Our use of additional or alternative third-party software would require us to enter into license agreements with third parties, which could result in higher royalty payments and a loss of product differentiation.

Our revenues might be harmed by resistance to adoption of our software by information technology departments.

Some potential customers may have already made a substantial investment in other third-party or internally developed software designed to model, administer, analyze and report on pay-for-performance programs. These companies may be reluctant to abandon these investments in favor of our software. In addition, information technology departments of potential customers may resist purchasing our software solutions for a variety of other reasons, particularly the potential displacement of their historical role in creating and running software and concerns that packaged software products are not sufficiently customizable for their enterprises. If the market for our products does not grow for any of these reasons, our revenues may be harmed.

Our inability to manage growth could affect our business adversely and harm our ability to sustain profitability.

To support our growth plans, we need to expand our existing management, operational, financial, human resources, customer service and management information systems and controls. This expansion will require significant capital expenditures and may divert our financial resources from other projects such as the development of new products or product upgrades. We may be unable to expand these systems and to manage our growth successfully, and this inability would adversely affect our business.

Mergers of or other strategic transactions by our competitors could weaken our competitive position or reduce our revenues.

If one or more of our competitors were to merge or partner with another of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively. Our competitors may also establish or strengthen cooperative relationships with our current or future systems integrators, third-party compensation consulting firms or other parties with whom we have relationships, thereby limiting our ability to promote our products and limiting the number of consultants available to implement our software. Disruptions in our business caused by these events could reduce our revenues.

If we are required or elect to account for employee stock option and employee stock purchase plans using the fair value method, it could significantly increase our net loss and net loss per share.

There has been ongoing public debate about whether employee stock option and employee stock purchase plans shares should be treated as a compensation expense and, if so, how to properly value such compensation. If we elect or are required to record an expense for our stock-based compensation plans using the fair value method, we could have significant additional compensation expense. For example, if we had historically accounted for stock-based compensation plans using the fair value method prescribed in Financial Accounting Standards Board Statement 123 as amended by Statement 148, in 2002 we would have recorded approximately $547,000 in additional expenses, and our basic and diluted loss per share would have been increased by $0.40 per share. Although we are not currently required to record any compensation expense using the fair value method in connection with option grants that have an exercise price at or above fair value at the grant date or for shares issued under our employee stock purchase plan, it is possible that future laws or regulations will require us to treat all stock-based compensation as an expense using the fair value method. See Notes 1 and 5 of our consolidated financial statements and our discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations – Application of Critical Accounting Policies and Use of Estimates" for a more detailed presentation of our accounting for stock-based compensation.

We may expand our international sales efforts but do not have substantial experience in international markets.

We may expand our international operations, and any such expansion would require substantial financial resources and a significant amount of attention from our management. International operations involve a variety of risks, particularly:

- Unexpected changes in regulatory requirements, taxes, trade laws and tariffs;
- differing ability to protect our intellectual property rights;
- differing labor regulations;
- greater difficulty in supporting and localizing our products;
- changes in a specific country's or region's political or economic conditions;
- greater difficulty in establishing, staffing and managing foreign operations; and
- fluctuating exchange rates.

We have limited experience in marketing, selling and supporting our products and services abroad. If we invest substantial time and resources in order to grow our international operations and are unable to do so successfully and in a timely manner, our business and operating results could be seriously harmed.

Natural disasters or other incidents may disrupt our business.

Our business communications, infrastructure and facilities are vulnerable to damage from human error, physical or electronic security breaches, power loss and other utility failures, fire, earthquake, flood, sabotage, vandalism and similar events. Although the source code for our software products is held by escrow agents outside of the San Francisco Bay area, our internal-use software and back-up are both located in the San Francisco Bay area. If a natural or man-made disaster were to hit this area, we may lose all of our internal-use software data. Despite precautions, a natural disaster or other incident could result in interruptions in our service or significant damage to our infrastructure. In addition, failure of any of our telecommunications providers could result in interruptions in our services and disruption of our business operations. Any of the foregoing could impact our provision of services and fulfillment of product orders, and our ability to process product orders and invoices and otherwise timely conduct our business operations.

Risks Related to the Securities Markets and Ownership of our Common Stock

Because some existing stockholders will together own % of our outstanding stock after this offering, the voting power of other stockholders, including purchasers in this offering, may be effectively limited.

After this offering, it is anticipated that, based on share ownership as of June 30, 2003, our officers, directors, major stockholders and their affiliates will beneficially own or control, directly or indirectly, 18,431,498 shares of common stock, which in the aggregate will represent approximately % of the outstanding shares of common stock (or % if the underwriters' over-allotment option is exercised in full). As a result, if some of these persons or entities act

together, they will have the ability to control all matters submitted to our stockholders for approval, including the election and removal of directors, amendments to our certificate of incorporation and bylaws and the approval of any business combination. This may delay or prevent an acquisition or cause the market price of our stock to decline. Some of these persons or entities may have interests different than yours. For example, because many of these stockholders purchased their shares at prices substantially below the price at which shares are being sold in this offering and have held their shares for a relatively longer period, they may be more interested in selling the Company to an acquiror than other investors or may want us to pursue strategies that are different from the wishes of other investors.

A substantial number of shares will be eligible for sale in the near future, which could cause our common stock price to decline significantly.

Additional sales of our common stock in the public market after this offering, or the perception that such sales could occur, could cause the market price of our common stock to decline. Upon completion of this offering, we will have shares of common stock outstanding, assuming no exercise of the underwriters' over-allotment option and no exercise of outstanding options or warrants. See "Summary – The Offering" for a detailed discussion of shares included and excluded from this number. The shares to be sold in this offering will be freely tradable without restriction or further registration under the Securities Act of 1933. We expect that substantially all of our existing stockholders will be subject to lock-up agreements with the underwriters that restrict their ability to transfer their stock for 180 days from the date of this prospectus. For a description of these agreements, see "Underwriting." After the lock-up agreements expire, an aggregate of additional shares will be eligible for sale in the public market, subject in most cases to the limitations of either Rule 144 or Rule 701 under the Securities Act. See "Shares Eligible for Future Sale."

In addition, Citigroup, on behalf of the underwriters, may in its sole discretion, at any time without notice, release all or any portion of the shares subject to the lock-up agreements, which would result in more shares being available for sale in the public market at earlier dates. Sales of common stock by existing stockholders in the public market, the availability of these shares for sale, our issuance of securities or the perception that any of these events might occur could materially and adversely affect the market price of our common stock.

There is no prior public market for our common stock. Our stock price is likely to be volatile and could decline following this offering, resulting in a substantial loss on your investment.

Prior to this offering, there has not been a public market for our common stock. An active trading market for our common stock may never develop or be sustained, which could affect your ability to sell your shares and could depress the market price of your shares. In addition, the initial public offering price has been determined through negotiations between us and the representatives of the underwriters and may bear no relationship to the price at which the common stock will trade upon completion of this offering. The stock market in general, and the market for technology-related stocks in particular, has been highly volatile. As a result, the market price of our common stock is likely to be similarly volatile, and investors in our common stock may experience a decrease in the value of their stock, including decreases unrelated to our operating performance or prospects. The price of our common stock could be subject to wide fluctuations in response to a number of factors, including those listed in this "Risk Factors" section of this prospectus and others such as:

- Our operating performance and the performance of other similar companies;
- developments with respect to intellectual property rights;
- publication of research reports about us or our industry by securities analysts;
- speculation in the press or investment community;
- terrorist acts; and
- announcements by us or our competitors of significant contracts, new technologies, acquisitions, commercial relationships, joint ventures or capital commitments.

As a new investor, you will incur substantial dilution as a result of this offering.

The initial public offering price will be substantially higher than the pro forma, net tangible book value per share of our outstanding common stock. As a result, investors purchasing common stock in this offering will incur immediate dilution of $ per share, assuming an initial public offering price of $ per share. This dilution is due in large part to earlier investors having generally paid substantially less than the initial public offering price when they purchased their shares. In addition, the exercise of outstanding options and warrants will, and future equity issuances may, result in further dilution to investors. See the section entitled "Dilution" elsewhere in this prospectus.

Because we do not intend to pay dividends, you will not receive funds without selling shares and depending on when you sell your shares, you may lose the entire amount of your investment.

We have never declared or paid any cash dividends on our capital stock and do not intend to pay cash dividends in the foreseeable future. We intend to invest our future earnings, if any, to fund our growth. Therefore, you will not receive any proceeds in respect of your stock prior to selling it. We also cannot assure you that you will receive a return on your investment when you do sell your shares or that you will not lose the entire amount of your investment.

Our management has broad discretion to determine how to use the funds raised in this offering, and may use them in ways that may not enhance our operating results or the price of our common stock.

Our management could spend the proceeds from this offering in ways our stockholders may not agree with or that do not yield a favorable return. We plan to use the net proceeds from this offering for general corporate purposes, including working capital, capital expenditures and potential acquisitions of complementary businesses, products and technologies. Until we use the proceeds of this offering, we plan to invest the net proceeds in interest-bearing, investment-grade securities, which may not yield a favorable rate of return. If we do not invest or apply the proceeds of this offering in ways that enhance stockholder value, we may require additional financing, which may not be available.

We may need to raise additional capital, which may not be available.

We expect that the net proceeds from this offering, together with our other capital resources, will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. After that, we may need to raise additional funds, and we cannot be certain that we will be able to obtain additional financing on favorable terms, if at all. If we need additional capital and cannot raise it on acceptable terms, we may not be able to:

- Develop enhancements and additional features for our products;
- develop new products and services;
- hire, train and retain employees;
- enhance our infrastructure;
- respond to competitive pressures or unanticipated requirements;
- pursue international expansion; or
- pursue acquisition opportunities.

Provisions in our charter documents and Delaware law may delay or prevent an acquisition of our company.

Our certificate of incorporation and bylaws contain provisions that could make it harder for a third party to acquire us without the consent of our board of directors. For example, if a potential acquiror were to make a hostile bid for us, the acquiror would not be able to call a special meeting of stockholders to remove our board of directors or act by written consent without a meeting. In addition, our board of directors has staggered terms, which means that replacing a majority of our directors would require at least two annual meetings. The acquiror would also be required to provide advance notice of its proposal to replace directors at any annual meeting, and will not be able to cumulate votes at a meeting, which will require the acquiror to hold more shares to gain representation on the board of directors than if cumulative voting were permitted.

Our board of directors also has the ability to issue preferred stock that could significantly dilute the ownership of a hostile acquiror. In addition, Section 203 of the Delaware General Corporation Law limits business combination transactions with 15% stockholders that have not been approved by the board of directors. These provisions and other similar provisions make it more difficult for a third party to acquire us without negotiation. These provisions may apply even if the offer may be considered beneficial by some stockholders.

Our board of directors could choose not to negotiate with an acquiror that it did not believe was in our strategic interests. If an acquiror is discouraged from offering to acquire us or prevented from successfully completing a hostile acquisition by these or other measures, you could lose the opportunity to sell your shares at a favorable price.

link1 "FORWARD-LOOKING STATEMENTS"

Forward-looking Statements

Forward-looking Statements

We have made statements under the captions “Summary,” “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Business” and in other sections of this prospectus that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as “may,” “might,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “intends,” “potential” or “continue,” the negative of these terms and other comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, our anticipated growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements, including those factors discussed under the caption entitled “Risk Factors.” You should specifically consider the numerous risks outlined under “Risk Factors.”

Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of any of these forward-looking statements. We undertake no obligation to update any of these forward-looking statements after the date of this prospectus to conform our prior statements to actual results or revised expectations.

Use of Proceeds

Use of Proceeds

We estimate that the net proceeds from the sale of shares of common stock by us in this offering will be approximately $ million ($ million if the underwriters’ over-allotment option is exercised in full) based on an assumed initial public offering price of $ per share and after deducting underwriting discounts and estimated offering expenses payable by us.

The principal purposes of this offering are to obtain additional working capital, establish a public market for our common stock and facilitate our future access to public capital markets. We currently expect to use the net proceeds from this offering for general corporate purposes, including working capital, capital expenditures and potential acquisitions of complementary businesses, products and technologies. We have no present commitments or agreements with respect to any acquisition or investment. Pending these uses, we intend to invest the net proceeds in short-term, interest-bearing, investment-grade securities. Our management will retain broad discretion in the allocation of the net proceeds of this offering. The amounts we actually spend will depend on a number of factors, including the amount of our future revenues and other factors described elsewhere in this prospectus.

Dividend Policy

Dividend Policy

We have never declared or paid any cash dividends on our capital stock. We currently expect to retain any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends on our common stock in the foreseeable future.

Capitalization

Capitalization

(in thousands, except share and per share data) The following table sets forth our cash and cash equivalents, bank line of credit and capitalization as of June 30, 2003 on an actual basis and as adjusted to reflect our receipt of the estimated net proceeds from the sale of shares of common stock by us in this offering at an assumed initial public offering price of $ per share, after deducting the underwriting discounts and estimated offering expenses. This table gives effect to a planned increase in the number of authorized shares of common stock, which will be effected in an amendment to our certificate of incorporation that will be effective upon the consummation of this offering and, in the case of the as adjusted data, the conversion of all of our outstanding shares of preferred stock into common stock effective upon the consummation of this offering. You should read this table along with "Selected Financial Data," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes appearing elsewhere in this prospectus.

	As of June 30, 2003	
	Actual	As Adjusted
	(unaudited)	
Cash and cash equivalents	$13,289	$
Bank line of credit	$5,405	$
Long-term debt, including current portion	$1,722	$
Stockholders' equity:		
Convertible Preferred Stock, $0.001 par value per share; 31,927,656 shares authorized, 30,379,476 shares issued and outstanding, actual; 5,000,000 shares authorized, no shares issued and outstanding, as adjusted	30	
Common Stock, $0.001 par value, 42,000,000 shares authorized, 1,488,421 shares issued and outstanding, actual; 100,000,000 shares authorized, shares issued and outstanding, as adjusted	2	
Additional paid-in capital	103,643	
Deferred stock-based compensation	(4,168)	
Notes receivable from stockholders	(238)	
Accumulated deficit	(94,836)	
Accumulated other comprehensive income	61	
Total stockholders' equity	4,494	
Total capitalization	$6,216	$

Shares of common stock to be outstanding after the offering do not include:

- 4,201,026 shares of common stock issuable upon exercise of outstanding options at a weighted average exercise price of $1.43 per share as of June 30, 2003;
- 843,197 shares of common stock issuable upon exercise of outstanding warrants at a weighted average exercise price of $3.63 per share as of June 30, 2003; and
- 4,858,274 shares of common stock available for future issuance under our various stock plans, plus the annual increases in the number of shares authorized under each of our stock plans beginning July 1, 2004.

Options to purchase shares of our common stock at a weighted average exercise price per share of $ will be fully vested and exercisable at the time the registration statement we have filed in connection with this offering is declared effective by the Securities and Exchange Commission.

Dilution

Dilution

Our pro forma net tangible book value as of June 30, 2003 was approximately $ million, or approximately $ per share. Pro forma net tangible book value per share represents the amount of our total tangible assets reduced by the amount of our total liabilities and divided by the total number of shares of common stock outstanding, after giving effect to the automatic conversion of our preferred stock into common stock upon consummation of this offering. Dilution in

pro forma net tangible book value per share represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the net tangible book value per share of common stock immediately after the completion of this offering. After giving effect to the sale of the shares of common stock offered by us at an assumed initial public offering price of $ per share, and after deducting the underwriting discount and estimated offering expenses payable by us, our pro forma net tangible book value as of June 30, 2003 would have been approximately $ million, or $ per share of common stock. This represents an immediate increase in pro forma net tangible book value of $ per share to existing stockholders and an immediate dilution of $ per share to new investors purchasing shares of our common stock at the initial public offering price. The following table illustrates this dilution on a per share basis:

Assumed initial public offering price per share	$
Pro forma net tangible book value per share as of June 30, 2003	$
Increase in pro forma net tangible book value per share attributable to new investors	
Pro forma net tangible book value per share after this offering	
Dilution per share to new investors	$

Dilution is determined by subtracting pro forma net tangible book value per share after the offering from the initial public offering price per share.

The following table sets forth, on a pro forma basis, as of June 30, 2003, the number of shares of common stock purchased from us, the total consideration paid, or to be paid, and the average price per share paid, or to be paid, by existing stockholders and by the new investors, at an assumed initial public offering price of $ per share, before deducting estimated underwriting discounts and commissions and offering expenses payable by us:

	Shares of Common Stock Purchased		Total Consideration		Average Price
	Number	Percent	Amount	Percent	Per Share
Existing stockholders		%		$%	
New Investors					
Total		100%		$100%	

If the underwriters exercise their over-allotment option in full, the percentage of shares held by existing stockholders will decrease to % of the total shares outstanding, and the number of shares held by new investors will increase to , or % of the total shares outstanding.

The foregoing discussion and tables are based upon the number of shares issued and outstanding on June 30, 2003 and assume no exercise of options outstanding as of June 30, 2003. As of that date, there were shares of our common stock issuable upon exercise of options outstanding at a weighted average exercise price of $ per share. Assuming the exercise in full of all the outstanding options, as adjusted net tangible book value as of June 30, 2003 would be $ per share, representing an immediate increase in the net tangible book value of $ per share to our existing stockholders and an immediate decrease in the net tangible book value of $ per share to purchasers of our common shares in this offering. For additional information concerning these options, see the section entitled “Management – Incentive Plans.”

Selected Consolidated Financial Data

Selected Consolidated Financial Data

(in thousands, except per share data) The selected consolidated financial data set forth below should be read together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes. We have derived the consolidated statement of operations data for the years ended December 31, 2000, 2001 and 2002 and the consolidated balance sheet data as of December 31, 2001 and 2002 from the audited consolidated financial statements included elsewhere in this prospectus. The consolidated statement of operations data for the years ended December 31, 1998 and 1999 and the consolidated balance sheet data as of December 31, 1998, 1999 and 2000 were derived from the audited consolidated financial statements that are not included in this prospectus. The consolidated statement of operations data for the six months ended June 30, 2002 and June 30, 2003 and the consolidated balance sheet data as of June 30, 2003 were derived from the unaudited consolidated financial statements included elsewhere in this prospectus. Historical results are not necessarily indicative of results to be expected for future periods and interim results are not necessarily indicative of results for the entire year.

	Year Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003
						(unaudited)	
Consolidated Statement of Operations Data:							
Revenues:							
License revenues	$–	$1,334	$8,879	$6,860	$9,820	$5,224	$16,603
Maintenance and service revenues	9	4,756	13,302	16,033	16,766	6,917	13,175

Total revenues	9	6,090	22,181	22,893	26,586	12,141	29,778
Cost of revenues:							
License revenues	—	241	840	650	814	366	1,011
Maintenance and service revenues	—	7,045	11,183	13,103	14,212	6,327	10,270
Total cost of revenues	—	7,286	12,023	13,753	15,026	6,693	11,281
Gross profit (loss)	9	(1,196)	10,158	9,140	11,560	5,448	18,497
Operating expenses:							
Sales and marketing	3,349	8,684	16,115	12,003	13,527	6,062	8,764
Research and development	2,354	4,852	9,701	10,659	11,118	5,227	5,266
General and administrative	974	2,668	5,048	4,859	5,053	2,174	2,525
Stock-based compensation(1)	1,064	3,229	4,312	1,878	424	280	2,027
Total operating expenses	7,741	19,433	35,176	29,399	30,122	13,743	18,582
Loss from operations	(7,732)	(20,629)	(25,018)	(20,259)	(18,562)	(8,295)	(85)
Interest expense and other income, net	157	93	(410)	(585)	(445)	(158)	(170)
Loss before cumulative effect of change in accounting principle	(7,575)	(20,536)	(25,428)	(20,844)	(19,007)	(8,453)	(255)
Cumulative effect of change in accounting principle	—	—	—	—	(123)	(123)	—
Net loss	$(7,575)	$(20,536)	$(25,428)	$(20,844)	$(19,130)	$(8,576)	$(255)

	Year Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003
						(unaudited)	
Basic and diluted net loss per share	$(35.07)	$(28.72)	$(23.83)	$(17.24)	$(13.98)	$(6.35)	$(0.18)
Weighted-average shares used in computing basic and diluted net loss per share	216	715	1,067	1,286	1,368	1,350	1,422

	Year Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003
						(unaudited)	
(1) Stock-based compensation consists of:							
Cost of maintenance and service revenues	$90	$552	$619	$309	$95	$63	$534
Sales and marketing	363	1,471	2,185	726	73	52	815
Research and development	339	637	767	399	119	77	460
General and administrative	272	569	741	444	137	88	218
Total stock-based compensation	$1,064	$3,229	$4,312	$1,878	$424	$280	$2,027

	As of December 31,					As of June 30,
	1998	1999	2000	2001	2002	2003
						(unaudited)
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$2,909	$14,877	$3,272	$12,034	$12,833	$13,289
Working capital	2,213	10,363	(12,116)	6,971	650	3,547
Total assets	4,257	22,508	15,625	19,664	20,695	27,961
Long-term debt, less current portion	17	1,570	2,308	439	986	838
Total liabilities	904	10,084	23,904	8,974	18,602	23,467
Total stockholders' equity (deficit)	3,353	12,424	(8,279)	10,690	2,093	4,494

Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis

Of Financial Condition and Results of Operations

The following information should be read together with our consolidated financial statements, including the notes thereto, and other information included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties.

Overview

General

We are a leading provider of Enterprise Incentive Management (EIM) software systems to global companies across multiple industries. Large enterprises use EIM systems to model, administer, analyze and report on pay-for-performance plans, which are designed to enable enterprises to align employee, sales and channel tactics with targeted business objectives, and thereby increase productivity, improve profitability and achieve competitive advantage. We develop, market, install and support rules-based enterprise application software to solve the complex problems of large scale enterprise incentive compensation systems. Our product suite is based on our proprietary technology and extensive domain expertise and provides the flexibility and scalability required to meet the dynamic EIM requirements of large, complex businesses across multiple industries.

We were incorporated in 1996, and began selling our first product, TrueComp, in mid-1999. In 2000, the first full year of TrueComp sales, our license revenues grew to approximately $8.9 million, while total revenues grew to approximately $22.2 million. At the same time, we grew our organization to a total of 180 personnel, largely in anticipation of future revenue growth. In 2001, license revenue growth was adversely affected by the general reduction in IT spending resulting from the economic downturn in the United States and the September 11 terrorist attacks, and we experienced a year-over-year decline in license revenues of 23% to approximately $6.9 million. This decline was offset in 2001 by growth in our maintenance and service revenues, such that overall revenues grew by 3% and our net loss decreased by 18% in 2001 compared to 2000. In 2002, license revenues grew by 43% to $9.8 million and total revenues grew by 16% to $26.6 million. Since the second quarter of 2002, our quarterly license revenues have grown by comparison to the prior year period for five consecutive quarters. For the six months ended June 30, 2003, we had total revenues of $29.8 million and a net loss of $255,000. From inception through June 30, 2003, we generated aggregate net operating losses of approximately $94.8 million.

Sources of Revenue

License Revenues. We generate license revenues from the sale of perpetual licenses to use our products, which we generally price on a per payee basis. In circumstances where third-party systems integrators provide integration and configuration services for deployment of our products, or the integration and configuration services we are to provide are not deemed essential to the functionality of the related software, we generally recognize all of the license revenues at the time the product has been delivered. In circumstances where we provide integration and configuration services and these services are deemed essential to the functionality of the related software, we recognize the revenues from these licenses on a percent-of-completion basis, with license fees recorded as deferred revenue pending recognition. Because our license revenue recognition differs based on contract terms and customer requirements, our license revenues may vary from period to period depending upon the mix of these arrangements we enter into in such periods. Please refer to "– Application of Critical Accounting Policies and Use of Estimates – Revenue Recognition," for further information regarding license revenue recognition.

Maintenance and Service Revenues. Maintenance and service revenues consist of sales of maintenance and upgrade rights associated with the sale of software licenses, integration and configuration services and training. We generally sell maintenance on an annual basis and provide customers with the right to receive product enhancements and new versions of the products purchased, as well as technical support. Maintenance revenues are recorded as deferred revenue at the time the associated license is sold or a maintenance renewal is purchased, and are recognized ratably over the term of the maintenance agreement. We derive service revenues when we provide integration, configuration or training services to customers. We price these services on a time-and-materials basis and we generally recognize these revenues when the services are performed. Integration and configuration services often are not started until one to two months after the software license is sold and generally take five to six months to complete; however, some integration and configuration projects can take twelve months or longer depending on the complexity of the project.

A substantial majority of our revenues have been, and are likely to continue to be, from licenses, maintenance and services related to our TrueComp product. In addition, while no single customer accounted for 10% or more of our revenues in 2000 or 2001, and only two customers accounted for more than 10% of our revenues for 2002, our quarterly revenues generally depend on relatively large sales of licenses or services to a relatively small number of customers. Any decline in sales of our TrueComp product or any delay or deferral of any large purchases by any of our customers could materially and adversely affect our revenues or operating results for a given quarter.

Cost of Revenue

Our cost of license revenues consists primarily of third-party royalties. Our cost of maintenance and service revenues consists primarily of salaries, benefits, travel and related overhead for technical support, training and consulting personnel, the cost of subcontractors for professional services and the cost of materials delivered with product enhancements and new releases. Because the cost of maintenance and service revenues is substantially higher, as a percentage of related revenues, than the cost of license revenues, our overall gross margins vary from period to period as a function of the mix of maintenance and service versus license revenues in such periods.

Operating Expenses

Sales and marketing expenses consist primarily of salaries, benefits and commissions, advertising, referral fees on direct sales, promotional campaigns and materials, travel and other related overhead. To date, all of our research and development expenses have been expensed as incurred, and consist primarily of salaries and benefits, as well as facilities and other related overhead. General and administrative expenses consist primarily of salaries and benefits, as well as finance, accounting, legal and administrative costs and related overhead. Prior to 2002, general and administrative expenses also included amortization of goodwill recorded in connection with our acquisition of The Rob Hand Consulting Group in 1999.

Deferred Stock-Based Compensation

We record deferred stock-based compensation when we grant stock options to employees with an exercise price lower than the deemed fair value of our common stock for financial accounting purposes on the date of grant. Deferred stock-based compensation is then amortized using the accelerated method. At June 30, 2003, we had total deferred stock-based compensation of approximately $4.2 million, which will be amortized over four years from the date of grant. For the quarters ending September 30, 2003 and December 31, 2003 and for 2004, we expect to amortize approximately $678,000, $665,000 and $1.8 million, respectively, of deferred stock-based compensation, based on options issued prior to June 30, 2003.

`Application of Critical Accounting Policies and Use of Estimates`

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The application of GAAP requires our management to make estimates that affect our reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation of our financial condition or results of operations will be affected.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application, while in other cases, management's judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions. We believe that the accounting policies discussed below are critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management's judgments and estimates. Our management has reviewed these critical accounting policies, our use of estimates and the related disclosures with our audit committee. Please refer to Note 1 to the consolidated financial statements for a further description of our accounting policies.

Revenue Recognition

We generate revenues primarily by licensing software and providing maintenance and professional services to our customers. Our software arrangements typically include: (i) an end-user license fee paid in exchange for the use of our products in perpetuity, generally based on a specified number of payees; and (ii) a maintenance arrangement that provides for technical support and product updates, generally over a period of twelve months. If we are selected to provide integration and configuration services, then the software arrangement will also include professional services, generally priced on a time-and-materials basis. Depending upon the elements in the arrangement and the terms of the related agreement, we recognize license revenues under either the residual or the contract accounting method.

Residual Method. License fees are recognized upon delivery when licenses are either sold separately from integration and configuration services, or together with integration and configuration services, provided that (i) the criteria described below have been met, (ii) payment of the license fees is not dependent upon performance of the integration and configuration services, and (iii) the services are not otherwise essential to the functionality of the software. We recognize these license revenues using the residual method pursuant to the requirements of Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, *Software Revenue Recognition with Respect to Certain Transactions*. Under the residual method, revenues are recognized when vendor-specific objective evidence of fair value exists for all of the undelivered elements in the arrangement (i.e., professional services and maintenance), but does not exist for one or more of the delivered elements in the arrangement (i.e., the software product). Each license arrangement requires careful analysis to ensure that all of the individual elements in the license transaction have been identified, along with the fair value of each undelivered element.

We allocate revenue to each undelivered element based on its respective fair value, with the fair value determined by the price charged when that element is sold separately. For a certain class of transactions, the fair value of the maintenance portion of our arrangements is based on stated renewal rates. The fair value of the professional services portion of the arrangement is based on the hourly rates that we charge for these services when sold independently from a software license. If evidence of fair value cannot be established for the undelivered elements of a license agreement, the entire amount of revenue from the arrangement is deferred until evidence of fair value can be established, or until the items for which evidence of fair value cannot be established are delivered. If the only undelivered element is maintenance, then the entire amount of revenue is recognized over the maintenance delivery period.

Contract Accounting Method. For arrangements where services are considered essential to the functionality of the software, such as where the payment of the license fees is dependent upon performance of the services, both the license and services revenues are recognized in accordance with the provisions of SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. We generally use the percentage-of-completion method because we are able to make reasonably dependable estimates relative to contract costs and the extent of progress toward completion. However, if arrangements do not allow us to make reasonably dependable estimates we will use the completed-contract method. If total cost estimates exceed revenues, we accrue for the estimated loss on the arrangement.

For all of our software arrangements, we will not recognize revenue until persuasive evidence of an arrangement exists and delivery has occurred, the fee is fixed or determinable and collection is deemed probable. We evaluate each of these criteria as follows:

Evidence of an Arrangement. We consider a non-cancelable agreement signed by us and the customer to be evidence of an arrangement.

Delivery. We consider delivery to have occurred when media containing the licensed programs is provided to a common carrier or, in the case of electronic delivery, the customer is given access to the licensed programs. Our typical end-user license agreement does not include customer acceptance provisions.

Fixed or Determinable Fee. We consider the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within our standard payment terms. If the fee is not fixed or determinable, we recognize the revenue as amounts become due and payable.

Collection is Deemed Probable. We conduct a credit review for all significant transactions at the time of the arrangement to determine the creditworthiness of the customer. Collection is deemed probable if we expect that the customer will be able to pay amounts under the arrangement as payments become due. If we determine that collection is not probable, we defer the revenue and recognize the revenue upon cash collection.

A customer typically prepays maintenance for the first twelve months, and the related revenues are deferred and recognized over the term of the initial maintenance contract. Maintenance is renewable by the customer on an annual basis thereafter. Rates for maintenance, including subsequent renewal rates, are typically established based upon a specified percentage of net license fees as set forth in the arrangement.

Professional services revenues primarily consist of integration and configuration services related to the installation of our products and training revenues. Our implementation services do not involve customization to, or development of, the underlying software code. Substantially all of our professional services arrangements are on a time-and-materials basis. To the extent we enter into a fixed-fee services contract, a loss will be recognized any time the total estimated project cost exceeds project revenues.

Certain arrangements result in the payment of customer referral fees to third parties that resell our software products. In these arrangements, license revenues are recorded, net of such referral fees, at the time the software license has been delivered to a third-party reseller and an end-user customer has been identified. To the extent a referral fee is paid to a third party when we sell directly to the end-user, the referral fee is recorded as a selling expense.

In arrangements where we purchase a third party's products or services and sell products or services to the same party within a relatively short time period, we account for such concurrent arrangements in accordance with APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, Emerging Issues Task Force 86-29, *Nonmonetary Transactions: Magnitude of Boot and the Exception to the Use of Fair Value* and the American Institute of Certified Public Accountants Technical Practice Aids 5100.46 and 5100.47, *Nonmonetary Exchanges of Software.* Accordingly, we record revenue on these transactions if the fair value of the products or services purchased or sold can be determined and the technology received in the transaction is expected, at the time of the exchange, to be deployed. If we are unable to determine the fair value of the products purchased or sold, or if the deployment of the purchased product is uncertain, we record the transaction at the historical cost basis of the products or services sold. During 2000, we entered into four sets of such concurrent transactions in which we and third parties purchased each other's software products and services for internal use. In these transactions, we received net cash consideration of $604,000. Excluding net cash consideration, revenues recognized from these transactions were $1.2 million, or 6% of total revenues, in 2000 and $402,000, or 2% of total revenues, in 2001. The fair value of the products purchased were recorded as property and equipment in the amount of $1.1 million, and are being amortized over their useful lives of three years. The amounts we paid for maintenance and services of $105,000 and $480,000 in 2000 and 2001, respectively, in these transactions were recorded as general and administrative expense as incurred. We did not enter into any concurrent transactions in 2001, 2002 or the six months ended June 30, 2003.

Allowance for Doubtful Accounts and Sales Return Reserve

We must make estimates of the uncollectibility of accounts receivable. The allowance for doubtful accounts, which is netted against our accounts receivable on our balance sheets, totaled $47,000 at December 31, 2001, $129,000 at December 31, 2002 and $103,000 at June 30, 2003. We record an increase in the allowance for doubtful accounts when the prospect of collecting a specific account receivable becomes doubtful. Management specifically analyzes accounts receivable and historical bad debts experience, customer creditworthiness, current economic trends, international situations (such as currency devaluation) and changes in our customer payment history when evaluating the adequacy of the allowance for doubtful accounts. Should any of these factors change, the estimates made by management will also change, which could affect the level of our future provision for doubtful accounts. Specifically, if the financial condition of our customers were to deteriorate, affecting their ability to make payments, an additional provision for doubtful accounts may be required and such provision may be material.

We generally guarantee that our services will be performed in accordance with the criteria agreed upon in the statement of work. Should these services not be performed in accordance with the agreed upon criteria, we would provide remediation services until such time as the criteria are met. In accordance with Statement of Financial Accounting Standards (SFAS) 48, *Revenue Recognition When Right of Return Exists*, management must use judgments and make estimates of sales return reserves related to potential future requirements to provide remediation services in connection with current period service revenues. When providing for sales return reserves, we analyze historical experience of actual remediation service claims as well as current information on remediation service requests as they are the primary indicators for estimating future service claims. Material differences may result in the amount and timing of our revenues if for any period actual returns differ from management's judgments or estimates. The sales return reserve balances, which are netted against our accounts receivable on our balance sheets, were $0 at December 31, 2001, $152,000 at December 31, 2002 and $232,000 at June 30, 2003.

Stock-Based Compensation

We have adopted SFAS 123, *Accounting for Stock-Based Compensation*, but in accordance with SFAS 123, we have elected not to apply fair value-based accounting for our employee stock option plans. Instead, we measure compensation expense for our employee stock option plans using the intrinsic value method prescribed by Accounting Principles Board Opinion (APB) 25, *Accounting for Stock Issued to Employees*, and related interpretations. We record deferred stock-based compensation to the extent the deemed fair value of our common stock for financial accounting purposes exceeds the exercise price of stock options granted to employees on the date of grant, and amortize these amounts to expense using the accelerated method over the vesting schedule of the options, generally four years. The deemed fair value of our common stock is determined by our board of directors. Because there has been no public market for our stock, the board of directors determined the deemed fair value of our common stock by considering a number of factors, including, but not limited to, our operating performance, significant events in our history, issuances of our convertible preferred stock, trends in the broad market for technology stocks and the expected valuation we would obtain in an initial public offering. We recorded deferred stock-based compensation of $1.7 million, $0, $0 and $4.5 million and amortization of such deferred compensation of $4.3 million, $1.9 million, $424,000 and $440,000 in the years ended December 31, 2000, 2001 and 2002 and the six months ended June 30, 2003, respectively. Based on deferred stock-based compensation recorded as of

June 30, 2003, we expect to amortize $678,000, $665,000 and $1.8 million in the three months ending September 30, 2003, the three months ending December 31, 2003 and in 2004, respectively. Had different assumptions or criteria been used to determine the deemed fair value of the stock options, materially different amounts of stock compensation expenses could have been reported.

As required by SFAS 123, as modified by SFAS 148, *Accounting for Stock Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123*, we provide pro forma disclosure of the effect of using the fair value-based method of measuring stock-based compensation expense. For purposes of the pro forma disclosure, we estimate the fair value of stock options issued to employees using the Black-Scholes option valuation model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected life of options and our expected stock price volatility. Therefore, the estimated fair value of our employee stock options could vary significantly as a result of changes in the assumptions used. See Note 1 to our consolidated financial statements included elsewhere in this prospectus.

Income Taxes

We are subject to income taxes in both the United States and foreign jurisdictions and we use estimates in determining our provision for income taxes. Deferred tax assets, related valuation allowances and deferred tax liabilities are determined separately by tax jurisdiction. This process involves estimating actual current tax liabilities together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. Our deferred tax assets consist primarily of net operating loss carryforwards. We assess the likelihood that deferred tax assets will be recovered from future taxable income, and a valuation allowance is recognized if it is more likely than not that some portion of the deferred tax assets will not be recognized. We provided a full valuation allowance against our net deferred tax assets at December 31, 2001 and 2002 and June 30, 2003. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax assets would increase income in the period such determination was made. Although we believe that our tax estimates are reasonable, the ultimate tax determination involves significant judgment that could become subject to audit by tax authorities in the ordinary course of business.

Results of Operations

The following table sets forth certain consolidated statements of operations data expressed as a percentage of total revenues for the periods indicated. Period-to-period comparisons of our financial results are not necessarily meaningful and you should not rely on them as an indication of future performance.

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
				(unaudited)	
Revenues:					
License revenues	40%	30%	37%	43%	56%
Maintenance and service revenues	60	70	63	57	44
Total revenues	100	100	100	100	100
Cost of revenues (as a percent of related revenues)					
License revenues	9	9	8	7	6
Maintenance and service revenues	84	82	85	91	78
Total cost of revenues	54	60	57	55	38
Gross profit	46	40	43	45	62

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
				(unaudited)	
Operating expenses:					
Sales and marketing	73	52	51	50	29
Research and development	44	47	42	43	18
General and administrative	23	21	19	18	8
Stock-based compensation	19	8	2	2	7
Total operating expenses	159	128	113	113	63
Loss from operations	(113)	(88)	(70)	(68)	0
Interest expense and other income, net	(2)	(3)	(2)	(1)	(1)
Loss before cumulative effect of change in accounting principle	(115)	(91)	(71)	(70)	(1)
Cumulative effect of change in accounting principle	–	–	–	(1)	–

Net loss	(115)%	(91)%	(72)%	(70)%	(1)%

Comparison of the Six Months Ended June 30, 2002 and 2003

Revenues

License Revenues. License revenues grew by 218% from $5.2 million, or 43% of total revenues, in the six months ended June 30, 2002, to $16.6 million, or 56% of total revenues, in the six months ended June 30, 2003. The increase in license revenues was primarily the result of the growth in size and productivity of our sales force, an increase in average transaction value and the addition of new customers.

Maintenance and Service Revenues. Maintenance and service revenues grew by 90% from $6.9 million in the six months ended June 30, 2002 to $13.2 million in the six months ended June 30, 2003. As a percentage of total revenues, maintenance and service revenues decreased from 57% in the 2002 period to 44% in the 2003 period. The absolute dollar increase in maintenance and service revenues was primarily attributable to an increase in integration and configuration services for new customers and, to a lesser extent, increased maintenance fees associated with sales of new licenses of our products.

Cost of Revenues and Gross Margin

Cost of License Revenues. Cost of license revenues increased by 176% from $366,000 in the six months ended June 30, 2002 to $1.0 million in the six months ended June 30, 2003. The increase was primarily attributable to third-party royalty costs on increased license sales. As a percentage of license revenues, cost of license revenues decreased from 7% in the 2002 period to 6% in the 2003 period. The slightly lower cost of license revenues as a percentage of license revenues was due to product enhancements that eliminated certain third-party royalty costs.

Cost of Maintenance and Service Revenues. Cost of maintenance and service revenues increased by 62% from $6.3 million in the six months ended June 30, 2002 to $10.3 million in the six months ended June 30, 2003. The increase was primarily attributable to the increases in the number of integration and configuration, training and technical support personnel. As a percentage of maintenance and service revenues, cost of maintenance and service revenues decreased from 91% in the 2002 period to 78% in the 2003 period. Increased maintenance and service revenues attributable to the growth in our customer base resulted in higher utilization rates and a decline in the cost of maintenance and service revenues as a percentage of related revenues.

Gross Margin. Our gross profit as a percentage of total revenues, or gross margin, increased from 45% for the six months ended June 30, 2002 to 62% for the six months ended June 30, 2003. The increase was primarily attributable to the 218% growth of higher margin license revenues in comparison to the 90% growth in maintenance and service revenues.

Operating Expenses

Sales and Marketing. Sales and marketing expenses increased by 45% from $6.1 million in the six months ended June 30, 2002 to $8.8 million in the six months ended June 30, 2003. The increase in absolute dollars was primarily associated with increased personnel expense of $1.2 million related to an increase in our sales and marketing headcount and an increase of $1.1 million in commission expenses and referral fees. To a lesser extent, the absolute dollar increase was attributable to a $522,000 increase in marketing program fees and ancillary sales and marketing costs. As a percentage of total revenues, sales and marketing expenses decreased from 50% in the 2002 period to 29% in the 2003 period. The decrease as a percentage of total revenues resulted primarily from increased productivity of our direct sales force in addition to an increase in the number of customer referrals from our strategic partners. We expect that sales and marketing expenses will continue to increase in absolute dollars as we expand our sales force and increase marketing activities.

Research and Development. Research and development expenses increased by 1% from $5.2 million in the six months ended June 30, 2002 to $5.3 million in the six months ended June 30, 2003. As a percentage of total revenues, research and development expenses decreased from 43% in the 2002 period to 18% in the 2003 period. The decrease as a percentage of total revenues was the result of revenues increasing 145% while the research and development expenses remained essentially constant. We expect research and development expenses to increase in absolute dollars in the future as we increase our spending to enhance the functionality of existing products and introduce new products.

General and Administrative. General and administrative expenses increased by 16% from $2.2 million in the six months ended June 30, 2002 to $2.5 million in the six months ended June 30, 2003. The increase in absolute dollars was primarily attributable to a $300,000 increase in personnel expense associated with increased headcount. As a percentage of total revenues, general and administrative expenses decreased from 18% in the 2002 period to 8% in the 2003 period. The decrease as a percentage of total revenues was the result of the revenues increasing 145% while the general and administrative costs increased only 16%. We expect general and administrative expenses to continue to increase in absolute dollars in the future as we invest in infrastructure to support continued growth and incur additional expenses related to being a public company.

Stock-based Compensation. Stock-based compensation increased to $2.0 million in the six months ended June 30, 2003 primarily as a result of $1.6 million of stock-based compensation recorded in connection with the issuance of 453,000 shares of our Series G preferred stock to certain of our executive officers and key employees at a discount to the deemed fair value of such stock for financial accounting purposes. To a lesser extent, the increase also reflects increased amortization of deferred stock-based compensation recorded in 2003.

Interest Expense and Other Income, Net

Interest expense decreased 17% from $263,000 for the six months ended June 30, 2002 to $217,000 for the six months ended June 30, 2003. Interest expense consists of interest paid on our line of credit and loans, as well as amortization of loan discounts associated with the fair value of warrants. Other income, net decreased 56% from $106,000 for the six months ended June 30, 2002 to $47,000 for the six months ended June 30, 2003. Other income, net consists primarily of interest income on bank balances.

Cumulative Effect of a Change in Accounting Principle

We recorded a transitional impairment loss of approximately $123,000 in January 2002 upon the adoption of SFAS 142, *Goodwill and Other Intangible Assets*. The transitional impairment loss was based on an assessment of the implied fair value of goodwill at the time of adoption of SFAS 142. The impairment loss reduced the carrying value of the goodwill we recorded in connection with our acquisition of The Rob Hand Consulting Group in 1999 to zero as of January 1, 2002.

Comparison of the Years Ended December 31, 2001 and 2002

Revenues

License Revenues. License revenues grew by 43% from $6.9 million, or 30% of total revenues, in 2001 to $9.8 million, or 37% of total revenues, in 2002. The increase in license revenues in 2002 resulted in part from strong license sales in the fourth quarter of 2002 of $3.0 million compared to approximately $345,000 of license revenues in the same period of 2001. We believe our license revenues in 2001 were negatively affected by the general reduction in IT spending in the aftermath of the September 11 terrorist attacks and the overall economic downturn in the United States during 2001.

Maintenance and Service Revenues. Maintenance and service revenues grew by 5% from $16.0 million in 2001 to $16.8 million in 2002. As a percentage of total revenues, maintenance and service revenues decreased from 70% in 2001 to 63% in 2002. The absolute dollar increase in 2002 was primarily the result of an increase in integration and configuration projects associated with our increased license revenues.

Cost of Revenues and Gross Margin

Cost of License Revenues. Cost of license revenues increased by 25% from $650,000 in 2001 to $814,000 in 2002. The increase in absolute dollars in 2002 was primarily attributable to third-party royalty costs on higher license revenues. As a percentage of license revenues, cost of license revenues decreased from 9% in 2001 to 8% in 2002. The lower cost of license revenues as a percentage of revenues for 2002 was due to increased average license values which did not increase unit based royalty costs.

Cost of Maintenance and Service Revenues. Cost of maintenance and service revenues increased by 8% from $13.1 million, or 82% of maintenance and service revenues, in 2001 to $14.2 million, or 85% of maintenance and service revenues, in 2002. The increase in absolute dollars and as a percentage of related revenues in 2002 was primarily due to increased personnel costs of $1.2 million associated with the increase in the number of integration and configuration, training and technical support personnel. Travel and entertainment cost also increased by $460,000. These increases were partially offset by a decrease in contractor fees of $798,000.

Gross Margin. Our gross margin increased from 40% in 2001 to 43% in 2002. The increase was primarily attributable to a 43% increase in license revenues, which generate higher margins compared to the 5% increase in maintenance and service revenues which generate lower margins.

Operating Expenses

Sales and Marketing. Sales and marketing expenses increased by 13% from $12.0 million in 2001 to $13.5 million in 2002. As a percentage of revenues, sales and marketing expenses were relatively consistent at 52% in 2001 compared to 51% in 2002. The absolute dollar increase in 2002 was primarily associated with increased commission costs of $1.8 million resulting from increased license sales and increased travel and entertainment costs of $342,000. These increases were partially offset by a decrease in marketing program fees of $442,000 due to cost control measures and a decrease in personnel costs of $227,000 due to a decrease in the marketing headcount and a reduction in average salary expense.

Research and Development. Research and development expenses increased by 4% from $10.7 million in 2001 to $11.1 million in 2002. The absolute dollar increase was primarily associated with the increase in contractor fees related to third-party development services of $215,000 and an increase in personnel costs of $162,000 as a result of higher average salaries. As a percentage of total revenues, research and development expenses decreased from 47% in 2001 to 42% in 2002. The decrease as a percentage of total revenues in 2002 was the result of revenues increasing at a greater rate than research and development costs.

General and Administrative. General and administrative expenses increased by 4% from $4.9 million in 2001 to $5.1 million in 2002. As a percentage of total revenues, general and administrative expenses decreased from 21% in 2001 to 19% in 2002. The increase in absolute dollars in 2002 was primarily attributable to an increase in outside legal fees of $826,000 associated with litigation expenses which were partially offset by a $332,000 decrease in personnel costs resulting from a decrease in average headcount, a $211,000 decrease in goodwill amortization due to our adoption of SFAS 142, *Goodwill and Other Intangible Assets*, on January 1, 2002, and a $98,000 decrease in depreciation and overhead expenses.

Stock-based Compensation. Stock-based compensation expenses decreased by 77% from $1.9 million in 2001 to $424,000 in 2002. The decrease was primarily due to the accelerated amortization of previously recorded deferred stock-based compensation from options granted with exercise prices below the deemed fair value of our common stock on the date of grant.

Interest Expense and Other Income, Net

Interest expense decreased 36% from $916,000 in 2001 to $582,000 in 2002. Interest expense consists of interest paid on our line of credit and loans, as well as amortization of loan discounts associated with the fair value of warrants. Other income, net decreased 59% from $331,000 in 2001 to $137,000 in 2002. Other income, net consists primarily of interest income on bank balances.

Cumulative Effect of a Change in Accounting Principle

We recorded a transitional impairment loss of approximately $123,000 in January 2002 upon the adoption of SFAS 142, *Goodwill and Other Intangible Assets*. The transitional impairment loss was based on an assessment of the implied fair value of goodwill at the time of adoption. The impairment loss reduced the carrying value of goodwill we recorded in connection with our acquisition of The Rob Hand Consulting Group in 1999 to zero as of January 1, 2002.

Comparison of the Years Ended December 31, 2000 and 2001

Revenues

License Revenues. License revenues decreased by 23% from $8.9 million, or 40% of total revenues, in 2000 to $6.9 million, or 30% of total revenues, in 2001. License revenues for 2001 were adversely affected by the general reduction in IT spending, particularly in third and fourth quarter, subsequent to the September 11 terrorist attacks and the overall economic downturn in the United States during 2001. License revenues for the quarter ended December 31, 2001 was $345,000 as compared to $2.4 million for the quarter ended December 31, 2000.

Maintenance and Service Revenues. Maintenance and service revenues increased by 21% from $13.3 million, or 60% of total revenues, in 2000 to $16.0 million, or 70% of total revenues, in 2001. The increase in 2001 was primarily attributable to increased service revenues associated with integration and configuration services for new customers and maintenance fees associated with sales of new licenses. The increase as a percentage of total revenues is primarily associated with the decrease in license revenues referenced above.

Cost of Revenues and Gross Margin

Cost of License Revenues. Cost of license revenues decreased by 23% from $840,000 in 2000 to $650,000 in 2001. Cost of license revenues as a percentage of related revenues was unchanged at 9% in 2001 and 2000. The decrease in cost of license revenues in absolute dollars in 2001 was due primarily to the decrease in third-party royalty costs associated with the decrease in license revenues.

Cost of Maintenance and Service Revenues. Cost of maintenance and service revenues increased by 17% from $11.2 million in 2000 to $13.1 million in 2001. As a percentage of related revenues, cost of maintenance and service revenues decreased from 84% in 2000 to 82% in 2001. The increase in absolute dollars in 2001 was primarily due to increased personnel costs of $1.1 million associated with the increase in the number of integration and configuration, training and technical support personnel. Additionally, facilities and overhead costs increased by $304,000 and travel and entertainment increased by $200,000.

Gross Margin. Our gross margin decreased from 46% in 2000 to 40% in 2001. The decrease in our gross margin was primarily attributable to the 23% decrease in license revenues, which generate higher margins. Maintenance and service revenues increased by 21% and accounted for 70% of the total revenues.

Operating Expenses

Sales and Marketing. Sales and marketing expenses decreased by 26% from $16.1 million, or 73% of total revenues, in 2000 to $12.0 million, or 52% of total revenues, in 2001. The decrease in 2001 was attributable to cost cutting measures that resulted in a $2.1 million decrease in personnel costs from a decrease in headcount and lower average salaries. Travel and entertainment costs decreased by $310,000 due to the reduced headcount and cost control measures. Additionally, marketing program fees were reduced by $1.0 million and professional fees were decreased by $757,000 primarily as a result of the elimination of our contracting arrangement for the management of our European operations. As a result of the decrease in absolute costs, sales and marketing expenses decreased as a percentage of total revenues.

Research and Development. Research and development expenses increased by 10% from $9.7 million, or 44% of total revenues, in 2000 to $10.7 million, or 47% of total revenues, in 2001. The absolute dollar increase in 2001 was primarily associated with costs of increased headcount, resulting in additional expenses of $1.8 million, partially offset by a decrease in contractor fees of $1.6 million resulting from the conversion of many contract developers to employees. The increase in headcount contributed to an increase in facilities and overhead costs of $872,000.

General and Administrative. General and administrative expenses decreased by 4% from $5.0 million, or 23% of total revenues, in 2000 to $4.9 million, or 21% of total revenues, in 2001. The decrease in 2001 was primarily attributable to a reduction in professional fees of $436,000 due to cost control measures. This decrease was partially offset by an increase in personnel expenses of $242,000.

Stock-based Compensation. Stock-based compensation expense decreased by 56% from $4.3 million in 2000 to $1.9 million in 2001. The decrease was primarily due to the accelerated amortization of previously recorded deferred stock-based compensation from options granted with exercise prices below the deemed fair value of our common stock on the date of grant.

Interest Expense and Other Income, Net

Interest expense increased 16% from $793,000 in 2000 to $916,000 in 2001. Interest expense consists of interest paid on our line of credit and loans, as well as amortization of loan discounts associated with the fair value of warrants. Other income, net decreased 14% from $383,000 in 2000 to $331,000 in 2001. Other income, net consists primarily of interest income on bank balances.

Selected Quarterly Operating Results

The tables below show our unaudited consolidated quarterly statements of operations data for each of the ten most recent quarters, as well as the percentage of revenues for each line item shown. This information has been derived from our unaudited consolidated financial statements, which, in our opinion, have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the information for the quarters presented. The results of operations for any quarter are not necessarily indicative of the results of operations in any future period.

	Three Months Ended									
	Mar 31,	Jun 30,	Sept 30,	Dec 31,	Mar 31,	Jun 30,	Sept 30,	Dec 31,	Mar 31,	Jun 30,
	2001	2001	2001	2001	2002	2002	2002	2002	2003	2003
	(unaudited)									
	(in thousands)									
Revenues:										
License revenues	$3,575	$1,655	$1,285	$345	$2,716	$2,508	$1,571	$3,025	$7,708	$8,89
Maintenance and service revenues	4,192	4,672	4,015	3,154	3,127	3,790	4,789	5,060	5,427	7,748
Total revenue	7,767	6,327	5,300	3,499	5,843	6,298	6,360	8,085	13,135	16,64
Cost of revenues:										
License revenues	340	148	108	54	179	187	152	296	498	513

Maintenance and service revenues	3,647	3,848	2,947	2,661	3,069	3,258	3,807	4,078	4,271	5,999
Total cost of revenues	3,987	3,996	3,055	2,715	3,248	3,445	3,959	4,374	4,769	6,512
Gross profit	3,780	2,331	2,245	784	2,595	2,853	2,401	3,711	8,366	10,13
Operating expenses:										
Sales and marketing	3,672	3,488	2,476	2,367	3,006	3,056	3,179	4,286	3,554	5,210
Research and development	3,077	3,045	2,331	2,206	2,462	2,765	3,376	2,515	2,703	2,563
General and administrative	1,229	1,218	922	1,490	801	1,373	1,323	1,556	1,282	1,243
Stock-based compensation	712	513	393	260	159	121	86	58	1,755	272
Total operating expenses	8,690	8,264	6,122	6,323	6,429	7,316	7,964	8,415	9,294	9,288
Income (loss) from operations	(4,910)	(5,933)	(3,877)	(5,539)	(3,833)	(4,462)	(5,563)	(4,704)	(928)	843
Interest expense and other income, net	(361)	13	(152)	(85)	(85)	(73)	(118)	(169)	(76)	(94)
Income (loss) before cumulative effect of change in accounting principle	(5,271)	(5,920)	(4,029)	(5,624)	(3,918)	(4,535)	(5,681)	(4,873)	(1,004)	749
Cumulative effect of change in accounting principle	—	—	—	—	(123)	—	—	—	—	—
Net income (loss)	$(5,271)	$(5,920)	$(4,029)	$(5,624)	$(4,041)	$(4,535)	$(5,681)	$(4,873)	$(1,004)	$749

	Three Months Ended									
	Mar 31, 2001	Jun 30, 2001	Sept 30, 2001	Dec 31, 2001	Mar 31, 2002	Jun 30, 2002	Sept 30, 2002	Dec 31, 2002	Mar 31, 2003	Jun 30, 2003
	(unaudited)									
Revenues:										
License revenues	46.0%	26.2%	24.2%	9.9%	46.5%	39.8%	24.7%	37.4%	58.7%	53.4%
Maintenance and service revenues	54.0	73.8	75.8	90.1	53.5	60.2	75.3	62.6	41.3	46.6
Total revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cost of revenues (as a percent of related revenues):										
License revenues	9.5	8.9	8.4	15.7	6.6	7.5	9.7	9.8	6.5	5.8
Maintenance and service revenues	87.0	82.4	73.4	84.4	98.1	86.0	79.5	80.6	78.7	77.4
Total cost of revenues	51.3	63.2	57.6	77.6	55.6	54.7	62.2	54.1	36.3	39.1
Gross profit	48.7	36.8	42.4	22.4	44.4	45.3	37.8	45.9	63.7	60.9
Operating expenses:										
Sales and marketing	47.3	55.1	46.7	67.6	51.4	48.5	50.0	53.0	27.1	31.3
Research and development	39.6	48.1	44.0	63.0	42.1	43.9	53.1	31.1	20.6	15.4
General and administrative	15.8	19.3	17.4	42.6	13.7	21.8	20.8	19.2	9.8	7.5

Stock-based compensation	9.2	8.1	7.4	7.4	2.7	1.9	1.4	0.7	13.4	1.6
Total operating expenses	111.9	130.6	115.5	180.7	110.0	116.1	125.2	104.1	70.8	55.8
Income (loss) from operations	(63.2)	(93.8)	(73.2)	(158.3)	(65.6)	(70.8)	(87.5)	(58.2)	(7.1)	5.1
Interest expense and other income, net	(4.6)	0.3	(2.8)	(2.4)	(1.4)	(1.1)	(1.9)	(2.1)	(0.6)	(0.6)
Income (loss) before cumulative effect of change in accounting principle	(67.9)	(93.6)	(76.0)	(160.7)	(67.1)	(72.0)	(89.3)	(60.3)	(7.6)	4.5
Cumulative effect of change in accounting principle	—	—	—	—	2.1	—	—	—	—	—
Net income (loss)	(67.9)%	(93.6)%	(76.0)%	(160.7)%	(69.2)%	(72.0)%	(89.3)%	(60.3)%	(7.6)%	4.5%

Our revenues in general, and our license revenues in particular, are difficult to forecast and are likely to fluctuate substantially from quarter to quarter due to a number of factors, many of which are outside of our control. For example, our license revenues in the quarter ended December 31, 2001 were adversely affected by the general reduction in IT spending in the aftermath of the September 11 terrorist attacks, and again in the quarter ended September 30, 2002 by the delay in closing a large contract due to competitive pressures. In addition, we budget our operating expenses based on our estimates of future revenues and a high percentage of our expenses are fixed in the short term. We also may be subject to unanticipated expenses. For example, general and administrative expenses in the quarter ended December 31, 2001 were increased by the costs of settling certain litigation. We recorded higher research and development expenses in the quarter ended September 30, 2002 due to an outsourced development project and we recorded higher sales and marketing costs in the quarter ended December 31, 2002 due to commissions that were earned upon invoicing a customer even though revenues had not yet been recognized. In addition, in the quarter ended March 31, 2002, our cost of maintenance and service revenues as a percentage of related revenues was higher than usual as a result of increased hiring in anticipation of new engagements that did not produce expected levels of revenues until later periods. If even a small number of large license transactions, or recognition of license revenue from such transactions, is delayed until after a quarter ends or we experience unusual operating expenses, our operating results could vary substantially from quarter to quarter and our net income could fall significantly short of expectations. If our operating results in future quarters fall below the expectations of market analysts and investors, the trading price of our common stock may fall. For a discussion of these and other factors that may cause our operating results to fluctuate from quarter to quarter, see "Risk Factors — *Our quarterly revenues and operating results can be difficult to predict and can fluctuate substantially, which may harm our results of operations.*"

Liquidity and Capital Resources

Since our inception in September 1996, we have funded our operations primarily through the issuance of convertible preferred stock that provided us with aggregate net proceeds of approximately $84.2 million. As of December 31, 2002 and June 30, 2003, we had cash and cash equivalents of $12.8 million and $13.3 million, respectively.

Net Cash Used in Operating Activities. We used $2.3 million net cash in operating activities in the six months ended June 30, 2003. Cash used in operating activities increased from $18.1 million in 2000, to $18.5 million in 2001 and decreased to $8.8 million in 2002. Net cash used in operating activities of $2.3 million for the six months ended June 30, 2003 was due primarily to a $7.3 million increase in accounts receivable partially offset by an increase in deferred revenues of $2.7 million. Net cash used in operating activities in 2000, 2001, and 2002 was primarily the result of our net operating losses during those periods offset by non-cash expenses including depreciation, amortization, and stock-based compensation. Also affecting net cash used in operating activities were changes in operating assets and liabilities which provided cash of $1.3 million in 2000, used cash of $2.5 million in 2001 and provided cash of $7.4 million in 2002. The $7.4 million change in 2002 was the result of a $4.9 million increase in deferred revenues plus other increases in liabilities offset by a $1.9 million increase in accounts receivable.

Net Cash Used in Investing Activities. We used $285,000 in investing activities in the six months ended June 30, 2003. Cash used in investing activities decreased from $4.2 million in 2000 to $456,000 in 2001 and increased to $668,000 in 2002. Net cash used in investing activities is primarily the result of capital expenditures including the purchases of equipment, software, furniture, and leasehold improvements to support the growth of our business. In 2000, capital expenditures of $3.6 million consisted primarily of equipment and software to support internal administration and growth in personnel. In 2001 and 2002, capital expenditures were approximately $646,000 and $657,000, respectively. Capital expenditures for the six months ended June 30, 2003 were approximately $389,000. We expect capital expenditures to increase in future periods consistent with our anticipated growth in personnel and infrastructure, including facilities and systems.

Net Cash Provided by Financing Activities. We generated $3.0 million in cash through our financing activities in the six months ended June 30, 2003. Cash provided by financing activities increased from $10.7 million in 2000 to $27.7 million in 2001 and decreased to $10.3 million in 2002. Net cash provided by financing activities in 2000 was due in large part to the issuance of $8.0 million of subordinated convertible notes payable which were converted into preferred stock in 2001. In 2001 and 2002, we received proceeds of $29.4 million and $8.9 million, respectively, from the issuance of preferred stock. In the six months ended June 30, 2003, we received $2.6 million in net proceeds from increases in short-term debt.

In March 2003, we amended a financing agreement with Silicon Valley Bank that includes a revolving line of credit that permits borrowings from time to time of the lesser of $7.0 million or 80% of eligible accounts receivable as determined by the lender. The agreement also provides for a $1.5 million term loan (Term Loan #1) payable in 36 monthly installments ending in September 2005 and a $1.0 million term loan (Term Loan #2) for equipment purchases

payable in 36 monthly installments ending in June 2006. Amounts drawn under both term loans cannot be reborrowed once repaid. In addition to the financing agreement with Silicon Valley Bank, we have an existing equipment loan with Transamerica Business Credit Corporation. At June 30, 2003, we had the following amounts available and amounts drawn under these agreements to support our ongoing financing requirements:

	Original Commitment Amount	Amount Drawn	Outstanding Principal Amount	Amount Available for Future Borrowing	Interest Rate
	(in thousands)				
Silicon Valley Bank line of credit	$7,000	$5,500	$5,500	$1,500	6.25%
Silicon Valley Bank Term Loan #1	1,500	1,500	1,125	—	6.50%
Silicon Valley Bank Term Loan #2	1,000	289	289	711	7.75%
Equipment Loan	2,500	1,108	308	—	12.64%
Total	$12,000	$8,397	$7,222	$2,211	

The financial covenants in the Silicon Valley Bank loan agreement require us to maintain minimum levels of monthly cash collections, quarterly revenues, and quarterly bookings. We were not in compliance with the revenue covenant as of December 31, 2002, but we received a waiver from the lender. As of June 30, 2003, we were in compliance with all covenants. We have no off-balance sheet arrangements, with the exception of operating lease commitments, that have not been recorded in our consolidated financial statements.

In September 2003, we amended the operating lease on our corporate headquarters in San Jose, California to increase the square footage to 44,500 and extend the term for seven years through 2010. The total rent obligation over the term of the lease is $10.3 million. We do not expect the amendment of the lease to result in significant capital expenditures or leasehold improvements.

The following table describes our commitments to settle contractual obligations in cash as of June 30, 2003. The contractual obligation for operating leases has been adjusted to reflect the September 2003 amendment to the operating lease for our corporate headquarters.

	Remaining 2003	2004	2005	2006	2007	2008 and Thereafter	Total
	(in thousands)						
Operating leases	$752	$1,762	$1,617	$1,400	$1,534	$4,161	$11,226
Term and equipment loans	496	707	471	48	—	—	1,722
Bank line of credit	5,500	—	—	—	—	—	5,500
Total contractual cash obligations	$6,748	$2,469	$2,088	$1,448	$1,534	$4,161	$18,448

We believe our existing cash balance, credit facilities, the net proceeds from this offering and cash from operations will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the timing and extent of spending to support product development efforts, the expansion of sales and marketing activities, the timing of introductions of new products and enhancement to existing products, and the continuing market acceptance of our products. To the extent that the net proceeds of this offering, together with existing cash and cash equivalents and any cash from operations, are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. Although we are currently not a party to any agreement or letter of intent with respect to potential investments in, or acquisitions of, complementary businesses, products or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing. In the event additional financing is required, we may not be able to raise it on acceptable terms or at all.

Quantitative and Qualitative Disclosures about Market Risk

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign exchange rates. We do not hold or issue financial instruments for trading purposes.

Interest Rate Risk. The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with an interest rate fixed at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, money market funds, government and non-government debt securities and certificates of deposit. We do not believe that a 10% change in interest rates will have a significant impact on our interest income. As of June 30, 2003, all of our investments were in money market accounts, certificates of deposit, high quality corporate debt obligations or United States government securities.

Our exposure to market risk also relates to the increase or decrease in the amount of interest expense we must pay on our outstanding debt instruments, primarily borrowings under an amended financing agreement we entered into with Silicon Valley Bank in March 2003 (See Note 3 of the notes to our consolidated financial statements). As of June 30, 2003, our revolving line of credit provides for borrowings up to $7.0 million, of which approximately $1.5 million is available for future borrowings. At June 30, 2003, approximately $5.5 million was outstanding under this revolving line of credit. In addition to the revolving line of credit, we have outstanding term loans with variable interest rates totaling $1.4 million as of June 30, 2003. The revolving line of credit

and term loans bear a variable interest rate based on the lender's prime rate plus 2.0% to 3.5%, with a floor ranging from 6.25% to 7.75%, depending on the type of loan. The risk associated with fluctuating interest expense is limited to these debt instruments and we do not believe that a 10% change in the prime rate would have a significant impact on our interest expense.

Foreign Currency Exchange Risk. Our revenues and our expenses, except those related to our United Kingdom, German and Australian operations, are denominated in United States dollars. As a result, we have relatively little exposure to currency exchange risks and foreign exchange losses have been minimal to date. We do not currently enter into forward exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. In the future, if we believe our foreign currency exposure has increased, we may consider entering into hedging transactions to help mitigate that risk.

Recent Accounting Pronouncements

In June 2001, the FASB issued SFAS 143, *Accounting for Asset Retirement Obligations*. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or normal use of the asset. As used in SFAS 143, a legal obligation results from existing law, statute, ordinance, written or oral contract, or by legal construction of a contract under the doctrine of promissory estoppel. SFAS 143 is effective for fiscal years beginning after June 15, 2002. We adopted SFAS 143 as of January 1, 2003. The adoption of SFAS 143 did not have a material impact on our consolidated financial position or results of operations.

In April 2002, the FASB issued SFAS 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. Among other provisions, SFAS 145 rescinds SFAS 4, *Reporting Gains and Losses from Extinguishment of Debt*. Accordingly, gains or losses from extinguishment of debt are not reported as extraordinary items unless the extinguishment qualifies as an extraordinary item under the criteria of APB 30. SFAS 145 is effective for fiscal years beginning after May 15, 2002. We adopted SFAS 145 as of January 1, 2003. The adoption of SFAS 145 did not have a material impact on our consolidated financial position or results of operations.

In July 2002, the FASB issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Previous guidance, provided under Emerging Issues Task Force (EITF) 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including certain costs incurred in a restructuring)*, required an exit cost liability be recognized at the date of an entity's commitment to an exit plan. The provisions of this statement are effective for exit or disposal activities that are initiated by a company after December 31, 2002. We adopted SFAS 146 as of January 1, 2003. The adoption of SFAS 146 did not have a material impact on our consolidated financial position or results of operations.

In November 2002, the FASB issued Statement of Financial Interpretations (FIN) 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The adoption of FIN 45 did not have a material impact on our consolidated financial position or results of operations.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities*. This interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. It explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. This interpretation applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. As of June 30, 2003, we did not have any investments in variable interest entities.

In April 2003, the FASB issued SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities.* SFAS 149 is generally effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of SFAS 149 will not have a significant impact on our consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS 150 is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the statement and still existing at the beginning of the interim period of adoption. The adoption of SFAS 150 did not have a significant impact on our consolidated financial position or results of operations.

Business

Business

Callidus Software

We are a leading provider of Enterprise Incentive Management (EIM) software systems to global companies across multiple industries. Large enterprises use EIM systems to model, administer, analyze and report on pay-for-performance plans, which are designed to align employee, sales and channel tactics with targeted business objectives, and thereby increase productivity, improve profitability and achieve competitive advantage. We develop, market, install and support rules-based enterprise application software to solve the complex problems of large scale enterprise incentive compensation systems. Our product suite is based on our proprietary technology and extensive domain expertise and provides the flexibility and scalability required to meet the dynamic EIM requirements of large, complex businesses across multiple industries. Our installed base of over 75 active customers includes industry leaders

in the insurance, retail banking, telecommunications, distribution, and manufacturing and technology industries, such as Allstate, JP Morgan Chase, AT&T Wireless, Airborne Express and Apple Computer. Our revenues were $26.6 million for the year ended December 31, 2002 and $29.8 million for the six months ended June 30, 2003.

Market Opportunity

Pay-for-Performance Programs

In today's competitive environment, pay-for-performance programs are increasingly recognized as important tools for companies to increase sales and productivity, gain market share and improve profitability. By rewarding employees and business partners for the achievement of quantitative and qualitative objectives, pay-for-performance programs provide incentives to achieve desired operating results, align behavior with corporate strategy and shareholder value and drive performance and competitive advantage in the marketplace. In 2001, AMR, a leading industry analysis firm, estimated that more than $1.5 trillion of pay-for-performance compensation is paid out annually by U.S. and European based companies.

The process of designing, maintaining and managing pay-for-performance programs to effectively meet corporate objectives is complex, expensive and time consuming. Large businesses such as banks, insurance companies, telecommunications providers and manufacturers need to calculate, report and pay sales commissions and incentives as often as weekly based on a large number of different compensation plans for thousands of internal and external payees. For large and complex pay-for-performance programs, these payments can represent millions of separate calculations per pay period, with total payouts ranging from approximately $100 million to over $1 billion annually. Employee turnover, changes to internal and external reporting systems, the need for very high levels of user security, regulatory restrictions and the dispersed nature of sales organizations themselves add further complexity to managing incentive compensation programs. The complexity of pay-for-performance programs is magnified by the use of management-by-objectives (MBOs), which compensate employees for the attainment of qualitative business objectives, such as customer satisfaction, quality of service and product development milestones.

While nearly all industries rely on pay-for-performance programs as a management tool, different industry verticals have distinct requirements and objectives for managing their pay-for-performance programs. For example, a manufacturer selling through the wholesale distribution channel concerned with gross product margin and customer discounts may want its pay-for-performance program to reward sales people for selling higher margin products and controlling discounts. A multi-line insurance company may also be concerned with customer discounts and gross margin by product line; however, because insurance companies must compensate both in-house and independent insurance agents under the separate regulations of 50 states, they must also contend with a variety of constraints including state-by-state license regulations and multi-year commission payouts tied to specific policy types.

Enterprise Incentive Management Requirements

Large companies increasingly require effective EIM systems to ensure that employees, agents and business partners are focused on achieving targeted business objectives to gain competitive advantage, increase productivity and improve bottom line results. Effective EIM systems must:

- ***Create Trust and Confidence in the Pay-for-Performance Programs.*** EIM systems must give finance personnel confidence in the integrity of the sales data and MBO attainment reports and at the same time generate trust among employees, agents and business partners that they will receive due credit and accurate compensation for achieving targeted business objectives.
- ***Report Incentive Compensation in a Timely Manner.*** Pay-for-performance program participants must receive goal attainment and reward notification on a regular basis, thereby reinforcing desired behavior and improving business performance.
- ***Facilitate Plan Modifications.*** EIM systems must enable management to adapt incentive compensation programs to align behavior with corporate objectives in response to competitive pressures.
- ***Provide Functionality and Scalability.*** EIM systems must enable large enterprises to address the complex industry-specific challenges they face and provide scalability to meet the performance requirements of processing millions of incentive compensation transactions.

To successfully implement and manage pay-for-performance programs, an EIM system must address each of the following requirements:

Data Acquisition. EIM systems require the acquisition of sales and operational data on which pay-for-performance compensation will be based. The pay-for-performance programs of large businesses may have anywhere from three data feeds, typically originating from order entry, accounts receivable and human resources, to as many as 30 data feeds. These additional data feeds may include information such as data from internal enterprise resource planning (ERP) or supply chain management systems to track individual products for a manufacturer or retailer, independent retail outlet data for a cellular telephone provider or transactional sales information provided by independent business partners such as retail banks to insurance companies. Assuring and maintaining the quality and validity of this data are essential to properly calculate and pay sales commissions. However, data originating from outside the enterprise, and in many cases inside the enterprise, is often incomplete or inaccurate and is subject to frequent change. For example, a key business partner might upgrade its in-house ERP system thus corrupting a data element that is essential to the commission calculation process.

Credit Allocation. Determining who gets credit for an individual transaction or performance objective is both technically difficult and subject to constant change. For example, in a sales incentive program, a large company may pay eight to fifteen payees for every transaction. These payees might include a telemarketing representative who created the sales lead, sales and support representatives who participated in the customer sale, branch, regional and area sales managers, the corporate vice president of sales and individuals in the marketing department responsible for sales of a product or service. Due to the large number of credits generated, the credit allocation process places a tremendous processing load on any EIM system. Credit allocation is further complicated by employee turnover and organizational change. As a result, the eight to fifteen people who receive credit for a transaction or performance milestone in one period may not be the same people in a subsequent period.

Measurement and Calculation. Determining the relevant compensation metrics and payment amounts presents additional challenges due to the number of compensation plans that may be used by large enterprises. In the example regarding sales force compensation discussed above, the eight to fifteen payees to be compensated for a given transaction may be compensated using as many different compensation plans. Specifically, sales representatives may be rewarded on the revenues and profitability of a given transaction, supervisors may be rewarded on the net contribution margin of the sales team and senior management may be rewarded on the contribution margin of the division.

Timing of Payments. Determining when a payee will be paid incentive compensation varies from company to company and industry to industry and is subject to frequent change depending on the goals and objectives management is trying to influence. For example, to manage accounts receivable, companies may reward sales people only upon collection. In other cases, sales commissions in excess of a certain value are paid out over a period of months or quarters in order to ensure employee retention and customer satisfaction. In still other industries, such as life insurance, calculation and pay-out of a commission may occur over a period as long as 20 years and the rights to receive these payments may be transferrable from one party to another.

Reporting Results. EIM systems must report results to payees with a high degree of accuracy. A successful reporting application must be capable of handling the large number of individual reports and report pages generated, the frequent rate of organizational change, the requirement for high levels of user security and the dispersed nature of sales organizations. Large businesses may generate more than a million report pages per week directed to thousands of payees who expect to see their individual commission reports accurately reflected in their native language and currency.

Enterprise Incentive Management Challenges

Historically, large businesses have sought to overcome the challenges inherent in pay-for-performance programs through labor-intensive, manual methods, that may involve numerous spreadsheets or desktop databases, or through the use of internally developed software solutions that are expensive to develop, inflexible and may not employ best practices or advanced technology. These manual methods or internally developed solutions may result in:

- ***Costly Errors.*** Industry studies estimate that on average, companies using manual methods to calculate pay-for-performance compensation for their sales forces overpay commissions by between 2% and 5% of the total payout. For example, an organization paying out $400 million per year in pay-for-performance compensation, may incur excess compensation expenses of $8 million to $20 million annually.
- ***Lost Productivity.*** Without a transparent and reliable resource to verify complex pay-for-performance calculations, payees may expend considerable time to confirm that they were not underpaid and to resolve any discrepancies, resulting in lost sales and operational productivity.
- ***Limited Flexibility.*** Manual methods and internally developed solutions are generally not equipped, or require substantial time and IT resources, to handle frequent changes to pay-for-performance programs resulting from payee turnover, new product introductions and evolving management priorities.

Recently, established ERP and customer relationship management (CRM) system providers have sought to provide solutions for managing pay-for-performance programs. However, EIM functionality generally is not core to these companies' product offerings, and we believe these companies have not developed the domain expertise required to meet the dynamic requirements of today's complex pay-for-performance programs.

Manual methods, internally developed solutions and solutions from ERP and CRM providers have historically been unable to provide large companies with an adequate means to accurately administer and report pay-for-performance compensation. These alternatives fail to meet EIM requirements due to the complexity and frequent rate of change of required internal and external data, the number of payees to whom credit must be allocated for each sales transaction, the number and unique nature of compensation plans, the variety of payment timing rules for compensation plans and the complexity of delivering timely and accurate reports.

The Callidus Solution

We develop, market, install and support a suite of rules-based EIM products to address the complex challenges of pay-for-performance programs for large enterprises. We provide a transparent and reliable data resource for enterprises to plan and manage pay-for-performance programs and accurately allocate credit among a wide range of payees. Our product suite allows management to accurately calculate and coordinate the payment of incentive compensation based on a highly flexible and scalable software architecture. In addition, our reporting product enables management to accurately and systematically report incentive compensation results to payees on a timely basis. Our solution is designed to enable large enterprises to achieve competitive advantage by ensuring that employees, agents and business partners are focused on targeted business objectives, thereby increasing productivity and driving bottom line results.

We believe we provide the most advanced EIM solutions available for three principal reasons:

We Solve Complex Pay-for-Performance Problems. Our TrueComp product enables enterprises to accurately reflect all sales data and to apply it to multiple pay-for-performance programs. TruePerformance enables our customers to plan and manage salary and MBO compensation. TrueResolution provides our customers the ability to efficiently manage sales commission dispute resolution with their independent distribution channels. TrueReferral offers our financial services customers the ability to effectively promote customer referrals by customer facing employees. Finally, TrueInformation provides reporting and analytics capabilities for our TrueComp, TrueResolution and TrueReferral products.

We Address Key Vertical Market Requirements. We believe domain expertise is critical to designing a successful EIM system. We apply our domain expertise to build specific functionality into our products to address the key requirements of the insurance, retail banking, telecommunications, distribution, and manufacturing and technology industries. For example, our TrueComp product includes functionality designed to address the complex pay-for-performance constraints affecting the insurance industry, including varied state-by-state regulatory requirements and transferability of incentive compensation payment rights.

We Have Superior Technology. Our products are based on our proprietary rules-based software and scalable grid computing architecture. We believe this technology differentiates our products and offers the following advantages:

- ***Performance and Scalability.*** Our products provide the capacity for vertical-specific functionality and the ability to rapidly and accurately process large transaction volumes.
- ***Flexibility, Reliability and Predictability.*** Our products facilitate changes to the rules governing a compensation plan to fine-tune incentives or adapt to changes in the competitive landscape without compromising the consistency and accuracy of results.
- ***Ease-of-Use.*** Our products enable non-technical personnel to configure and administer EIM systems and allow employees, agents and business partners to readily access up-to-date compensation information through an intuitive web-based interface.
- ***Lower Total Cost of Ownership.*** Our products are based on a standardized set of code designed to reduce the time and expense required to integrate and configure our products, upgrades and new releases and to enhance overall return on investment in our products.

Our customers use our EIM products to effectively manage complex and dynamic pay-for-performance programs, streamline resolution of incentive compensation disputes, reduce costly errors and improve profitability. The industry-specific functionality of our products enables our customers to address the important challenges for their pay-for-performance programs, including managing widely distributed agency channels in the heavily regulated insurance industry, managing large pay-outs to the independent dealer channel in the telecommunications and distribution industries, promoting referrals and cross-selling in the retail banking industry and promoting higher-margin products while controlling discounts in the manufacturing and technology industries.

Callidus Strategy

Our objective is to extend our leadership position in EIM systems for large businesses. To achieve this goal we are pursuing the following strategies:

Capitalize on Our Technological Leadership. We believe that most major enterprises utilize pay-for-performance programs, and that the majority of these enterprises are currently using manual methods or internally developed solutions that do not adequately address the key requirements of EIM systems. We intend to leverage our early-mover advantage and our technological leadership in the EIM market by continuing to invest in research and development to expand our product line and increase our products' functionality, and thereby to capitalize on the EIM market opportunity.

Continue Our Focus on Vertical Markets and Develop Additional Referenceable Accounts. Each of our five principal industry markets, insurance, retail banking, telecommunications, distribution, and manufacturing and technology, is a very large pay-for-performance market with distinct industry needs. Our domain expertise enables our products to offer industry-specific advantages in functionality, implementation and deployment and allows us to achieve greater efficiency and effectiveness in our sales, marketing and product development efforts. We intend to add marquee customers in each of our vertical markets and to leverage these referenceable accounts to increase penetration of our target markets. We also intend to invest in new vertical markets, such as pharmaceuticals and retail, that we believe present significant market opportunities.

Increase the Industry-Specific Modeling and Analytic Capabilities of Our Products. We are developing new products and product enhancements to provide customers with more extensive industry-specific modeling and analytic capabilities required in increasingly competitive marketplaces. These products will be designed to provide detailed information about the financial performance of sales channels, customers and products in various scenarios, enabling customers to proactively align compensation incentives to targeted business objectives and to more fully understand the effects of these changes on their pay-for-performance programs.

Continue to Build Loyalty Through Superior Customer Care. We believe our commitment to customer support is one of our principal competitive advantages. A member of our executive staff is responsible for maintaining our relationship with each major customer, and our customer advocacy group maintains quarterly contact with every account to ensure that our products and services are responsive to evolving customer needs. As we grow our installed base, we intend to increase investment in customer care to further strengthen customer loyalty and referenceability.

Products

Our EIM product suite models, administers, analyzes and reports on every aspect of the incentive compensation process. Our core products combine a flexible rules-based architecture with grid-based computing, providing customers with reliable, flexible and highly scalable solutions for EIM systems. The majority of our products are Java-based, enabling efficient implementation on any operating system, and all of our products are designed to be operated by business users and compensation professionals rather than IT administrators. Our product suite features user-defined security combined with a complete audit trail, allowing for reduced errors in incentive compensation, enhanced trust and confidence between operational and finance personnel and reduced cost of incentive compensation programs.

Our TrueComp product allows our customers to administer and analyze pay-for-performance programs for the sales force and distribution channels. TrueInformation, which generally is purchased with TrueComp, provides reporting and analytics capabilities for distributing pay-for-performance compensation information throughout the enterprise. TruePerformance enables customers to plan, implement and measure salary and MBO compensation. TrueResolution offers the ability to manage sales channel commission disputes. TrueReferral, which integrates with TrueComp, offers our financial services customers the ability to effectively promote customer referrals.

TrueComp

TrueComp automates the modeling, design, administration, reporting and analysis of pay-for-performance programs for enterprise level sales and distribution organizations. Our customers use TrueComp to design, test and implement sales compensation plans that reward on the profitability of the sale, discourage excessive sales discounts, encourage team selling and promote new product introduction or other sales activities the company wishes to encourage. TrueComp enables our customers to accurately acquire and reflect all relevant sales data, apply it precisely to each payee's pay-for-performance program and automate the day-to-day activities associated with administering transaction-driven, variable incentive compensation. TrueComp provides a flexible, user-maintainable system that can be modified easily to align direct or indirect sales compensation with corporate goals and shareholder value.

TrueComp consists of four principal modules: TrueIntegration collects and integrates the different data feeds used to compile the applicable sales data; TrueComp Repository serves as the database; TrueComp Manager serves as our rules-based engine; and the TrueComp Grid is our proprietary computing architecture. TrueComp's modular, structured approach to defining compensation plans avoids the reliability and maintenance issues associated with internally developed solutions and enables systematic administration over a high volume of transactions and varied compensation plans that is not attainable using manual methods. TrueComp guides users through the process of paying variable compensation by a graphical and intuitive rule editor, which is usable by compensation analysts without coding or scripting skills. TrueComp was initially shipped in the second quarter of 1999 and to date has accounted for a substantial majority of our revenues.

TrueInformation

TrueInformation is a self-service, web-based reporting and analytics portal that provides visibility into incentive compensation systems throughout the organization. TrueInformation provides reporting and analytics capabilities, enabling management to access a comprehensive model of pay-for-performance programs. By providing timely and accurate compensation information throughout the enterprise, TrueInformation engenders trust and

confidence among operational and finance personnel, thereby improving morale and operational results while reducing errors that increase the costs of incentive compensation. TrueInformation includes user-defined security parameters that allow for appropriate controls on dissemination of sensitive compensation data and is accessed through an intuitive web-based interface that offers ease of use throughout the organization. TrueInformation was initially shipped in the fourth quarter of 2002.

TruePerformance

TruePerformance provides tools and analytics to accurately plan, implement, manage and measure non-commission-based compensation programs. The primary features of TruePerformance include a compensation planner and a web-based team planner. The compensation planner provides forecasting, simulation and management capabilities for compensation policies, labor costs and personnel budgets. The team planner provides compensation professionals with a full view of employee and organizational data and provides compensation policy planning and MBO criteria development and assignment functionality. These features allow our customers to simulate the effects of changes in compensation strategy on their workforces, conduct market pay analysis, compare multiple incentive pay plan scenarios and plan for changes in compensation, promotions, job changes, new hires and reductions in force. By enabling our customers to effectively and efficiently create compensation plans and motivate employees, we believe TruePerformance allows our customers to build trust and confidence in their workforces, translate pay increases to bottom-line results, improve organizational consistency and achieve a greater return on investment. TruePerformance was initially shipped in the first quarter of 2003. TruePerformance was developed by an independent software company, and we have worldwide distribution rights to the product and the option to acquire all rights to the product. TruePerformance is currently available for NT SQL and NT Oracle platforms and we have contracted for the development of versions to support additional platforms.

`TrueResolution`

TrueResolution is a rules-based engine that streamlines and automates the resolution of sales commission disputes, thereby reducing the associated cost and diversion of management and sales resources. Optimized for the largest sales channel organizations, TrueResolution eliminates manual, error-prone sales operation processes and allows dispute resolution to be initiated from the field where the majority of disputes originate. TrueResolution automates functions such as changes, transfers and splits to territory assignments, quota adjustments, organizational changes and payee information updates. TrueResolution enables sales professionals and business partners to submit and track their claims through a completely web-based self-service workflow process, which automates the evaluation, routing, resolution and approval of day-to-day requests and consistently communicates payment and resolution status to sales people. TrueResolution keeps management informed of changes that may affect compensation, produces an audit trail for all requests and resolutions, reduces errors and the risk of fraud and promotes enforcement of enterprise policies. TrueResolution was initially shipped in the second quarter of 2002 and to date has not accounted for a material portion of our revenues.

`TrueReferral`

TrueReferral is a web-based sales referral tracking application that enables financial services customers to more effectively incentivize and manage up-sales and cross-sales between departments. TrueReferral automates the entire customer referral process, including prospecting and referral submission, validation and routing. TrueReferral generates completed sales referrals that are fed into TrueComp for referral reward processing. TrueReferral became commercially available in the third quarter of 2003.

`Technology`

Our products are based on our proprietary TrueComp Manager rules engine, which is implemented on our scalable TrueComp Grid computing architecture. This technology offers our customers high degrees of functionality and flexibility coupled with scalability and reliability that are designed to maximize the return on investment in their EIM systems.

`The TrueComp Manager Rules Engine`

TrueComp Manager employs rules-based enterprise application software technology designed to offer significant advantages over traditional enterprise application software, which generally requires a substantial investment in installation and customization for deployment and upgrades. TrueComp Manager's rules-based design minimizes installation and configuration requirements, requires no customization, provides maximum flexibility to modify plan parameters and calculation and payment rules and facilitates deployment of product enhancements and new releases. Flexibility of configuration is particularly important for EIM systems, where pay-for-performance compensation is used to drive business performance and where it may be necessary to make frequent and substantial changes in compensation to respond to business conditions related to markets, competition and regulatory influences. With rules-based software, non-programmers, such as compensation analysts, can make changes or implement new compensation plans without a programming background. In addition, as there is no custom code or database customization with our software, we can write automated upgrade kits that significantly reduce the cost of deploying product enhancements and new releases. As a result, we can distribute major new releases with significant additional functionality regularly and customers can take advantage of the new capabilities without the substantial expenses associated with upgrading traditional enterprise software.

TrueComp Manager is designed to capture two aspects of the business practices surrounding compensation: a data model and a process model. Our data model defines how our users categorize different transactions and other events associated with their EIM systems. Our process model defines how rules may be applied to describe a compensation plan. We leverage our extensive domain expertise in each vertical market we target by ensuring our data and process models are designed to utilize the information and decision making criteria our customers use to model and manage their businesses.

Our data model enables TrueComp to categorize data brought in from other systems such as ERP, CRM, human resources and supply chain management systems to create a framework for how the customer views that data. For example, customers may organize transactional data according to geographic regions, sales channels or product lines. Categorization allows our products to model the business the way our customers manage their businesses.

Our process model provides a series of logical decision points where rules can be used to determine the outcomes for a given transaction under a particular compensation plan. Our process model addresses critical requirements of the EIM system, including credit allocation, measuring and calculating incentive compensation and determining the time of payment. The combination of these critical decision points, together with a powerful yet user-friendly rule language, makes it possible for TrueComp to pay on virtually any kind of business compensation model.

TrueComp Grid

We have achieved high transaction performance levels for our rules-based engine by employing a proprietary grid computing architecture. Computation grids allow the sharing and aggregation of distributed computing resources so that they may be presented as a single, unified resource for solving large-scale data intensive computing applications. Using TrueComp Grid, customers can harness virtually unlimited numbers of processors to provide the degree of performance needed at their transaction levels. These processors can be in the form of mainframe-class single chassis systems, symmetric multiprocessors or racks of inexpensive NT blade servers. Our proprietary technology is designed to ensure optimal performance with the available computing resources and automatically balances the computation load across the grid array.

Customers

While our products can serve the pay-for-performance program needs of all companies, we have focused principally on five vertical markets, each of which has its own unique characteristics. The following table provides a list of our representative customers and illustrates typical characteristics of our vertical markets:

	Insurance	Retail Banking	Telecommunications	Distribution	Manufacturing & Technology
Representative Customers	• Allstate • CUNA Mutual Group • MONY Life • United Healthcare	• Citizens Bank • HSBC• J.P. Morgan Chase & Co.• KeyBank	• ALLTEL • AT&T Wireless• Telstra• VerizonDirectories	• 7-Eleven • Airborne Express • British Sky Broadcasting • DIRECTV	• Apple Computer • Intuit • Ondeo Nalco • VERITAS Software
Payee Profile	• Independent agents • Captive agents	• Private bankers • Mortgage brokers• Retail employees	• Internal sales• Independent dealer channels	• Internal sales • Retail distributors	• Internal sales • Distributors
Transactions Per Month	50,000 – 100 million	9,000 – 2 million	3,000 – 20 million	100,000 – 8 million	500 – 4 million
No. of Payees	500 – 150,000	500 – 35,000	400 – 30,000	500 – 100,000	250 – 10,000

We currently have over 75 active customers across our vertical markets. In addition, we are continuing to invest in the relevant domain expertise to target the pharmaceutical and retail industries.

Services

We provide a full range of services to our customers, including professional services, maintenance and technical support and educational services.

Professional Services. We provide integration and configuration services to our customers and partners. These services include the installation of our software, identification and sourcing of legacy data, configuration of TrueComp rules necessary to create compensation plans, creation of custom reports, integration of our other products including TruePerformance, TrueResolution, TrueInformation and TrueReferral and other general testing and tuning services for our software. We generally act as either the prime contractor or as a subcontractor depending on the customer's specific requirements and preferences. As the prime contractor, we integrate and configure the software to the customer's specifications, generally on a time-and-materials basis. We also provide services to our systems integration partners on a subcontracting basis when our specific domain expertise is required by these partners.

Maintenance and Technical Support. We have maintenance and technical support centers in the United States, the United Kingdom and Australia. We currently offer three levels of support, including standard, premium and premium plus, which are generally contracted for a period of one year. Under each of these levels of support, our customers are provided with on-line access to our customer support database, telephone support and all product enhancements and new releases. In the case of premium support, our customers are provided with access to a Callidus support engineer 24 hours a day, 7 days a week. Premium plus support includes an onsite support engineer in addition to all of the services included in our premium support plan.

Education Services. We offer our customers a full range of education services including computer and web based training, classroom training and on-site customer training. We provide classes for all of our products to our customers and provide educational services to our partners on a scheduled and as-requested basis.

Sales and Marketing

We sell and market our software through a direct sales force and in conjunction with our partners. In the United States, we have sales offices in Atlanta, Austin, Chicago, New York and San Jose. Outside the United States, we have sales offices in London, Munich and Sydney.

Sales. Our direct sales force, consisting of experienced account executives, subject matter experts, technical pre-sales engineers and field management, is responsible for the sale of our products to global enterprises across multiple industries and is organized into geographic and industry territories. Our telesales department is responsible for sales lead generation and first line customer contact, while our non-quota carrying customer advocacy group is responsible for post-sales customer support. These services include informing our customers of new Callidus products, managing user groups and maintaining proactive contact with our customers.

Marketing. Our marketing activities include traditional product marketing functions such as production of both hardcopy and on-line product and company promotional material, gathering of customer and partner input for new product features and creation of sales product demonstrations. We generate awareness of our company and sales leads for our products through print and web-based advertising, seminars, direct mail and customer and partner events. Additionally, we maintain an extensive web site that is used to educate our customers and prospects about our products and services.

Strategic Relationships

We actively promote and maintain strategic relationships with systems integration partners. These relationships provide customer referrals and co-marketing opportunities that expand our contacts with potential customers. In addition, these relationships allow us to leverage our business model by subcontracting or outsourcing integration and configuration services required to allow us to expand license sales.

In August 2003, we became an IBM Strategic Alliance Partner for Enterprise Incentive Management. Under our agreement with IBM, we co-market our products globally to banking, insurance and telecommunications customers, and we optimize our products to operate on IBM product platforms including Websphere, DB/2 and AIX. Neither we nor IBM is required to pay the other party royalty or other fees resulting from this relationship and both parties will generally contract directly with the third- party introduced to it through this relationship. Our relationship with IBM is non-exclusive and either of us may enter into similar relationships with other parties.

We also have an ongoing relationship with Accenture, which provides systems integration and configuration services to our customers. While we do not have any agreements with Accenture governing our long-term relationship, we expect to continue to rely on Accenture as a key collaborator in selling and integrating our products on a customer-by-customer basis. We also maintain active partnerships with the Alexander Group International (AGI), a compensation consulting and professional services firm that integrates and configures our products, and Iconixx Corporation, a professional services firm that specializes in the implementation of EIM systems.

Research and Development

Our research and development organization consists of experienced software engineers, software quality engineers and technical writers. We organize the development staff along product lines, with an engineering services group providing centralized support for technical documentation and advanced support. We employ advanced software development tools including automated testing, performance monitoring, source code control and defect tracking systems.

Competition

Our principal competition comes from established ERP vendors including Oracle, PeopleSoft and SAP, CRM vendors including Siebel Systems, pure-play EIM vendors including Centive, Motiva and Synygy and internally developed software solutions. We believe that the principal competitive factors affecting our market are:

- Industry-specific domain expertise;
- scalability and flexibility of solutions;
- superior customer service; and
- functionality of solutions.

We believe that we compete effectively with the established ERP and CRM companies due to our established market lead, domain expertise, rules-based application software and highly scalable software architecture. EIM systems are generally not part of these vendors' core product offerings, whereas we believe we have more fully developed the domain expertise required to meet the dynamic requirements of today's complex pay-for-performance programs.

We believe that we compete effectively with the pure-play EIM system vendors due to our established market leadership, robust, scalable architecture and commitment to customer service. While each of the pure-play EIM system vendors has domain knowledge of the EIM market, we believe that we have developed superior scalability demanded by the telecommunications, retail banking or insurance markets. Additionally, we have created substantial product differentiation by adding features into our products that are specific to each a given vertical market.

We also believe that our products offer a more cost-effective and complete alternative to internally developed solutions. These solutions are generally expensive, inflexible and difficult to maintain for large companies with complex pay-for-performance programs, thereby increasing total cost of ownership and limiting the ability to implement pay-for-performance programs that effectively address targeted business objectives.

Many of our competitors and potential competitors have significantly greater financial, technical, marketing, service and other resources than we have. Many of these companies also have a larger installed base of users, have longer operating histories or have greater name recognition than we have. Our competitors may also be able to respond more quickly than we can to changes in customer requirements or may announce new products, services or enhancements that better meet the needs of customers or changing industry standards. Increased competition may cause price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on our business, results of operations and financial condition.

Intellectual Property

Our success and ability to compete is dependent in part on our ability to develop and maintain the proprietary aspects of our technology and operate without infringing upon the proprietary rights of others. We rely primarily on a combination of copyright, trade secret and trademark laws, confidentiality procedures, contractual provisions and other similar measures to protect our proprietary information. Due to the rapidly changing nature of applicable technologies, we believe that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how and development of new products are generally more advantageous than patent protection. We have an ongoing trademark registration program pursuant to which we register some of our product names, slogans and logos in the United States and in some foreign countries.

We also use contractual provisions to protect our intellectual property rights. We license our software directly to customers. These license agreements, which address our technology, documentation and other proprietary information, include restrictions intended to protect and defend our intellectual property. These licenses are generally non-transferable and are perpetual. We also require all of our employees, contractors and many of those with whom we have business relationships to sign non-disclosure and confidentiality agreements.

Certain of our products also include third-party software that we obtain the rights to use through license agreements and our TruePerformance product was developed by an independent contractor, from whom we have a license to distribute the product worldwide and an option to acquire all rights to the product.

Employees

As of June 30, 2003, we had approximately 250 employees. None of our employees is represented by unions. We consider our relationship with our employees to be good and have not experienced interruptions of operations due to labor disagreements.

Properties

We lease our headquarters in San Jose, California which consists of approximately 44,500 square feet. The lease on our San Jose headquarters expires in 2010. We also lease facilities in Austin, Chicago, New York, Sydney, London and Munich. We believe that our properties are in good operating condition and adequately serve our current business operations. We also anticipate that suitable additional or alternative space, including those under lease options, will be available at commercially reasonable terms for future expansion.

Legal Proceedings

On or about March 29, 2002, we received a copy of a complaint filed by Gordon Food Service in the United States District Court for the Western District of Michigan alleging breach of contract and misrepresentation in connection with software purchased by Gordon Food. On December 9, 2002, the court granted our motion to transfer venue and ordered that the case be transferred to the San Jose division of the United States District Court for the Northern District of California. Gordon Food has moved the court to file an amended complaint asserting, among other things, breach of contract and misrepresentation. We have reviewed the claims alleged in the complaint and believe that such claims are without merit and intend to contest the claims vigorously if an amended complaint is filed.

In addition, we are from time to time a party to various litigation matters incidental to the conduct of our business. There is no pending or threatened legal proceeding to which we are a party that, in our opinion, is likely to have a material adverse effect on our future financial results.

Management

Management

Executive Officers and Directors

The following table sets forth information regarding the executive officers and directors of Callidus.

Name	Age	Position	Director or Executive Officer Since
Reed D. Taussig	49	President; Chief Executive Officer; Chairman of the Board of Directors	1997
Christopher W. Cabrera	36	Vice President, Worldwide Sales and Business Development	2000
Ronald J. Fior	46	Vice President, Finance; Chief Financial Officer	2002
Bertram W. Rankin	45	Senior Vice President, Worldwide Marketing	2003
Robert W. Warfield	42	Senior Vice President, Research and Development; Chief Technology Officer	2001
Daniel P. Welch	46	Vice President, Worldwide Client Services	1998
Michael A. Braun	53	Director	2000
George James	66	Director	1999
Terry L. Opdendyk	55	Director	2002
R. David Spreng	42	Director	2003

Reed D. Taussig has served as our President, Chief Executive Officer and director since November 1997. In August 2003, Mr. Taussig was elected as the Chairman of our Board of Directors. From April 1995 to October 1997, Mr. Taussig co-founded and served as President and Chief Executive Officer of inquiry.com, a web-based exchange and research facility for information technology professionals. From August 1991 to August 1994, Mr. Taussig served as Senior Vice President of North American Operations for Gupta Corporation (now Centura Software Corporation), an application development tools and database provider. From November 1987 to August 1991, Mr. Taussig served as Senior Vice President of Worldwide Operations for Unify Corporation, an e-commerce application software company. Mr. Taussig holds a B.A. in Economics from the University of Arizona.

Christopher W. Cabrera has served as our Vice President, Worldwide Sales and Business Development since January 2003. Prior to assuming his current position, Mr. Cabrera served as our Vice President of North American Sales from September 2000 to January 2003 and Managing Director of Western Area Sales from June 1999 to September 2000. Mr. Cabrera holds a B.A. in Business Administration from the University of Southern California and a M.B.A. from Santa Clara University.

Ronald J. Fior has served as our Vice President, Finance and Chief Financial Officer since September 2002. From December 2001 to July 2002, Mr. Fior served as Vice President of Finance and Chief Financial Officer for Ingenuity Systems, a bioinformatics software development company. From July 1998 until October 2001, Mr. Fior served as Chief Financial Officer and Vice President of Finance and Operations of Remedy Corporation, a software development company. Prior to this, Mr. Fior served for 13 years as Chief Financial Officer of numerous divisions and companies within the publishing operations of The Thomson Corporation, including the ITP Education Group and the International Thomson Publishing Group. Mr. Fior holds a Bachelor Commerce degree from the University of Saskatchewan and is a Chartered Accountant.

Bertram W. Rankin has served as our Senior Vice President, Worldwide Marketing since June 2003. Prior to joining Callidus, Mr. Rankin served as Vice President of Marketing at NetManage, a supplier of host access and integration solutions to Fortune 1000 organizations, from October 2000 to May 2003. From July 1998 to October 2000, Mr. Rankin served as General Manager and Vice President, Marketing for Ricoh Silicon Valley, a software company and subsidiary of Ricoh Company. Mr. Rankin holds a M.B.A. from the Stanford Graduate School of Business and a B.A. in Economics from Harvard University.

Robert W. Warfield has served as our Chief Technology Officer and Senior Vice President, Research and Development since December 2001. From 1998 to 2001, Mr. Warfield served as Executive Vice President of Products and Services and Chief Technology Officer at iMiner, a private information mining company. From 1997 to 1998, Mr. Warfield served as Vice President of Research and Development at Rational Software, a provider of software development applications. From 1996 to 1997, Mr. Warfield served as Vice President of Research and Development and Chief Technology Officer at Integrity QA Software, a provider of software development applications. Mr. Warfield holds a B.A. in Computer Science from Rice University.

Daniel P. Welch has served as our Vice President, Worldwide Client Services since September 1998. From May 1993 to July 1998, Mr. Welch served as Vice President of Eastern Area Sales, then Vice President of Worldwide Sales for Brightware, a provider of interactive electronic commerce software. From January 1985 to May 1993, Mr. Welch served as Director of Accell Development, and then as Director of Professional Services for Unify Corporation, a software solutions company. From February 1983 to January 1985, Mr. Welch served as Vice President of Engineering for Pharmacy Accounting Management, a software company. Mr. Welch holds a B.A. in Marketing from Michigan State University.

Michael A. Braun has served as a director of Callidus since February 2000. Mr. Braun has served as the Chief Executive Officer and Managing Member of the Interim CEO Network, an executive recruiting company, since November 2000. Mr. Braun retired from IBM Corporation, an information technology company, in July 2000. From October 1999 to July 2000, Mr. Braun served as General Manager of the Global Small Business Unit at IBM, prior to which time he served as the General Manager of the Consumer Division from August 1998 to October 1999. Mr. Braun was President, Chief Executive Officer and a Director of Blaze Software, a rules-based application software company, from June 1996 to July 1998, and Chairman of the Board of Directors of Blaze Software from July 1998 until December 1999. From 1993 to 1996, he was President and Chief Executive Officer of Kaleida Labs, a multimedia software joint venture between IBM and Apple Computer. Prior to this, Mr. Braun held numerous executive positions at IBM. Mr. Braun received a B.A. in Psychology from the University of Rochester and a M.B.A. from the Simon School at the University of Rochester.

George James has served as a director of Callidus since May 1999. Mr. James currently serves as director of The Sharper Image, a consumer products company, and Pacific States Industries, a private lumber distribution company. From 1985 to 1998, Mr. James served as Senior Vice President and Chief Financial Officer of Levi Strauss & Company, an apparel manufacturer. Prior to joining Levi Strauss & Company, Mr. James was Executive Vice President and Chief Financial Officer, and later Group President, with Crown Zellerbach Corporation, a paper mill company, from 1982 to 1985. His previous experience also includes ten years with Arcata Corporation, a forest product and printing company, as Senior Vice President and Chief Financial Officer, and three years with PepsiCo Leasing Corporation, an equipment leasing company, as Vice President of Finance. Mr. James holds a B.A. in Economics from Harvard College and a M.B.A. from the Stanford Graduate School of Business.

Terry L. Opdendyk has served as a director of Callidus since September 2002 and previously served as a director of Callidus from February to November 1997. Mr. Opdendyk currently serves as chairman of ONSET Venture Services Corporation and is a general partner or managing director of a number of entities that are general partners of various venture capital funds known collectively as ONSET Ventures. Mr. Opdendyk has been with ONSET Ventures since he founded it in 1984. Mr. Opdendyk also serves as a Director of Arcot Systems, an e-business security technology company, Nextance, an enterprise software company, Automated Power Exchange, an energy market services company, and Visus Technology, a software company. Prior to 1984, Mr. Opdendyk served as president of VisiCorp, as an executive with Intel Corporation and as a technical manager with Hewlett Packard Corporation. Mr. Opdendyk holds a B.S. in computer science from Michigan State University and a M.S. in computer science from Stanford University.

R. David Spreng has served as a director of Callidus since February 2003. Mr. Spreng has served as the managing general partner of Crescendo Venture Management since September 1998. Mr. Spreng served as president of IAI Ventures, a venture capital firm, from March 1996 to September 1998. Mr. Spreng is also a Director of CoSine Communications, a global telecommunications equipment supplier. Mr. Spreng holds a B.S. in accounting from the University of Minnesota.

Executive officers are elected by the board of directors on an annual basis and serve until their successors have been duly elected and qualified. Other than the family relationship between Christopher W. Cabrera and Brian E. Cabrera, our Vice President and General Counsel, who are brothers, there are no family relationships among any of our directors, executive officers or key employees.

Board Composition

Our board of directors currently consists of five members. The exact number of directors may change from time to time, solely as determined by resolution adopted by a majority of the entire board of directors. No director may be removed from office by the stockholders of the Company except for cause with the affirmative vote of the holders of not less than a majority of the outstanding shares of common stock. All directors hold office until their successors have been elected and qualified or until their earlier death, resignation, disqualification or removal. Effective upon the closing of this offering, we will divide the terms of office of the directors into three classes:

- Class I, whose term will expire at the annual meeting of stockholders to be held in 2004;
- Class II, whose term will expire at the annual meeting of stockholders to be held in 2005; and

- Class III, whose term will expire at the annual meeting of stockholders to be held in 2006.

Upon the closing of this offering, Class I shall consist of George James and Reed D. Taussig; Class II shall consist of R. David Spreng and Terry L. Opdendyk; and Class III shall consist of Michael A. Braun. Any additional directorships resulting from an increase in the number of directors will be distributed among the three classes so that, to the extent possible, each class will consist of one third of the directors. This classification of the board of directors may have the effect of delaying or preventing changes in control or management of our company.

Committees of the Board of Directors

Our board of directors has elected a nominating and corporate governance committee, an audit committee and a compensation committee. Upon the completion of this offering each of our committees will have the composition and responsibilities described below:

Nominating and Corporate Governance Committee

Our nominating and corporate governance committee is comprised of Messrs. Opdendyk and James, both of whom are non-management members of our board of directors. The nominating and corporate governance committee is responsible for, among other things:

- Recommending to our board of directors nominees to the board of directors to be proposed for election by the stockholders and individuals to be considered by the board to fill any vacancies on the board of directors that may occur;
- developing, evaluating and recommending to our board of directors a set of corporate governance guidelines applicable to our company;
- establishing criteria for board and board committee membership, including as to director independence;
- overseeing the process for evaluating the performance of our board of directors;
- evaluating the current composition, organization and governance of our board of directors and its committees, determining future requirements and making recommendations to our board of directors for approval;
- reviewing and recommending director compensation; and
- reviewing and evaluating annually our nominating and corporate governance committee's performance, including the compliance with its charter.

Audit Committee

Our audit committee is comprised of Messrs. James, Braun and Spreng, each of whom is a non-management member of our board of directors. Messrs. James, Braun and Spreng are independent directors within the meaning of the independent director and audit committee requirements for quotation on the Nasdaq National Market. Mr. James is a "financial expert" within the meaning of Section 407 of the Sarbanes-Oxley Act of 2002. The audit committee is responsible for, among other things:

- Assisting our board of directors in its oversight of:
  - The integrity of our financial statements;
  - the qualifications, independence and performance of our company's independent auditors;
  - the performance of our internal audit function; and
  - our compliance with legal and regulatory requirements;
- preparing the audit committee report to be filed with the SEC;
- appointing, compensating, retaining, overseeing and terminating (if necessary) our independent accountants;
- reviewing with our chief executive officer and chief financial officer internal controls and procedures, including any significant deficiencies in the design or operation of our internal controls, and any allegations of fraud that involve our management or other employees who have a significant role in our internal controls; and
- reviewing and assessing annually our audit committee's performance and the adequacy of its charter.

The members of the audit committee will also act as our Qualified Legal Compliance Committee (QLCC), which is responsible for reviewing any reports made to our QLCC by attorneys representing us or our subsidiaries of a material violation or breach arising under United States federal or state laws.

Compensation Committee

Our compensation committee is comprised of Messrs. Braun and Spreng, both of whom are non-management members of our board of directors. In accordance with our compensation committee charter, both members of the compensation committee are outside directors as that term is defined in Section 162(m) of the Internal Revenue Code of 1986, as amended, and both members are nonemployee directors within the meaning of Rule 16b-3 of the rules promulgated under the Securities Exchange Act of 1934. The compensation committee is responsible for, among other things:

- Overseeing our compensation and benefits policies generally;
- evaluating the performance of our executives;
- overseeing and setting executive compensation;
- producing an annual report on executive compensation for inclusion in our annual proxy statement;
- approving and reviewing any employment, severance and change of control agreements with our senior executives, as well as any other compensation arrangements; and
- reviewing and assessing annually our compensation committee's performance and the adequacy of its charter.

Director Compensation

Each of our directors who is not an officer or employee of Callidus will be paid a quarterly retainer of $5,000 and a fee of $1,000 plus expenses for each meeting of the board of directors attended and an additional fee of $750 plus expenses for each committee meeting attended. We have also established the 2003 Stock Incentive Plan, which provides for an initial policy of automatic option grants to nonemployee directors. Each nonemployee director will receive options to purchase 30,000 shares of our common stock on first becoming a director, which will vest over four years, and will receive an annual grant of an

option to purchase 10,000 shares, vested immediately. In addition, the chair of the audit committee will receive an annual option grant to purchase 10,000 shares of our common stock, and the chairs of the compensation and nominating and corporate governance committees will each receive an annual option grant to purchase 5,000 shares of our common stock, which will be vested immediately upon grant.

Prior to this offering, Messrs. Braun, James, Opdendyk and Spreng received stock option grants under our 1997 Stock Option Plan as compensation for their service as board members. See "1997 Stock Option Plan." Messrs. Braun, James, Opdendyk and Spreng were granted the following options to purchase shares of our common stock on the dates, at the exercise prices, and with the vesting schedules set forth below:

Name	Number of Shares Subject to Options	Date of Grant	Exercise Price	Vesting Schedule
Michael A. Braun	15,000	1-11-00	$10.00	1
	14,640	3-13-01	0.83	2
	4,620	4-10-01	0.83	2
	15,000	8-6-02	0.83	1
	10,740	12-23-02	0.83	2
	48,000	8-26-03	4.17	1
George James	15,000	5-11-99	3.17	1
	14,640	3-13-01	0.83	2
	1,200	4-10-01	0.83	2
	15,000	8-6-02	0.83	1
	14,160	12-23-02	0.83	2
	48,000	8-26-03	4.17	1
Terry L. Opdendyk	48,000	8-26-03	4.17	1
R. David Spreng	48,000	8-26-03	4.17	1

(1) Twenty-five percent of the shares subject to the option vest twelve months after the vesting commencement date specified in the option agreement and one-forty-eighth of the shares vest each month thereafter.

(2) One-forty-eighth of the shares subject to the option vest each month after the vesting commencement date specified in the option agreement.

As described in further detail under the heading "– Employment Contracts, Change of Control Arrangements and Severance Agreements," upon a change of control of Callidus, any options to purchase common stock then held by Messrs. Braun, James, Opdendyk and Spreng will immediately become 100% vested and exercisable.

Compensation Committee Interlocks and Insider Participation

None of our executive officers or members of our board of directors serves as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving as a member of our board of directors or compensation committee. In 2002, Messrs. Taussig and Swett, our founder and a former member of our board of directors, participated in deliberations of our board of directors concerning executive officer compensation. Messrs. Tidd, our former chief financial officer and current Vice President, Client Services, C. Cabrera, Welch, Warfield and Fior were also present for some of the deliberations of our board of directors concerning executive compensation.

Executive Compensation

The following table sets forth all compensation awarded, earned or paid for services rendered in all capacities to us during 2002, to our Chief Executive Officer and the five most highly compensated executive officers in 2002 other than the Chief Executive Officer. We refer to these individuals collectively as the "named executive officers."

Summary Compensation Table

			Long-Term Compensation Awards
	Annual Compensation		Securities Underlying
Name and Principal Position	Salary	Bonus	Options
Reed D. Taussig President; Chief Executive Officer; Chairman of the Board	$222,188	$25,000	300,000
Christopher W. Cabrera Vice President, Worldwide Sales and Business Development	197,500	98,855	75,000
Ronald J. Fior(1) Vice President, Finance; Chief Financial Officer	58,333	10,000	210,000
Michael C. Tidd(2) Former Chief Financial Officer; Vice President, Client Services	197,500	25,000	15,000
Robert W. Warfield Senior Vice President, Research and Development and Chief Technology Officer	200,000	27,500	45,000

Daniel P. Welch Vice President, Worldwide Client Services	197,500	60,751	45,000

(1) Mr. Fior joined our company and began serving as our Vice President, Finance and Chief Financial Officer on September 16, 2002. The salary and bonus figures shown in the table above are therefore only for the four months of 2002 during which Mr. Fior was employed by us.

(2) Mr. Tidd served as our Chief Financial Officer until September 15, 2002 and presently serves as our Vice President, Client Services.

Stock Option Grants in 2002

The following table sets forth information concerning grants of stock options made to our named executive officers during 2002. We did not grant stock appreciation rights to any of our named executive officers during 2002.

	Individual Grant				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
Name	Number of Securities Underlying Options Granted (#)	Percent of Total Options Granted to Employees in 2002	Exercise or Base Price ($/Sh)	Expiration Date	5% ($)	10% ($)
Reed D. Taussig	150,000	10.48%	$0.83	12-22-12	$78,297	$198,421
	150,000	10.48	0.83	4-2-12	78,297	198,421
Christopher W. Cabrera	75,000	5.24	0.83	12-22-12	39,149	99,210
Ronald J. Fior	45,000	3.14	0.83	12-22-12	23,489	59,526
	165,000	11.53	0.83	10-14-12	86,127	218,263
Michael C. Tidd	15,000	1.05	0.83	12-22-12	7,830	19,842
Robert W. Warfield	45,000	3.14	0.83	12-22-12	23,489	59,526
Daniel P. Welch	45,000	3.14	0.83	12-22-12	23,489	59,526

All options granted to our named executive officers in 2002 vest as to one-forty-eighth of the shares subject to the option each month starting on the vesting commencement date specified in the option, with the exception of the option to purchase 150,000 shares of our common stock granted to Mr. Taussig in April 2002, which provides that 100% of the shares subject to the option will become fully vested and exercisable on the seventh anniversary of the date of grant of the option, provided that in the event we complete an initial public offering of our common stock at a minimum valuation of $6.67 per share, 25% of the shares subject to the option will immediately vest and become exercisable upon the occurrence of such event and the remaining shares will vest each month thereafter as to an additional one- thirty-sixth of the shares subject to the option. The percentage of total options granted was based on aggregate grants of options to purchase 1,431,575 shares of our common stock to all of our employees and named executive officers in 2002. In the event of a change of control of Callidus, the officers listed above will be entitled to additional vesting as described in "– Employment Contracts, Change of Control Arrangements and Severance Agreements – Change of Control Arrangements."

The options were granted to our named executive officers at an exercise price equal to the per share fair value of our common stock on the grant date, as determined by our board of directors. Because there was no public market for our stock prior to this offering, the board determined the fair value of our common stock by considering a number of factors, including, but not limited to, our current financial performance and prospects for future growth and profitability, the status of product releases and product integration and the absence of a resale market for our common stock.

The table above sets forth the hypothetical gains or option spreads that would exist for the options at the end of their respective 10-year terms based on assumed annualized rates of compound stock price appreciation of 5% and 10% from the dates the options were granted until the expiration of the 10-year option term. The disclosure of 5% and 10% assumed rates is required by the rules of the Securities and Exchange Commission and does not represent our estimate or projection of future common stock prices or stock price growth.

Aggregated Option Exercises in 2002 and 2002 Year End Option Values

None of our named executive officers exercised any stock options in 2002. The following table sets forth certain information regarding the number of shares of common stock subject to exercisable and unexercisable stock options and the value of such options held by our named executive officers at December 31, 2002.

	Number of Securities Underlying Unexercised Options at December 31, 2002		Value of Unexercised In-the-Money Options at December 31, 2002	
Name	Exercisable	Unexercisable	Exercisable	Unexercisable
Reed D. Taussig	340,800	300,000	–	–
Christopher W. Cabrera	131,072	83,937	–	–
Ronald J. Fior	165,000	45,000	–	–
Michael C. Tidd	109,800	15,000	–	–
Robert W. Warfield	258,000	45,000	–	–
Daniel P. Welch	124,800	45,000	–	–

Because the value of unexercised in-the-money options is based on a fair value of $0.83 per share and exercise prices of $0.83 per share, or greater, none of unexercised options held by the named executive officers at December 31, 2002 were in-the-money.

Employment Contracts, Change of Control Arrangements and Severance Agreements

Change of Control Arrangements

From October 1998 through June 2003, we entered into change of control agreements with Messrs. Taussig, C. Cabrera, Welch, Rankin, Warfield, Fior, Tidd, Braun and James and other key employees, providing that in the event that such individual is involuntarily terminated for reasons other than cause at any time during the period commencing 90 days prior to a change of control of Callidus and ending on the first anniversary of the change of control, he shall receive accelerated vesting of 50% of the then unvested shares subject to any stock option agreements he has at such time. Under the terms of the agreement, a change of control is generally defined to include (i) the acquisition by any person of beneficial ownership, directly or indirectly, of our securities representing 50% or more of the total voting power represented by our then outstanding voting securities; (ii) a change in the composition of our board of directors within a rolling two-year period, as a result of which fewer than a majority of the directors are deemed to be incumbent directors, as defined in the agreements; (iii) a merger or consolidation involving Callidus other than a merger or consolidation which would result in our voting securities outstanding immediately prior to such merger or consolidation representing at least 50% of the total voting power of the surviving entity immediately after such merger or consolidation; and (iv) a sale or disposition by us of all or substantially all of our assets.

In September 2003, we entered into or amended change of control agreements with Messrs. Taussig, C. Cabrera, Fior, Rankin, Warfield, Welch, Braun, James, Opdendyk and Spreng. These agreements provide that in the event of a change of control of Callidus (as defined above), any options to purchase common stock then held by such individuals will immediately become 100% vested and exercisable.

Agreement with Reed D. Taussig

In April 2002, we entered into an agreement with Mr. Taussig, in which he was granted an option to purchase 150,000 shares of our common stock at an exercise price of $0.83 per share. The agreement provides that the shares shall become 100% vested on the seventh anniversary of the date of grant, provided that, in the event we complete an initial public offering of our common stock at a minimum valuation of $6.67 per share, 25% of the shares subject to the option will immediately vest and become exercisable upon the occurrence of such event and one-thirty-sixth of the shares subject to the option will vest each month thereafter.

Agreement with Ronald J. Fior

In August 2002, we entered into a severance agreement with Mr. Fior pursuant to which we agreed to pay him six months of his base salary plus benefits in the event he is terminated for reasons other than cause.

Agreements with Robert W. Warfield

In November 2001, we entered into a severance agreement with Mr. Warfield pursuant to which we agreed to pay him six months of his base salary plus benefits in the event he is terminated for reasons other than cause.

In May 2003, we entered into an agreement with Mr. Warfield pursuant to which we granted him an option to purchase 132,000 shares of our common stock at an exercise price of $1.00 per share. The agreement provides that one-forty-eighth of the shares subject to the option vest each month from the date of grant, provided, that in the event we complete an initial public offering of our common stock for a price equal to or greater than $6.67 per share, an additional 25% of the shares subject to the option will immediately vest and become exercisable upon the initial public offering.

Limitations on Liability and Indemnification Matters

We have adopted provisions in our certificate of incorporation that limit the liability of our directors and executive officers for monetary damages for breach of their fiduciary duties to the maximum extent permitted by Delaware law. Under Delaware law, a certificate of incorporation may provide that directors of a corporation will not be personally liable for monetary damages for breach of their fiduciary duties as directors except liability for:

- Any breach of their duty of loyalty to our company or our stockholders;
- acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law; or
- any transaction from which the director derived an improper personal benefit.

Our certificate of incorporation provides that we must indemnify our directors and officers and may indemnify our other employees and agents to the fullest extent permitted by law. We believe that the indemnification provisions of our certificate of incorporation are necessary to attract and retain qualified persons as directors, officers and key employees. Our certificate of incorporation also permits us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in that capacity, regardless of whether Delaware law or our bylaws would otherwise permit indemnification. We maintain directors' and officers' liability insurance on behalf of such persons.

We have entered into and expect to continue to enter into, agreements to indemnify our directors, executive officers and other employees as determined by the board of directors. These agreements provide for indemnification for related expenses including attorneys' fees, judgments, fines and settlement amounts incurred by any of these individuals in any action or proceeding. We believe that these provisions and agreements are necessary to attract and retain qualified persons as our employees, directors and executive officers.

At present we are not aware of any pending litigation or proceeding involving any director, officer, employee or agent of our company in such person's capacity with our company where indemnification will be required or permitted. We are also not aware of any threatened litigation or proceeding that might result in a claim for indemnification.

Equity Compensation Plans

1997 Stock Option Plan

Our 1997 Stock Option Plan provides for the award of stock options and stock purchase rights. The plan was initially adopted by our board of directors in January 1997 and initially approved by our stockholders in January 1997. The plan is administered by the board of directors, but the board may delegate the administration of the plan to a committee at any time.

The plan provides for the grant of incentive stock options (ISOs) within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, only to our employees and employees of our parent or subsidiary. Nonstatutory stock options (NSOs), and stock purchase rights may be granted to employees, directors and consultants.

Generally, each option granted under the plan is required to expire on or before the tenth anniversary of the date of grant. The exercise price of each ISO is required to be not less than 100% of the fair value of the underlying stock subject to the option on the date of grant and the exercise price of each NSO is required to be not less than 85% of the fair value of the underlying stock subject to the option on the date of grant. These minimum price provisions are increased and other conditions and restrictions apply, with respect to awards granted to persons who own or are deemed to own more than 10% of the total combined voting power of all classes of our stock.

Options granted under the plan generally vest as to twenty-five percent of the shares one year after the date of grant and as to one-forty-eighth of the shares each month thereafter. If an optionee's service relationship with us ceases for any reason other than disability or death, the optionee may exercise any vested options up to three months from cessation of service (unless the terms of the stock option agreement provide for earlier or later termination). If an optionee's service relationship with us ceases due to disability or death, the optionee (or his or her beneficiary) may exercise any vested options up to twelve months from cessation of service (unless the terms of the stock option agreement provide for earlier or later termination).

Generally, if we merge with or into another corporation, or sell substantially all of our assets, all outstanding options under the plan shall be assumed or substituted for by any surviving entity or a parent or subsidiary of the surviving entity. If the surviving entity determines not to assume or substitute for such awards, then, the vesting provisions of such stock awards will be accelerated and any unexercised stock awards will be exercisable for a period of fifteen days from the date that our plan administrator gives the optionees notice that such options will not be assumed by the surviving entity or its subsidiary or parent.

The plan terminates ten years after its initial adoption, unless earlier terminated by the board. The board of directors may amend or terminate the plan at any time, subject to stockholder approval where required by applicable law. Any amendment or termination may not impair the rights of holders of outstanding awards without their consent.

We have reserved 6,700,082 shares for issuance under the plan. Following our initial public offering, we will no longer grant options from our 1997 Stock Option Plan and all shares that remain available for future grant under this plan will become available for issuance under our 2003 Stock Incentive Plan, as described below.

2003 Stock Incentive Plan

Subject to stockholder approval, our 2003 Stock Incentive Plan will become effective on the date of this prospectus. The plan will be administered by the board of directors or by a committee appointed by the board.

Under the plan, the board of directors may grant stock options or other types of stock-based awards, such as restricted stock, restricted stock units, stock bonus awards or stock appreciation rights. Incentive stock options may be granted to our employees. Nonstatutory stock options and other stock-based awards may be granted to employees, consultants or outside directors.

We expect that options granted under the plan to optionees other than outside directors will generally vest as to twenty-five percent of the shares one year after the date of grant and as to one-forty-eighth of the shares each month thereafter. If an optionee's service relationship with us ceases for any reason other than disability or death, the optionee may exercise any vested options up to 90 days after cessation of service (unless the terms of the stock option agreement provide for earlier or later termination). If an optionee's service relationship with us ceases due to disability or death, the optionee (or his or her beneficiary) may exercise any vested options up to twelve months from cessation of service (unless the terms of the stock option agreement provide for earlier or later termination).

The plan provides for nondiscretionary, automatic grants to outside directors of nonstatutory stock options. An outside director will be granted automatically an initial nonstatutory option to purchase 30,000 shares upon first becoming a member of our board of directors. The initial option vests and becomes exercisable over four years, with the first 25% of the shares subject to the initial option vesting on the first anniversary of the date of grant date and the remainder vesting monthly thereafter. Immediately after each of our regularly scheduled annual meeting of stockholders, each outside director will be automatically granted a nonstatutory option to purchase 10,000 shares of our common stock, the chair of the audit committee will be automatically granted a nonstatutory option to purchase 10,000 shares of our common stock and the chairs of the compensation and nominating and corporate governance committees will each be automatically granted nonstatutory options to purchase 5,000 shares of our common stock. Each annual option will be fully vested and exercisable as of the date of grant. The options granted to outside directors will have a per share exercise price equal to 100% of the fair market value of the underlying shares on the date of grant.

Generally, if we merge with or into another corporation, or sell substantially all of our assets, all outstanding options under the plan shall be assumed or substituted for by any surviving entity or a parent or subsidiary of the surviving entity. If the surviving entity determines not to assume or substitute for such awards, then, the vesting provisions of such stock awards will be accelerated and any unexercised stock awards will be exercisable for a period of fifteen days from the date that our plan administrator gives the optionees notice that such options will not be assumed by the surviving entity or its subsidiary or parent.

The plan terminates ten years after its initial adoption, unless earlier terminated by the board. The board of directors may amend or terminate the plan at any time, subject to stockholder approval where required by applicable law. Any amendment or termination may not impair the rights of holders of outstanding awards without their consent.

We have reserved 2,000,000 shares of common stock for issuance under the plan. On July 1 of each year beginning July 1, 2004 the aggregate number of shares reserved for issuance under this plan will increase automatically by a number of shares equal to the lesser of (i) 5% of our outstanding shares, (ii) 2,800,000 shares or (iii) a lesser number of shares approved by the board. In addition, all shares available for issuance under the 1997 Stock Option Plan that available for future grant upon our initial public offering will cease to become issuable under our 1997 Stock Option Plan and will instead be available for issuance under our 2003 Stock Incentive Plan. We anticipate that approximately 158,274 shares previously authorized for issuance under our 1997 Stock Option Plan will become available for issuance under our 2003 Stock Incentive Plan, based on the number of shares available for future grant on June 30, 2003.

Employee Stock Purchase Plan

Subject to stockholder approval, our 2003 Employee Stock Purchase Plan will become effective on the date of this prospectus. The purchase plan is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1986. The purchase plan is designed to enable eligible employees to purchase shares of our common stock at a discount on a periodic basis through payroll deductions.

We have initially reserved 1,200,000 shares of our common stock for issuance under our purchase plan. The number of shares reserved for issuance under the plan will increase automatically on July 1 of each year beginning July 1, 2004 by an amount equal to the lesser of (i) 2% of our outstanding shares, (ii) 1,200,000 shares or (iii) a lesser number of shares approved by the board.

Our employees generally will be eligible to participate in this plan if they are employed by us or by a designated subsidiary. Our employees are not eligible to participate in the purchase plan if they hold more than 5% of our stock or would become holders of more than 5% of our stock as a result of their participation in the plan. Under the purchase plan, eligible employees may acquire shares of our common stock through payroll deductions. Our eligible employees may select a rate of payroll deduction between one and fifteen percent of their cash compensation. An employee's participation in this plan will end automatically upon termination of employment for any reason.

Except for the first offering period, each offering period will be for twelve months and will consist of consecutive six-month purchase periods. The first offering period is expected to begin on the date of this prospectus and end on or about February 15, 2005. We expect that the first purchase period will be more than six months long. After that, the offering periods will begin on each February 16 and August 16 and last for twelve months with six-month purchase periods. The purchase price for shares of our common stock purchased under the purchase plan at the end of each purchase period will be 85% of the lesser of the fair market value of our common stock on the first day of the applicable offering period or the last day of the applicable purchase period. Our board will have the authority to change the starting date of any offering period, the purchase date of a purchase period and the duration of any offering period or purchase period.

401(k) Plan

In 1999, we established a 401(k) tax deferred savings plan, whereby eligible employees may contribute a percentage of their eligible compensation to their 401(k) plan (presently from 1% up to the maximum allowed under IRS rules). While we may make matching contributions to our employees accounts under the plan, to date we have not made any such matching contributions.

Certain Relationships and Related Party Transactions

Certain Relationships and Related Party Transactions

2000 Convertible Note Private Placement

From September 2000 through December 2000, we issued and sold approximately $8.0 million aggregate principal amount of subordinated convertible notes bearing simple interest at the prevailing prime rate plus 1.00% to four of our significant stockholders. All of the notes were converted into shares of our Series F Preferred Stock on March 13, 2001, as described below. In connection with the sale of the notes, we also issued to the stockholders who purchased the notes, warrants to purchase 340,187 shares of our common stock at an exercise price of $0.83 per share at the time the notes were converted into Series F Preferred Stock. The following table sets forth the names of the stockholders that purchased the notes, the corresponding aggregate principal amount of the notes that each such stockholder acquired, the number of shares of common stock to be issued immediately following completion of this offering upon the automatic net exercise of the warrants issued to such stockholder in connection with the private placement, assuming an initial public offering price of $ per share, the midpoint of the range on the cover of this prospectus, and the value of such shares of common stock at such assumed initial public offering price.

		Shares of Common Stock Issuable Upon Net-Exercise of Warrants	Value of Shares of Common Stock Issuable Upon Net-Exercise of Warrants
Investor Name	**Amount Invested**		
Crosspoint Venture Partners(1)	$2,094,400		
Goldman, Sachs & Co.(2)	1,951,202		
Crescendo Ventures(3)	480,000		
ONSET Ventures(4)	3,474,400		
	$8,000,002		

(1) Crosspoint Venture Partners LS 2000 was the record holder of $2,094,400 aggregate principal amount of the notes, and is the record holder of warrants to purchase 88,527 shares of our common stock.

(2) The Goldman Sachs Group, Inc. was the record holder of $1,463,400 aggregate principal amount of the notes, and is the record holder of warrants to purchase 61,831 shares of our common stock; Stone Street Fund 1999, L.P. was the record holder of $243,901 aggregate principal amount of the notes, and is the record holder of warrants to purchase 10,305 shares of our common stock, Stone Street Fund 1998, L.P. was the record holder of $187,357 aggregate principal amount of the notes, and is the record holder of warrants to purchase 7,916 shares of our common stock; and Bridge Street Fund 1998, L.P. was the record holder of $56,544 aggregate principal amount of the notes, and is the record holder of warrants to purchase 2,389 shares of our common stock.

(3) Crescendo World Fund, LLC was the record holder of $419,891 aggregate principal amount of the notes, and is the record holder of warrants to purchase 17,967 shares of our common stock; Eagle Ventures WF, LLC was the record holder of $20,109 aggregate principal amount of the notes, and is the record holder of warrants to purchase 859 shares of our common stock; and Wessel German American Venture Partners Gbr was the record holder of $40,000 aggregate principal amount of the notes, and is the record holder of warrants to purchase 1,711 shares of our common stock.

(4) ONSET Enterprise Associates II, L.P. was the record holder of $1,737,200 aggregate principal amount of the notes, and is the record holder of warrants to purchase 74,338 shares of our common stock; and ONSET Enterprise Associates III, L.P. was the record holder of $1,737,200 aggregate principal amount of the notes, and is the record holder of warrants to purchase 74,339 shares of our common stock.

Series F Preferred Stock Private Placement

Between March 2001 and January 2002, we issued and sold 10,213,815 shares of our Series F Preferred Stock, which are convertible into 6,128,280 shares of our common stock, at a purchase price of $3.92 per share of Series F Preferred Stock, to five of our significant stockholders and issued warrants to acquire 510,203 shares of our Series F Preferred Stock, which are convertible into 306,121 shares of our common stock, at an exercise price of $3.92 per share of Series F Preferred Stock, to one of our significant stockholders. The following table sets forth the names of the stockholders that invested in the financing, the corresponding number of shares of common stock to be issued upon conversion of the Series F Preferred Stock and number of shares of common stock issuable upon exercise of the warrants to acquire shares of our Series F Preferred Stock sold to such stockholders, assuming the conversion of our Series F Preferred Stock upon the completion of this offering, and the aggregate value of such shares at an estimated initial public offering price of $ per share, the midpoint of the range on the cover of this prospectus:

Investor Name	Shares of Common Stock Issuable Upon Conversion of Series F Preferred Stock	Shares of Common Stock Issuable Upon Exercise of Warrants	Value of Shares of Common Stock Issuable
Crosspoint Venture Partners(1)	3,061,224	—	
Goldman, Sachs & Co.(2)	310,217	—	
Crescendo Ventures(3)	673,321	—	
ONSET Ventures(4)	552,907	—	
INVESCO Private Capital, Inc.(5)	1,530,611	306,121	
	6,128,280	306,121	

(1) Crosspoint Venture Partners LS 2000 will be the record holder of 3,061,224 shares of our common stock issuable upon conversion of our Series F Preferred Stock.

(2) The Goldman Sachs Group, Inc. will be the record holder of 232,664 shares of our common stock issuable upon conversion of our Series F Preferred Stock; Stone Street Fund 1999, L.P. will be the record holder of 38,777 shares of our common stock issuable upon conversion of our Series F Preferred Stock; Stone Street Fund 1998, L.P. will be the record holder of 29,787 shares of our common stock issuable upon conversion of our Series F Preferred Stock; and Bridge Street Fund 1998, L.P. will be the record holder of 8,989 shares of our common stock issuable upon conversion of our Series F Preferred Stock.

(3) Crescendo World Fund, LLC will be the record holder of 650,117 shares of our common stock issuable upon conversion of our Series F Preferred Stock; Eagle Ventures WF, LLC will be the record holder of 16,839 shares of our common stock issuable upon conversion of our Series F Preferred Stock; and Wessel German American Venture Partners Gbr will be the record holder of 6,365 shares of our common stock issuable upon conversion of our Series F Preferred Stock.

(4) ONSET Enterprise Associates II, L.P. will be the record holder of 276,454 shares of our common stock issuable upon conversion of our Series F Preferred Stock; and ONSET Enterprise Associates III, L.P. will be the record holder of 276,453 shares of our common stock issuable upon conversion of our Series F Preferred Stock.

(5) Chancellor V, L.P. will be the record holder of 600,306 shares of our common stock issuable upon conversion of our Series F Preferred Stock and warrants to purchase an additional 120,061 shares of our common stock issuable upon conversion of our Series F Preferred Stock; Chancellor V-A, L.P will be the record holder of 281,326 shares of our common stock issuable upon conversion of our Series F Preferred Stock and warrants to purchase an additional 56,265 shares of our Series F Preferred Stock; Euromedia Venture Fund will be the record holder of 555,153 shares of our common stock issuable upon conversion of our Series F Preferred Stock and warrants to purchase an additional 111,030 shares of our common stock issuable upon conversion of our Series F Preferred Stock; and Citiventure 2000, L.P. will be the record holder of 93,826 shares of our common stock issuable upon conversion of our Series F Preferred Stock and warrants to purchase an additional 18,765 shares of our common stock issuable upon conversion of our Series F Preferred Stock.

2002 Convertible Note Private Placement

On November 15, 2002, we issued and sold $1.9 million aggregate principal amount of subordinated convertible notes bearing simple interest at the prevailing prime rate plus 1.00% to four of our significant stockholders. Upon completion of the Series G Preferred Stock financing in December 2002, $1.0 million of principal and accrued interest thereon was repaid and the remaining subordinated convertible notes and accrued interest were converted into shares of Series G Preferred Stock.

The following table sets forth the names of the stockholders that purchased the notes and the corresponding aggregate principal amount of the notes that each such stockholder acquired:

Investor Name	Amount Invested
Crosspoint Venture Partners(1)	$1,000,000
INVESCO Private Capital, Inc.(2)	500,000
Crescendo Ventures(3)	220,000
ONSET Ventures(4)	180,000

	$1,900,000

(1)	Crosspoint Venture Partners 1997, L.P. was the record holder of $1,000,000 aggregate principal amount of the notes.
(2)	Euromedia Venture Fund was the record holder of $181,350 aggregate principal amount of the notes; Citiventure 2000, L.P. was the record holder of $30,650 aggregate principal amount of the notes; Chancellor V, L.P. was the record holder of $196,100 aggregate principal amount of the notes; and Chancellor V-A, L.P. was the record holder of $91,900 aggregate principal amount of the notes.
(3)	Crescendo World Fund, LLC was the record holder of $209,946 aggregate principal amount of the notes and Eagle Ventures WF, LLC was the record holder of $10,054 aggregate principal amount of the notes.
(4)	ONSET Enterprise Associates III, L.P. was the record holder of $180,000 aggregate principal amount of the notes.

Series G Preferred Stock Private Placement

On December 24, 2002, we issued and sold 8,000,000 shares of our Series G Preferred Stock, which are convertible into 4,799,996 shares of our common stock, at a purchase price of $1.00 per share of Series G Preferred Stock to four of our significant stockholders. As noted above, a portion of the 8,000,000 shares issued in the Series G Preferred Stock financing was issued upon conversion of the outstanding principal and interest accrued to date on the subordinated convertible notes issued and sold in November of 2002. The remainder of the consideration for the Series G Preferred Stock was paid to us in cash on December 24, 2002. In March 2003, we sold an additional 300,000 shares of our Series G Preferred Stock, which are convertible into 180,000 shares of our common stock, at a purchase price of $1.00 per share of Series G Preferred Stock to four of our executive officers. The following table sets forth the names of the investors, the corresponding number of shares of common stock to be issued upon conversion of the Series G Preferred Stock purchased in the financings assuming completion of this offering and the value of such shares at an estimated initial public offering price of $ per share, the midpoint of the range on the cover of this prospectus:

	Shares of Common Stock Issuable Upon Conversion of Series G Preferred Stock	Value of Shares of Common Stock Issuable
Investor Name		
Crosspoint Venture Partners(1)	2,361,753	
INVESCO Private Capital, Inc.(2)	986,245	
Crescendo Ventures(3)	731,999	
ONSET Ventures(4)	719,999	
Ronald J. Fior	15,000	
Robert W. Warfield	60,000	
Christopher W. Cabrera	30,000	
Daniel P. Welch	15,000	
	4,919,996	

(1)	Crosspoint Venture Partners 2000 Q, L.P. will be the record holder of 2,119,270 shares of common stock issuable upon conversion of our Series G Preferred Stock and Crosspoint Venture Partners 2000, L.P. will be the record holder of 242,483 shares of common stock issuable upon conversion of our Series G Preferred Stock.
(2)	Chancellor V, L.P. will be the record holder of 386,805 shares of common stock issuable upon conversion of our Series G Preferred Stock; Chancellor V-A, L.P. will be the record holder of 181,272 shares of common stock issuable upon conversion of our Series G Preferred Stock; Euromedia Venture Fund will be the record holder of 357,711 shares of common stock issuable upon conversion of our Series G Preferred Stock; and Citiventure 2000, L.P. will be the record holder of 60,457 shares of common stock issuable upon conversion of our Series G Preferred Stock.
(3)	Crescendo World Fund, LLC will be the record holder of 698,547 shares of common stock issuable upon conversion of our Series G Preferred Stock and Eagle Ventures WF, LLC will be the record holder of 33,452 shares of common stock issuable upon conversion of our Series G Preferred Stock.
(4)	ONSET Standby Fund, L.P. will be the record holder of 480,000 shares of common stock issuable upon conversion of our Series G Preferred Stock, GS PEP I ONSET Standby Fund, L.P. will be the record holder of 162,142 shares of common stock issuable upon conversion of our Series G Preferred Stock, and GS PEP I Offshore ONSET Standby Fund, L.P. will be the record holder of 77,857 shares of Series G Preferred Stock.

Advances For Restricted Stock Purchase

In January 1998, Mr. Taussig, our President, Chief Executive Officer and Chairman of the Board of Directors, purchased 289,200 shares of our common stock at an exercise price of $0.17 per share pursuant to an exercise of stock options for restricted stock. In partial payment of the purchase price, Mr. Taussig executed a full recourse secured note in favor of Callidus in the principal amount of $47,718, bearing interest at 6.13% per annum, compounded annually. As of June 30, 2003, the aggregate principal and interest outstanding on the loan was approximately $66,000. The loan is due and payable, together with interest accrued to date, on January 7, 2008.

In December 1998, Mr. Welch, our Vice President, Worldwide Client Services, purchased 45,000 shares of our common stock at an exercise price of $0.83 per share pursuant to an exercise of stock options for restricted stock. In payment of the purchase price, Mr. Welch executed a full recourse secured note in favor of Callidus in the principal amount of $37,500, bearing interest at 4.52% per annum, compounded annually. As of June 30, 2003, the aggregate principal and interest outstanding on the loan was approximately $46,000. The loan is due and payable, together with interest accrued to date on December 31, 2003.

In December 1998, Mr. Tidd, our Vice President, Client Services, purchased 60,000 shares of our common stock at an exercise price of $0.83 per share pursuant to an exercise of stock options for restricted stock. In payment of the purchase price, Mr. Tidd executed a full recourse secured note in favor of Callidus in the principal amount of $50,000, bearing interest at 4.52% per annum, compounded annually. As of June 30, 2003, the aggregate principal and interest outstanding on the loan was approximately $61,000. The loan is due and payable, together with interest accrued to date on December 31, 2003.

Principal Stockholders

Principal Stockholders

The following table sets forth information known to us with respect to the beneficial ownership of our common stock as of June 30, 2003 and after the sale of shares of common stock by us in this offering, by the following:

- each person known by us to own beneficially more than 5% of our common stock;
- each of the directors and named executive officers individually; and
- all directors and executive officers as a group.

Beneficial ownership is determined in accordance with SEC rules, which generally attribute beneficial ownership of securities to each person who possesses, either solely or shared with others, the power to vote or dispose of those securities. These rules also treat as outstanding all shares of capital stock that a person would receive upon exercise of stock options or warrants held by that person that are immediately exercisable or exercisable within 60 days of the determination date, which in the case of the following table is June 30, 2003. Shares issuable pursuant to stock options and warrants exercisable within 60 days are deemed outstanding for computing the percentage of the person holding such options or warrants, but are not deemed outstanding for computing the percentage of any other person. The information presented in this table assumes the conversion of our preferred stock to common stock upon the consummation of this offering and the number of shares of common stock outstanding after this offering includes shares of common stock being offered for sale by us in this offering. The percentage of beneficial ownership for the following table is based on 17,420,414 shares of common stock outstanding as of June 30, 2003, and shares of common stock outstanding after the completion of this offering, assuming no exercise of the underwriters' over-allotment option. To our knowledge, except as indicated in the footnotes to this table and pursuant to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock.

	Shares Beneficially Owned Before the Offering		Percent of Shares Outstanding After the Offering
Name and Address of Beneficial Owner	**Number**	**Percent**	
Crosspoint Venture Partners(1)	6,765,521	38.64%	
2925 Woodside Road			
Woodside, CA 94062			
ONSET Ventures(2)	2,983,169	16.98	
2400 Sand Hill Road, Suite 150			
Menlo Park, CA 94025			
INVESCO Private Capital(3)	2,822,977	15.93	
1166 Avenue of the Americas			
New York, NY 10036			
Crescendo Ventures(4)	2,350,128	13.47	
480 Cowper Street, Suite 300			
Palo Alto, CA 94301			
The Goldman Sachs Group, Inc.(5)	1,342,529	7.67	
85 Broad Street			
New York, NY 10014			

	Shares Beneficially Owned Before the Offering		Percent of Shares Outstanding After the Offering
Name and Address of Beneficial Owner	**Number**	**Percent**	
Reed D. Taussig(6)	643,899	3.62%	
Christopher W. Cabrera(7)	178,696	1.02	
Ronald J. Fior(8)	187,500	1.07	
Michael C. Tidd(9)	232,299	1.32	
Robert W. Warfield(10)	457,500	2.57	
Daniel P. Welch(11)	192,300	1.10	
Michael A. Braun(12)	51,049	*	

George James(13)	59,524	*
Terry L. Opdendyk(14)	2,983,169	16.98
R. David Spreng(15)	2,350,128	13.47
All directors and executive officers as a group (11 persons)(16)	7,516,064	39.17

*	Less than one percent

(1)	Includes 88,527 shares of common stock that may be acquired upon exercise of common stock warrants exercisable within 60 days after June 30, 2003. The affiliates of Crosspoint Venture Partners are Crosspoint Venture Partners 1997, L.P., Crosspoint Venture Partners LS 2000, Crosspoint Venture Partners 2000 Q, L.P. and Crosspoint Venture Partners 2000, L.P.
(2)	Includes 148,677 shares of common stock that may be acquired upon exercise of common stock warrants exercisable within 60 days after June 30, 2003. Also includes 3,750 shares that may be acquired from Robert Gillette, a former employee, upon exercise of a common stock option on or before October 14, 2004. The affiliates of ONSET Ventures are ONSET Venture Services Corporation, ONSET Enterprise Associates II, L.P., ONSET Enterprise Associates III, L.P., ONSET Standby Fund, L.P., GS PEP I ONSET Standby Fund, L.P., and GS PEP I Offshore ONSET Standby Fund, L.P. Terry L. Opdendyk, in his capacity as a general partner of ONSET Ventures, may be deemed to have shared voting or dispositive power over these shares. Mr. Opdendyk disclaims this beneficial ownership, except to the extent of his pecuniary interest therein.
(3)	Includes 306,121 shares of common stock that may be acquired upon exercise of convertible warrants exercisable within 60 days after June 30, 2003. The affiliates of INVESCO Private Capital are Chancellor V, LP, Chancellor V-A, LP, Citiventure 2000 LP and Euromedia Venture Fund.
(4)	Includes 20,537 shares of common stock that may be acquired upon exercise of common stock warrants exercisable within 60 days after June 30, 2003. The affiliates of Crescendo Ventures are Crescendo World Fund, LLC, Eagle Ventures WF, LLC and Wessel German American Venture Partners Gbr. R. David Spreng, in his capacity as a managing general partner of Crescendo Ventures may be deemed to have shared voting or dispositive power over these shares. Mr. Spreng disclaims this beneficial ownership, except to the extent of his pecuniary interest therein.
(5)	Includes 82,441 shares of common stock that may be acquired upon exercise of common stock warrants exercisable within 60 days after June 30, 2003. The affiliates of The Goldman Sachs Group, Inc. are Stone Street Fund 1998, L.P., Bridge Street Fund 1998, L.P., and Stone Street Fund 1999, L.P.
(6)	Includes 365,799 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003 and excludes shares that will vest upon the consummation of this offering. Includes 3,600 shares of common stock beneficially owned by Kathryn E. Taussig, 3,600 shares of common stock beneficially owned by Madeline G. Taussig, and 3,600 shares of common stock beneficially owned by Olivia J. Taussig, to which Mr. Taussig may be deemed in his capacity as their father to have shared voting or dispositive power.
(7)	Includes 147,197 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003.
(8)	Includes 172,500 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003.
(9)	Includes 112,300 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003.
(10)	Includes 397,500 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003 and excludes shares that will vest upon the consummation of this offering.
(11)	Includes 132,300 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003.
(12)	Includes 47,300 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003.
(13)	Includes 44,525 shares of common stock that may be acquired upon the exercise of stock options exercisable within 60 days after June 30, 2003.
(14)	Represents 2,983,169 shares of common stock beneficially owned by affiliates of ONSET Ventures, including 148,677 shares that may be acquired by affiliates of ONSET Ventures upon the exercise of common stock warrants within 60 days after June 30, 2003 and 3,750 shares that may be acquired by affiliates of ONSET Ventures from Robert Gillette, a former employee, upon exercise of a common stock option on or before October 14, 2004 of which Mr. Opdendyk may be deemed in his capacity as a founder and general partner of ONSET Ventures, to have shared voting or dispositive power. Mr. Opdendyk disclaims beneficial ownership of these shares, except to the extent of his pecuniary interest therein.
(15)	Represents 2,350,128 shares of common stock beneficially owned by affiliates of Crescendo Ventures, including 20,537 shares that may be acquired upon the exercise of common stock warrants within 60 days after June 30, 2003, of which Mr. Spreng may be deemed, in his capacity as a managing general partner of Crescendo Ventures, to have shared voting or dispositive power. Mr. Spreng disclaims beneficial ownership of these shares, except to the extent of his pecuniary interest therein.
(16)	Includes shares issuable upon exercise of options and warrants as described in footnotes (6)-(15) above as well as an immediately exercisable option to acquire 180,000 shares of our common stock held by Mr. Rankin, our Senior Vice President, Worldwide Marketing.

Description of Capital Stock

Description of Capital Stock

General

Subject to stockholder approval, we intend to amend our certificate of incorporation and bylaws. These amendments will be effective prior to closing of this offering. The following description of capital stock assumes the effectiveness of these amendments except as otherwise noted.

Upon the closing of this offering, we will be authorized to issue 100,000,000 shares of common stock, $0.001 par value, and 5,000,000 shares of undesignated preferred stock, $0.001 par value.

Common Stock

As of June 30, 2003, there were 1,488,421 shares of common stock outstanding which were held of record by approximately 120 stockholders. There will be shares of common stock outstanding, assuming no exercise of the underwriters' over-allotment option and no exercise of outstanding options, after giving effect to the sale of the shares of common stock offered hereby.

The holders of common stock are entitled to one vote per share on all matters to be voted upon by the stockholders. Subject to preferences that may be applicable to any outstanding preferred stock, the holders of common stock are entitled to receive ratably such dividends, if any, as may be declared from time to time by the board of directors out of funds legally available therefor. See "Dividend Policy." In the event of liquidation, dissolution or winding up of Callidus, the holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of

preferred stock, if any, then outstanding. The common stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of common stock are fully paid and non-assessable, and the shares of common stock to be issued upon completion of this offering will be fully paid and non-assessable.

Preferred Stock

Our board of directors has the authority, without action by our stockholders, to designate and issue preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof, any or all of which may be greater than the rights of the common stock, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series or the designation of such series, without further vote or action by the stockholders. It is not possible to state the actual effect of the issuance of any shares of preferred stock upon the rights of holders of the common stock until the board of directors determines the specific rights of the holders of the preferred stock. However, these effects might include:

- restricting dividends on the common stock;
- diluting the voting power of the common stock;
- impairing the liquidation rights of the common stock; and
- delaying or preventing a change in control of our company without further action by the stockholders.

Immediately after this offering there will be no shares of preferred stock outstanding. We have no present plans to issue any shares of preferred stock.

Warrants

At June 30, 2003, assuming the conversion of our preferred stock upon the consummation of this offering, warrants to purchase an aggregate of 843,197 shares of our common stock were outstanding. These warrants generally expire five to ten years from the date of issue and have a weighted average exercise price of $3.63 per share.

Anti-Takeover Effects of Delaware Law and Our Charter Documents

Certain provisions of Delaware law and our certificate of incorporation and bylaws could make the acquisition of our company through a tender offer, a proxy contest or other means more difficult and could make the removal of incumbent officers and directors more difficult. We expect these provisions to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of our company to first negotiate with our board of directors.

Delaware Law

After this offering, we will be subject to the "business combination" provisions of Section 203 of the Delaware General Corporation Law, an anti-takeover law. In general, such provisions will prohibit us from engaging in various "business combination" transactions with any "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless:

- the transaction is approved by our board of directors prior to the date the interested stockholder obtained such status;
- upon consummation of the transaction which resulted in the stockholder becoming an interested stockholder, the stockholder owned at least 85% of our voting stock outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding (1) shares owned by persons who are directors and also officers and (2) shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or
- on or subsequent to such date the business combination is approved by our board of directors and authorized at an annual or special meeting of stockholders by the affirmative vote of at least two-thirds of our outstanding voting stock which is not owned by the interested stockholder.

Section 203 defines "business combination" to include:

- any merger or consolidation involving us and the interested stockholder;
- any sale, transfer, pledge or other disposition involving the interested stockholder of 10% or more of our assets;
- subject to exceptions, any transaction that results in the issuance or transfer by us of any of our stock to the interested stockholder; or
- the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through us.

Section 203 defines an "interested stockholder" as:

- any entity or person beneficially owning 15% or more of our outstanding voting stock; and
- any entity or person affiliated with or controlling or controlled by the entity or person.

A Delaware corporation may "opt out" of the anti-takeover law with an express provision in its original certificate of incorporation or an express provision in its certificate of incorporation or bylaws resulting from a stockholders' amendment approved by at least a majority of the outstanding voting shares. We have not "opted out" of the provisions of the anti-takeover law. We expect the existence of this provision to have an anti-takeover effect with respect to transactions our board of directors does not approve in advance. We also anticipate that Section 203 may also discourage attempts that might result in a premium over the market price for the shares of common stock held by stockholders.

Our Charter Documents

Classified Board of Directors. Our board of directors will be divided into three classes, each serving staggered three-year terms. As a result, only a portion of our board of directors will be elected each year. To implement the classified structure, prior to the closing of this offering, two of the nominees to the board will be appointed to one-year terms, two will be appointed to two-year terms and one will be appointed to a three-year term. Thereafter, directors will be elected for three-year terms at each annual meeting of stockholders. Directors may be removed only for cause and with the approval of the holders of a

majority of our outstanding common stock. The board of directors will have the exclusive right to increase or decrease the size of the board and to fill vacancies on the board. This system of electing directors may tend to discourage a third party from making a tender offer or otherwise attempting to obtain control of us, because it generally makes it more difficult for stockholders to replace a majority of the directors.

Stockholder Meetings. Under our certificate of incorporation, only the board of directors, the chairman of the board, the president or the secretary may call special meetings of stockholders.

Requirements for Advance Notification of Stockholder Nominations and Proposals. Our bylaws contain advance notice procedures with respect to stockholder proposals and the nomination of candidates for election as directors, other than nominations made by or at the direction of the board of directors or a committee of the board.

No Cumulative Voting. Our certificate of incorporation does not provide for cumulative voting in the election of directors, which, may frustrate the ability of minority stockholders to obtain representation on the board of directors.

No Action By Written Consent. Delaware law provides that stockholders may execute an action by written consent in lieu of a stockholder meeting unless such ability is eliminated by a certificate of incorporation provision. Elimination of written consents of stockholders may lengthen the amount of time and increased expense required to take stockholder actions because actions by written consent are not subject to the minimum notice requirement of a stockholder's meeting. Without the availability of stockholders' actions by written consent, a holder controlling a majority of our capital stock would not be able to amend our certificate of incorporation or bylaws or remove directors without holding a stockholder meeting. The stockholder would have to obtain the consent of a majority of the board of directors, the chairman of the board, the president or the secretary to call a stockholders' meeting and satisfy the notice periods determined by the board of directors.

Preferred Stock. We have undesignated preferred stock that may be issued by the board of directors at any time, which may have the effect of delaying or preventing a change of control of our company.

Our certificate of incorporation provides that the vote of the holders of at least two-thirds of the outstanding shares entitled to vote at the election of directors, voting together as a single class, is required to amend the following provisions of our certificate of incorporation:

- Article 6, which relates to removal of directors and vacancies on the board of directors;
- Article 7, which relates to corporate governance, including provisions relating to stockholder action by written consent and special meetings of stockholders;
- Article 10, which relates to the limitation of liability and indemnification of directors and officers;
- Article 11, which relates to amendment of our bylaws; and
- Article 12, which relates to amendment of the preceding provisions of the certificate of incorporation.

Our bylaws and our certificate of incorporation provide that amendment of any provision of our bylaws requires the affirmative vote of at least two-thirds of the outstanding shares entitled to vote at the election of directors, voting together as a single class.

Listing

Application has been made to have our common stock approved for quotation on the Nasdaq National Market under the symbol "CALD".

Transfer Agent and Registrar

The Transfer Agent and Registrar for our common stock is American Stock Transfer and Trust Company.

Shares Eligible for Future Sale

Shares Eligible for Future Sale

Prior to this offering, there has been no market for our common stock. Future sales of substantial amounts of our common stock in the public market could adversely affect market prices prevailing from time to time. Furthermore, because only a limited number of shares will be available for sale shortly after this offering due to existing contractual and legal restrictions on resale as described below, there may be sales of substantial amounts of our common stock in the public market after the restrictions lapse. This may adversely affect the prevailing market price and our ability to raise equity capital in the future.

Upon completion of this offering, we will have shares of common stock outstanding, assuming no exercise of the underwriters' over-allotment option, and no exercise of any options or warrants after June 30, 2003. Of these shares, shares, or shares if the underwriters exercise their over-allotment option in full, sold in this offering will be freely transferable without restriction or registration under the Securities Act, except for any shares purchased by one of our existing "affiliates," as that term is defined in Rule 144 under the Securities Act. The remaining shares of common stock existing are "restricted securities" as defined in Rule 144. Restricted securities may be sold in the public market only if registered or if they qualify for an exemption from registration under Rules 144 or 701 of the Securities Act. As a result of the contractual lock-up periods described below and the provisions of Rules 144 and 701, these shares will be available for sale in the public market as follows:

Number of Shares	Date
	On the date of this prospectus
	At various times after 180 days from the date of this prospectus (subject, in some cases, to volume limitations and applicable holding periods)

Rule 144

In general, under Rule 144 as currently in effect, beginning 90 days after this offering, a person, or persons whose shares are aggregated, who owns shares that were purchased from us or any affiliate at least one year previous to such date, is entitled to sell within any three-month period a number of shares that does not exceed the greater of 1% of our then-outstanding shares of common stock, or approximately shares immediately after this offering, or the average weekly trading volume of our common stock on the Nasdaq National Market during the four calendar weeks preceding the filing of a notice of the sale on Form 144. Sales under Rule 144 are also subject to manner of sale provisions, notice requirements and the availability of current public information about us. We are unable to estimate the number of shares that will be sold under Rule 144 since this will depend on the market price for our common stock, the personal circumstances of the stockholder and other factors.

Rule 144(k)

Under Rule 144(k), a person who is not deemed to have been one of our affiliates at any time during the three months preceding a sale, and who owns shares within the definition of "restricted securities" under Rule 144 that were purchased from us or any affiliate at least two years previous to such date, would be entitled to sell shares under Rule 144(k) without regard to the volume limitations, manner of sale provisions, public information requirements or notice requirements described above.

Rule 701

In general, any of our employees, directors, officers, consultants or advisors who purchased shares from us before the effective date of this offering acquired the shares in reliance on the exemption from registration provided by Rule 701.

Securities issued in reliance on Rule 701 are restricted securities but, subject to the contractual restrictions described below, beginning 90 days after the date of this prospectus, may be sold by persons other than "affiliates," as defined in Rule 144, subject only to the manner of sale provisions of Rule 144 and by "affiliates" under Rule 144 without compliance with its one-year minimum holding period requirement.

Registration Rights

Following this offering, the holders of 17,420,487 shares of our outstanding common stock and the holders of warrants to purchase 843,205 shares of our common stock will, under some circumstances, have the right to require us to register their shares for future sales. These registration rights are generally subject to conditions and limitations, which include the right of the underwriters of an offering to limit the number of shares included in the registration under some circumstances.

Demand Registration Rights. Prior to the earlier of 180 days after the closing of this offering or December 31, 2004, the holders of outstanding shares with registration rights have the right to demand that we file one registration statement if such holders making the request hold, in the aggregate, at least 50% of the registrable securities. We are obligated to register their shares only if the securities to be registered have an anticipated public offering price of $30,000,000 or would include at least 20% of the registrable securities. If we are eligible to file a registration statement on Form S-3, the holders of the shares having registration rights have the right to demand on one occasion in any 12 month period that we file a registration statement on Form S-3, so long as the holders making the request hold, in the aggregate, at least 25% of the registrable shares and the aggregate amount of securities to be sold under the registration statement on Form S-3 exceeds $1,500,000.

Piggyback Registration Rights. If we register any securities for public sale, stockholders with registration rights will have the right to include their shares in the registration statement. The underwriters of any underwritten offering will have the right to limit the number of shares having registration rights to an amount no less than 33 1/3% of all shares to be included in such offering.

Expenses of Registration. We will pay all expenses relating to any demand or piggyback registration other than underwriting discounts and commissions. However, if a request for registration is withdrawn by the holders of a majority of the shares having registration rights after we have begun the registration process, the stockholders having initiated the registration shall be deemed to have forfeited certain of their registration rights, unless such holders agree to reimburse us for our expenses to date in connection with the incomplete registration.

Expiration of Registration Rights. The registration rights described above will expire five years after this offering is completed. The registration rights will terminate earlier for a particular stockholder if that holder, following this offering, holds less than one percent of our outstanding common stock or such holder can resell all of its securities in a three-month period under Rule 144 of the Securities Act.

Registration of these shares under the Securities Act would result in these shares becoming freely tradable without restriction under the Securities Act immediately upon the effectiveness of the registration, except for shares purchased by affiliates.

Stock Options

As of June 30, 2003, options to purchase a total of 4,201,026 shares of common stock were outstanding. An additional 158,274 shares of common stock were available for future option grants under our stock plans.

Upon completion of this offering, we intend to file a registration statement under the Securities Act covering all shares of common stock subject to outstanding options or issuable pursuant to our 1997 Stock Option Plan, 2003 Stock Incentive Plan and 2003 Employee Stock Purchase Plan. Subject to Rule 144 volume limitations applicable to affiliates, shares issued after the effective date of the Form S-8 registration statement pursuant to the exercise of stock options or otherwise under these stock plans will be eligible for re-sale in the open market, except to the extent that the shares are subject to vesting restrictions or the contractual restrictions described below.

Lock-up Agreements

We, our officers and directors and our other stockholders have agreed that, for a period of 180 days from the date of this prospectus, we and they will not without the prior written consent of Citigroup, dispose of or hedge any of the shares of our common stock or any securities convertible into or exchangeable for our common stock, subject to limited exceptions. Citigroup in its sole discretion may release any of the securities subject to these lock-up agreements at any time without notice.

Underwriting

Underwriting

Citigroup Global Markets Inc., Lehman Brothers Inc. and U.S. Bancorp Piper Jaffray Inc. are acting as representatives of the underwriters named below. Subject to the terms and conditions stated in the underwriting agreement dated the date of this prospectus, each underwriter named below has agreed to purchase, and we have agreed to sell to that underwriter, the number of shares set forth opposite the underwriter's name.

Underwriter	Number of shares
Citigroup Global Markets Inc.	
Lehman Brothers Inc.	
U.S. Bancorp Piper Jaffray Inc.	
Total	

The underwriting agreement provides that the obligations of the underwriters to purchase the shares included in this offering are subject to approval of legal matters by counsel and to other conditions. The underwriters are obligated to purchase all the shares (other than those covered by the over-allotment option described below) if they purchase any of the shares.

The underwriters propose to offer some of the shares directly to the public at the public offering price set forth on the cover page of this prospectus and some of the shares to dealers at the public offering price less a concession not to exceed $ per share. The underwriters may allow, and dealers may reallow, a concession not to exceed $ per share on sales to other dealers. If all of the shares are not sold at the initial offering price, the representatives may change the public offering price and the other selling terms. The representatives have advised us that the underwriters do not intend sales to discretionary accounts to exceed five percent of the total number of shares of our common stock offered by them.

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to additional shares of common stock at the public offering price less the underwriting discount. The underwriters may exercise the option solely for the purpose of covering over-allotments, if any, in connection with this offering. To the extent the option is exercised, each underwriter must purchase a number of additional shares approximately proportionate to that underwriter's initial purchase commitment.

We, our officers and directors and our other stockholders have agreed that, for a period of 180 days from the date of this prospectus, we and they will not, without the prior written consent of Citigroup, dispose of or hedge any of the shares of our common stock or any securities convertible into or exchangeable for our common stock, subject to limited exceptions. Citigroup in its sole discretion may release any of the securities subject to these lock-up agreements at any time without notice.

Each underwriter has represented, warranted and agreed that:

- it has not offered or sold and, prior to the expiry of a period of six months from the closing date, will not offer or sell any shares included in this offering to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995;
- it has only communicated and caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 ("FSMA")) received by it in connection with the issue or sale of any shares included in this offering in circumstances in which section 21(1) of the FSMA does not apply to us;
- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the shares included in this offering in, from or otherwise involving the United Kingdom; and
- the offer in The Netherlands of the shares included in this offering is exclusively limited to persons who trade or invest in securities in the conduct of a profession or business (which include banks, stockbrokers, insurance companies, pension funds, other institutional investors and finance companies and treasury departments of large enterprises).

Prior to this offering, there has been no public market for our common stock. Consequently, the initial public offering price for the shares was determined by negotiations between us and the representatives. Among the factors considered in determining the initial public offering price were our record of operations, our current financial condition, our future prospects, our markets, the economic conditions in and future prospects for the industry in which we compete, our management and currently prevailing general conditions in the equity securities markets, including current market valuations of publicly traded companies considered comparable to our company. We cannot assure you, however, that the prices at which the shares will sell in the public market after this offering will not be lower than the initial public offering price or that an active trading market in our common stock will develop and continue after this offering.

We have applied to have our common stock included for quotation on the Nasdaq National Market under the symbol "CALD".

The following table shows the underwriting discounts and commissions that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase additional shares of common stock.

	Paid by Callidus	
	No Exercise	Full Exercise
Per Share		$$
Total		$$

In connection with the offering, Citigroup on behalf of the underwriters, may purchase and sell shares of common stock in the open market. These transactions may include short sales, syndicate covering transactions and stabilizing transactions. Short sales involve syndicate sales of common stock in excess of the number of shares to be purchased by the underwriters in the offering, which creates a syndicate short position. "Covered" short sales are sales of shares made in an amount up to the number of shares represented by the underwriters' over-allotment option. Transactions to close out the covered syndicate short involve either purchases of the common stock in the open market after the distribution has been completed or the exercise of the over-allotment option. In determining the source of shares to close out the covered syndicate short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. The underwriters may also make "naked" short sales of shares in excess of the over-allotment option. The underwriters must close out any naked short position by purchasing shares of common stock in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of bids for or purchases of shares in the open market while the offering is in progress.

The underwriters also may impose a penalty bid. Penalty bids permit the underwriters to reclaim a selling concession from a syndicate member when Citigroup repurchases shares originally sold by that syndicate member in order to cover syndicate short positions or make stabilizing purchases.

Any of these activities may have the effect of preventing or retarding a decline in the market price of the common stock. They may also cause the price of the common stock to be higher than the price that would otherwise exist in the open market in the absence of these transactions. The underwriters may conduct these transactions on the Nasdaq National Market or in the over-the-counter market, or otherwise. If the underwriters commence any of these transactions, they may discontinue them at any time.

We estimate that our portion of the total expenses of this offering will be $.

The underwriters may, from time to time, engage in transactions with and perform services for us in the ordinary course of their business.

A prospectus in electronic format may be made available on the websites maintained by one or more of the underwriters. The representatives may agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. The representatives will allocate shares to underwriters that may make Internet distributions on the same basis as other allocations. In addition, shares may be sold by the underwriters to securities dealers who resell shares to online brokerage account holders.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments the underwriters may be required to make because of any of those liabilities.

Material U.s. Federal Tax Considerations for Non-u.s. Holders of Common Stock

Material U.s. Federal Tax Considerations for

Non-u.s. Holders of Common Stock

The following is a general discussion of the material U.S. federal income and estate tax consequences of the ownership and disposition of common stock by a beneficial owner that is a "non-U.S. holder" and that does not own, and is not deemed to own, more than 5% of our common stock. A "non-U.S. holder" is a person or entity that, for U.S. federal income tax purposes, is a:

- non-resident alien individual, other than certain former citizens and residents of the United States subject to tax as expatriates,
- foreign corporation or
- foreign estate or trust.

A "non-U.S. holder" does not include an individual who is present in the United States for 183 days or more in the taxable year of disposition and is not otherwise a resident of the United States for U.S. federal income tax purposes. Such an individual is urged to consult his or her own tax advisor regarding the U.S. federal income tax consequences of the sale, exchange or other disposition of common stock.

This discussion is based on the Internal Revenue Code of 1986, as amended (the "Code"), and administrative pronouncements, judicial decisions and final, temporary and proposed Treasury Regulations, changes to any of which subsequent to the date of this prospectus may affect the tax consequences described herein. This discussion does not address all aspects of U.S. federal income and estate taxation that may be relevant to non-U.S. holders in light of their particular circumstances and does not address any tax consequences arising under the laws of any state, local or foreign jurisdiction. Prospective holders are urged to consult their tax advisors with respect to the particular tax consequences to them of owning and disposing of common stock, including the consequences under the laws of any state, local or foreign jurisdiction.

Dividends

As discussed under “Dividend Policy” above, we do not currently expect to pay dividends. In the event that we do pay dividends, dividends paid to a non-U.S. holder of common stock generally will be subject to withholding tax at a 30% rate or a reduced rate specified by an applicable income tax treaty. In order to obtain a reduced rate of withholding, a non-U.S. holder will be required to provide an Internal Revenue Service Form W-8BEN certifying its entitlement to benefits under a treaty.

The withholding tax does not apply to dividends paid to a non-U.S. holder who provides a Form W-8ECI, certifying that the dividends are effectively connected with the non-U.S. holder’s conduct of a trade or business within the United States. Instead, the effectively connected dividends will be subject to regular U.S. income tax as if the non-U.S. holder were a U.S. resident. A non-U.S. corporation receiving effectively connected dividends may also be subject to an additional “branch profits tax” imposed at a rate of 30% (or a lower treaty rate).

Gain on Disposition of Common Stock

A non-U.S. holder generally will not be subject to U.S. federal income tax on gain realized on a sale or other disposition of common stock unless:

- the gain is effectively connected with a trade or business of the non-U.S. holder in the United States, or
- we are or have been a U.S. real property holding corporation, as defined in the Code, at any time within the five-year period preceding the disposition or the non-U.S. holder’s holding period, whichever period is shorter, and our common stock has ceased to be traded on an established securities market prior to the beginning of the calendar year in which the sale or disposition occurs.

We are not, and do not anticipate becoming, a U.S. real property holding corporation.

Information Reporting Requirements and Backup Withholding

Information returns will be filed with the Internal Revenue Service in connection with payments of dividends and the proceeds from a sale or other disposition of common stock. You may be required to comply with certification procedures to establish that you are not a U.S. person in order to avoid information reporting and backup withholding tax requirements. The certification procedures required to claim a reduced rate of withholding under a treaty will satisfy the certification requirements necessary to avoid the backup withholding tax as well. The amount of any backup withholding from a payment to you will be allowed as a credit against your U.S. federal income tax liability and may entitle you to a refund, provided that the required information is furnished to the Internal Revenue Service.

Federal Estate Tax

An individual non-U.S. holder who is treated as the owner of, or has made certain lifetime transfers of, an interest in the common stock will be required to include the value of the stock in his gross estate for U.S. federal estate tax purposes, and may be subject to U.S. federal estate tax unless an applicable estate tax treaty provides otherwise.

link1 "LEGAL MATTERS"

Legal Matters

Legal Matters

The validity of the issuance of the shares of common stock offered hereby will be passed upon for Callidus by Davis Polk & Wardwell, Menlo Park, California. Shearman & Sterling LLP, Menlo Park, California, will pass upon certain legal matters in connection with this offering for the underwriters.

link1 "EXPERTS"

Experts

Experts

The consolidated balance sheets of Callidus Software Inc. and subsidiaries as of December 31, 2001 and 2002 and the related consolidated statements of operations, stockholders’ equity (deficit) and comprehensive loss, and cash flows for each of the years in the three-year period ended December 31, 2002 have been included in this prospectus in reliance upon the report of KPMG LLP, independent accountants, appearing elsewhere herein, upon the authority of said firm as experts in accounting and auditing. KPMG LLP’s audit report refers to a change in accounting for goodwill and other intangible assets effective January 1, 2002.

link1 "WHERE YOU CAN FIND MORE INFORMATION"

Where You Can Find More Information

Where You Can Find More Information

We have filed with the Securities and Exchange Commission (SEC), a registration statement on Form S-1 under the Securities Act with respect to the common stock offered hereby. This prospectus does not contain all of the information set forth in the registration statement and the exhibits and schedules thereto. For further information with respect to us and our common stock, reference is made to the registration statement and the exhibits and any schedules filed therewith. Statements contained in this prospectus as to the contents of any contract or other document referred to are not necessarily complete and in each instance, if such contract or document is filed as an exhibit, reference is made to the copy of such contract or other document filed as an exhibit to the registration statement, each statement being qualified in all respects by such reference. A copy of the registration statement, including the exhibits and schedules thereto, may be read and copied at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site at http://www.sec.gov, from which interested persons can electronically access the registration statement, including the exhibits and any schedules thereto. The registration statement, including the exhibits and schedules thereto, are also available for reading and copying at the offices of Nasdaq Operations, 1735 K Street, N.W., Washington, D.C. 20006.

As a result of the offering, we will become subject to the full informational requirements of the Securities Exchange Act of 1934, as amended. We will fulfill our obligations with respect to such requirements by filing periodic reports and other information with the SEC. We intend to furnish our stockholders with annual reports containing consolidated financial statements certified by an independent public accounting firm. We also maintain an Internet site at http://www.callidussoftware.com.

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Index to Consolidated Financial Statements

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When the reverse common stock split referred to in Note 1 to the Consolidated Financial Statements has been consummated, we will be in a position to render the following report.

/s/ KPMG LLP

Form of Independent Auditors' Report

The Board of Directors and Stockholders Callidus Software Inc.

We have audited the accompanying consolidated balance sheets of Callidus Software Inc. and subsidiaries (the Company) as of December 31, 2001 and 2002, and the related consolidated statements of operations, stockholders' equity (deficit) and comprehensive loss, and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Callidus Software Inc. and subsidiaries as of December 31, 2001 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*.

Mountain View, California September 22, 2003 **CALLIDUS SOFTWARE INC.**

Consolidated Balance Sheets

	As of December 31,		As of June 30, 2003	
	2001	2002	Actual	Pro Forma
			(unaudited)	
	(in thousands, except per share data)			
Current assets:				
Cash and cash equivalents	$12,034	$12,833	$13,289	$13,289
Accounts receivable, net of allowances of $47, $281, $335 and 335, respectively	2,628	4,395	11,654	11,654
Prepaids and other current assets	716	674	753	753
Total current assets	15,378	17,902	25,696	25,696
Property and equipment, net	3,379	2,016	1,600	1,600
Deposits and other assets	784	777	665	665
Goodwill	123	—	—	—
Total assets	$19,664	$20,695	$27,961	$27,961
Current liabilities:				
Bank line of credit	$1,875	$2,765	$5,405	$5,405
Current portion of long-term debt	2,002	883	884	884
Accounts payable	1,270	1,978	1,623	1,623
Accrued payroll and related expenses	667	2,258	2,439	2,439
Accrued expenses	984	3,116	2,954	2,954
Deferred revenue	1,609	6,252	8,844	8,844
Total current liabilities	8,407	17,252	22,149	22,149
Long-term debt, less current portion	439	986	838	838
Deferred rent	128	88	60	60
Long-term deferred revenue	—	276	420	420
Total liabilities	8,974	18,602	23,467	23,467
Stockholders' equity:				
Convertible preferred stock, $0.001 par value Authorized 31,928 shares (actual); 5,000 shares (pro forma); issued and outstanding 21,429, 29,926, 30,379 and no shares, respectively; aggregate liquidation value of $112,686, $132,586, $133,492 and $0, respectively	21	30	30	—
Common stock, $0.001 par value. Authorized 42,000 shares (actual); 100,000 shares (pro forma); issued and outstanding 1,353, 1,400, 1,488 and 17,420, respectively	2	2	2	17
Additional paid-in capital	87,016	96,935	103,643	103,658
Deferred stock-based compensation	(621)	(90)	(4,168)	(4,168)
Notes receivable from stockholders	(238)	(238)	(238)	(238)
Accumulated other comprehensive income (loss)	(39)	35	61	61
Accumulated deficit	(75,451)	(94,581)	(94,836)	(94,836)
Total stockholders' equity	10,690	2,093	4,494	4,494
Total liabilities and stockholders' equity	$19,664	$20,695	$27,961	$27,961

See accompanying notes to consolidated financial statements.

CALLIDUS SOFTWARE INC.

Consolidated Statements of Operations

				Six Months Ended	
	Year Ended December 31,			June 30,	
	2000	2001	2002	2002	2003
				(unaudited)	
	(in thousands, except per share data)				
Revenues:					

License revenues	$8,879	$6,860	$9,820	$5,224	$16,603
Maintenance and service revenues	13,302	16,033	16,766	6,917	13,175
Total revenues	22,181	22,893	26,586	12,141	29,778
Cost of revenues:					
License revenues	840	650	814	366	1,011
Maintenance and service revenues	11,183	13,103	14,212	6,327	10,270
Total cost of revenues	12,023	13,753	15,026	6,693	11,281
Gross profit	10,158	9,140	11,560	5,448	18,497
Operating expenses:					
Sales and marketing	16,115	12,003	13,527	6,062	8,764
Research and development	9,701	10,659	11,118	5,227	5,266
General and administrative	5,048	4,859	5,053	2,174	2,525
Stock-based compensation(1)	4,312	1,878	424	280	2,027
Total operating expenses	35,176	29,399	30,122	13,743	18,582
Loss from operations	(25,018)	(20,259)	(18,562)	(8,295)	(85)
Interest expense	(793)	(916)	(582)	(263)	(217)
Other income, net	383	331	137	105	47
Loss before cumulative effect of change in accounting principle	(25,428)	(20,844)	(19,007)	(8,453)	(255)
Cumulative effect of change in accounting principle	—	—	(123)	(123)	—
Net loss	$(25,428)	$(20,844)	$(19,130)	$(8,576)	$(255)
Basic and diluted net loss per share	$(23.83)	$(17.24)	$(13.98)	$(6.35)	$(0.18)
Weighted-average shares used in computing basic and diluted net loss per share	1,067	1,286	1,368	1,350	1,422
(1) Stock-based compensation consists of:					
Cost of maintenance and service revenues	$619	$309	$95	$63	$534
Sales and marketing	2,185	726	73	52	815
Research and development	767	399	119	77	460
General and administrative	741	444	137	88	218
Total stock-based compensation	$4,312	$1,878	$424	$280	$2,027

See accompanying notes to consolidated financial statements.

Callidus Software Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity (Deficit) and Comprehensive Loss

Years Ended December 31, 2000, 2001 and 2002 and Six Months Ended June 30, 2003

	Convertible preferred stock		Common stock		Additional paid-in capital	Deferred stock-based compensation	Notes receivable from stockholders	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholders' equity (deficit)	Compre loss
	Shares	Amount	Shares	Amount							
	(in thousands)										
Balances as of December 31, 1999	11,713	$12	1,462	$2	$49,361	$(6,946)	$(826)	$—	$(29,179)	$12,424	
Exercise of stock options and restricted stock purchase agreements for cash and notes receivable	—	—	142	—	492	—	(300)	—	—	192	

Repayment on notes receivable and repurchase of restricted stock	—	—	(122)	—	(290)	—	291	—	—	1	
Deferred stock-based compensation	—	—	—	—	1,709	(1,709)	—	—	—	—	
Cancellation of unvested stock options	—	—	—	—	(1,312)	363	—	—	—	(949)	
Amortization of stock-based compensation	—	—	—	—	—	5,261	—	—	—	5,261	
Issuance of stock options and warrants to nonemployees	—	—	—	—	233	—	—	—	—	233	
Cumulative translation adjustment	—	—	—	—	—	—	—	(13)	—	(13)	$(13
Net loss	—	—	—	—	—	—	—	—	(25,428)	(25,428)	(25,
Balances as of December 31, 2000	11,713	12	1,482	2	50,193	(3,031)	(835)	(13)	(54,607)	(8,279)	$(25
Issuance of Series F preferred stock, net of issuance costs of $451	7,595	7	—	—	29,397	—	—	—	—	29,404	
Conversion of notes and accrued interest to Series F preferred stock and common stock warrants	2,121	2	—	—	8,230	—	—	—	—	8,232	
Exercise of stock options	—	—	17	—	27	—	—	—	—	27	
Repayment on notes receivable and repurchase of restricted stock	—	—	(146)	—	(558)	—	597	—	—	39	
Cancellation of unvested stock options	—	—	—	—	(532)	266	—	—	—	(266)	
Amortization of stock-based compensation	—	—	—	—	—	2,144	—	—	—	2,144	
Issuance of stock options and warrants to nonemployees	—	—	—	—	259	—	—	—	—	259	
Cumulative translation adjustment	—	—	—	—	—	—	—	(26)	—	(26)	$(26
Net loss	—	—	—	—	—	—	—	—	(20,844)	(20,844)	(20,
Balances as of December 31, 2001	21,429	21	1,353	2	87,016	(621)	(238)	(39)	(75,451)	10,690	$(20

Issuance of Series F preferred stock, net of issuance costs of $42	497	1	—	—	1,907	—	—	—	—	1,908	
Issuance of Series G preferred stock, net of issuance costs of $65	7,095	7	—	—	7,023	—	—	—	—	7,030	
Conversion of notes and accrued interest to Series G preferred stock	905	1	—	—	904	—	—	—	—	905	
Exercise of stock options	—	—	47	—	29	—	—	—	—	29	
Cancellation of unvested stock options	—	—	—	—	(107)	23	—	—	—	(84)	
Amortization of stock-based compensation	—	—	—	—	—	508	—	—	—	508	
Issuance of stock options and warrants to nonemployees	—	—	—	—	163	—	—	—	—	163	
Cumulative translation adjustment	—	—	—	—	—	—	—	74	—	74	$74
Net loss	—	—	—	—	—	—	—	—	(19,130)	(19,130)	(19,
Balances as of December 31, 2002	29,926	30	1,400	2	96,935	(90)	(238)	35	(94,581)	2,093	$(19
Issuance of Series G preferred stock	453	—	—	—	2,040	—	—	—	—	2,040	
Exercise of stock options	—	—	88	—	75	—	—	—	—	75	
Deferred stock-based compensation	—	—	—	—	4,518	(4,518)	—	—	—	—	
Cancellation of unvested stock options	—	—	—	—	(2)	—	—	—	—	(2)	
Amortization of stock-based compensation	—	—	—	—	—	440	—	—	—	440	
Issuance of stock options and warrants to nonemployees	—	—	—	—	77	—	—	—	—	77	
Cumulative translation adjustment	—	—	—	—	—	—	—	26	—	26	$26
Net loss	—	—	—	—	—	—	—	—	(255)	(255)	(255
Balances as of June 30, 2003 (unaudited)	30,379	$30	1,488	$2	$103,643	$(4,168)	$(238)	$61	$(94,836)	$4,494	$(22

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
				(unaudited)	
	(in thousands)				
Cash flows from operating activities:					
Net loss	$(25,428)	$(20,844)	$(19,130)	$(8,576)	$(255)
Adjustments to reconcile net loss to net cash used in operating activities:					
Depreciation and amortization	1,652	2,397	2,026	1,156	805
Provision for doubtful accounts and sales returns	12	(35)	411	25	139
Stock-based compensation	4,312	1,878	424	280	2,027
Non-cash expenses associated with nonemployee options and warrants	102	364	106	41	113
Cumulative effect of change in accounting principle	—	—	123	—	—
Accrued interest on convertible notes payable	—	233	5	—	—
Changes in operating assets and liabilities:					
Accounts receivable	(1,640)	1,411	(1,930)	(967)	(7,277)
Prepaids and other current assets	(438)	253	45	129	(78)
Accounts payable	1,053	(1,218)	687	345	(360)
Accrued payroll and related expenses	201	(208)	1,588	442	223
Accrued expenses	88	(263)	1,920	234	(340)
Deferred revenue	1,998	(2,432)	4,878	925	2,723
Net cash used in operating activities	(18,088)	(18,464)	(8,847)	(5,966)	(2,280)
Cash flows from investing activities:					
Purchases of property and equipment	(3,622)	(646)	(657)	(212)	(389)
(Increase) decrease in deposits	(608)	190	(11)	243	104
Net cash provided by (used in) investing activities	(4,230)	(456)	(668)	31	(285)
Cash flows from financing activities:					
Proceeds from subordinated convertible notes payable	8,000	—	1,900	—	—
Repayments of subordinated convertible notes payable	—	—	(1,000)	—	—
Proceeds from bank line of credit and issuance of warrants	1,966	1,713	16,517	3,327	10,358
Repayments of bank line of credit	(755)	(2,501)	(15,552)	(947)	(7,746)
Proceeds from long-term debt	2,075	447	1,500	—	289
Repayments of long-term debt	(752)	(1,426)	(2,073)	(980)	(436)
Net proceeds from issuance of preferred stock and warrants	—	29,404	8,938	1,908	453
Net proceeds from issuance of common stock	192	27	29	24	75
Proceeds from notes receivable from stockholders	1	39	—	—	—
Net cash provided by financing activities	10,727	27,703	10,259	3,332	2,993
Effect of exchange rates on cash and cash equivalents	(14)	(21)	55	64	28
Net increase (decrease) in cash and cash equivalents	(11,605)	8,762	799	(2,539)	456
Cash and cash equivalents at beginning of period	14,877	3,272	12,034	12,034	12,833
Cash and cash equivalents at end of period	$3,272	$12,034	$12,833	$9,495	$13,289
Supplemental disclosures of cash flow information:					
Cash paid for interest	$647	$873	$517	$214	$117
Noncash investing and financing activities:					
Conversion of notes payable and accrued interest to preferred stock	$—	$8,232	$905	$—	$—
Repurchase of restricted stock and repayment of notes receivable and interest with common stock	$290	$558	$—	$—	$—

Notes receivable for exercise of restricted stock purchase agreements	$300	$—	$—	$—	$—
Issuance of warrants in connection with operating lease	$90	$—	$—	$—	$—
Deferred stock-based compensation	$1,709	$—	$—	$—	$4,518
Cancellation of unvested stock options	$363	$266	$23	$—	$—

See accompanying notes to consolidated financial statements.

CALLIDUS SOFTWARE INC.

Notes to Consolidated Financial Statements

Years Ended December 31, 2000, 2001 and 2002

(Information as of June 30, 2003 and for the six month periods

ended June 30, 2002 and 2003 is unaudited)

Note 1 The Company and Significant Accounting Policies

Description of Business

The Company is a provider of Enterprise Incentive Management (EIM) software systems to global companies across multiple industries. Large enterprises use EIM systems to model, administer, analyze and report on pay-for-performance plans, which are designed to align employee, sales and channel tactics with targeted business objectives, and thereby increase productivity, improve profitability and achieve competitive advantage. The Company develops, markets, installs and supports rules-based enterprise application software to solve the complex problems of large scale enterprise incentive compensation systems.

Unaudited Interim Financial Statements

The accompanying consolidated balance sheet as of June 30, 2003, the consolidated statements of operations and cash flows for the six months ended June 30, 2002 and 2003, and the consolidated statement of stockholders' equity and comprehensive loss for the six months ended June 30, 2003 are unaudited. In the opinion of management, such information includes all adjustments consisting of normal recurring adjustments necessary for a fair presentation of this interim information when read in conjunction with the audited consolidated financial statements and notes hereto. Results for the six months ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

Proposed Initial Public Offering and Pro Forma Information

On September 22, 2003, the Board of Directors authorized the filing of a registration statement with the Securities and Exchange Commission (SEC) to sell shares of its common stock in an initial public offering (IPO). On August 26, 2003, the Board of Directors approved an amendment to the Company's certificate of incorporation to set the authorized number of shares of common stock at 100 million and the authorized number of shares of preferred stock at 5 million. The amendment is subject to stockholder approval and is expected take effect upon consummation of the IPO.

The unaudited pro forma balance sheet as of June 30, 2003 reflects the assumed automatic conversion of the Series A through G convertible preferred stock into 15,932,037 shares of common stock as though the completion of the IPO had occurred on June 30, 2003. Common stock issued in such IPO and any related estimated net proceeds are excluded from such pro forma information.

Stock Split

On August 26, 2003, the Board of Directors authorized a three-for-five reverse stock split of the Company's common stock, to be effective prior to the IPO. Accordingly, all share and per share amounts for the Company's common stock, common stock issuable upon exercise of stock options, exercise or conversion of warrants and conversion of the Company's convertible preferred stock, and net loss per common share information have been restated to retroactively reflect the reverse stock split.

Principles of Consolidation

The consolidated financial statements include the accounts of Callidus Software Inc. and its wholly owned subsidiaries (collectively, the Company), which include wholly-owned subsidiaries in the United

Kingdom, Germany and Australia. All intercompany transactions and balances have been eliminated in consolidation.

Certain Risks and Uncertainties

The Company's products and services are concentrated in the software industry, which is characterized by rapid technological advances and changes in customer requirements. A critical success factor is management's ability to anticipate or to respond quickly and adequately to technological developments in its industry and changes in customer requirements. Any significant delays in the development or introduction of products or services could have a material adverse effect on the Company's business and operating results.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Foreign Currency Translation

The functional currencies of the Company's foreign subsidiaries are their respective local currencies. Accordingly, gains and losses from the translation of the financial statements of the foreign subsidiaries are reported as a separate component of accumulated other comprehensive income (loss). Foreign currency transaction gains and losses are included in other income, net in the accompanying consolidated statements of operations.

Cash and Cash Equivalents

For purposes of the accompanying consolidated statements of cash flows, the Company considers all highly liquid instruments with an original maturity on the date of purchase of three months or less to be cash equivalents. Cash equivalents as of December 31, 2001 and 2002 consisted of money market accounts, certificates of deposit, high quality corporate debt obligations or United States government securities.

Financial Instruments and Concentration of Credit Risk

The fair value of the Company's financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate their carrying value due to their short maturity. The carrying value of the Company's debt approximates fair market value based upon the borrowing rates available to the Company for loans with similar terms. Financial instruments that subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and trade accounts receivable. Management believes the financial risks associated with these financial instruments are minimal. The Company maintains its cash and cash equivalents with high quality financial institutions.

The Company's customer base consists of businesses throughout North America, Europe and Asia-Pacific. The Company performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable. As of December 31, 2001, the Company had two customers, comprising 17% and 11%, respectively, of accounts receivable. As of December 31, 2002, the Company had two customers, comprising 28% and 21%, respectively, of accounts receivable. As of June 30, 2003, the Company had three customers, comprising 17%, 13%, and 10%, respectively, of accounts receivable.

Valuation Accounts

Trade accounts receivable are recorded at the invoiced amount where revenue has been recognized and do not bear interest. The Company offsets gross trade accounts receivable with its allowance for doubtful accounts and sales return reserve. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The sales return reserve is the Company's best estimate of the probable amount of remediation services it will have to provide for ongoing professional service arrangements. To determine the adequacy of the sales return reserve, the Company analyzes historical experience of actual remediation service claims as well as current information on remediation service requests. Provisions for allowance for doubtful accounts are recorded in general and administrative expenses, while provisions for sales returns are offset against maintenance and service revenues.

Below is a summary of the changes in the Company's valuation accounts for the years ended December 31, 2000, 2001 and 2002 and the six months ended June 30, 2003 (in thousands):

Allowance for Doubtful Accounts	Balance at Beginning of Period	Provision	Write-offs	Balance at End of Period
Year ended December 31, 2000	$70	$12	$—	$82
Year ended December 31, 2001	82	(35)	—	47
Year ended December 31, 2002	47	107	25	129
Six months ended June 30, 2003 (unaudited)	129	(26)	—	103

Sales Return Reserve	Balance at Beginning of Period	Provision	Remediation Service Claims	Balance at End of Period
Year ended December 31, 2000	$—	$—	$—	$—
Year ended December 31, 2001	—	—	—	—
Year ended December 31, 2002	—	304	152	152
Six months ended June 30, 2003 (unaudited)	152	165	85	232

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets, generally three to five years. Leasehold improvements are amortized over the lesser of the assets' estimated useful lives or the related lease term.

Impairment of Long-Lived Assets

The Company accounts for long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 requires long-lived assets, such as property and equipment and purchased intangibles subject to amortization to be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to estimated and undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized **CALLIDUS SOFTWARE INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

equal to the amount by which the carrying amount of the asset group exceeds the fair value of the asset group. Long-lived assets held for sale are measured at the lower of their carrying amount or fair value less cost to sell and the Company ceases depreciation (amortization).

Research and Development Costs

Software development costs associated with new products and enhancements to existing products are expensed as incurred until technological feasibility, in the form of a working model, is established, at which time any additional development costs would be capitalized in accordance with SFAS No. 86, *Computer Software to Be Sold, Leased, or Otherwise Marketed*. To date, the Company's software development has been completed concurrently with the establishment of technological feasibility and accordingly, no costs have been capitalized.

Goodwill

In July 1999, the Company acquired all of the outstanding stock of The Rob Hand Consulting Group, Inc. (HCG), in exchange for 30,000 shares of the Company's common stock. HCG was a software consulting company located in Austin, Texas. The acquisition was accounted for as a purchase resulting in total goodwill of $632,000, of which $211,000 was amortized to general and administrative expense in each of 2000 and 2001.

The Company adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets,* as of January 1, 2002. Upon adoption of SFAS No. 142, the Company identified a single reporting unit. The Company then compared the implied fair value of the reporting unit with the carrying amount of the reporting unit, both of which were measured as of the date of adoption. The carrying amount of the reporting unit exceeded its implied fair value, resulting in a transitional impairment loss of $123,000 that reduced the carrying value of goodwill to zero, which was recognized as a cumulative effect of a change in accounting principle in the consolidated statements of operations.

Prior to the adoption of SFAS No. 142, goodwill was amortized on a straight-line basis over the estimated useful life of three years and assessed for recoverability by determining whether the amortization of the goodwill balance over its remaining life could be recovered through undiscounted future operating cash flows. Had goodwill not been amortized in previous periods consistent with SFAS No. 142, the adjusted net loss and adjusted basic and diluted net loss per share, excluding amortization of goodwill, would have been as follows (in thousands, except per share data):

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
Net loss, as reported	$(25,428)	$(20,844)	$(19,130)	$(8,576)	$(255)
Add back:					
Amortization of goodwill	211	211	—	—	—
Adjusted net loss	$(25,217)	$(20,633)	$(19,130)	$(8,576)	$(255)
Basic and diluted net loss per share, as reported	$(23.83)	$(17.24)	$(13.98)	$(6.35)	$(0.18)
Add back:					
Amortization of goodwill	0.20	0.16	—	—	—
Adjusted basic and diluted net loss per share	$(23.63)	$(17.08)	$(13.98)	$(6.35)	$(0.18)

CALLIDUS SOFTWARE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis, as well as operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Stock-Based Compensation

The Company has stock-based employee compensation plans, which are described more fully in Notes 5 and 9. The Company accounts for these plans under the recognition and measurement principles of Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. Under APB No. 25, deferred stock-based compensation expense is based on the difference, if any, on the date of the grant between the fair value of the Company's stock and the exercise price of related equity awards. Deferred stock-based compensation is amortized and expensed in accordance with the accelerated method provided for in Financial Accounting Standards Board (FASB) Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. As such, the Company recorded deferred stock-based compensation totaling $1.7 million, $-0-, $-0- and

$4.5 million during the years ended December 31, 2000, 2001 and 2002 and the six months ended June 30, 2003, respectively. Amortization of deferred stock-based compensation recognized during the years ended December 31, 2000, 2001, and 2002 and the six months ended June 30, 2002 and 2003, totaled $4.3 million, $1.9 million, $424,000, $280,000 and $440,000, respectively. In addition, in the six months ended June 30, 2003, the Company also recorded $1.6 million of stock-based compensation in connection with the sale of Series G Preferred Stock to certain of its employees.

The following table illustrates the effect on net loss if the Company had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation,* to stock-based employee compensation (in thousands):

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
				(unaudited)	
Net loss, as reported	$(25,428)	$(20,844)	$(19,130)	$(8,576)	$(255)
Add: Stock-based employee compensation expense included in reported net loss	4,312	1,878	424	280	2,027
Less: Stock-based employee compensation expense determined under the fair value method for all awards	(4,641)	(1,745)	(971)	(561)	(2,318)
Pro forma net loss	$(25,757)	$(20,711)	$(19,677)	$(8,857)	$(546)
Basic and diluted net loss per share, as reported	$(23.83)	$(17.24)	$(13.98)	$(6.35)	$(0.18)
Add: Stock-based employee compensation expense included in reported net loss	4.04	1.46	0.31	0.21	1.43
Less: Stock-based employee compensation expense determined under the fair value method for all awards, net of tax	(4.35)	(1.36)	(0.71)	(0.42)	(1.63)
Pro forma basic and diluted net loss per share	$(24.14)	$(17.14)	$(14.38)	$(6.56)	$(0.38)

Revenue Recognition

Revenues consist of fees for licenses of the Company's software products, maintenance and support, consulting, and training.

The Company recognizes license revenues using the residual method in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions*. Under the residual method, revenues are recognized in a multiple-element arrangement in which vendor-specific objective evidence (VSOE) of fair value exists for all of the undelivered elements in the arrangement, but does not exist for one or more of the delivered elements in the arrangement. The Company has determined that it has VSOE for its maintenance and support, consulting and training services. For the majority of the Company's arrangements, fair value of the maintenance portion is based on the price charged when that element is sold separately; however, for a certain class of transactions, fair value is based on stated renewal rates in the arrangement. The fair value of consulting and training services is based on the rates charged for those services when sold independently from a software license. If evidence of fair value cannot be established for the undelivered elements of a license agreement, the entire amount of revenue from the arrangement is deferred until evidence of fair value can be established, or until the items are delivered. If the only undelivered element is maintenance, then the entire amount of revenue is recognized over the maintenance delivery period.

Revenues from license fees are recognized when an agreement has been signed, delivery of the product has occurred, the fee is fixed or determinable, collectibility is probable, and the arrangement does not require services that are essential to the functionality of the software. If an arrangement provides for unspecified additional software products during a contractual period, the license revenues are recognized ratably over that period. Revenues from maintenance agreements providing technical support and software update and upgrade rights are recognized ratably over the term of the maintenance agreements. Revenues

from services that are not essential to the functionality of the software are recognized as the services are performed.

Where the Company provides services that are deemed essential to the functionality of the software, such as where the payment of the license fees is dependent upon performance of the services, the Company recognizes the software license and service revenues for the entire arrangement using the percentage-of-completion method, as required by AICPA SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Progress toward completion is generally measured by the level of labor costs incurred relative to the total estimated labor costs to complete the project. The Company generally sells its services on a time-and-materials basis. To the extent the Company enters into a fixed-fee services contract, a loss will be recognized any time total estimated project costs exceed total project revenues.

Certain arrangements result in the payment of customer referral fees to third parties that resell the Company's software products. In these arrangements, license revenues are recorded, net of such referral fees, at the time the software license has been delivered to a third-party reseller and an end-user customer has been identified. To the extent a referral fee is paid to a third party when the Company sells directly to the end-user, the referral fee is recorded as a selling expense.

In situations where the Company purchases products or services from a third party and sells products or services to the same party within a relatively short time period, the Company recognizes license and associated maintenance and service revenues based on the fair value of the software and services exchanged, which is determined based upon VSOE of the fair value for the bundled license and maintenance software product and for the professional

services. During 2000, the Company entered into four sets of such concurrent transactions in which the Company and third parties purchased each other's software products for internal use. In these transactions, the Company received net cash consideration of $604,000. Excluding net cash consideration, revenues recognized from these transactions were $1.2 million, or 6% of total revenues, in 2000 and $402,000, or 2% of total revenues, in 2001. The fair value of products purchased were recorded as property and equipment in the amount of $1.1 million, and are being amortized over their useful lives of three years. The amounts we paid for maintenance and services of $105,000 and $480,000 in 2000 and 2001, respectively, in these transactions were recorded as general and administrative expense as incurred. The Company did not enter into any concurrent transactions in 2001, 2002 or the six months ended June 30, 2003.

Deferred revenues are recorded when cash payments are received from customers in advance of the Company recognizing the associated revenues and when invoices have been issued for maintenance and support arrangements that have contractually commenced but for which cash has not yet been received.

Cost of Revenues

Cost of license revenues consists primarily of third-party royalties. Cost of maintenance and service revenues consists primarily of salaries, benefits, travel and allocated overhead costs related to consulting, training and other professional services personnel, including cost of services provided by third-party consultants engaged by the Company.

Advertising Costs

The Company expenses advertising costs in the period incurred. Advertising expense was $718,000, $287,000, $200,000, $114,000 and $260,000 for the years ended December 31, 2000, 2001, and 2002 and for the six months ended June 30, 2002 and 2003, respectively.

Net Loss Per Share

Basic and diluted net loss per share is calculated by dividing net loss attributable to common stockholders for the period by the weighted-average common shares outstanding during the period, less shares subject to repurchase. Net loss attributable to common stockholders is the same as net loss except in 2001, when the net loss attributable to common stockholders was increased due to an in-substance preferred stock dividend. Basic and diluted net loss per share consists of the following components for the periods presented (in thousands):

	Year Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003
						(unaudited)	
Basic and diluted net loss per share:							
Loss before cumulative effect of change in accounting principle	$(35.07)	$(28.72)	$(23.83)	$(17.24)	$(13.89)	$(6.26)	$(0.18)
Cumulative effect of change in accounting principle	—	—	—	—	(0.09)	(0.09)	—
Basic and diluted net loss per share	$(35.07)	$(28.72)	$(23.83)	$(17.24)	$(13.98)	$(6.35)	$(0.18)

Diluted net loss per share does not include the effect of the following antidilutive potential common shares because the Company was in a net loss position for all periods presented (in thousands):

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
Convertible preferred stock	4,732	8,284	10,896	10,825	15,724
Stock options	777	2,021	2,839	2,693	3,733
Warrants	20	362	689	687	795
Totals	5,529	10,667	14,424	14,206	20,252

The weighted-average exercise price of stock options excluded as of December 31, 2000, 2001 and 2002 and June 30, 2002 and 2003 was $5.85, $2.11, $1.53, $1.78 and $3.62, respectively. The weighted-average exercise price of warrants excluded as of December 31, 2000, 2001 and 2002 and June 30, 2002 and 2003 was $15.08, $4.08, $3.75, $4.08 and $7.26, respectively.

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net loss per share is as follows (in thousands, except per share amounts):

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
Numerator:					
Net loss, as reported	$(25,428)	$(20,844)	$(19,130)	$(8,576)	$(255)

In-substance preferred stock dividend (see Note 5)	—	(1,324)	—	—	—
Net loss attributable to common stockholders	$(25,428)	$(22,168)	$(19,130)	$(8,576)	$(255)
Denominator:					
Basic and diluted:					
Weighted-average common shares outstanding	1,528	1,442	1,389	1,383	1,423
Less: Weighted-average unvested shares subject to repurchase	(461)	(156)	(21)	(33)	(1)
Denominator on basic and diluted calculation	1,067	1,286	1,368	1,350	1,422
Basic and diluted net loss per share	$(23.83)	$(17.24)	$(13.98)	$(6.35)	$(0.18)
Shares used above to compute basic and diluted net loss per share			1,368		1,422
Pro forma adjustment to reflect weighted-average effect of assumed conversion of preferred stock (unaudited)			10,896		15,808
Shares used in computing pro forma basic and diluted net loss per common share (unaudited)			12,264		17,230
Pro forma basic and diluted net loss per common share (unaudited)			$(1.56)		$(0.01)

Pro forma basic and diluted net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding for the period (excluding shares subject to repurchase) plus the weighted average number of shares of common stock resulting from the assumed conversion of outstanding shares of convertible preferred stock upon the closing of the planned IPO as if the shares had been converted immediately upon their issuance.

Comprehensive Loss

Comprehensive loss is the total of net loss and foreign currency translation adjustments. Foreign currency translation adjustment amounts are excluded from net loss and are reported in accumulated other comprehensive loss in the accompanying consolidated financial statements.

Recent Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or normal use of the asset. As used in SFAS No. 143, a legal obligation results from existing law, statute, ordinance, written or oral contract, or by legal construction of a contract under the doctrine of promissory estoppel. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Company adopted SFAS No. 143 as of January 1, 2003. The adoption of SFAS No. 143 did not have a material impact on consolidated financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. Among other provisions, SFAS No. 145 rescinds SFAS No. 4, *Reporting Gains and Losses from Extinguishment of Debt*. Accordingly, gains or losses from extinguishment of debt are not reported as extraordinary items unless the extinguishment qualifies as an extraordinary item under the criteria of APB 30. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. The Company adopted SFAS No. 145 as of January 1, 2003. The adoption of SFAS No. 145 did not have a material impact on consolidated financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Previous guidance, provided under Emerging Issues Task Force (EITF) No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including certain costs incurred in a restructuring)*, required an exit cost liability be recognized at the date of an entity's commitment to an exit plan. The provisions of this statement are effective for exit or disposal activities that are initiated by a company after December 31, 2002. The Company adopted SFAS No. 146 as of January 1, 2003. The adoption of SFAS No. 146 did not have a material impact on consolidated financial position or results of operations.

In November 2002, the FASB issued FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The adoption of FIN 45 did not have a material impact on the Company's consolidated financial position or results of operations.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities*. This interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. It explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to

decide whether to consolidate that entity. This interpretation applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. As of June 30, 2003, the Company did not have any investments in variable interest entities.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS 149 is generally effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of SFAS 149 will not have a material impact on the Company's consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the statement and still existing at the beginning of the interim period of adoption. The adoption of SFAS No. 150 will not have a material impact on the Company's consolidated financial position or results of operations.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

Note 2 Property and Equipment, Net

Property and equipment consisted of the following (in thousands):

	As of December 31,		As of June 30,
	2001	2002	2003
			(unaudited)
Equipment	$3,569	$3,946	$4,130
Software	2,563	2,698	1,069
Furniture and fixtures	974	1,065	2,919
Leasehold improvements	582	624	639
	7,688	8,333	8,757
Less accumulated depreciation and amortization	4,309	6,317	7,157
Property and equipment, net	$3,379	$2,016	$1,600

Note 3 Debt

Bank Line of Credit

In 2001, the Company had a credit facility in the form of a revolving line of credit and an equipment finance line, which was collateralized by substantially all of the Company's assets. The revolving line of credit bore interest at the lender's prime rate plus 2.0% but not less than 8.0% per annum, payable monthly. The amount outstanding under the revolving line of credit was $1.9 million as of December 31, 2001 and was fully repaid upon expiration in 2002.

During 2002, the Company entered into a master loan and security agreement (Master Agreement) including a revolving line of credit and two term loans. The Master Agreement is collateralized by substantially all of the Company's assets. The amount available under the revolving line of credit is the lesser of $7.0 million or 80% of eligible accounts receivable as determined by the lender. The credit line bears interest at the higher of lender's prime rate plus 2.00% or 6.25% per annum (6.50% and 6.25% as of December 31, 2002 and June 30, 2003, respectively), payable monthly and expires in March 2004. The amount outstanding under the Master Agreement revolving line of credit was $2.9 million and $5.5 million as of December 31, 2002 and June 30, 2003, respectively.

As discussed in Note 5, in connection with the signing of the credit facility and the Master Agreement, the Company issued fully vested common stock warrants to the lenders. The fair value of the warrants is included on the accompanying consolidated balance sheets as a discount to bank line of credit. The debt discount is being amortized over the terms of the respective agreements and the amortization is classified as interest expense on the accompanying consolidated statements of operations. As a result of the additional interest expense associated with the debt issuance cost amortization, the effective interest rates on the revolving line of credit under the Master Agreement for the year ended December 31, 2002 and the six months ended June 30, 2003 were 12.9% and 9.1%, respectively. As of December 31, 2001 and 2002 and June 30, 2003, the unamortized debt issuance cost was $48,000, $122,000, and $95,000, respectively.

Long-Term Debt

In September 2000, the Company entered into an equipment loan and security agreement with a lender for a credit facility collateralized by the equipment being financed. Amounts were borrowed in the form of individual term loans, payable in 36 monthly installments bearing interest at a weighted-average rate of 12.64% as of December 31, 2002. Amounts outstanding under the agreement were $785,000, $494,000 and $308,000 as of December 31, 2001 and 2002 and June 30, 2003, respectively. A balloon payment equal to 10% of the loan principal is due at the end of each loan term.

As of December 31, 2001, the Company had $1.7 million outstanding under a loan agreement, which bore interest at a rate of 14.17% and was fully repaid in 2002.

Under the Master Agreement discussed in the Bank Line of Credit section, the Company entered into two term loans. The first term loan was for $1.5 million, bears interest at the higher of lender's prime rate plus 2.25% or 6.50% per annum (6.75% and 6.50% as of December 31, 2002 and June 30, 2003, respectively), and is payable in 36 monthly installments ending in September 2005. The amount outstanding under the first term loan was $1.4 million and $1.1 million as of December 31, 2002 and June 30, 2003, respectively. The second term loan allows for borrowings of up to $1.0 million, bears interest at the higher of lender's prime rate plus 3.50% or 7.75% (7.75% as of June 30, 2003), and is payable in 36 monthly installments ending in June 2006. The amount outstanding under the second term loan was $289,000 as of June 30, 2003. The terms of the Master Agreement provide for the maintenance of a number of financial covenants. The Company was not in compliance with the revenue covenant for the quarter ended December 31, 2002, for which it obtained a waiver. The Company was in compliance with all of the covenants as of June 30, 2003.

The aggregate maturities of long-term debt as of December 31, 2002 are due as follows:

Year	Amount
	(in thousands)
2003	$883
2004	611
2005	375
	$1,869

Convertible Notes Payable

In September and December 2000, the Company issued a total of $8.0 million of subordinated convertible promissory notes (the First Subordinated Convertible Notes) due June 16, 2001, bearing interest at the prime rate plus 1.0% per annum payable annually. The First Subordinated Convertible Notes were unsecured and subordinate in right of payment to any present and future senior indebtedness of the Company. Upon completion of the Series F preferred stock financing in March 2001, the First Subordinated Convertible Notes and accrued interest of $8,232,000 were converted into 2,121,063 shares of Series F preferred stock.

In November 2002, the Company issued a total of $1.9 million of subordinated convertible promissory notes (the Second Subordinated Convertible Notes) due December 31, 2002 bearing interest at the prime rate plus 1.0% per annum payable annually. The Second Subordinated Convertible Notes were unsecured and subordinate in right of payment to any present and future senior indebtedness of the Company. Upon completion of the Series G preferred stock financing in December 2002, $1.0 million of principal and accrued interest was repaid and the remaining Second Subordinated Convertible Notes and accrued interest of $905,000 were converted into 905,048 shares of Series G preferred stock.

Interest expense related to all borrowings was $792,000, $916,000, $582,000, $263,000 and $217,000 in the years ended December 31, 2000, 2001, and 2002, and for the six months ended June 30, 2002 and 2003, respectively.

Note 4 Commitments and Contingencies

Contingencies

On or about March 29, 2002, the Company received a copy of a complaint filed by Gordon Food Service in the United States District Court for the Western District of Michigan alleging breach of contract and misrepresentation in connection with software purchased by Gordon Food. On December 9, 2002, the court granted the Company's motion to transfer venue and ordered that the case be transferred to the San Jose division of the United States District Court for the Northern District of California. Gordon Food has moved the court to file an amended complaint asserting, among other things, breach of contract and misrepresentation.

At December 31, 2002, the Company was a defendant in various lawsuits, including the Gordon Food litigation discussed above. Management and legal counsel for the Company determined that a loss on these lawsuits was both probable and estimable, and accordingly, accrued for the probable loss as of December 31, 2002, related to these litigation matters. In the six months ended June 30, 2003, one of the lawsuits was settled at the amount accrued.

The Company is also involved with certain other litigation matters in the ordinary course of business. In the opinion of management, the claims are without merit and none of the claims will have a material adverse effect on the Company's business or financial condition.

Other Contingencies

The Company generally warrants that its products shall perform to its standard documentation. Under the terms of the warranty, should a product not perform as specified in the documentation, the Company will repair or replace the product. Such warranties are accounted for in accordance with SFAS 5, *Accounting for Contingencies*. To date the Company has not incurred material costs related to warranty obligations.

The Company's product license agreements include a limited indemnification provision for claims from third parties relating to the Company's intellectual property. Such indemnification provisions are **CALLIDUS SOFTWARE INC.**

accounted for in accordance with FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The indemnification is limited to the amount paid by the customer. To date the Company has not incurred any costs related to such indemnification provisions.

Operating Leases

The Company leases its facilities under several noncancelable operating leases, which expire through December 2010, including the new facilities lease agreement entered into in September 2003 (see Note 9). For leases with escalating rent payments, rent expense is amortized on a straight-line basis over the life of the lease. The Company had deferred rent of $146,000, $128,000 and $111,000 as of December 31, 2001 and 2002 and June 30, 2003, respectively.

Future minimum lease payments under the Company's operating leases as of December 31, 2002 are as follows (in thousands):

Year ending December 31:	
2003	$1,535
2004	1,284
2005	421
Future minimum lease payments	$3,240

In 2000, the Company issued warrants to purchase 5,400 shares of common stock with an exercise price of $11.67 per share in connection with a building lease. These warrants vested immediately and the estimated fair value of $90,000 was recorded in other assets in the accompanying consolidated balance sheets and is being amortized into rent expense over the lease term of five years. As of December 31, 2002, these common stock warrants remained unexercised and outstanding.

Rent expense for the years ended December 31, 2000, 2001, and 2002 and for the six months ended June 30, 2002 and 2003 was $1.8 million, $2.1 million, $2.3 million, $1.1 million and $1.1 million, respectively.

Note 5 Stockholders' Equity (Deficit)

Convertible Preferred Stock

The Company has authorized 31,927,656 shares of convertible preferred stock at a par value of $0.001 per share. The amounts and terms of the Company's convertible preferred stock are as follows:

Series	Date Issued	Shares Authorized	Shares Issued and Outstanding	Issue Price	Potential Common Shares*
A	September 1996 and November 1997	1,000,000	1,000,000	$1.00	600,000
B	January 1998	1,600,000	1,600,000	2.50	960,000
C	July 1998	2,944,163	2,944,163	1.97	883,247
D	February 1999	3,883,493	3,883,493	3.09	1,318,675
E	November and December 1999	2,500,000	2,285,005	6.00	970,039
F	March 2001, October 2001, and January 2002	11,000,000	10,213,815	3.92	6,128,280
G	December 2002 and March 2003	9,000,000	8,453,000	1.00	5,071,796

* Adjusted for a 2-for-1 common stock split in March 1998, a 1-for-2 reverse common stock split in March 2001 and the 3-for-5 reverse common stock split described in Note 1.

The rights, preferences, and privileges of the convertible preferred stock are as follows:

- Each share of the Series A, B, C, D, E, F and G preferred stock is convertible at the option of the holder at any time into such number of fully paid and nonassessable shares of common stock as is determined by dividing the original issue price by the conversion price in effect at the time that the certificate is surrendered for conversion. All shares of Series A, B, C, D, E, F and G preferred stock automatically convert into common stock upon the earlier of an initial public offering of the Company's common stock resulting in aggregate proceeds of not less than $25.0 million and an offering price of at least $8.33 per share, or the written election of holders of not less than the majority of the then outstanding shares of preferred stock.
- Holders of Series A, B, C, D, E, F and G preferred stock are entitled to receive noncumulative annual dividends at the rate of $0.10, $0.25, $0.197, $0.309, $0.60, $0.392, and $0.10 per share, respectively, with certain adjustments for stock splits, stock dividends, recapitalization, and similar events, when and if declared by the board of directors. No dividends have been declared as of December 31, 2001 and 2002 and June 30, 2003.
- The liquidation preference for the Series A, B, C, D, E, F and G preferred stock is $1.00, $2.50, $1.97, $3.09, $6.00, $7.84, and $2.00 per share, respectively, plus all declared but unpaid dividends. If the assets are insufficient to make payments in full to all holders of preferred stock, assets will be distributed ratably (i) first, to holders of Series F and Series G preferred stock, until such holders have received the liquidation preference of $7.84 and $2.00 per share, respectively, and (ii) second, among the holders of Series A, B, C, D and E preferred stock in proportion to the full amounts to which they would have otherwise been entitled. Any remaining assets shall be distributed ratably among the holders of the Series A, B, C, D and E preferred stock and common stock on an "as-if converted" basis until such time that aggregate distributions to holders of Series A, B, C, D and E preferred stock (including preferential distributions) equals $5.00, $5.00, $2.50, $3.49, and $6.60 per share, respectively, plus all declared but unpaid dividends. After that time, any remaining assets will be distributed on a pro rata basis to the holders of common stock.

- The holders of Series A, B, C, D, E, F and G preferred stock have voting rights on an "as-if converted" basis. Each holder of preferred stock is entitled to the number of votes equal to the number of shares of common stock into which the shares of preferred stock could be converted. All shares of all series of preferred stock and all shares of common stock vote together as a single class, except with respect to certain matters specified in the Company's Certificate of Incorporation, on which the holders of preferred stock are entitled to a class or series vote.

In March 2003, the Company issued Series G preferred stock to officers and employees of the Company at a discount to the fair value of such stock. Accordingly, a stock compensation charge of $1.6 million was recorded in the three months ended March 31, 2003, and is reflected as stock-based compensation on the accompanying consolidated statements of operations.

Common Stock

The Company has reserved 21,975,354 shares of common stock for issuance under its stock option plan, upon exercise of warrants and upon the conversion of outstanding convertible preferred stock.

Stock Option Plan

As of December 31, 2002 and June 30, 2003, the Company had reserved 5,200,082 shares of common stock under its 1997 Stock Option Plan (the Plan) which provides for the granting of stock options to employees, directors or consultants.

Under the Plan, incentive and nonstatutory options to purchase the Company's common stock may be granted to employees at prices not lower than the fair value of the stock at the date of grant for incentive stock options and not less than 85% of the fair value for nonstatutory options. These options vest as determined by the board, generally over 4 years at a rate of 25% 12 months after the vesting commencement date and 1/48 th each month thereafter and expire 10 years from the date of grant. In certain instances, holders of options granted under the Plan may exercise their options prior to complete vesting of shares, subject to the Company's right of repurchase of unvested shares.

As of December 31, 2001 and 2002, 486,450 shares of common stock were outstanding pursuant to the exercise of unvested stock options for cash and full recourse promissory notes. The promissory notes totaled $238,000 with market interest rates and terms of 5 to 10 years. The shares issued vest according to the employees' normal stock option vesting schedule. The unvested shares are subject to repurchase at the option of the Company at the original purchase price (ranging from $0.17 to $3.17) upon termination of the holder's employment. A total of 146,250 shares were repurchased during 2001. Approximately $214,000 was recorded as compensation expense in 2001 relating to repurchases of vested shares at a price above the fair value of the Company's common stock. No shares were repurchased during 2002. The number of shares subject to repurchase at December 31, 2000, 2001, and 2002 and June 30, 2003 was 273,832, 41,311, 1,540 and 234, respectively.

During 2002, the Company granted an option to an executive, outside of the Plan, to purchase 150,000 shares of the Company's common stock with an exercise price of $0.83 per share. This option vests upon the earlier of (i) 100% on the seventh anniversary of the date of grant or (ii) 25% upon an IPO or sale of the Company with a minimum valuation of $6.67 per share, and 1/36 th each month thereafter.

During 1997, the Company granted options to certain consultants to purchase 30,225 shares of the Company's common stock with an exercise price of $0.02. The options were fully vested at the date of grant. In 2000, 9,520 shares from these option grants were exercised. The fair value of the options on the date of grant, determined using the Black-Scholes option-pricing model, was not significant. These options were not issued under a specific option plan.

A summary of the status of the Company's options under the Plan are as follows:

		Options Outstanding	
	Shares Available for Grant	Number of Shares	Weighted-Average Exercise Price
Balances as of December 31, 1999	199,642	696,810	3.43
Authorized	450,000	—	—
Repurchased	121,545	—	—
Granted	(316,012)	316,012	11.13
Exercised	—	(132,751)	3.83
Canceled	159,798	(159,798)	5.63
Balances as of December 31, 2000	614,973	720,273	6.27
Authorized	1,350,000	—	—
Repurchased	146,250	—	—
Granted	(2,332,372)	2,332,372	0.83
Exercised	—	(17,167)	1.57
Canceled	492,214	(492,214)	3.33
Balances as of December 31, 2001	271,065	2,543,264	1.88
Authorized	1,530,000	—	—
Granted	(1,282,775)	1,282,775	0.83
Exercised	—	(46,644)	0.62
Canceled	201,810	(201,810)	2.53
Balances as of December 31, 2002	720,100	3,577,585	1.48

Granted	(625,950)	625,950	0.97
Exercised	—	(88,385)	0.85
Canceled	64,124	(64,124)	0.93
Balances as of June 30, 2003 (unaudited)	158,274	4,051,026	1.43

The per share weighted-average fair value of options granted with exercise prices that equal fair value in 2000, 2001, and 2002, was $1.98, $0.10 and $0.08, respectively. In 2000 and for the six months ended June 30, 2003, the per share weighted average fair value of options granted with exercise prices less than fair value was $10.47 and $6.28, respectively. The fair value of each option was estimated using the Black-Scholes option-pricing model (excluding a volatility assumption) with the following weighted average assumptions: no dividend yield; weighted average risk-free interest rate of 6.0%, 4.9%, 3.8% and 2.7% for fiscal 2000, 2001 and 2002 and for the six months ended June 30, 2003, respectively; and an expected life of 2.4, 2.8, 2.8 and 2.8 years for 2000, 2001, 2002 and for the six months ended June 30, 2003, respectively. These calculations are based on a multiple-option valuation approach and forfeitures are recognized as they occur.

As of December 31, 2002, the range of exercise prices and weighted average remaining contractual life of outstanding options were as follows:

	Options Outstanding			Options Exercisable	
		Weighted Average Remaining	Weighted Average		Weighted Average
Range of Exercise Prices	Number of Shares	Contractual Life (Years)	Exercise Price	Number of Shares	Exercise Price
$ 0.17 – 0.42	51,716	5.16	$0.35	51,716	$0.35
0.83 – 0.83	3,157,931	8.91	0.83	813,320	0.83
2.50 – 8.33	246,775	6.68	4.83	196,059	4.77
10.00 – 10.00	22,200	7.03	10.00	15,405	10.00
11.67 – 11.67	44,100	7.12	11.67	31,130	11.67
13.33 – 13.33	54,863	7.42	13.33	35,263	13.33
$ 0.17 – 13.33	3,577,585	8.64	$1.48	1,142,893	$2.28

As of June 30, 2003, the range of exercise prices and weighted average remaining contractual life of outstanding options were as follows:

	Options Outstanding			Options Exercisable	
		Weighted Average Remaining	Weighted Average		Weighted Average
Range of Exercise Prices	Number of Shares	Contractual Life (Years)	Exercise Price	Number of Shares	Exercise Price
$ 0.17 – 0.42	51,716	4.67	$0.35	51,716	$0.35
0.83 – 0.83	3,113,585	8.45	0.83	1,208,345	0.83
0.92 – 5.00	718,312	8.85	1.88	188,781	4.12
6.67 – 10.00	68,450	6.44	8.30	60,404	8.27
11.67 – 11.67	44,100	6.63	11.67	36,644	11.67
13.33 – 13.33	54,863	6.92	13.33	42,125	13.33
$ 0.17 – 13.33	4,051,026	8.40	$1.43	1,588,015	$2.07

Equity Instruments Issued to Nonemployees

In connection with the Master Agreement (see Note 3), the Company issued warrants to purchase up to 260,000 shares of the Company's Series G preferred stock at an exercise price of $1.00 per share. The warrants are fully exercisable for ten years from the date of issuance. The estimated fair value of the warrants, $236,000, was recorded as a discount to bank line of credit and is being amortized to interest expense over the commitment period. The unamortized amount as of December 31, 2002 and June 30, 2003 was $122,000 and $95,000, respectively.

In connection with the credit facility (see Note 3), the Company issued warrants to purchase up to 10,500 shares of the Company's common stock at an exercise price of $10.30 per share in February 1999, 2,625 shares of the Company's common stock at an exercise price of $20.00 per share in May 2000, and 19,132 shares of the Company's Series F preferred stock at an exercise price of $3.92 per share in September 2001. These warrants are fully exercisable for between five and ten years from the date of issuance. The estimated fair value of the warrants, $74,000, $33,000 and $64,000 in 1999, 2000 and 2001, respectively, were recorded as a discount to bank line of credit and amortized to interest expense over the commitment periods.

In connection with the equipment finance line (see Note 3), the Company issued a warrant to the lender to purchase up to 8,490 shares of the Company's common stock at an exercise price of $20.00 per share. The warrant is fully exercisable until the later of (a) seven years after the date of grant or (b) three years after the closing of an initial public offering of the Company's common stock. The estimated fair value of the warrants, $56,000, was recorded as a discount to the current portion of long-term debt and is being amortized to interest expense over the commitment period.

In connection with its Series F preferred stock financing, the Company issued warrants to purchase 340,182 shares of the Company's common stock at an exercise price of $0.83 per share in 2001 and warrants to purchase 510,203 shares of the Company's Series F preferred stock at an exercise price of $3.92 per share in 2001. The warrants are fully exercisable for a period of five years from the date of issuance. The estimated fair value of these warrants is recorded in additional paid-in capital.

The 510,203 warrants to purchase Series F preferred stock issued in 2001 represented an in-substance preferred stock dividend amounting to $1.3 million. This dividend resulted in an increase to net loss available to common stockholders and is reflected in Note 1, Net Loss Per Share.

During 2000 and 2001, the Company issued options and warrants to nonemployees and advisors for the purchase of 4,500 and 6,000 shares of common stock at a weighted average exercise price of $16.90 and $0.83, respectively. These options and warrants vest over a period of two to four years and are exercisable 10 years from the date of issuance. The Company accounted for these options and warrants under the fair-value method and as variable awards. Accordingly, the Company recorded an expense at the grant date equal to the fair value of the options on the grant date and adjusted the expense at the end of each period until the vesting date. For the years ended December 31, 2000 and 2001, such adjustments resulted in an expense of $52,000 and a credit of $18,000, respectively.

As of December 31, 2002, all nonemployee options and warrants described above remained unexercised and outstanding.

The Company used the Black-Scholes option-pricing model and the following assumptions in its calculations of the estimated fair value of the equity instruments issued to nonemployees:

				Six Months Ended June 30,
	2000	2001	2002	2003
Volatility	100%	100%	100%	100%
Risk-free interest rate	6.0%	4.2%	3.8%	3.9%
Estimated life	Contract Term	Contract Term	Contract Term	Contract Term

Note 6 Income Taxes

Loss before cumulative effect of change in accounting principle included losses from the Company's foreign subsidiaries of approximately ($2,909,000) for 2000, ($942,000) for 2001 and ($526,000) for 2002.

The provision for income taxes differs from the expected tax benefit amount computed by applying the statutory federal income tax rates to loss before taxes as follows:

	Year Ended December 31,		
	2000	2001	2002
	(in thousands)		
Federal tax at statutory rate	$(8,629)	$(7,084)	$(6,494)
State taxes, net of federal benefit	5	12	10
Non-deductible expenses	136	116	105
Net operating losses not benefited	8,271	6,094	5,948
Research and experimentation credits	217	245	287
Stock-based compensation	—	617	144
Total provision for income taxes	$—	$—	$—

Deferred income taxes reflect the net tax effect of temporary timing differences between the carrying amount of assets and liabilities for financial reporting purposes, and the amount used for income tax purposes. Net deferred income tax assets as of December 31, 2001 and 2002 consist of the following (in thousands):

	2001	2002
Deferred tax assets:		
Net operating loss carryforwards and deferred start-up costs	$20,924	26,055
Property and equipment	65	269
Accrued expenses	297	756

Research and experimentation credit carryforward	3,067	4,482
Deferred stock compensation	412	641
Gross deferred tax assets	24,765	32,203
Less valuation allowance	24,765	32,203
Net deferred tax assets	$—	$—

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of the future taxable income during the periods in which those temporary differences become deductible. Based on the level of historical taxable income and projections for future taxable income over the period, which the deferred tax assets are deductible, management believes it is more likely than not that the Company will not realize the benefits of such deferred assets. As of December 31, 2001 and 2002, the net deferred tax assets were fully offset by a valuation allowance due to the uncertainty of the Company's ability to realize such assets. The net changes in the total valuation allowance for the years ended December 31, 2000, 2001 and 2002 was an increase of $7.4 million, $7.5 million, and $7.4 million, respectively.

The Company has net operating loss carryforwards for federal and California income tax purposes of approximately $69.4 million and $28.6 million, respectively, available to reduce future income subject to income taxes. The federal net operating loss carryforwards, if not utilized, will expire over 20 years beginning in 2012. The California net operating loss carryforward, if not utilized, will expire over 12 years beginning in 2006.

The Company also has research credit carryforwards for federal and California income tax purposes of approximately $2.7 million and $1.9 million, respectively, available to reduce future income taxes. The **CALLIDUS SOFTWARE INC.**

federal research credit carryforward, if not utilized, will expire over 20 years beginning in 2012. The California research credit carries forward indefinitely.

Federal and California tax laws impose restrictions on the utilization of net operating loss and tax credit carryforwards in the event of an "ownership change," as defined in Section 382 of the Internal Revenue Code. The Company has not yet determined if an ownership change has occurred. Should an ownership change have previously occurred or were one to occur in the future, the Company's ability to utilize its net operating loss and tax credit carryforwards may be subject to restriction pursuant to these provisions.

Note 7 Employee Benefit Plan

In 1999, the Company established a 401(k) tax-deferred savings plan, whereby eligible employees may contribute a percentage of their eligible compensation (presently from 1% up to the maximum allowed under IRS rules). Company contributions are discretionary. No such Company contributions have been made since the inception of this plan.

Note 8 Segment Information

The Company has adopted SFAS No. *131, Disclosures about Segments of an Enterprise and Related Information*. SFAS No. 131 establishes standards for the reporting by business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method of determining what information is reported is based on the way that management organizes the operating segments within the Company for making operational decisions and assessments of financial performance. The Company's chief operating decision maker is considered to be the Company's chief executive officer (CEO). The CEO reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. By this definition, the Company operates in one business segment, which is the development, marketing and sale of enterprise software.

Geographic Information Total revenues consist of (in thousands):

				Six Months Ended	
	Year Ended December 31,			June 30,	
	2000	2001	2002	2002	2003
United States	$20,926	$19,189	$21,059	$8,658	$27,513
Europe	476	2,773	2,729	1,580	1,678
Asia Pacific	779	931	2,798	1,903	587
	$22,181	$22,893	$26,586	$12,141	$29,778

Substantially all of the Company's long-lived assets are located in the United States.

Significant customers (as a percentage of total revenues):

				Six Months Ended	
	Year Ended December 31,			June 30,	
Customer	2000	2001	2002	2002	2003
A	—	—	12%	15%	—
B	—	—	12%	—	—
	—	—	—	14%	—

D	–	–	–	16%	–
E	–	–	–	–	12%

CALLIDUS SOFTWARE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 9 Subsequent Events

The Company increased the number of shares of common stock reserved under its 1997 Stock Option Plan from 5,200,082 to 5,800,082 shares in July 2003 and from 5,800,082 to 6,700,082 shares in August 2003.

In July 2003, the Company granted to employees options to purchase 263,025 shares of common stock. In connection with these option grants, deferred stock-based compensation of $2.2 million has been recorded based on the fair value of the common stock on the date of grant.

In August 2003, the Company granted to employees options to purchase 871,800 shares of common stock. In connection with these option grants, deferred stock-based compensation of $6.0 million has been recorded based on the fair value of the common stock on the date of grant.

In July 2003, the Company repaid approximately $5.5 million of debt that was outstanding under a bank line of credit as of June 30, 2003.

In August 2003, the board of directors adopted the 2003 Stock Incentive Plan, subject to approval by the Company's stockholders. The 2003 Stock Incentive Plan will become effective upon the completion of the IPO. Under the plan, the board of directors may grant stock options or other types of stock-based awards, such as restricted stock, restricted stock units, stock bonus awards or stock appreciation rights. Incentive stock options may be granted to the Company's employees. Nonstatutory stock options and other stock-based awards may be granted to employees, consultants or nonemployee directors. Upon effectiveness, 2,000,000 shares of common stock will be reserved for issuance under the plan. On July 1 of each year beginning July 1, 2004, the aggregate number of shares reserved for issuance under this plan will increase automatically by a number of shares equal to the lesser of (i) 5% of the Company's outstanding shares, (ii) 2,800,000 shares or (iii) a lesser number of shares approved by the board.

In August 2003, the board of directors adopted the 2003 Employee Stock Purchase Plan, subject to approval by the Company's stockholders. The 2003 Employee Stock Purchase Plan will become effective upon the completion of the IPO, and is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code. The Employee Stock Purchase Plan is designed to enable eligible employees to purchase shares of the Company's common stock at a discount on a periodic basis through payroll deductions. Upon effectiveness, 1,200,000 shares of common stock will be reserved for issuance under the plan. The number of shares reserved for issuance under the plan will increase automatically on July 1 of each year beginning July 1, 2004 by an amount equal to the lesser of (i) 2% of the Company's outstanding shares, (ii) 1,200,000 shares or (iii) a lesser number of shares approved by the board. Except for the first offering period, each offering period will be for 12 months and will consist of consecutive six-month purchase periods. The purchase price for shares of common stock purchased under the purchase plan will be 85% of the lesser of the fair market value of the Company's common stock on the first day of the applicable offering period or the fair market value of the Company's common stock on the last day of each purchase period.

In September 2003, the Company amended the lease on its corporate headquarters in San Jose, California to increase the square footage and extend the term for seven years through 2010. As a result of the lease amendment, rent obligations will increase to $1.8 million in 2004, $1.6 million in 2005, $1.4 million in 2006, $1.5 million in 2007, $1.6 million in 2008, $1.6 million in 2009 and $1.0 million in 2010.

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Shares

Common Stock

Prospectus

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Citigroup

Lehman Brothers

U.S. Bancorp Piper Jaffray

PAGEBREAK

Part Ii

Information Not Required in Prospectus

Item 13.	*Other Expenses of Issuance and Distribution.*

The following table sets forth the costs and expenses, other than the underwriting discount, payable by the registrant in connection with the sale of the securities being registered. All amounts are estimates except the SEC registration fee, the NASD filing fee and the Nasdaq National Market listing fee.

	Amount To Be Paid
SEC Registration Fee	$6,075
NASD Filing Fee	8,000
Nasdaq National Market Listing Fee	155,000
Printing Costs	200,000
Directors and Officers' Insurance	850,000
Legal Fees and Expenses	750,000
Accounting Fees and Expenses	750,000
Blue Sky Fees and Expenses	25,000
Transfer Agent and Registrar Fees	5,000
Miscellaneous	925
Total	$2,750,000

Item 14. ***Indemnification of Directors and Officers.***

Section 145 of the Delaware General Corporation Law provides that a corporation may indemnify directors and officers as well as other employees and individuals against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with any threatened, pending or completed actions, suits or proceedings in which such person is made a party by reason of such person being or having been a director, officer, employee or agent to the Registrant. The Delaware General Corporation Law provides that Section 145 is not exclusive of other rights to which those seeking indemnification may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise. Section 10 of the Registrant's certificate of incorporation provides for indemnification by the Registrant of its directors, officers and employees to the fullest extent permitted by the Delaware General Corporation Law.

Section 102(b)(7) of the Delaware General Corporation Law permits a corporation to provide in its certificate of incorporation that a director of the corporation shall not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) for unlawful payments of dividends or unlawful stock repurchases, redemptions or other distributions, or (iv) for any transaction from which the director derived an improper personal benefit. The Registrant's certificate of incorporation provides for such limitation of liability.

The Registrant's policy is to enter into indemnification agreements with each of its directors, executive officers and certain of its other key employees that provide the maximum indemnity allowed to directors and executive officers by Section 145 of the Delaware General Corporation Law and the certificate of incorporation, as well as certain additional procedural protections. In addition, the indemnification agreements provide that the Registrant's directors, executive officers and specified key employees will be indemnified to the fullest possible extent not prohibited by law against all expenses, including attorney's fees, and settlement amounts paid or incurred by them in any action or proceeding, including any derivative action by or in the right of the Registrant, on account of their services as directors, or executive officers or employees of the Registrant or as directors or officers of any other company or enterprise when they are serving in these capacities at the request of the Registrant. The Registrant will not be obligated pursuant to the indemnification agreements to indemnify or advance expenses to an indemnified party with respect to proceedings or claims initiated by the indemnified party and not by way of defense, except with respect to proceedings specifically authorized by the Registrant's board of directors or brought to enforce a right to indemnification under the indemnification agreement, the Registrant's certificate of incorporation or any statute or law. Under the agreements, the Registrant is not obligated to indemnify the indemnified party (1) for any expenses incurred by the indemnified party with respect to any proceeding instituted by the indemnified party to enforce or interpret the agreement, if a court of competent jurisdiction determines that each of the material assertions made by the indemnified party in any proceeding was not made in good faith or was frivolous; (2) for any amounts paid in settlement of a proceeding unless the Registrant consents to such settlement; (3) with respect to any proceeding brought by the Registrant to enforce or interpret an indemnification agreement if a court determines that each of the material defenses asserted by the indemnitee was made in bad faith or was frivolous; (4) on account of any suit in which judgment is rendered against the indemnified party for an accounting of profits made from the purchase or sale by the indemnified party of securities of the Registrant pursuant to the provisions of §16(b) of the Securities Exchange Act of 1934, and related laws; (5) on account of the indemnified party's conduct which is finally adjudged to have been knowingly fraudulent or deliberately dishonest, or to constitute willful misconduct or a knowing violation of the law; (6) on account of any conduct from which the indemnified party derived an improper personal benefit; (7) on account of conduct the indemnified party believed to be contrary to the best interests of the Registrant or its stockholders; (8) on account of conduct that constituted a breach of the indemnified party's duty of loyalty to the registrant or its stockholders; or (9) if a final decision by a court having jurisdiction in the matter shall determine that such indemnification is not lawful.

The indemnification provisions in the certificate of incorporation and the indemnification agreements entered into between the Registrant and its directors, executive officers and key employees may be sufficiently broad to permit indemnification of the Registrant's officers, directors and key employees for liabilities arising under the Securities Act of 1933.

The Registrant maintains standard policies of insurance under which coverage is provided (a) to its directors and officers against loss rising from claims made by reason of breach of duty or other wrongful act, and (b) to the Registrant with respect to payments which may be made by the Registrant to such officers and directors pursuant to the above indemnification provision or otherwise as a matter of law.

The proposed form of Underwriting Agreement, which will be filed as Exhibit 1.1 to this Registration Statement, provides for indemnification of directors and officers of the Registrant by the underwriters against certain liabilities.

Item 15. *Recent Sales of Unregistered Securities.*

During the past three years, the Registrant has issued securities in the following transactions, each of which was exempt from the registration requirements of the Securities Act of 1933, as amended, under Section 4(2) of the Securities Act, as transactions by an issuer not involving any public offering, or under Rule 701 thereunder. The common stock share numbers summarized below have been adjusted to reflect the three-for-five reverse stock split expected to be effective prior to the effectiveness of this Registration Statement. No underwriters were involved in any of the below-referenced sales of securities.

Preferred Stock and Warrants

From September 2000 to December 2000, the Registrant issued and sold an aggregate principal amount of $8,000,002 convertible promissory notes to certain of its stockholders, convertible into shares of its Series F Preferred Stock, and agreed to issue warrants to purchase common stock upon conversion of the notes, based on a specified formula. In March 2001, when the notes were converted into Series F Preferred Stock, the Registrant issued warrants to purchase an additional 340,189 shares of Common Stock to ten accredited investors pursuant to Section 4(2) of the Securities Act.

On March 13, 2001, the Registrant issued and sold an aggregate of 6,667,896 shares of its Series F Preferred Stock (convertible upon the consummation of this offering into 4,000,732 shares of the Registrant's common stock) to ten accredited investors, all of whom were stockholders of the Registrant, for $26,138,148 pursuant to Section 4(2) of the Securities Act.

On October 26, 2001, the Registrant issued and sold an aggregate of 3,048,471 shares of its Series F Preferred Stock (convertible upon the consummation of this offering into 1,829,080 shares of the Registrant's common stock) to six accredited investors and warrants to purchase an additional 510,203 shares of Series F Preferred Stock (convertible upon the consummation of this offering into 306,121 shares of the Registrant's common stock) to four accredited investors for an aggregate purchase price of $11,950,006 pursuant to Section 4(2) of the Securities Act.

On January 22, 2002, the Registrant issued and sold an aggregate of 497,448 shares of its Series F Preferred Stock (convertible upon the consummation of this offering into 298,468 shares of the Registrant's common stock) to one accredited investor for $1,949,996 pursuant to Section 4(2) of the Securities Act.

On November 15 2002, the Registrant issued and sold an aggregate principal amount of $1,900,000 convertible promissory notes, convertible into shares of its Series G Preferred Stock, to eight accredited investors, all of whom were stockholders of the Registrant, pursuant to Section 4(2) of the Securities Act.

On December 24, 2002, the Registrant issued and sold an aggregate of 8,000,000 shares of its Series G Preferred Stock (convertible upon the consummation of this offering into 4,799,996 shares of the Registrant's common stock) to nine accredited investors, all of whom were stockholders of the Registrant, for $8,000,000 pursuant to Section 4(2) of the Securities Act.

In March 2003, the Registrant issued and sold an aggregate of 453,000 shares of its Series G Preferred Stock (convertible upon the consummation of this offering into 271,800 shares of the Registrant's common stock) to eight accredited investors pursuant to Section 4(2) of the Securities Act.

Common Stock

From July 1, 2000 to June 30, 2001, the Registrant issued and sold 43,255 shares of common stock to twenty-eight employees for $82,737 pursuant to Rule 701 of the Securities Act.

From July 1, 2001 to June 30, 2002, the Registrant issued and sold 36,662 shares of common stock to ten employees for $22,386 pursuant to Rule 701 of the Securities Act.

From July 1, 2002 to June 30, 2003, the Registrant issued and sold 98,883 shares of common stock to fourteen employees for $81,762 pursuant to Rule 701 of the Securities Act.

The recipients of securities in each such transaction represented their intentions to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the share certificates and warrants issued in such transactions. All recipients had adequate access, through their relationships with us, to information about us.

Item 16. *Exhibits and Financial Statement Schedules.*

(a) The following exhibits are filed as part of this Registration Statement:

Exhibit Number	Description
1.1	Form of Underwriting Agreement*
3.1	Amended and Restated Certificate of Incorporation
3.2	Amended and Restated By-Laws

Exhibit Number	Description
4.2	Amended and Restated Registration and Information Rights Agreement dated as of December 24, 2002
5.1	Opinion of Davis Polk & Wardwell*
10.1	OEM Partner Agreement with Cezanne Software, Inc. effective July 31, 2002*†
10.2	Amendment to OEM Partner Agreement with Cezanne Software, Inc. dated December 18, 2002*†
10.3	Loan and Security Agreement with Silicon Valley Bank dated September 26, 2002
10.4	Loan Modification Agreement with Silicon Valley Bank dated March 27, 2003
10.5	Lease Agreement between W9/ PHC II San Jose, L.L.C. and Callidus Software Inc.

10.6	1997 Stock Option Plan
10.7	2003 Stock Incentive Plan
10.8	2003 Employee Stock Purchase Plan
10.09	Form of Change of Control Agreement with Messrs. Taussig, C. Cabrera, Welch, Rankin, Warfield, Fior, Tidd, Braun and James entered into between October 1998 and June 2003.
10.10	Form of Change of Control Agreement with Messrs. Warfield, Welch, Taussig, Rankin, C. Cabrera, Fior, Braun, James, Opdendyk and Spreng entered into in September 2003.
10.11	Form of Indemnification Agreement
10.12	Severance Agreement with Robert W. Warfield dated November 15, 2001
10.13	Severance Agreement with Bertram W. Rankin dated May 10, 2003
10.14	Severance Agreement with Ronald J. Fior dated August 30, 2002
10.15	Note and Security Agreement from Daniel P. Welch dated December 31, 1998
10.16	Note and Security Agreement from Michael C. Tidd dated December 31, 1998
10.17	Note and Security Agreement from Reed D. Taussig dated January 7, 1998
10.18	Non-Plan Option Agreement with Reed D. Taussig
10.19	Stock Option Agreement with Robert W. Warfield
21.1	Subsidiaries of the Registrant
23.1	Consent of KPMG LLP, Independent Auditors
23.2	Consent of Davis Polk & Wardwell (included in Exhibit 5.1)*
24.1	Power of Attorney (included on signature page)

* To be filed by amendment.

† Confidential treatment will be requested with respect to certain portions of this exhibit. Omitted portions will be filed separately with the Securities and Exchange Commission.

Item 17.	***Undertakings***

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, or persons controlling the Registrant pursuant to the foregoing provisions, the Registrant has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer, or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question of whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective. (2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Signatures

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Jose, State of California, on the 22nd day of September 2003.

CALLIDUS SOFTWARE INC.

By:	/s/ REED D. TAUSSIG

Name: Reed D. Taussig

Title:	President, Chief Executive Officer and Chairman of the Board of Directors

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Reed D. Taussig and Ronald J. Fior, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this registration statement and any and all additional registration statements pursuant to Rule 462(b) of the Securities Act of 1933, as amended, and to file the same, with all exhibits thereto, and all other documents in connection therewith, with the Securities and Exchange Commission, granting unto each said attorney-in-fact and agents full power and authority to do and perform each and every act in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or either of them or their or his substitute or substitutes may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, as amended, this Registration Statement has been signed by the following persons in the capacities and on the dates indicated.

Signature	**Title**	**Date**

/s/ REED D. TAUSSIG Reed D. Taussig	President, Chief Executive Officer, and Chairman of the Board of Directors (Principal Executive Officer)	September 22, 2003
/s/ RONALD J. FIOR Ronald J. Fior	Chief Financial Officer, Vice President, Finance (Principal Accounting and Financial Officer)	September 22, 2003
/s/ MICHAEL A. BRAUN Michael A. Braun	Director	September 22, 2003
/s/ GEORGE JAMES George James	Director	September 22, 2003
/s/ TERRY L. OPDENDYK Terry L. Opdendyk	Director	September 22, 2003
/s/ R. DAVID SPRENG R. David Spreng	Director	September 22, 2003

Exhibit Index

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