

FD (Fair Disclosure) Wire

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Q1 2005 RightNow Technologies, Inc. ▼ Earnings Conference Call - Final

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OPERATOR: Today's call is being recorded. At this time, I would like to welcome everyone to the RightNow Technologies first quarter 2005 earnings conference call. All lines will be placed on mute. After the speakers' remarks there will be a question-and-answer period. Susan Carstensen, RightNow's CFO, will begin the call. Please go ahead ma'am.

SUSAN CARSTENSEN, CFO, RIGHTNOW TECHNOLOGIES, INC. ▼ : Good afternoon, everyone, and welcome to the RightNow first-quarter earnings call. First, I will cover the Safe Harbor and then turn the call over to **Greg Gianforte**, CEO and Founder.

During the course of the call, we may make projections or forward-looking statements regarding future conditions or events which may drive our future business, current and new products and services and their performance, the size and strength of the market, and our financial performance and outlook of the Company. These forward-looking statements may include, but are not limited to, statements about revenue growth and profitability, market acceptance of our products, other statements related to our operating results, and the implications of our announced acquisition of Convergent Voice assets. These forward-looking statements speak only as of today and are based upon the information currently available to us. This information will likely change over time. By discussing our current perception of our market and future performance of the Company and our products with you today, we are not undertaking an obligation to provide updates in the future. We caution you that such statements are just projections and actual events and results may differ materially. Please refer to the documents we file from time to time with the SEC, specifically our annual report on Form 10-K. These documents contain and identify important factors that could cause the actual results to differ materially from those contained in our projections and forward-looking statements.

With that, I'll turn the call over to **Greg**.

GREG GIANFORTE, VP FINANCE & ADMINISTRATION, CFO, TREASURER, RIGHTNOW TECHNOLOGIES, INC. ▼ : Thanks, Susan, and thank you, everyone, for joining us. First I will talk about the quarter and then spend some time talking about what we're seeing in the market, and our agreement to acquire the Convergent Voice assets.

I'm pleased to announce that we have concluded our 29th consecutive quarter of revenue growth and continued to build our recurring revenue and deferred revenue. I will cover the highlights, but first, the results.

Total revenue in the quarter was \$18.3 million, with software, hosting and support revenue of 13.9 million. EPS was \$0.02. When you look at the quarter, we noticed a couple of things.

First, we continue to make solid progress with our new products. We now have over 90 marketing automation customers, over 50 sales automation customers and 40 complete CRM customers. And for the first time, in Q1, our new offerings contributed more than 10% for total business, with our core customer service business making up the rest. On-demand as a delivery model is becoming more and more accepted as a preferable way for organizations of all sizes to buy enterprise software.

Second, as we have grown and increased average deal sizes, we may be seeing some signs of seasonality in our North American and European new business. This is reflected primarily in our perpetual license revenue, which decreased from Q4, while recurring revenue increased from the fourth quarter.

We saw greater strength in our existing customer base than in our new business in Q1. After completing our early quarter reviews, I am really encouraged by the strength of our pipeline for Q2 and beyond.

Taking a closer look, we signed 60 new customers in the quarter, 5% of our total installed base. New customers in Q1 include Cinema Now, Flyfone, Rambus, NYK Line, Kentucky Virtual University and the U.S. State Department. We continue to see a diverse mix of business from all verticals, with high-tech, government education, telecommunication and media leading the pack. Existing customers such as Electronic Arts, Leapfrog, Cabela's, Medicare, Veterans Benefits Administration, Sprint, Sony, Toyota, and Hallmark all renewed or expanded their licenses with us.

Let me give you four examples of customer wins from the quarter. We signed a sales, marketing and service deal with Alaska Airlines. They were looking to improve revenue and customer satisfaction and reduce abandonment rates. Their director of CRM is an ex Siebel employee, so you can imagine who our competition was. And we believe we won because we can provide a 360-degree view of the customer, a knowledge base to drive self-service, native e-mail marketing capabilities, the depth of our service solution, and last but not least, really, the industry expertise, given we are the solution of choice for 14 airlines worldwide.

A second customer example -- we signed \$500,000 new sales and marketing deal with an e-commerce Internet property, where we displaced Responsys and three other systems. We beat the usual suspects in sales automation because the customer wanted a single integrated solution that centralized their analytics for customer service and marketing, added capacity and expertise, so that we could deliver over 5 million customer messages per month, and the ability to easily integrate with their back-office systems.

In a third example, Ticketmaster U.S. replaced their long-time incumbent product with our call center solution for 100 agents in both the U.S. and India. And they're looking to reduce costs and increase satisfaction for their Ticketmaster branded sites as well as their own sites like Major League Baseball.

In the fourth example, one of our outsource call center partners, Convergys, chose to significantly expand their relationship with us beyond multi-channel customer service and standardize on our platform for complete on-demand CRM and for increased capacity. Convergys has been a partner since October of 2000 and currently has more than 3000 agents that use RightNow service. They are deploying RightNow for e-mail management, call tracking, live chat, self-service, and now sales automation and marketing automation with over 20 of their clients. Convergys uses our proprietary partner hosting management system to remotely manage their deployments, and our hosting infrastructure, on a daily basis.

Competitively, we did not observe much change in Q1. We're still seeing the legacy enterprise CRM vendors, especially in the customer service space, and we're also seeing on-demand CRM vendors. Our key advantages are simple. The legacy CRM vendors cannot match the ease-of-use or cost/ownership value proposition that we deliver. And the other on demand vendors can't match our depth and breadth within CRM or our use of customer intelligence and knowledge-based technology to drive closer customer relationships.

Every quarter we give you the number of interactions we serve; once again that number increased sequentially to 166 million during the quarter. Last year we served more than 500 million interactions, and I said our goal was to be at 1 billion in the year 2006. At this pace, I believe we will cross the 750 million interaction mark in 2005, clearly, tracking on our mission to help customers better serve their clients.

Next, I would like to tell you about the Convergent Voice acquisition. We have had a relationship with this group since August of 2002, essentially licensing their platform. A critical component of multi-channel customer service solutions is the ability to handle voice interactions in an automated way. The most cost-effective way to do this is with speech recognition. And in fact, one of the broadest patents we now own relates to an application that facilitates voice interaction with a dynamic knowledge base or menu. As that technology has matured, we've worked with Convergent Voice to build an application platform that enables customers to complete the following types of transactions -- to call and query the same self-learning knowledge base that the customer interacts with on the Web; to submit a question over the phone that creates a ticket that can be subsequently answered either electronically or via a return phone call, or to submit a query via voice recognition into a back-office system -- for example, to check on order status.

Let me give you a customer example. One large telecommunications company replaced their existing IVR voice application, which interacted with a static knowledge base, with our application -- which, naturally, used our self-learning knowledge base -- and this customer achieved over a 2000 phone call reduction per day coming into their call center. And in this case, RightNow hosts this voice recognition system application for the client, but we could also have deployed it on premise. A live phone call with an agent can cost 5 to \$10 more than a voice self-service phone call. At 2000 call a day being eliminated, you can quickly do the math and figure out how significant this ROI is. As customer interest for this platform has increased, we decided to buy the intellectual property and hire the people who developed it in order to compete more effectively in this space.

Additionally, in the first quarter, we added Joe Brown as Vice President of Voice Solutions to our team to help drive this business. Joe brings 28 years of voice and software experience and is the past CEO and President of Edify Corporation. We are very pleased to have David Lanning and the team from Convergent Voice join Joe in moving this business ahead.

Since Joe joined in February, we have initiated several voice self-service pilots and are building a strong pipeline. We are very comfortable making this step because the voice self-service is an immediately adjacent opportunity with our existing business. We sell to the same customers and prospects we've always been engaged with and we have literally thousands of RightNow knowledge bases already in place that could be leveraged.

A final point I will make on this is that the average transaction size we have seen for the limited number of voice self-service deals we've done to date has been significantly above our average transaction size at \$500,000 each. Susan will get into the specifics shortly about the financials, but I want to talk for a moment about our headcount, specifically our sales capacity.

We ended last year with 87 quota-carrying sales reps. Our goal was to increase that total by 30% this year. I'm happy to report that we ended the first quarter with just over 100 reps, ahead of plan, and covering more than half of our full-year goal. People always ask us in meetings if we'll be able to hire fast enough to support our growth objectives, and we're real pleased with our efforts on this front this quarter.

While the extra hires had a significantly negative effect -- slightly negative effect on Q1 sales and marketing spending, I think that getting these people on board early in the year will have a positive effect on their productivity as the year progresses.

With that, I will turn it over to Susan, who will cover the first-quarter financials and details on the acquisition.

SUSAN CARSTENSEN: Thanks, Greg. Revenues for the quarter of 18.3 million represents a 43% year-over-year and a 4% quarter-over-quarter increase. Software support and hosting revenue for the quarter was down 3% sequentially and up 29% year-over-year. But within that, recurring revenue was up 8.5% sequentially and 25% year-over-year, and the perpetual revenue component is down sequentially 29%. Professional services revenue for the quarter was up 33% sequentially and 109% year-over-year. Services revenue in the first quarter was higher-than-expected as we made up for some of the revenue that we failed to capture in the fourth quarter around the holidays.

Looking at the mix of revenue for the quarter, we saw 58% recurring revenue, 18% perpetual revenue, and 24% professional services revenue. In dollars, recurring revenue was 10.6 million, up from 9.8 million last quarter and 8.5 million last year.

I would like to jump to the balance sheet for a minute because the combination of revenue and deferred revenue is the key financial metric in the business.

We increased deferred revenue 3.7 million, or 7.5%, to 52.8 million from December 31, and 16.1 million, or 44%, from one year ago. The current deferred revenue balance which represents revenue to be recognized over the next 12 months grew 1.9 million from last quarter.

We provide maximum visibility into the business by recording all the amounts due in accounts and term receivables and all the business sold in deferred revenue. While we don't disclose an actual bookings number, looking at our revenue and change in deferred revenue, you can see that our billed business was similar to the fourth quarter and up 57% year-over-year.

Now, I will give you some more details about the business we did in Q1 which is reflected in revenue and deferred revenue. Mix across geographies was 75% Americas, 15% EMEA and 10% Asia-Pac. We were pleased particularly with the business our installed base teams across the world completed this quarter as well as Asia-Pac in general. Rakutan (ph), a financial services firm in Japan, renewed and expanded their deployment, along with numerous others. Our partners influenced 12% of our business this quarter, with good results from over 15 partners across the world.

While the majority of our business comes from sales of our service-related modules, we're pleased with the traction we're getting with the other elements of the CRM suite released in the fourth quarter. The new applications in sales and marketing generated over 10% of the business in Q1.

We added 60 new customers this quarter and renewed and expanded relationships with many of our existing customers. Comparing the first quarter of 2005 with the first quarter of 2004, our average customer account is up 18% and average revenue per customer is up 21%. Average deal size increased slightly to approximately \$116,000 this quarter, which is a 26% increase year-over-year. We continue to retain approximately 90% of our customers to receive over 100% of the available renewal dollars and finished the quarter with 1273 active customers.

Our mix of business by revenue size has remained pretty steady. For the quarter, 39% was from organizations with revenues over 1 billion, 48% from organizations with revenue under 1 billion, and approximately 13% from government and education entities.

Now, back on the expense side of the P&L, the gross margin for the software hosting and license was 85%, clearly, impacted by the lower perpetual revenue number and our voice self-service business. Professional services margins of 40% were in line with our longer-term expectations we discussed last quarter. We were pleased with the execution and utilization within this group.

Total operating expenses grew from 12.5 million last quarter to 13.0 million this quarter, which resulted in a 3% operating margin. Sales and marketing costs were 52% of revenue, research and development 12%, and G&A 8%. Sales and marketing expenses were higher as a percentage of revenue this quarter than last, due to the timing of sales hires. Greg mentioned we exceeded our hiring goals and ended the quarter with just over 100 quota-carrying reps on board.

I talked briefly about an adjusted EBITDA metric last quarter. I do believe this metric captures the margins in the business from a leading-indicator perspective a little more than cash flow from operations and, clearly, more than earnings, given our deferred revenue model. Adjusted EBITDA is calculated straight off the financials by taking revenue plus change in deferred revenue (technical difficulty) proxy for bookings, less expenses, plus depreciation, and \$5 million, or 23%, of that bookings number. And while we are certainly not happy with \$0.02 of EPS relative to our guidance, we're not too disappointed with the 23% adjusted EBITDA margin on the business we did this quarter.

We ended the quarter with total headcount of 438, comprised of 15 people in hosting, 40 in tech support, 78 in pro services, 184 in sales and marketing, 83 in the development group, and 38 in G&A.

In terms of the balance sheet, we ended the quarter with total cash and short-term interest-bearing investment balance of 52.9 million. In the first quarter, we generated 3.2 million of cash from operations. We did see a larger percentage of monthly term agreements this quarter. It may be one of the competitive pressures we're seeing as the market is becoming more educated about on-demand and associating on-demand with monthly payments. But while we get paid more for these arrangements over the term, it does have an impact on the timing of cash flow.

We invested approximately 1.1 million of capital, consisting primarily of normal hosting capacity increases and headcount-related equipment purchases.

Before turning to guidance, I would like to explain the financial impacts of our acquisition of Convergent Voice assets announced today. Our prior arrangement provides for paying revenue-based loyalty, which impacts our gross margin from software support and hosting. Given the strategic nature of the technology, we elected to purchase the intellectual property and hire the people involved to maximize our revenue opportunity and increase our ability to leverage the growth in our margins over time.

We expect the purchase price to be largely allocated to identifiable intangible assets that will be capitalized and amortized ratably over the estimated life. The personal we've been able to hire will be included in our services and R&D line items. The acquisition should have a \$0.02 to \$0.03 dilutive effect in '05 and provide incremental revenue and margin thereafter. Specifically, we expect to see approximately \$150,000 a quarter more in the cost of sales line and approximately \$200,000 a quarter more in development. Beyond that, we expect incremental profitable revenue from the voice business in 2006 and beyond, albeit at slightly lower gross margins than our traditional business, given the voice self-service hosting cost, but improving like our traditional business with volume.

Moving to guidance for the second quarter and full year, second-quarter revenue is anticipated to be 19.5 million to 20.5 million. Looking at our business booked, we expect recurring revenue to be up in Q2 compared to the slight decrease we saw in Q2 of 2004. We are seeing a higher run rate in sales and marketing due to the increased hires and we'll see some impact on

expenses in Q2 from the acquisition. Accordingly, we expect second-quarter earnings per share of \$0.02 to \$0.03 on diluted shares of 33.8 million.

For the full year, we continue to anticipate revenue in the range of 81 to 85 million, which represents growth of approximately 35% over fiscal year 2004. We anticipate earnings per share of \$0.13 to \$0.17 on an average diluted share count of 33.9 million. We expect cash from operations in the range of 18 million to 22 million for the full year 2005. As previously discussed, we have a plan to invest approximately \$5 million in property plant and equipment during the year. In Q2, it's primarily furniture and fixtures related to some of the new offices we have been setting up, as well as incremental hosting capacity.

With that, I would like to open it up for questions.

OPERATOR: (OPERATOR INSTRUCTIONS). Keith Gay, Thomas Weisel Partners.

KEITH GAY, ANALYST, THOMAS WEISEL PARTNERS: It looks like you're tracking ahead on sales reps and you have maintained your overall revenue guidance for the year. So, I guess the question is do you expect those sales reps to become effective earlier, and therefore, might you see an improvement relative to that 81 to 85 million in your guidance? And also, on the expense side it looks like sales and marketing expense as a percentage of revenue is about 51.5 percent. But, since you've gotten these sales reps on earlier, where do you see that, perhaps, as a percentage of revenue by the end of the year?

GREG GIANFORTE: I would say, Keith, that although we are ahead in hiring, because of the deferred revenue model it's very hard for them to have impact on this year's revenue, although hiring them early does put us a little ahead on the curve. But, because most of the stuff they sell goes into deferred revenue, it's hard to have an effect on the revenue in this period.

KEITH GAY: And then, on the expense side, where do you see leverage on that sales and marketing line going?

SUSAN CARSTENSEN: On the sales and marketing line, like I said, we're at 51.6% this quarter, approximately 50% for the year.

KEITH GAY: On the Convergent deal, can you give us a sense of the size of that deal, in terms of what the monetary consideration was? And then, do you expect that you might see some revenues from that deal this year, or are you just being conservative and not expecting much in the way of revenues until next year?

SUSAN CARSTENSEN: We have been offering the platform since we've been licensing it from them. And so, there's a certain amount of revenues, clearly, already baked into our original plan. In terms of the consideration, we're not disclosing the exact terms. No significant impact on cash or the balance sheet.

GREG GIANFORTE: It was a cash deal, so there's no dilution to the shares. And it won't have a major impact on cash at all. It will sharpen cash flow next quarter.

KEITH GAY: A final question. Greg, Craig as you're broadening into sales force automation, do you find that customers are measuring you more on things like broadness of offering, verticalization of solutions, versus -- you have an easy way win when you go in with a focused, deep customer support solution. Are you finding that the bake-off or the selling environment on a competitive front, in terms of your positioning, has changed at all?

GREG GIANFORTE: I would say that one of the strengths we have -- and I did some work this quarter; I was out with clients and working with them. One of the things that seems to resonate with customers and one of their -- as we've talked to them -- why did you purchase from us, after the fact? They come back and say the breadth of the CRM suite. We have seen this confirmed also from the analysts. We had a quote here recently from Forrester, who said, we have now the broadest CRM suite in the on-demand space. You know, a quote from Gartner last fall where they said at least two years ahead of other people in the customer service space. These are significant acknowledgments. Also, we had a report this quarter from Forrester with our new sales capability -- they actually ranked this number two, just behind Salesforce and ahead of Siebel, just on our SFA capability. So, we are -- as we serve larger customers and their requirements tend to be more complex, breadth of solution set is extremely important to them in making a purchase decision.

OPERATOR: Ross MacMillan, Morgan Stanley.

ROSS MACMILLAN, ANALYST, MORGAN STANLEY: Susan, just one on the Convergent deal. When you went through the costs on the assumed dilution relative to prior expectations, is that really all just operating procs, or are any of those in-process R&D costs or amortization of intangibles? So, anything else that is running through the P&L that isn't just an operating item?

SUSAN CARSTENSEN: You know, the 150,000 that would be in cost of sales will include the amortization of the intellectual property. But, there isn't any in-process R&D.

ROSS MACMILLAN: I presume the lion's share, therefore, of all the costs we're talking about incrementally are actual operating costs?

SUSAN CARSTENSEN: Yes.

GREG GIANFORTE: I would just add, Ross, that this deal overall for us was really -- it was a cost trade-off decision, in that we were paying a royalty; we're seeing results that we -- what we were expecting. And so, it was really a question do we pay royalties or do we get the guys on board?

ROSS MACMILLAN: Makes sense. Just on the other comment, Susan, that you made where you saw a higher proportion of monthly subscriptions this quarter. I guess I'm just curious, what do you make of that shift, first of all? And in terms of the model as you look forward, I noticed that you hadn't changed the assumption on the cash flow from operations guidance this year of 18 to 22 million. But, clearly there's a big difference in the cash flow if you get paid monthly rather than on terms where you get paid two years up-front. So, just trying to understand. Are you still

on the kind of assumption that Q1 was maybe a slight blip in terms of the proportion of subscription, and that sort of tails back to where you had been in terms of term licenses?

SUSAN CARSTENSEN: We looked in detail at Q1. And while, as I said, we sold more of the monthly subscriptions, we really did not have enough data to call it a trend and make any significant change in the cash flow assumption. Customers pay us more for it, and one of our foundational elements is to provide them a choice. But, it's too early. We think the 18 to 22 still holds for cash from operations.

ROSS MACMILLAN: Was it across the board? Did you see larger customers look towards subscription? Or was it any particular customer size segment?

SUSAN CARSTENSEN: No, it really wasn't separate by segment. The only factor I have been wondering about is whether on-demand goes along with monthly payment. So, as it becomes more and more accepted, I think we're seeing some customers who just kind of expect that. Whereas we had typically sold -- and still, the majority of our revenues is two-year term license. We're fairly unique in the industry with selling that.

ROSS MACMILLAN: Got it. Maybe just one last one then, just on the new customers. That 60 number was a little bit below where you've been trending for the last two to three quarters, but it was kind of in line, I think, with last year's number. I think the attrition rate actually was a little bit lower here. Just curious as to, again, why you think that maybe the net new customer addition was a little bit lower here? Was it specific to any geography? I know that you're incentivizing your inside sales guys to sell more additional cross-sell and up-sell, but I was just curious as to whether there was anything else happening on the new customer wins that might help explain that?

GREG GIANFORTE: I think, Ross, 60 represents 5% increase in overall installed base. I think the business in Q1 here -- we did more business with existing clients. I think that's -- it's been kind of a situation in the overall software where it's not just us, but generally that there is more business that's available from installed base during Q1. So, we're not disappointed with that number. We think adding 60 customers, good solid customers during the quarter is a great accomplishment.

OPERATOR: Tad Piper, Piper Jaffray.

TAD PIPER, ANALYST, PIPER JAFFRAY: A couple of metrics questions. Did you disclose the number of total transactions in the quarter and how many perpetual transactions you had?

SUSAN CARSTENSEN: We did -- let's see; I checked. We did over 300 transactions in the quarter. Approximately 10% are perpetual.

TAD PIPER: I just want to follow-up a little bit on Ross' question about the change to more monthly. Obviously, it also shifting your -- there seems to be more growth in deferred revenue on the long-term basis as well. Can you just talk to that a little bit? Deferred revenue growth

does seem to be more long-term in nature than current deferred growth, which we have seen for a couple of quarters.

SUSAN CARSTENSEN: We are definitely seeing some customers that are willing to make long-term commitments, whether it is two years or three years; they're moving beyond kind of the one-year term, which is how we had originally thought people would sign up for the monthly subscriptions.

GREG GIANFORTE: I think that is indicative of the confidence they have in our solution.

TAD PIPER: Does it influence your guidance at all? It just seems like the growth in current deferred we would expect to be greater, and yet, guidance for the year at 81 to 84 pretty much remains consistent with where you have been. Besides, just current deferred, I would have thought, would need to grow faster given the model, unless you're banking on more perpetual license revenue kind of in the latter part of the year.

SUSAN CARSTENSEN: No. I think we see growth in both current and noncurrent throughout the rest of the year and it builds up to the 81 to 85 expectation.

TAD PIPER: Lastly, is there any change in the gross margins due to the Convergent deal? You were saying you used to pay a royalty and now it's going to be in-house. Is it kind of at a point now where it doesn't make that big difference, but you are assuming that business is going to grow, so it will make a difference going forward?

SUSAN CARSTENSEN: I had talked about kind of an incremental \$150,000 a quarter in that cost of software hosting and support.

TAD PIPER: But presumably you paid a royalty previously.

SUSAN CARSTENSEN: Right. We paid a royalty previously. The 150 is incremental cost for '05. The crossover point, really, is in '06, where the leverage from better cost structure (technical difficulty)

TAD PIPER: So, the growth in that business, basically, you're kind of getting ahead of the curve on that. So, in the near-term, it actually does dampen gross margins but it should improve them into '06?

SUSAN CARSTENSEN: Right. That's correct.

OPERATOR: Ed Maguire, Merrill Lynch.

ED MAGUIRE, ANALYST, MERRILL LYNCH: I was wondering if you could -- just following up on that last question about gross margins in the Convergent Voice applications. What is it about their offering that has a higher cost of hosting?

GREG GIANFORTE: I could talk to that. Historically, there were two components. There was the royalty piece, which under this arrangement goes away entirely. But then also, to provision

voice self-service applications, there is a telephony infrastructure component. And you have to maintain enough voice port to never have a situation where you block a phone call. Whereas if we're running Web self-service for a client, if we overload a server, although we maintain 40 or 50% capacity, the server just slows down a little bit; you don't run out of ports. So, you end up provisioning more equipment to handle the voice self-service application. And there is a telephony transport component, although that, too, will go away as we internalize VoIP and remove the telco charges. So, it's just a little more complicated on the hosting side. So, even without the royalties, the hosting cost will be slightly higher for the voice self-service business than they will be for a traditional CRM hosting business.

ED MAGUIRE: Moving on to business in Europe, it looked like it was down quarter-over-quarter. Was that a result of a mix shift more toward the recurring business? I remember you had a pretty large perpetual transaction that closed last quarter.

SUSAN CARSTENSEN: No real new trends or shifts. The different regions tend to fluctuate quarter-over-quarter. Nothing significantly new in Europe.

OPERATOR: Nathan Schneiderman, Wedbush Morgan Securities.

NATHAN SCHNEIDERMAN, ANALYST, WEDBUSH MORGAN SECURITIES: I have a couple of questions for you. I just wanted to be clear -- what do you think went wrong to miss the EPS guidance you gave last quarter? What part of the business performed differently than you were looking for?

GREG GIANFORTE: I would say that our perpetual revenue number we have always said is going to be between 15 and 25%; in more recent periods it's been between 20 and 25%. In Q1, it came in at 18%. It is that item alone that --

SUSAN CARSTENSEN: Combined with sales hiring.

GREG GIANFORTE: -- combined with the sales hiring that accounts for the EPS earnings. And understand, we don't have that many shares outstanding. \$0.01 is a couple of hundred thousand dollars; it's not a big variance.

NATHAN SCHNEIDERMAN: To be clear, you referenced a hire in February related to the acquisition. Did the acquisition actually boost the cost structure in Q1?

GREG GIANFORTE: The hire occurred in Q1. The definitive agreement was just signed this month. So, it was signed in Q2.

NATHAN SCHNEIDERMAN: Following up on the first question I asked, given the EPS miss in Q1, I'm just curious why you feel comfortable with -- effectively, after you adjust for the acquisition-related costs you're reiterating -- pretty close to reiterating your full-year 2005 guidance. So, what is it that gives you confidence that you can hit the full-year EPS number, even though you are starting off a little slow there. I don't know -- you had referenced pipeline earlier -- I don't know if that's fundamental or if there are other reasons. But, could you just explain that?

GREG GIANFORTE: That's what I would point back to, is the pipeline. I mean, we have confidence in what we see in the business and what is in front of us here. The business is there for us to support the guidance that we have given.

NATHAN SCHNEIDERMAN: So it's nothing other than the pipeline strength that you see?

SUSAN CARSTENSEN: It's the combination of pipeline strength and we have got \$38 million of it in current deferred revenue. So, we've got a large portion of the revenue, really, recorded and billed already.

NATHAN SCHNEIDERMAN: Greg, when you talked about your comfort in the pipeline, can you drill down a little bit there in what specifically are you seeing? Are you talking about the quantity of deals, dollar value of deals, something else? Can you just give us some more details or information related to do that?

GREG GIANFORTE: It is all of that. We have a very detailed and structured pipeline review process. I am personally in the reviews every two weeks with the senior managers across the business. We go through and we look at the strength of the business in each region of the world, and we at least review the larger deals that are being worked by the sales teams. And, you know, this last review we did I was impressed by the number of deals, the size of the deals, the traction we're getting with the new products. It's a combination of all that.

SUSAN CARSTENSEN: Plus the sales capacity we have on board to deliver it.

GREG GIANFORTE: The one other point I would point to is that we did do a lot of hiring in Q4. And we have been particularly impressed with the rate at which these new reps are coming up to speed. Most of them that we hired in Q4 actually had some sort of transaction in Q1. So, this is encouraging to us. Now, a lot of that is pilots and other stuff that will result in more significant revenue later in the year.

NATHAN SCHNEIDERMAN: Final question for you, and then I will drop off. Siebel announced a new offering for hosted contact center. I gather traditionally you have competed against Siebel's on-premise solution. How has that started? What are the early signs here? What is your evaluation of the product? How has it started to affect sales cycles? And what is your outlook for any changes in the competitive situation because of Siebel?

GREG GIANFORTE: That's a really good question. You know, we looked at it. And it appears to us that that is essentially a repackaging of the technology they bought from Anetto (ph) a year ago. But, it doesn't mean we're not taking it seriously. We went back and did a deep dive with our sales teams on what they're seeing in the field. And Siebel is very good at making a lot of noise about these things, but we have yet to see that in a competitive engagement anywhere. So, it looked like it took them about a year to put their name on what they bought from Anetto.

OPERATOR: Laura Lederman, William Blair.

LAURA LEDERMAN, ANALYST, WILLIAM BLAIR: A few questions. How do you forecast going forward as to how much is going to come from perpetual versus recurring revenues, given that it does cause variability in the EPS line?

GREG GIANFORTE: I would say, Laura, that we have always -- I think one of the strengths of our business is that we structured it to give our customers a lot of choice. And in that regard, we give them the choice of buying perpetually, term, or on a monthly subscription. And then, in turn, our obligation to you and the rest of the financial community is to provide a lot of visibility into our business so you know exactly what is going on. And I would offer that I think, given the metrics we provide, we're probably giving you more visibility than virtually any other technology company I know of. Everything we sell, whether it's term, subscription or perpetual, shows up on our balance sheet. And as Susan mentioned, really the best leading indicator of what is going on in the business is the revenue plus change in deferred revenue -- that's less expense (indiscernible) adjusted EBITDA. And that number is up 150% over Q1 a year ago. So, physically, how do we forecast perpetual? We have said that we have seen it between 20 and 25%, in a range between 15 and 25. We believe on a going basis it will be between the 20 and 25%. But, part of it's based on the choices that our customers make.

LAURA LEDERMAN: Switching gears a little bit. Can you talk a little bit about how much came in under monthly billing? Can you give us a feel for the magnitude of that, any way you're willing to put some numbers around it?

SUSAN CARSTENSEN: Probably the best way to look at it is to look straight at the balance sheet. You can see we had increases in current term receivables of about \$3 million from December to March. We had increases in non-current term receivables, 2.5 million from December to March. But, you really can see it pretty much straight off the balance sheet in the mix of the receivables.

LAURA LEDERMAN: Thank you? I didn't receive that yet, given I'm out. Two other questions. One is, (indiscernible) acquisitions, is there anything else that you would be looking at? Do you plan to make other acquisitions periodically, and how large would they be? And how do you feel about dilutive versus accretive acquisitions?

SUSAN CARSTENSEN: We've pretty specifically talked about not really being out there trying to acquire a lot of technology and bolt it all together. We think that's what's failed with a lot of the software companies in the past, specifically some of the CRM companies. It's very important to have solutions that actually work that run effectively in our hosting environment. This was a classic buy versus build. And given that we had already seen the product, had the integration, it was much faster time to market and much faster for accretive earnings than to start from scratch and start building it.

LAURA LEDERMAN: Final question. If you look at the 90% of revenues that come from service, can you talk a little bit of how much of that is FAQ knowledge base, how much is call center? Can you give us a feel for a breakout within that broad category?

GREG GIANFORTE: As we've discussed previously, and I don't believe it's changed in Q1, about half of that revenue is complete call center deals where we are the agent desktop, handling the phone calls and e-mails and Web requests. And the other 50% is components of e-service, whether it be e-mail management, Web-based self-service, live chat, etcetera. And that didn't really change in Q1.

OPERATOR: Brad Whitt. RBC Capital Management.

BRAD WHITT, ANALYST, RBC CAPITAL MANAGEMENT: Greg, can you talk a little bit about any kind of trends you're seeing in voice over IP, and whether or not that's being a catalyst for your business at all as people look to upgrade some of their infrastructure in the call centers?

GREG GIANFORTE: It doesn't directly impact our business. I would say that the bigger drivers in our business have been the movement toward outsourcing and the fact that a lot of these call centers are still using client/server application that don't deploy well across multiple locations. Now, voice over IP is making it easier to deploy multi-location call centers. So, in that sense it is impacting our business, but it is indirect and positive.

OPERATOR: Brent Thill, Prudential.

BRENT THILL, ANALYST, PRUDENTIAL: The new customer metric you mentioned -- it was 60 in Q1. The number we had for Q1 last year was 69. Is that accurate?

SUSAN CARSTENSEN: That sounds accurate.

BRENT THILL: Circling back, I think you had 80 in Q4. It just seems like that metric should -- considering where you're at in terms of your lifecycle of the Company, that number should be growing quite a bit faster. And I know you mentioned that you're happy with where that number came in. But, just give us a sense it's not moving in the right direction year-over-year or sequentially.

GREG GIANFORTE: It absolutely needs to move up. My point was more that given Q1, more business tends to come from the installed base. I would fully expect it to move up in future quarters.

BRENT THILL: Greg, were there any changes in the quota structure or territory in Q1 for the sales reps? Now that they're taking on more of an end-to-end solution, how are you incenting them for -- differently versus last year, if anything is different?

GREG GIANFORTE: We have been aggressively hiring new reps. And you've got to find homes for them all. We did change many of the territory assignments in January of this year. And I think that was received very well, but people take a little time to settle in. I think overall, as we have added, we created a territory in the Northeast last year; we created an office in Chicago -- a region in Chicago this past quarter; there was some realignment done in January to get the right reps working for the right managers covering the right territories.

SUSAN CARSTENSEN: The sales reps are still primarily split between new business reps and installed base reps. We're not segmenting them between sales automation reps versus customer service reps. They go through pretty extensive training programs so they understand the full suite and can sell any one of the 15 different modules, or whatever kind of meets that immediate business (indiscernible) customer.

GREG GIANFORTE: The people we've been hiring for some time are really generalists, in the sense that they come with the ability to do the consultative kind of engagements that are really essential for us to understand where we can drive value within our clients' organizations, and then formulate a proposal that makes sense for them.

OPERATOR: Patrick Mason, Pacific Growth.

PATRICK MASON, ANALYST, PACIFIC GROWTH: Just to get a little more detail, you said about 10% of the business came from the SFA, I guess the marketing products. Is that primarily from existing customers, or were there any new customers using those products?

SUSAN CARSTENSEN: It's a mix of new customers and existing customers who are buying the solutions.

PATRICK MASON: So, you did sell some of those to new customers is what you're saying?

SUSAN CARSTENSEN: Oh, yes.

GREG GIANFORTE: In fact, that one I mentioned -- the e-commerce platform, the \$500,000 transaction -- that was a brand-new customer.

PATRICK MASON: Secondly, just more directionally on your professional services revenue. That, obviously, you said popped due to the holiday season coming out of Q4. A lot of that fell into the Q1. Just directionally, is that going to be more flat or up or down going into Q2, would you expect?

SUSAN CARSTENSEN: I would expect directionally slightly up, but not near the same jump as from Q4 to Q1.

PATRICK MASON: Then lastly, on just the sales hiring, obviously, you said you hired quite a few, obviously, this quarter. You're just over 100, I guess, from 87 last quarter. Do you expect to continue that trend and hire most of your goal within the first half of the year, or do you expect to slow down on that and then hire some in the second half of the year?

SUSAN CARSTENSEN: Realistically, it tends to be a little harder to hire them in the very last part of the year. So, I don't know that we'll continue it quite as aggressively as Q1, but it will be more evenly split between Q2 and Q3.

OPERATOR: Karen Haus, WR Hambrecht.

KAREN HAUS, ANALYST, WR HAMBRECHT: Susan, just a quick housekeeping question. When you gave guidance for 2005 previously, I know you didn't include any stock option expensing. And I know the deadline has been pushed out. Has the guidance you have given us for either 2005 or '06 included any kind of stock option expense at this point?

SUSAN CARSTENSEN: 2005 does not include any stock option expense and that guidance was pushed out to 2006. And I have not given guidance on 2006 yet.

KAREN HAUS: Do you expect there to be any kind of accelerated vesting of options in 2005 to take advantage of the fact that the deadline for expensing has been pushed out?

SUSAN CARSTENSEN: We looked at it a little bit, but most companies seem like they are accelerating the vesting when they have underwater options. And we don't really have that.

KAREN HAUS: So, we don't expect to see any kind of incremental pop in share count towards the back half of the year, other than just a normal progressive increase?

SUSAN CARSTENSEN: Not at this point.

OPERATOR: (OPERATOR INSTRUCTIONS). Robert Schwartz, Jefferies & Co.

STEVE CANE, ANALYST, JEFFERIES & CO.: Steve Cane again for Robert Schwartz. I guess I'm limited to one. I will ask you about -- in terms of the loading of the quarter, if I did the numbers correctly, it looks like DSOs are down. That, combined with perpetual licenses being down. And many other companies saying they have seen softness, particularly in March. I am wondering if -- did you see any softness in March? Can you comment on kind of how the quarter looked from that perspective?

SUSAN CARSTENSEN: No, we did not see softness particularly in March.

STEVE CANE: Okay. So, it's pretty --

GREG GIANFORTE: If you wanted to characterize the quarter, it was kind of like we got off to slow start, we finished strong in March. But again, that's very high-level color.

OPERATOR: Thomas Ernst, Deutsche Bank.

THOMAS ERNST, ANALYST, DEUTSCHE BANK: A quick question and then I have a follow-up. Did you have, or did Convergent have revenues outside of RightNow before you acquired them?

SUSAN CARSTENSEN: They had some. Recently it's been more directly from us.

GREG GIANFORTE: We are the primary customer.

SUSAN CARSTENSEN: They have been in business a while and they have been doing some work for some other companies, but not as much recently.

THOMAS ERNST: More importantly, you mentioned the push that some customers are giving you the monthly term agreements. Do you feel perhaps there's an opportunity to change your pricing structure, and maybe you are a little bit misaligned in that if you emphasized the price points to monthlies more, that that would help accelerate demand? I know you like the two-year term for the visibility in the deferred revenue, but is there an opportunity to switch to monthly and emphasize it?

SUSAN CARSTENSEN: Then I would have to decrease that cash flow guidance. We are looking at all of it. Because we are a little bit opposite the rest of the industry, it's like is the one -- are three-year terms with one year paid up-front the right mix, or is it monthly and optimize the price points, or the two-year net 30? We're running numbers on all of those.

GREG GIANFORTE: There's the decisions that the customers make based on the proposals you put in front of them, and there's also the way you compensate your sales staff on the various contract types. So, we're looking at all of that.

OPERATOR: John Torrey, Montgomery Inc.

JOHN TORREY, ANALYST, MONTGOMERY INC.: A question on the monthlies again. It looks like -- I don't have all the numbers in front of me -- but it looks like you probably had a slightly higher mix of longer-term monthly contracts this quarter relative to what you have seen before. Any reason for that that you can offer up, and is there any sort of active selling of longer-term monthly agreements among the sales force?

SUSAN CARSTENSEN: This asks a little bit to what Greg just alluded to in terms of sales compensation and such. Because the price points are generally higher for these monthly commitments, and our reps are incented based on the larger deals they sign, they will act toward a long-term monthly deal if the customer is in line with that.

JOHN TORREY: Any notion in terms of the actual revenue that you might be leaving on the table by extending the length of the contracts, though?

SUSAN CARSTENSEN: We have a lot of price discipline in what they charge for those monthlies, so it's actually revenue enhanced.

GREG GIANFORTE: It's done at a premium. If they discount the monthly subscription significantly, they're not going to get paid right away. We have a number of controls in place to get the behavior that we want to have, but again, there's an opportunity to look at all that.

OPERATOR: James Cappello (ph), Kearney (ph) Capital.

JAMES CAPPELLO, ANALYST, KEARNEY (PH) CAPITAL: A question on the competitive landscape with Convergent. Can you tell me if it competes at all with the likes of Nuance or Witness Systems?

GREG GIANFORTE: Good question. We do not compete with Nuance or ScanSoft. They are really providers of speech recognition engines. In fact, the Convergent Voice platform runs on

top of Nuance or ScanSoft. It is more likely -- essentially what we have is a finished voice application which is very different from the other vendors in the marketplace. And you might look at somebody like Two Vox (ph) or BeVocal as another, I have to call it, toolkit provider. If you were an IT organization or a systems integrator, you might go to one of those other vendors and they'd give you a toolbox of things you could voice applications together with. And instead of an erector set, we actually come in with a finished, polished packaged application that would then run on top of Nuance or ScanSoft, if that makes sense. That is the right way to think about that competitive space.

JAMES CAPPELLO: Does it touch anything that Witness does, or Nice or Verant?

GREG GIANFORTE: Not really, no.

OPERATOR: That would conclude today's question-and-answer session. I would like to turn the conference back to our speakers for any additional or closing comments.

GREG GIANFORTE: I would just thank everyone for their attention and we'll look forward to continue working with you. Thank you.

OPERATOR: Thank you for your participation on today's conference call. You may disconnect at this time.

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