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ONYX
SOFTWARE

Dear Shareholders, Customers and Employees:

Onyx Software celebrates 10 years in the CRM business this year. It's been a decade of major swings in the technology market and significant changes in the competitive landscape. Throughout, Onyx has maintained that our ability to deliver success rapidly, cost effectively, and with integrity gives us a sustainable competitive advantage. Demonstrating this ability in an industry where success is often elusive is increasingly a key competitive differentiator for Onyx. As one of the only constants in an ever-changing list of CRM vendors, Onyx has staying power which reflects our dogged determination to deliver value to our customers.

In the midst of the difficult economics of recent years, Onyx successfully accomplished several vital transitions that I believe will keep us ahead of an evolving marketplace:

- Our early vision of the Internet as disruptive technology drove our decision to obsolete a successful client-server product with a complete product re-write. Today, Onyx is successfully deploying customers on what we believe to be the industry's best component web service architecture in CRM, demonstrating a substantial lead over our competitors' promises of similar deliverables.
- Onyx succeeded as a leading software vendor to software companies that are often technology's harshest critics. Technology became our largest customer segment in our early years, and when the tech sector receded we were able to offset the disproportionate impact by developing solid lines of business in financial services, healthcare and government. Today, Onyx enjoys a highly diversified customer base as well as strength in targeted vertical markets.
- Expansion of our market footprint from a nearly exclusive mid-market focus to also include larger enterprises required different selling skills to coordinate sales processes of increased complexity. Most of our sales force today has been recruited with this new sales model in mind.
- Our revised market approach was no longer well served by a boutique and mid-tier partner model, and today we've effectively transitioned to distribution relationships with some of the world's leading IT services organizations.
- Onyx has transitioned from being "the Best Kept Secret" to being acclaimed by customers in independent third-party research. Onyx customers rate themselves highest in CRM maturity associated with such technology-driven factors as integration with legacy systems and broad user adoption.[1]
- Amidst nearly triple-digit revenue growth leading up to 2000, Onyx made an untimely over-commitment to real estate that required a focused effort in recent years to resolve excess facilities. With the final lease termination payment related to the vast majority of these obligations completed in April, the cash-generation capability of our business will no longer be hidden in the shadow of this past decision.

As a result of our customer-focused foresight in earlier times, I believe Onyx is well-positioned today to address an emerging embedded CRM market as well as our traditional market — two large and distinct business opportunities. Onyx's embedded CRM initiative has already successfully partnered with organizations that control significant shares of markets seeking CRM functionality delivered as part of a broader service offering. Onyx's componentized multi-tenant web-service architecture is an incredible strength as we address this embedded CRM market opportunity.

As our traditional CRM market matures, Onyx expects increased demand for industry-specific functionality, as well as software that easily accommodates business process changes. Already in 2004, Onyx has delivered releases providing vertical-specific functionality for the institutional asset management, healthcare management and government segments. Our recent Onyx Enterprise CRM version 5.0 release can help customers solve discrete business problems faster and more effectively than with their previous systems.

Onyx intends to continue to advance the CRM technology and value curve with our recent acquisition of Visuale's Business Process Management (BPM) assets, and plans to deliver the first products utilizing this technology later this year. The fusion of CRM and BPM technology promises to let customers easily modify their end-to-end business processes while minimizing the need for professional services. I believe BPM technology will allow Onyx to further drive down the total cost of CRM ownership while powering even more rapid creation of customized CRM functionality — and the result will be yet another incredible set of strengths for Onyx.

The major evolutions we've successfully completed give us a strong foundation to succeed in two distinct, large and growing market opportunities. The consistent, principled business approach that has made Onyx great remains intact. We continue to attract and retain world-class executives, managers and staff. Onyx products remain reliable, flexible, scalable and cost-effective to deploy and operate. Our technology vision still resonates with customers. Most of all, Onyx continues to deliver what customers need — not merely what they ask for.

We feel that with these major transitions behind us and the incredible set of assets we've developed during those lean years just now ripe for exploitation, the future is bright for Onyx Software.

Sincerely,

Brent Frei
CEO

Sources:

1. SMBs Boost Their CRM Maturity with Software, Wendy Close, Gartner Inc., December 4, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended December 31, 2003

or

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

For the transition period from to

Commission File Number 0-25361

Onyx Software Corporation
(Exact Name of Registrant as Specified in its Charter)

Washington	**91-1629814**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

1100 — 112th Avenue N.E., Suite 100, Bellevue, Washington 98004-4504
(Address of Principal Executive Offices)

(425) 451-8060
(Registrant's Telephone Number, Including Area Code)

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

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, $.01 Par Value Per Share
Preferred Stock Purchase Rights, $.01 Par Value Per Share

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

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

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

The aggregate market value of the voting and nonvoting stock held by nonaffiliates of the registrant at June 30, 2003 was approximately $33,526,862 based upon the closing sale price on the Nasdaq National Market reported for such date.

The number of shares of the registrant's common stock outstanding at February 27, 2004 was 13,988,948.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of shareholders to be held in 2004, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

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ONYX SOFTWARE CORPORATION

FORM 10-K
For the Year Ended December 31, 2003

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PART I

Our disclosure and analysis in this report contain forward-looking statements, which provide our current expectations or forecasts of future events. Forward-looking statements in this report include, without limitation:

- information concerning possible or assumed future results of operations, trends in financial results and business plans, including those relating to earnings growth and revenue growth;
- statements about the level of our costs and operating expenses relative to our revenues, and about the expected composition of our revenues;
- statements about our future capital requirements and the sufficiency of our cash, cash equivalents, investments and available bank borrowings to meet these requirements;
- information about the anticipated release dates of new products;
- other statements about our plans, objectives, expectations and intentions; and
- other statements that are not historical facts.

Words such as "believes," "anticipates" and "intends" may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking. Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including the factors described in the section entitled "Important Factors That May Affect Our Business, Our Results of Operations and Our Stock Price" in this report. Other factors besides those described in this report could also affect actual results. You should carefully consider the factors described in the section entitled "Important Factors That May Affect Our Business, Our Results of Operations and Our Stock Price" in evaluating our forward-looking statements.

You should not unduly rely on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to publicly revise any forward-looking statement to reflect circumstances or events after the date of this report, or to reflect the occurrence of unanticipated events. You should, however, review the factors and risks we describe in the reports we file from time to time with the Securities and Exchange Commission, or SEC.

ITEM 1. BUSINESS

Overview

Onyx Software Corporation is a leading provider of enterprise-wide customer relationship management, or CRM, solutions designed to promote strategic business improvement and revenue growth by enhancing the way businesses market, sell and service their products. We focus on our customers' success as the prime criterion for how we judge our own success. Using the Internet in combination with traditional forms of interaction, including phone, mail, fax and e-mail, our solution helps enterprises to more effectively acquire, manage and maintain customer, partner and other relationships. We market our solution to companies that want to merge new, online business processes with traditional business processes to enhance their customer-facing operations, such as marketing, sales, customer service and technical support. Our solution is Internet-based, which means companies can take advantage of lower costs and faster deployment associated with accessing CRM software with a simple browser. Our solution uses a single data model across all customer interactions, allowing for a single repository for all marketing, sales and service information. It is fully integrated across all customer-facing departments and interaction media. Our solution is designed to be easy to use, widely accessible, rapidly deployable, scalable, flexible, customizable and reliable, which can result in a comparatively low total cost of ownership and rapid return on investment.

Our integrated product family allows enterprises to automate the customer lifecycle across the entire enterprise instead of automating only individual departments. We target mid- to large-sized organizations and divisions of Fortune 1000 companies, marketing and selling our software and services through a direct sales force as well as through value-added resellers, or VARs, and partners who embed components of Onyx functionality in solutions targeted to specific vertical industries, which we refer to as vertical service providers, or VSPs. Our Internet-based solution can be easily implemented and flexibly configured to address an enterprise's specific business needs. We believe our solution provides broad functionality that enables our customers to compete more effectively in today's intensely competitive and dynamic business environment.

Our principal executive offices are located at 1100-112th Avenue N.E., Suite 100, Bellevue, Washington 98004-4504. We were incorporated in Washington in 1994. We make available on our website, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after filing or furnishing the information to the SEC. The Internet address for the information is http://www.onyx.com/investors/sec.asp.

Industry Background

In recent years, an increasing number of enterprises have sought to use technology to improve their interactions with their customers. Many of these enterprises have implemented CRM software systems to automate their customer-facing departments. The market for CRM systems, however, has changed substantially in the last several years. In the early 1990s, software vendors addressed the CRM market by delivering systems designed specifically for individual departments. For example, some vendors delivered systems for customer service or support, some for help desk, some for sales-force automation, and some for marketing intelligence. These systems effectively automated the single department at which they were targeted, but the companies that used them often were left with the difficult task of integrating disparate customer information spread across these separate systems to get a complete view of their relationship with each customer.

When we delivered our first products in 1994, we were one of the few vendors to offer a single system for all customer-facing departments. Since 1995, there has been significant consolidation within the market, with many of the single-department vendors being acquired or acquiring complementary vendors so that, in combination, they could offer a more complete CRM solution. These solutions, however, remain limited in their ability to distribute and share information. Moreover, the significant customization that some of these applications require creates inconsistencies in deployments across the installed base, thereby limiting the ability of third parties to develop integrated technologies for these products. As a result, most of these vendors are still largely single-department software vendors. In addition to consolidation among the CRM vendors, enterprise resource planning, or ERP, vendors have also entered the CRM market with their own technology or by acquiring CRM companies.

We believe that, with the wide proliferation of the Internet over the last several years, an increasing number of customers, partners, distributors and suppliers want to employ Web-enabled solutions in their operations; that is, they want to use the Internet as a means of conducting business. Traditional businesses are responding to this desire by deploying Internet- and e-mail-based interaction systems for their customer-facing departments. To address these new demands, an increasing number of vendors are entering the CRM market with Web-based systems designed to automate Internet- and e-mail-based customer interactions. Like the CRM vendors of the early 1990s, these new vendors typically offer solutions that automate only one department. In addition, these new solutions typically have been designed to handle only Internet- or e-mail-based communication rather than more traditional forms of communication, such as phone, mail, fax or personal interaction. We believe that companies adopting these new applications face a significant integration challenge to get a comprehensive view of their business relationships. They are required to integrate data from multiple departmental applications and to integrate data collected from the Internet or e-mail with separate data collected by phone, mail, fax or in person. The appropriate deployment of CRM technologies to manage multiple revenue streams is also a challenge. Onyx has developed a Web-enabled solution that spans all customer-facing departments.

With this convergence of traditional businesses interacting online and e-businesses interacting by traditional means, we believe there is a strong opportunity for an enterprise-wide CRM solution that automates and integrates Internet, e-mail and traditional interactions across all customer-facing departments.

Our solution is designed for companies that are combining e-business communication with traditional business. We believe that our ability to align and integrate strategy with enabling CRM technologies will provide an enhanced solution for clients looking to acquire a competitive advantage in their marketplace.

Advantages of the Onyx Solution

We believe that organizations will achieve competitive advantage by aligning their brand, strategy, processes and technology to deliver extraordinary customer experiences. The Onyx solution is designed to promote strategic business improvement and revenue growth for our customers by enhancing the way they market, sell and service their products, both directly and through partners. The Onyx solution combines sales strategy with strong business processes and leading-edge technology to deliver a comprehensive CRM operating environment tailored to the specific business needs of each customer.

We believe our solution enables our customers to compete more effectively in today's intensely competitive and dynamic business environment, which may result in increased revenue, greater efficiencies, higher customer loyalty, stronger partnerships and superior financial performance for our customers.

Our solution provides the following key advantages:

Strategic Business Improvement — Our solution is designed to increase both the effectiveness and the efficiency of how our customers market and sell their products and service their customers and partners. Each of our customers has specific business objectives for its CRM operating environment, such as increased revenues, increased customer satisfaction and loyalty or increased margins. We tailor our implementations and create appropriate operating metrics to help our customers achieve their goals and deliver extraordinary customer experiences.

Business Alignment — Our solution aligns all customer-facing departments around a common sales and marketing strategy and around holistic customer relationships. Onyx's integrated solution gives organizations the ability to manage the entire customer lifecycle from end to end, rather than simply automating departmental functions. We use integrated workflow and an integrated data model that, unlike traditional customer interaction software, such as sales-force automation software or other point solutions, provide a single repository of marketing, service and sales information throughout the organization.

Business Integration — Our solution enables companies to integrate their Internet-based initiatives with traditional forms of relationship management so they can utilize the Internet in the way that they believe is most effective for their business. This flexibility makes our solution attractive to customers that vary widely in their approach to combining traditional and electronic interactions with their customers and partners.

Rapid Deployment — From strategy development to technology implementation, our solution is designed to be rapidly deployable throughout the enterprise so companies can quickly adapt to rapid changes in the business environment.

Ease of Use

Our solution facilitates consistent communication and collaboration across the organization through clearly defined and customized operating procedures and a suite of easy-to-use interfaces. Interfaces and processes can be tailored by audience, device and skill level. We have won users' choice awards for leading ease of use.

Return on Investment

The total cost of deploying a CRM solution includes more than the cost of the software. Our solution is designed to provide rapid and significant results at a reasonable total expense. As a result, we believe our solution offers higher overall return on investment and faster payback than other CRM solutions. Our design philosophy takes the entire cost of ownership into account, including training, integration with other systems, upgrades and maintenance, hardware and other necessary support.

Scalability and Flexibility

We designed our software so that it can scale up and down to serve the needs of large and small businesses. Studies sponsored by us and run in scalability labs showed our solution's ability to scale to 57,000 simultaneous users in a real-world testing environment. A CRM solution needs to be able to scale down as well so that it can handle the needs of smaller divisions or other smaller groups within a large enterprise. Our software is flexible, scalable and widely deployable across a wide spectrum of business sizes. We currently have solutions deployed that range from 25 seats to 5,000 seats.

Internet Architecture

We have developed our software using an Internet architecture that provides users with a comprehensive Internet interface for managing customer and partner relationships. The Internet interface gives our customers and partners more flexibility for integrating additional applications and for deploying the system across a larger and more distributed workforce than would be possible with traditional client-server architectures.

Web Services Components

We have taken advantage of our Internet architecture and its Web services components to expose data and processes from within our application to make it easier for other software applications to access them, even if they are written in a different programming language. We believe this technology approach, which we call Embedded CRM, allows us to address a broader array of industry-specific and user-specific needs by diversifying the form our software can take. Our software utilizes extensible markup language, or XML, making it easy to integrate with other systems.

Strategy

Our objective is to be the leading provider of enterprise-wide CRM solutions for mid- and large-sized organizations. Our strategy to achieve this goal includes the following key elements:

Exploit Demand for Integrated CRM Applications

We offer companies a single platform for automating both Internet-based and traditional types of customer interactions. It becomes more important to integrate these two channels of interaction as traditional businesses go online and e-businesses add traditional infrastructure to support growing customer bases.

Provide Rapidly Deployable Solutions

We designed our solution to be quickly and efficiently adopted, installed and deployed in mid- to large-sized organizations. We believe the length of time it takes to deploy traditional CRM solutions and the high cost of deployment are unacceptable to growing numbers of organizations. Competitive pressures encourage organizations of all sizes to adopt information technology solutions that are quickly deployed, meet business-critical needs and provide interfaces that minimize user training and facilitate incremental upgrades, extensions and scalability. We plan to continue to design our products to maintain low total cost of ownership.

Pursue VSP Delivery Model

We have a strong presence in the emerging VSP market. VSPs will typically use components of our software embedded within their existing vertical solutions or configure specialized versions of our products to serve potential customers in specific market segments and in many cases, host the solution for customers over the Internet with guaranteed service-level agreements. This model is well suited for companies with limited information technology or capital resources, as well as for those companies who need only a subset of our technology.

Leverage Embedded CRM Capabilities

Our Embedded CRM capabilities allow us to offer subsets of CRM functionality, as well as the full suite, and to provide more cost-effective, industry-specific delivery options. We offer three models to partners: *Onyx Embedded CRM as CRM components,* where we offer our CRM suite as autonomous functional components; *Onyx Embedded CRM as an application framework,* where the full Onyx CRM suite and technology platform enable the integration of one or more applications to create a new application; and *Onyx Embedded CRM in an application stack,* where the full Onyx CRM suite is offered as one of a number of hosted offerings.

Maintain Industry-Leading Customer Satisfaction

We plan to maintain industry-leading customer satisfaction through high-quality products, superior implementation and responsive customer service and support. Our position as a leader in customer satisfaction continues to be highlighted by third parties such as Gartner Inc. In 2003, Gartner research showed Onyx ranked second out of 12 mid-market focused CRM vendors in overall user satisfaction. In related Gartner research, Onyx users rated themselves more mature in CRM than those using other CRM solutions. Gartner believes CRM user maturity is significant because previous Gartner research suggests a strong correlation between CRM maturity and profitability.

Expand Strategic Partnerships

We are actively adding key distribution, integration and technology partners on a worldwide basis. We believe that expanding the quality of our partnerships will provide us with increased access to various geographic and vertical markets and potential customers. We are targeting companies which have established customer bases and proven expertise in their respective markets. Key to our partnering strategy is our Embedded CRM technology, which allows partners to embed components of our CRM solution as Web services within their own offerings. In addition to traditional VARs, which might tailor a standard version of the Onyx solution for a specific market, Embedded CRM partners select specific functional components of our solution and embed them into the workflow of their own non-CRM applications. We have entered into several Embedded CRM partnerships and have a team dedicated to developing and supporting more such partnerships in 2004.

Expand Internationally Our products are localized in 11 languages and we are compliant with Unicode, an industry-wide standard that enables companies to use multi-lingual text in a single data base, at all three levels of our architecture. Our products are currently installed and operational in more than 28 countries. We plan to expand our global operations by investing in our sales channels in major international markets.

Increase Vertical Market Penetration We plan to design and deliver additional industry-specific functionality as part of our software to better meet the requirements of specific vertical markets. We believe industry-specific capabilities can give us an advantage over competitors. We are initially focusing on the financial services, healthcare and high-technology industries, as well as selected geographies in what we perceive to be the growing government market.

Offer Go-to-Market Strategy Consulting We believe our customers must clearly understand their CRM strategies to effectively implement a CRM solution. We provide sales and marketing strategy consulting to complement our solution.

Products and Services

Our CRM solution enables companies to manage their customer relationships through one integrated, enterprise-wide technology platform. Users of our solution, including employees in sales, marketing, service and support, as well as customers and partners, can access the system through a variety of software interfaces and hardware devices.

Products

We offer a comprehensive CRM solution consisting of a core e-Business Engine and three audience-specific portals: the Onyx Employee Portal, the Onyx Partner Portal and the Onyx Customer Portal. We also offer a number of complementary products that work in combination with the portals. This Internet technology platform enables our customers to combine CRM capabilities, content from other enterprise systems and the Internet to manage all aspects of their customer relationships through our products' core capabilities, as well as through links to peripheral enterprise-based and Internet-based applications. The platform also enables a high degree of flexibility in tailoring our product to meet an individual customer's specific business needs.

The Onyx e-Business Engine is the backbone of our solution, and enables companies to manage customer relationships across departments. Our e-Business Engine can be divided into four key elements: the Universal Interface Framework, the e-Business Process Technology, the e-Business Data Center and the e-Business Integration Framework. These four elements in combination enable customers to deploy enterprise-class CRM systems in a scalable and extensible fashion:

- *The Universal Interface Framework* enables enterprises to deliver customer data to multiple user communities through a variety of offline and online interfaces, including Windows-based clients, Internet-based clients, Outlook-based clients and handheld devices.
- *The e-Business Process Technology* manages the flow of information and process through all customer-facing departments, including marketing, sales and service organizations. The e-Business Process

Technology is responsible for CRM activity, including list management, marketing campaign execution, e-mail marketing, marketing collateral distribution, lead management, sales process management, forecasting, quote generation, reporting, service automation, knowledge management, incident escalation and routing, workflow management, Internet-based qualification, e-mail support, Internet-based lead capture, Internet-based support, partner management and other Internet-based and non-Internet-based customer management processes.

- *The e-Business Data Center* is an enterprise-wide, customer-centric solution for managing all customer-related information. The e-Business Data Center consists of multiple data storage structures, including a transactional data structure, a reporting/analytics data structure and a content distribution data structure.
- *The e-Business Integration Framework* consists of multiple integration technologies that are designed to enable customers to link our e-Business Engine with other systems, including Internet-based content, Internet-based applications, legacy ERP and accounting applications, computer telephony solutions, reporting applications, commerce solutions and desktop productivity applications.

Onyx Employee Portal is a personalizable Internet-based interface designed for use by our customers' employees. The Onyx Employee Portal can be configured for multiple internal teams, such as marketing, sales, service and management, and is designed to provide the applications and content they require. In addition to providing access to the Onyx solution, end users can access third-party content and applications from within the Onyx Employee Portal.

Onyx Partner Portal is a personalizable Internet-based interface designed for use by partners of our customers. The Onyx Partner Portal includes a broad set of capabilities that are designed to enable companies and their partners to share information regarding prospects, customers, marketing, sales and service to better serve customers. This product also provides a strong security model for controlling partner access to customer information.

Onyx Customer Portal is a personalizable Internet-based interface designed for use by customers of our customers. The Onyx Customer Portal includes a broad set of capabilities that enable companies to interact with their customers online, including areas such as literature fulfillment, on-line profiling, lead capture, customer self help, incident management and profile management. The Onyx Customer Portal can be integrated with commerce platforms, such as IBM Websphere and Microsoft Commerce Server.

We typically price our core applications on a per-user basis with varying price points, depending on the amount of functionality being purchased. There is also a platform fee that varies depending on the number of users licensed to use the platform database server. In addition, we offer several products that complement our core offerings. The pricing structures for these complementary products vary from flat fees to server-based pricing to per-user fees, or some combination of such fees.

Professional Services

In addition to the products described above, we also provide consulting, customer support and training services as follows:

Consulting	We offer our customers high-quality consulting services, including business process reengineering, change management, product installation and configuration, product migration, systems integration, data conversion, custom development, and project management. Independently, or in conjunction with certified partners, we work closely with our customers to identify their business needs and tailor the solution to these needs in an efficient, cost-effective manner.
Customer Support	We have implemented a comprehensive customer support program to assist customers who use, configure, and build upon our

products. The support program includes e-mail support, on-line support via the Internet and telephone support from our four worldwide support centers. In addition, we offer a premium support program that allows our customers to contact our support centers around the world seven days a week, 24 hours a day.

Training We offer a broad range of classroom and on-premise education courses. Classroom-based educational courses cover the implementation and administration of our products. On-premise education includes client-specific end-user training and technical training.

Go-to-Market Strategy Consulting Through our strategic services team, we provide sales and marketing strategy services in advance of implementing our software. We can also provide go-to-market and strategic account management training, coaching and skills assessment services. Much of this training is supported by tools in our software solutions.

We price our consulting services based on the time spent and resources used or fix the price for discrete portions of an engagement. We price our support programs as a percentage of the software license fee plus additional amounts for premium support services. We price training services on a per-class or fixed-project basis. We price strategic services either on a fixed-project basis or on a time-spent-and-resources-used basis, depending on the type of engagement.

We have established a number of relationships with systems integrators for implementing our software. We have conducted joint implementation projects with Accenture, Avanade (an Accenture/Microsoft partnership), Crowe-Chizek, Deloitte & Touche, DMR Consulting, Fujitsu, IBM Global Services, Metavante, TietoEnator, and Unisys. We frequently participate in joint sales and marketing efforts with our systems integrators.

Onyx Technology

Internet-Based Architecture

The Onyx Internet Architecture is built with Internet technologies designed to deliver the superior accessibility and manageability required for large-scale CRM deployments. This multi-tier architectural approach has enabled us to deliver thin-client, portal-based offerings that target internal front-office employees (Onyx Employee Portal), as well as external customers and partners (Onyx Customer Portal and Onyx Partner Portal). With the Onyx Employee Portal, front-office employees can access customer information anytime and anywhere they have a secure Internet connection via their Web browser. Relevant functionality and information is consolidated in a single interface for sales, marketing, service and support users.

XML Integration Framework

The Onyx e-Business Engine delivers enterprise-class integration through a data-driven, component-based architecture that manages data natively as XML and leverages XML for customization and integration. This XML integration approach allows our software to integrate directly with other enterprise-class systems and leading middleware products through COM, CORBA or Web Services. Such flexibility enables the Onyx portal suite to act as the foundation and single interface for managing mission-critical customer and partner relationships. Simultaneously, this approach reduces the complexity and cost of integration processes associated with non-XML-based, proprietary architectures.

Enterprise Class Platform

We believe that our CRM platform provides the extensibility, scalability and flexibility required by large, enterprise-class organizations and high-end systems integrators seeking to create value-added, vertically focused solutions for their customers. The Onyx platform is an interface-independent platform that provides enterprise-wide front-office capabilities to the Onyx portal suite and to audience-specific and industry-specific interfaces. Through highly extensible, data-driven business services, the Onyx platform lets customers and partners align and adapt their CRM solution to meet their unique business objectives. Partners and customers can adapt existing functionality and create new functionality by leveraging the object-level infrastructure delivered within the platform. Through platform optimization, stateless operation, and caching services, the Onyx e-Business Engine is also designed to scale up to meet the needs of even the largest and most demanding organizations. Onyx has benchmarked its application suite at up to 57,000 concurrent users simulating real-world operating environments. Finally, the customization and integration framework in the Onyx e-Business Engine provides flexibility for building business rules, workflow and integration components, which gives organizations the ability to customize our products to meet complex business requirements.

Our products are based on standard Internet technologies and the emerging .NET architectures and use industry-standard, low-cost modular components. We believe this combination of technology and flexible design enables us to offer an attractive combination of reliability, performance, scalability, integration and low total cost of ownership. Key aspects of our technology that enable us to provide a robust CRM solution are as follows:

Support for Multiple Platforms. The Onyx portal applications and application server are currently optimized for the Microsoft Windows Server platform. The Onyx Enterprise Database can be deployed on the SQL Server or Oracle database running on Sun Solaris or IBM AIX. Onyx introduced support for the Oracle database in June 2002 and offers continued support for both the SQL server and the Oracle database with the most recent release of the product line in January 2003. With regard to multi-platform development, we do not code to the lowest common denominator in support of multiple platforms; rather, we maximize code reuse while leveraging vendor-specific language extensions to optimize for operating systems and relational database engines.

n-tiered Architecture. Our software consists of a relationship-centric, integrated data model surrounded by a set of configurable business logic and presentation objects. This architecture uses multiple tiers to deliver a balance between configurability, performance and administration. The logical tiers are presentation services, or user interfaces, business logic services, or business rules, and data services, or data storage and retrieval. All application tiers can be deployed on a single server or separated among different machines, which allows customers to deploy a physical server topology that aligns with their needs. All tiers can be customized, and customizations other than changes to the out-of-the-box open source user interface components can be preserved during system upgrades.

Configuration. To adapt to rapidly changing business needs, our software solution architecture offers broad customization at all tiers:

- *Presentation Services Tier.* Our Internet-based portal interface can be customized by leveraging our graphical administration tools and the inherent openness, extensibility and customizability of Internet forms architecture.

- *Business Logic Services Tier.* Our application's business logic can be customized via a suite of graphical administration tools coupled with an open programmatic customization framework. The graphical administration tools allow customers to easily model business terminology, processes, workflow and security. For more complex customizations, customers are not limited to graphical user interface administration tools; they can also use market-available development tools to extend the application. Our customization framework provides an industry-standard development environment in which complex processes and rules can be modeled. Business terminology, rules, workflows and security models are inherited by alternative client interfaces.

- *Data Services Tier.* Our software application includes a generic data access integration framework that can be used to manage data residing inside or outside the standard Onyx e-Business Data Center. By using this service and the forms customization framework, the Onyx e-Business Engine can manage information that extends beyond core CRM.

Integration With Other Enterprise Applications. Through our e-Business Integration Framework, Onyx supports integration at all tiers of the n-tier architecture: presentation services, business logic services and data services. This enables our software and other third-party applications to integrate at the optimal interface point, which provides a high degree of flexibility. The Onyx e-Business Integration Framework enables integration with third-party or legacy systems via batch, real-time, peer-to-peer or enterprise application integration and/or web services. Data from third-party or legacy systems can be managed through the Onyx e-Business Engine, which offers employees a real-time view of enterprise information without requiring redundant storage of information in multiple databases. These interfaces are object-based and allow bi-directional integration between our products and other business applications.

Store and Forward Synchronization Architecture. Store and forward synchronization architecture creates a mobile user's data snapshot as a replica of the enterprise database upon completion of synchronization between the mobile client and the enterprise database. In addition, our architecture provides error detection and recovery by automatically restarting the data synchronization process at the point of failure should a connectivity link fail. Our synchronization system also provides configurable data conflict resolution algorithms and enables synchronization to be performed without user intervention or attention.

Integrated Data Model. Our solution includes a customer-centric, integrated data model. Our customer-centric design coordinates all data, processes and interactions around the people and company records that form its center. All transactions, sales opportunities, service and support incidents are attributes of the customer. This fundamental part of the architecture allows any relationship information to be shared with any other part of the organization and ensures that every user within an organization can have access to the same data. This data model also provides flexibility to add to or modify the application as the needs of the enterprise change over time.

Multiple Interface Support. The Onyx Universal Interface Framework exposes the full breadth of business objects via either a COM+or SOAP interface, thus enabling multiple interfaces, including Windows desktop applications, Web applications and personal digital assistants to access the Onyx e-Business Engine.

Standards-Based Tools and Components. Our application's integration interfaces and administration tools are built on open, published, industry-standard tools and technologies.

Cross-Platform Interoperability. Although the Onyx e-Business Engine is built on Microsoft standard technologies, it can integrate with applications running on disparate platforms, such as a J2EE-based application server.

Customers and Markets

We target mid- to large-sized businesses and divisions of Fortune 500 companies in a wide variety of industries. We believe that these enterprises have a strong need to move quickly and deliver increasing levels of customer service through both e-business and traditional channels, and that they are deploying new technologies as a competitive advantage. We have licensed our products to 991 customers through December 31, 2003. The following is a representative list of our current customers who purchased more than $150,000 in software licenses from January 1, 2002 to December 31, 2003.

Financial Services

American Express Third Party Distribution
Australian Central Credit Union
Boston Private Bank & Trust
Fisher Investments
Glenmede Trust
Mellon Bank
Nuveen Investments
Pacific Investment Management Company
Reuters
Riggs Bank
Saxon Mortgage
State Street Global Advisors
Strong Financial Corporation
SunAmerica
Suncorp Metway

Technology

Clearswift
Daiwabo Information Systems
Konica Minolta Business Technologies
Legato
Suricata

Health Care & Insurance

Gentiva Health Services
Haemonetics
HealthNow, NY
Kyorin Pharmaceutical Co.
Nihon Iyakuhin Kougyou
Regence Group
UPMC Health Plan
VHA

Government

Cambridgeshire County Council
Camelot PLC
Highland Council
Knowsley Metropolitan Borough Council
London Borough of Ealing
London Borough of Hillingdon
London Borough of Islington
London Borough of Lambeth
Ontario Lottery and Gaming
Redcar & Cleveland Council
Worcestershire County Council
Workcover Corporation

Telecommunications & Media

NTL Group
ONE
Reed Business Information
Reed ConstructionData
Singapore Cable Vision

Other

Amway Korea
Calor Gas
CCH Australia
Clean Harbors Environmental Services
Europ Assistance
Greene King BBW
Hafslund ASA
Medical Staffing Network
The Andersons
Turner Sports

Sales and Marketing

We market and sell our software and services through a direct sales force, as well as through our VARs. We have direct sales offices in the United States, Australia, Germany, Hong Kong, Japan, Malaysia, Singapore and the United Kingdom, and VARs in North America, Asia, Australia, Europe and Latin America. As of December 31, 2003, we employed 95 people in sales and marketing. We support our field sales force with market development representatives and sales engineers.

VARs complement our direct sales effort in many of our markets. Our VARs typically sell our software in conjunction with their implementation services. Some also provide the first line of technical support for the customer.

We also distribute software through a network of VSPs, which host our software to customers within a specific vertical industry over the Internet, typically on a subscription basis. This model is well suited for companies with limited information technology resources, capital resources or time necessary for implementing our system internally. VSPs offer varying levels of managed services from simple system administration operations to complete business consulting services.

Our marketing programs are focused on lead generation and brand awareness. Direct marketing programs are targeted at key executives such as chief executive officers and chief information officers, as well as vice presidents of sales, service and marketing.

To support our direct and indirect sales channels, we have sponsored a series of joint seminars, including Internet-based seminars, with key customers and partners, such as Microsoft, and premier systems integration partners, such as IBM Global Services. Our marketing personnel engage in a variety of marketing activities, including managing and maintaining the Onyx Web site, conducting targeted direct-mail campaigns, placing advertisements, presenting at industry conferences and trade shows, conducting public relations programs and establishing and maintaining relationships with recognized industry analysts.

Our sales process consists of several phases: lead generation, initial contact, lead qualification, needs assessment, enterprise overview, product demonstration, proposal generation and contract negotiation. Our sales cycle is lengthy and variable, typically ranging between six and eighteen months, although it varies substantially from customer to customer, and occasionally sales require substantially more time.

We have a network of VARs which market, sell and install our systems in their respective markets. We collaborate with our VARs in a variety of areas, including seminars, trade shows and conferences. In some markets, our VARs also create market-specific collateral and product demonstrations and assist in localizing our products and related documentation.

We typically enter into buy-sell contracts with VARs pursuant to which they purchase our products with a right to resell the products to end users, subject to Onyx's standard licensing terms. The VARs do not have a right to return the product, regardless of their ability to resell the product to an end user. In addition, our revenues from the sale of our products to VARs are independent of the VARs' ability to collect payment from an end user. We typically do not grant exclusive sales territories to our VARs, but may do so if a proposed distribution transaction merits such an arrangement.

We typically license our products to VSPs pursuant to contracts under which they may include our products as part of their subscription-based services offered over the Internet.

Research and Development

As of December 31, 2003, we employed 77 people in research and development. Our research and development expenses for 2003 were $11.8 million, as compared to $14.7 million in 2002 and $22.0 million in 2001. Our research and development team is responsible for designing, developing and releasing our products. The group is organized into four disciplines: development, quality assurance, documentation and program management. Members from each of these disciplines, along with a product manager from our marketing department, form separate product teams that work closely with sales, marketing and professional services members, and with customers and prospective customers to better understand market needs and requirements. We also use third-party development firms to expand the capacity and technical expertise of our internal research and development team. Additionally, we sometimes license third-party technology that is incorporated into our products. We believe this approach significantly shortens our time to market without compromising our competitive position or product quality. Therefore, we expect to continue to draw on third-party resources in the foreseeable future.

We have a well-defined software development methodology that we believe allows us to deliver products that satisfy real business needs and meet commercial quality expectations. This methodology is based on the following key components:

- specification and review of business requirements, functional requirements, prototypes, technical designs, test plans and documentation plans;
- iterative, scheduled quality assurance of code and documentation;
- frequent stabilization of product;
- test automation definition, instrumentation and execution;
- test of functions, components, systems, integration, performance, stress and internationalization;
- full product regression testing before beta or general availability releases;

- trial deployments in an internal production environment prior to release;
- external beta releases; and
- general availability release of English and localized products.

We emphasize quality assurance throughout the software development life cycle. We believe that strong emphasis placed on analysis and design early in the project life cycle reduces the number and costs of defects that may be found in later stages. Our development methodology focuses on delivery of product to a global market, which enables localization into multiple languages from a single code base.

Intellectual Property and Other Proprietary Rights

To protect our proprietary rights, we rely primarily on a combination of copyright, trade secret and trademark laws, confidentiality agreements with employees and third parties, and protective contractual provisions such as those contained in license agreements with consultants, vendors and customers, although we have not signed these agreements in every case. Despite our efforts to protect our proprietary rights, unauthorized parties may copy aspects of our products and obtain and use information that we regard as proprietary. Other parties may breach confidentiality agreements and other protective contracts we have entered into, and we may not become aware of, or have adequate remedies in the event of, any breach.

"Onyx" is a registered trademark in the United States and in a number of international jurisdictions. All other trademarks or service marks appearing in this report are trademarks or service marks of the respective companies that use them. We have registered copyrights in the United States for "Onyx Enterprise Portal" and "Onyx Customer Center."

We pursue the registration of some trademarks and service marks in the United States and in other countries, but we have not secured registration of all our marks. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States, and effective copyright, trademark and trade secret protection may not be available in other jurisdictions. A significant portion of our marks include the word "Onyx." Other companies use "Onyx" in their marks alone or in combination with other words, and we cannot prevent all third-party uses of the word "Onyx." We license trademark rights to third parties. The licensees may not abide by compliance and quality control guidelines with respect to the licensed trademark rights and may take actions that fail to adequately protect these marks, which would have a negative impact on the value of these rights and our use of them in our business.

Competition

Our solution targets the CRM systems market. This market is intensely competitive, fragmented, rapidly changing and significantly affected by new product introductions. We believe that we compete effectively as a result of our integrated, relationship-centric, rapidly deployable, Internet-enabled systems and our commitment to providing high-quality solutions that yield a rapid return on investment and a low total cost of ownership.

The dominant competitor in our industry is Siebel Systems, Inc., which holds a significantly greater percentage of the CRM market than we do. We face competition in the CRM systems market primarily from

- front-office software application vendors, such as Pivotal Corporation (recently acquired by CDC Software) and Siebel Systems, Inc.,
- providers of hosted CRM solutions, such as Salesforce.com and RightNow Technologies,
- large enterprise software vendors, such as Amdocs Limited, Oracle Corporation, SAP AG and PeopleSoft, Inc., and
- our potential customers' information technology departments, which may seek to develop proprietary systems.

In addition, because we offer extensive e-business capabilities, we also face competition from other software application vendors such as Kana Communications, Inc. and E.piphany. Microsoft released its first version of a CRM product targeting small to medium businesses in 2003. As a result, we have begun to compete with Microsoft in certain CRM opportunities. Further, as we develop new products, including new product versions, we may begin competing with companies with whom we have not previously competed.

Employees

As of December 31, 2003, we had 330 employees, including 77 people in research and development, 95 people in sales and marketing, 112 people in consulting, customer support and training and 46 people in general and administrative services. These numbers exclude independent contractors and other temporary employees.

Important Factors That May Affect Our Business, Our Results of Operations and Our Stock Price

Our operating results fluctuate and could fall below expectations of investors, resulting in a decrease in our stock price.

Our operating results have varied widely in the past, and we expect that they will continue to fluctuate in the future. If our operating results fall below the expectations of investors, it could result in a decrease in our stock price. Some of the factors that could affect the amount and timing of our revenue and related expenses and cause our operating results to fluctuate include:

- general economic conditions, which may affect our customers' capital investment levels in management information systems and the timing of their purchases;
- rate of market acceptance of our CRM solution;
- budget and spending decisions by our prospective and existing customers;
- customers' and prospects' decisions to defer orders or implementations, particularly large orders or implementations, from one quarter to the next, or to proceed with smaller-than-forecasted orders or implementations;
- level of purchases by our existing customers, including additional license and maintenance revenues;
- our ability to enable our products to operate on multiple platforms;
- our ability to compete in the highly competitive CRM market;
- the loss of any key technical, sales, customer support or management personnel and the timing of any new hires;
- our ability to develop, introduce and market new products and product versions on a timely basis;
- variability in the mix of our license versus service revenue, the mix of our direct versus indirect license revenue and the mix of services that we perform versus those performed by third-party service providers;
- our ability to successfully expand our operations, and the amount and timing of expenditures related to this expansion; and
- the cost and financial accounting effects of any acquisitions of companies or complementary technologies that we may complete.

As a result of all of these factors, we cannot predict our revenue with any significant degree of certainty, and future product revenue may differ from historical patterns. It is particularly difficult to predict the timing or amount of our license revenue because:

- our sales cycles are lengthy and variable, typically ranging between six and eighteen months from our initial contact with a potential customer to the signing of a license agreement, although the sales cycle varies substantially from customer to customer, and occasionally sales require substantially more time;
- a substantial portion of our sales are completed at the end of the quarter and, as a result, a substantial portion of our license revenue is recognized in the last month of a quarter, and often in the last weeks or days of a quarter;
- in recent quarters, the contracting process of our sales cycle has taken more time than we have historically experienced;
- the amount of unfulfilled orders for our products at the beginning of a quarter is small because our products are typically shipped shortly after orders are received; and
- delay of new product releases can result in a customer's decision to delay execution of a contract or, for contracts that include the new release as an element of the contract, will result in deferral of revenue recognition until such release.

Even though our revenue is difficult to predict, we base our decisions regarding our operating expenses on anticipated revenue trends. Many of our expenses are relatively fixed, and we cannot quickly reduce spending if our revenue is lower than expected. As a result, revenue shortfalls could result in significantly lower income or greater loss than anticipated for any given period, which could result in a decrease in our stock price.

We may be unable to obtain the funding necessary to support the expansion of our business, and any funding we do obtain could dilute our shareholders' ownership interest in Onyx.

Our future revenue may be insufficient to support the expenses of our operations, capital needs of Onyx Software Co., Ltd., or Onyx Japan, and the expansion of our business. We may therefore need additional equity or debt capital to finance our operations. If we are unable to generate sufficient cash flow from operations or to obtain funds through additional financing, we may have to reduce our development and sales and marketing efforts and limit the expansion of our business.

We currently have loan and security agreements with SVB that allow us to borrow up to the lesser (a) 70% of eligible domestic and individually approved foreign accounts receivable and (b) $13.0 million under a domestic line, plus up to the lesser of (a) 75% of eligible foreign accounts receivable and (b) $2.0 million under a line guaranteed by Exim Bank. At the time of this filing, however, no additional amounts are available under the lines of credit based on the level of our borrowing base and our outstanding letters of credit. We were in compliance with the financial covenants of these facilities as of December 31, 2003, based on an amendment to the loan agreement on January 12, 2004, which was retroactively effective as of December 31, 2003. Absent the amendment, we would have been out of compliance with the loan agreement as of December 31, 2003. If we are unable to maintain compliance with our covenants in the future or if SVB decides to restrict our cash deposits, our liquidity would be further limited and our business, financial condition and operating results could be materially harmed.

We previously announced that we had restructured our lease for our principal business offices to reduce our excess facilities obligations. The termination of these excess facilities commitments is contingent upon the following conditions, among others, being met as of April 30, 2004: (a) we are current in our payments under the lease and (b) we have not filed a bankruptcy or other liquidation petition, or otherwise attempted to reject or contest the lease. If we are not in compliance with any of these conditions as of April 30, 2004, our original lease will not terminate and we will be required to continue making payments on the excess facilities subject to the original lease. If this were to take place, our business, financial condition and operating results would be materially adversely affected.

We believe our future revenue performance will be comparable to the most recent quarterly periods reported and that our existing cash and cash equivalents will be sufficient to meet our capital requirements for at least the next 12 months. Accordingly, we believe that we have sufficient resources to continue as a going concern through at least December 31, 2004. Should our revenue results for subsequent quarters fall below the results we achieved in the fourth quarter of 2003, we would likely take action to restructure our operations to preserve our cash. Such actions would primarily consist of reductions in headcount. Due to the fact that lower cash balances could negatively impact our sales efforts, we may seek additional funds in the future through public or private equity financing or from other sources to fund our operations and pursue our growth strategy. We may experience difficulty in obtaining funding on favorable terms, if at all. Any financing we might obtain may contain covenants that restrict our freedom to operate our business or may require us to issue securities that have rights, preferences or privileges senior to our common stock and may dilute current shareholders' ownership interest in Onyx.

We have incurred losses in recent periods, and may not again achieve profitability, which could cause a decrease in our stock price.

If we do not return to profitability in future quarters, our stock price could decrease. We incurred net losses in each quarter from Onyx's inception through the third quarter of 1994, from the first quarter of 1997 through the second quarter of 1999, and from the first quarter of 2000 through the fourth quarter of 2003. As of December 31, 2003, we had an accumulated deficit of $128.2 million. Our accumulated deficit and financial condition have caused some of our potential customers to question our viability, which we believe has in turn hampered our ability to sell some of our products.

In the near-term, we believe our costs and operating expenses, excluding restructuring-related charges, may decrease in certain areas as we continue to maintain strict cost controls. We expect our costs and operating expenses in the near-term to be at a level that is in line with our expected revenue. We may not be able to increase our revenue sufficiently to keep pace with any growth in expenditures, if at all, and, as a result, may be unable to achieve or maintain profitability in the future.

Although profitable in the third and fourth quarters of 2003, Onyx Japan incurred substantial losses in previous periods. The minority shareholders' capital account balance as of December 31, 2003 was $119,000. Additional Onyx Japan losses above approximately $283,000 in the aggregate will be absorbed 100% by Onyx, as compared to 58% in prior periods, which could impact our ability to achieve profitability in future periods.

Economic conditions could adversely affect our revenue growth and ability to forecast revenue.

Our revenue growth and potential for profitability depend on the overall demand for CRM software and services. Because our sales are primarily to corporate customers, we are also impacted by general economic and business conditions. A softening of demand for computer software caused by the weakened economy, both domestic and international, has affected our sales and may continue to result in decreased revenue and growth rates. When economic conditions weaken, sales cycles for software products tend to lengthen, and, as a result, we experienced longer sales cycle in 2001, 2002 and 2003. We expect to continue to experience longer sales cycles than usual in the foreseeable future. As a result of the economic downturn, we have also experienced and may continue to experience difficulties in collecting outstanding receivables from our customers.

Our management team uses our software to identify, track and forecast future revenue, backlog and trends in our business. Our sales force monitors the status of all proposals, such as the date when they estimate that a transaction will close and the potential dollar amount of such sale. We aggregate these estimates regularly in order to generate a sales pipeline and then evaluate the pipeline at various times to look for trends in our business. While this pipeline analysis provides us with visibility about our potential customers and the associated revenue for budgeting and planning purposes, these pipeline estimates may not consistently correlate to revenue in a particular quarter or over a longer period of time. The slowdown in the domestic and international economies, as well as the effects of terrorist activity and actual and threatened armed conflict, may continue to cause customer purchasing decisions to be delayed, reduced in amount or cancelled, which could reduce the rate of conversion of the pipeline into contracts during a particular period of time. In particular, as a result of the economic slowdown, we believe that a number of our potential customers may delay or cancel their purchase of our software, consulting services or customer support services or may elect to develop their own CRM solution or solutions. A variation in the pipeline or in the conversion of the pipeline into contracts could adversely affect our business and operating results. In addition, because a substantial portion of our sales are completed at the end of the quarter, and often in the last weeks or days of a quarter, we may be unable to adjust our cost structure in response to a variation in the conversion of the pipeline into contracts in a timely manner, which could adversely affect our business and operating results. We have also recently experienced a trend of smaller initial orders by new purchasers of our software. Some customers are reluctant to make large purchases before they have had the opportunity to observe how our software performs in their organization, and have opted instead to make their planned purchase in stages. Additional purchases, if any, may follow only if the software performs as expected. We believe that this trend is a symptom of poor economic conditions, lack of successful deployments by competitors and increasing averseness to risk among our customers and potential customers. To the extent that this trend continues, it will adversely affect our revenues.

Fluctuations in support and service revenue could decrease our total revenue or decrease our gross margins, which could cause a decrease in our stock price.

During 2001, 2002, 2003, our support and service revenue represented a higher percentage of our total revenue than in past periods, which negatively impacted our gross margins. To the extent that this trend continues, our gross margins will continue to suffer. Due largely to the decrease in license revenue in 2001, 2002 and 2003, support and service revenue represented 62% of our total revenue in 2001, 67% of our total revenue in 2002 and 79% of our total revenue in 2003. We anticipate that support and service revenue will continue to represent a significant percentage of total revenue. Because support and service revenue has lower gross margins than license revenue, a continued increase in the percentage of total revenue represented by support and service revenue or a further decrease in license revenue, as we experienced in 2001, 2002 and 2003, could have a detrimental effect on our overall gross margins and thus on our operating results. Our support and service revenue is subject to a number of risks. First, we subcontract some of our consulting, customer support and training services to third-party service providers. Third-party contract revenue generally carries even lower gross margins than our service business overall. As a result, our support and service revenue and related margins may vary from period to period, depending on the mix of third-party contract revenues. Second, support and service revenue depends in part on ongoing renewals of support contracts by our customers, some of which may not renew their support contracts. The renewal rates of our support contracts declined during 2001, 2002 and 2003. We believe this occurred at least in part as a result of the economic downturn, and we cannot offer any assurance that these rates will increase or that they will not continue to decline. Finally, support and service revenue could decline further if customers select third-party service providers to install and service our products more frequently than they have in the past. If support and service revenue is lower than anticipated, our operating results could fall below the expectations of investors, which could result in a decrease in our stock price.

We have a limited operating history and are subject to the risks of new enterprises.

We commenced operations in February 1994 and commercially released the first version of our flagship product in December 1994. Accordingly, we have a limited operating history, and we face all of the risks and uncertainties encountered by early-stage companies. These risks and uncertainties include:

- no history of sustained profitability;
- uncertain growth in the market for, and uncertain market acceptance of, our solution;
- reliance on one product family;
- the risk that competition, technological change or evolving customer preferences, such as preferences for different computing platforms, could harm sales of our solution;
- the need to implement our sales, marketing and after-sales service initiatives, both domestically and internationally;
- the need to execute our product development activities;

- dependence on a limited number of key technical, customer support, sales and managerial personnel; and

- the risk that our management will be unable to effectively manage growth, a downturn or any acquisition we may undertake.

The evolving nature of the CRM market increases these risks and uncertainties. Our limited operating history makes it difficult to predict how our business will develop.

If we are unable to compete successfully in the highly competitive CRM market, our business will fail.

Our solution targets the CRM market. This market is intensely competitive, fragmented, rapidly changing and significantly affected by new product introductions. We face competition in the CRM market primarily from front-office software application vendors, large enterprise software vendors and our potential customers' information technology departments, which may seek to develop proprietary CRM systems. The dominant competitor in our industry is Siebel Systems, Inc., which holds a significantly greater percentage of the CRM market than we do. Other companies with which we compete include, but are not limited to, Amdocs Limited, E.piphany, Inc., Kana Communications, Inc., Microsoft Corporation, Oracle Corporation, PeopleSoft, Inc., Pivotal Corporation (recently acquired by CDC Software), RightNow Technologies, Salesforce.com, and SAP AG.

In addition, as we develop new products, including new product versions operating on new platforms, we may begin competing with companies with whom we have not previously competed. It is also possible that new competitors will enter the market. In 2002, we experienced an increase in competitive pressures in our market, which has resulted in enhanced pricing competition among our competitors. A continued increase in competitive pressures in our market or our failure to compete effectively may result in pricing reductions, reduced gross margins and loss of market share. Many of our competitors have longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, marketing and other resources than we do. Furthermore, we believe that there may be ongoing consolidation among our competitors. As a result of consolidation among our competitors, our competitors may be able to adapt more quickly to new technologies and customer needs, devote greater resources to promoting or selling their products and services, initiate and withstand substantial price competition, take advantage of acquisition or other strategic opportunities more readily or develop and expand their product and service offerings more quickly than we can. In addition, our competitors may form strategic relationships with each other and with other companies in attempts to compete more successfully against us. These relationships may take the form of strategic investments, joint marketing agreements, licenses or other contractual arrangements, any of which may increase our competitors' ability, relative to ours, to address customer needs with their software and service offerings and that may enable them to rapidly increase their market share.

If we do not retain our key employees and management team, and integrate our new senior management personnel, our ability to execute our business strategy will be limited.

Our future performance will depend largely on the efforts and abilities of our key technical, sales, customer support and managerial personnel and on our ability to attract and retain them. In addition, our ability to execute our business strategy will depend on our ability to recruit additional experienced management personnel and to retain our existing executive officers. The competition for qualified personnel in the computer software and technology markets is particularly intense. We have in the past experienced difficulty in hiring qualified technical, sales, customer support and managerial personnel, and we may be unable to attract and retain such personnel in the future. In addition, due to the intense competition for qualified employees, we may be required to increase the level of compensation paid to existing and new employees, which could materially increase our operating expenses. Our key employees are not obligated to continue their employment with us and could leave at any time. On January 12, 2004, we announced that Onyx's co-founder and Chief Executive Officer, Brent Frei, would be transitioning out of his role and that we would be initiating a search for a new Chief Executive Officer. It is uncertain what individual, if any, we may be able to attract for this position, what the financial cost of his or her compensation package will be, and what effect, if any, a new Chief Executive Officer may have on our business prospects.

The market price of our common stock has fluctuated substantially since our initial public offering in February 1999. Consequently, potential employees may perceive our equity incentives such as stock options as less attractive, and current employees whose options are no longer priced below market value may choose not to remain employed by us. In that case, our ability to attract or retain employees will be adversely affected.

We have been named as a defendant in securities class actions and other litigation that could result in substantial costs and divert management's attention and resources if pending settlements do not receive final court approval.

We, several of our officers and directors and Dain Rauscher Wessels have been named as defendants in a series of related lawsuits filed in the United States District Court for the Western District of Washington on behalf of purchasers of publicly traded Onyx common stock during various time periods. The consolidated amended complaint in these lawsuits alleges that we violated the Securities Act of 1933, or Securities Act, and the Securities Exchange Act of 1934, or Exchange Act, and seeks certification of a class action for purchasers of Onyx common stock in Onyx's February 12, 2001 public offering and on the open market during the period January 23, 2001 through July 24, 2001. The parties have executed an agreement to settle the matter on terms that will not require a payment by any of the defendants, inasmuch as the settlement consideration will be paid entirely by insurance proceeds. The court has preliminarily approved the settlement and has set a final approval hearing for September 9, 2004. None of the complaints or claims specifies the amount of damages to be claimed.

Onyx's directors and some of its officers have been named as defendants in a shareholder derivative lawsuit filed in the Superior Court of Washington in and for King County. The complaint alleges that the individual defendants breached their fiduciary duty and their duty of care to Onyx by allegedly failing to supervise Onyx's public statements and public filings with the SEC. The complaint alleges that, as a result of these breaches, misinformation about Onyx's financial condition was disseminated into the marketplace and filed with the SEC. The complaint asserts that these actions have exposed Onyx to harmful and costly securities litigation that could potentially result in an award of damages against Onyx, and seeks to recover on behalf of Onyx any amounts the company is required to pay in that litigation. The parties have executed an agreement to settle the matter on terms that will not require a payment by any of the defendants, inasmuch as the settlement consideration will be paid entirely by insurance proceeds. The settlement agreement will be presented to the court for approval. The settlements of both the derivative action and the putative class action described above are contingent on both settlements receiving final court approval.

Onyx, one of its officers and one of its former officers have also been named as defendants in a lawsuit filed in the United States District Court for the Southern District of New York on behalf of purchasers through December 6, 2000 of Onyx common stock sold under the February 12, 1999 registration statement and prospectus for our initial public offering. The complaint alleges that Onyx and the individual defendants violated the Securities Act by failing to disclose excessive commissions allegedly obtained by our underwriters pursuant to a secret arrangement whereby the underwriters allocated initial public offering shares to certain investors in exchange for the excessive commissions. The complaint also asserts claims against the underwriters under the Securities Act and the Exchange Act in connection with the allegedly undisclosed commissions. The parties have agreed in principle to settle the matter, along with similar lawsuits against more than 300 other issuers. The terms of the settlement, which are in the process of being definitively documented, would require Onyx and the other issuers to contribute to the settlement, which is being funded by a consortium of insurance carriers for the various issuers, only in the event that their carriers become insolvent or their insurance coverage is exhausted. We believe it is unlikely that any such contribution by Onyx will be required. In the event any of the above settlements do not receive final court approval, Onyx intends to vigorously defend itself and, where applicable, its officers and directors against these lawsuits and claims, and believes it has several meritorious defenses and, in certain instances, counterclaims. If we are not successful in our defense of these claims, however, we could be forced to make significant payments to the plaintiffs and their lawyers and such payments, if not covered by our insurance carriers, could harm our financial condition, operating results and cash flows. Even if these claims are not successful, the litigation could result in substantial costs to Onyx and could divert management's time and attention away from business operations. The uncertainty associated with this unresolved litigation may also impair our relationships with existing customers and our ability to obtain new customers.

Our solution may not achieve significant market acceptance.

Continued growth in demand for and acceptance of CRM systems remains uncertain. Even if the market for CRM systems grows, businesses may purchase our competitors' solutions or develop their own. We believe that many of our potential customers are not fully aware of the benefits of CRM systems and that, as a result, CRM systems have not achieved, and may not achieve, market acceptance. We also believe that many of our potential customers perceive the implementation of a CRM system to require a great deal of time, expense and complexity. This perception has been exacerbated by well-publicized failures of certain CRM projects of some of our competitors. This, in turn, has caused some potential customers to approach purchases of CRM systems with caution or to postpone their orders or decline to make a purchase altogether. We have spent, and will continue to spend, considerable resources educating potential customers not only about our solution but also about CRM systems in general. Even with these educational efforts, however, continued market acceptance of our solution may not increase. We will not succeed unless we can educate our target market about the benefits of CRM systems and the cost effectiveness, ease of use and other benefits of our solution.

If potential customers do not accept the Onyx product family, our business will fail.

We rely on one product family for the success of our business. License revenue from the Onyx product family has historically accounted for nearly all of our license revenue. We expect product license revenue from the Onyx product family to continue to account for a substantial majority of our future revenue. As a result, factors adversely affecting the pricing of or demand for the Onyx product family, such as competition or technological change, could dramatically affect our operating results. If we are unable to successfully deploy current versions of the Onyx product family and to develop, introduce and establish customer acceptance of new and enhanced versions of the Onyx product family, our business will fail.

If we are unsuccessful in our attempt to enable our products to operate on multiple platforms, our revenue growth could be limited.

We originally designed our products to operate exclusively on the Windows NT and Microsoft BackOffice platforms. As a result, our primary market has historically been to customers that have developed or are willing to develop their enterprise computing systems around these platforms, which limits our potential sales. We announced the general availability of an Oracle version of Onyx Employee Portal, or OEP, designed to operate on the Unix platform in June 2002. Later in 2002, we also introduced an Oracle version of OEP designed to run on IBM AIX. Subsequent product versions have been released on these platforms. If these product versions or new product versions do not achieve general market acceptance, our revenue growth will be limited. We believe that our ability to effectively expand our business into large enterprises depends in part on the successful release and market acceptance of our new platform versions. If we are unable to expand into large enterprises, the growth of our business and our revenue will be limited. Moreover, enabling our products to run on multiple platforms could lengthen the development cycle, thus delaying the release date of future product versions or new products, which could further restrict our revenue growth.

Privacy and security concerns, particularly related to the use of our software on the Internet, may limit the effectiveness of and reduce the demand for our solution.

The effectiveness of our solution relies on the storage and use of customer data collected from various sources, including information derived from customer registrations, billings, purchase transactions and surveys. The collection and use of such data by our customers for customer profiling may raise privacy and security concerns. Our customers generally have implemented security measures to protect customer data from disclosure or interception by third parties. These security measures may not, however, be effective against all potential security threats. If a well-publicized breach of customer data security were to occur, our solution may be perceived as less desirable, which could limit our revenue growth.

In addition, due to privacy concerns, some Internet commentators, consumer advocates and governmental or legislative bodies have suggested legislation to limit the use of customer profiling technologies. The European Union and some European countries have already adopted some restrictions on the use of customer profiling data. If major countries or regions adopt legislation or other restrictions on the use of customer profiling data, our solution would be less useful to customers, and our sales could decrease.

We may be unable to efficiently restructure or expand our sales organization, which could harm our ability to expand our business.

To date, we have sold our solution primarily through our direct sales force. As a result, our future revenue growth will depend in large part on recruiting, training and retaining direct sales personnel and expanding our indirect distribution channels. These indirect channels include VARs, VSPs, original equipment manufacturer, or OEM, partners, system integrators and consulting firms. We have experienced and may continue to experience difficulty in recruiting qualified direct sales personnel and in establishing third-party relationships with VARs, VSPs, OEM partners, systems integrators and consulting firms.

In April 2003, we eliminated two significant sales positions: Senior Vice President of the Americas and one of our regional sales management positions in North America. We do not plan to hire individuals in either of these positions in the near term. Our sales organization for the Americas has been realigned and is now headed by an executive who has been with Onyx since 1995. This executive has past experience managing Onyx's global sales organization. The restructuring of the management of our sales organization for the Americas may result in some disruption in our sales activities in this market and in turn, reduce our sales or limit our sales growth.

If our customers cannot successfully implement our products in a timely manner, demand for our solution will be limited.

The implementation of our products involves a significant commitment of resources by prospective customers. Our customers frequently deploy our products to large numbers of sales, marketing and customer service personnel, who may not accept our products. Our products are also used with a number of third-party software applications and programming tools. This use may present significant technical challenges, particularly as large numbers of personnel attempt to use our software concurrently. If an implementation is not successful, we may be required to deliver additional consulting services free of charge in order to remedy the problem. If our customers have difficulty deploying our software or for any other reason are not satisfied with our software, our operating results and financial condition may be harmed.

Rapid changes in technology could render our products obsolete or unmarketable, and we may be unable to introduce new products and services successfully and in a timely manner.

The CRM market is characterized by rapid change due to changing customer needs, rapid technological developments and advances introduced by competitors. Existing products can become obsolete and unmarketable when products using new technologies are introduced and new industry standards emerge. New technologies could change the way CRM systems are sold or delivered. We may also need to modify our products when third parties change software that we integrate into our products. As a result, the life cycles of our products are difficult to estimate.

To be successful, we must continue to enhance our current product line and develop new products that successfully respond to changing customer needs, technological developments and competitive product offerings. We may not be able to successfully develop or license the applications necessary to respond to these changes, or to integrate new applications with our existing products. We have delayed enhancements or new product release dates several times in the past, and may be unable to introduce enhancements or new products successfully or in a timely manner in the future. If we delay release of our products and product enhancements, or if they fail to achieve market acceptance when released, it could harm our reputation and our ability to attract and retain customers, and our revenue may decline. In addition, customers may defer or forego purchases of our products if we, our competitors or major technology vendors introduce or announce new products or product enhancements.

If we do not expand our international operations and successfully overcome the risks inherent in international business activities, the growth of our business will be limited.

To be successful in the long term, we will need to expand our international operations. This expansion may be delayed as a result of our recent operating expense reduction measures and general economic conditions. If we do expand internationally, it will require significant management attention and financial resources to successfully translate and localize our software products to various languages and to develop direct and indirect international sales and support channels. Even if we successfully translate our software and develop new channels, we may not be able to maintain or increase international market demand for our solution. We, or our VARs or VSPs, may be unable to sustain or increase international revenues from licenses or from consulting and customer support. In addition, our international sales are subject to the risks inherent in international business activities, including

- costs of customizing products for foreign countries;
- export and import restrictions, tariffs and other trade barriers;
- the need to comply with multiple, conflicting and changing laws and regulations;
- reduced protection of intellectual property rights and increased liability exposure; and
- regional economic, cultural and political conditions, including the direct and indirect effects of terrorist activity and armed conflict in countries in which we do business.

As noted above, Onyx Japan was profitable in the third and fourth quarters of 2003; however, Onyx Japan incurred substantial losses in previous periods. The minority shareholders' capital account balance as of December 31, 2003 was $119,000. Additional Onyx Japan losses above approximately $283,000 in the aggregate will be absorbed 100% by Onyx, as compared to 58% in prior periods. Additional funding may be required to continue the operation of the joint venture. Our joint venture partners are not obligated to participate in any capital call and have indicated that they do not currently intend to invest additional sums in Onyx Japan. We are, however, discussing other ways our partners can assist Onyx Japan. If Onyx Japan incurs losses in future periods and no additional capital is invested, we may have to further restructure Onyx Japan's operations.

Our foreign subsidiaries operate primarily in local currencies, and their results are translated into U.S. dollars. We do not currently engage in currency hedging activities, but we may do so in the future. Changes in the value of the U.S. dollar relative to foreign currencies have not materially affected our operating results in the past. Our operating results could, however, be materially harmed if we enter into license or other contractual agreements involving significant amounts of foreign currencies with extended payment terms if the values of those currencies fall in relation to the U.S. dollar over the payment period.

If we are unable to develop and maintain effective long-term relationships with our key partners, or if our key partners fail to perform, our ability to sell our solution will be limited.

We rely on our existing relationships with a number of key partners, including consulting firms, system integrators, VARs, VSPs and third-party technology vendors, that are important to worldwide sales and marketing of our solution. We expect an increasing percentage of our revenue to be derived from sales that arise out of our relationships with these key partners. Key partners often provide consulting, implementation and customer support services, and endorse our solution during the competitive evaluation stage of the sales cycle.

Although we seek to maintain relationships with our key partners, and to develop relationships with new partners, many of these existing and potential key partners have similar, and often more established, relationships with our competitors. These existing and potential partners, many of which have significantly greater resources than we have, may in the future market software products that compete with our solution or reduce or discontinue their relationships with us or their support of our solution. In addition, our sales will be limited if

- we are unable to develop and maintain effective, long-term relationships with existing and potential key partners;
- our existing and potential key partners endorse a product or technology other than our solution;
- we are unable to adequately train a sufficient number of key partners; or
- our existing and potential key partners do not have or do not devote the resources necessary to implement our solution.

We may be unable to adequately protect our proprietary rights, which may limit our ability to compete effectively.

Our success depends in part on our ability to protect our proprietary rights. To protect our proprietary rights, we rely primarily on a combination of copyright, trade secret and trademark laws, confidentiality agreements with employees and third parties, and protective contractual provisions such as those contained in license agreements with consultants, vendors and customers, although we have not signed these agreements in every case. Despite our efforts to protect our proprietary rights, unauthorized parties may copy aspects of our products and obtain and use information that we regard as proprietary. Other parties may breach confidentiality agreements and other protective contracts we have entered into, and we may not become aware of, or have adequate remedies in the event of, a breach. We face additional risk when conducting business in countries that have poorly developed or inadequately enforced intellectual property laws. While we are unable to determine the extent to which piracy of our software products exists, we expect piracy to be a continuing concern, particularly in international markets and as a result of the growing use of the Internet. In any event, competitors may independently develop similar or superior technologies or duplicate the technologies we have developed, which could substantially limit the value of our intellectual property.

Intellectual property claims and litigation could subject us to significant liability for damages and result in invalidation of our proprietary rights.

In the future, we may have to resort to litigation to protect our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Any litigation, regardless of its success, would probably be costly and require significant time and attention of our key management and technical personnel. Although we have not been sued for intellectual property infringement, we may face infringement claims from third parties in the future. The software industry has seen frequent litigation over intellectual property rights, and we expect that participants in the industry will be increasingly subject to infringement claims as the number of products, services and competitors grows and the functionality of products and services overlaps. Infringement litigation could also force us to

- stop or delay selling, incorporating or using products that incorporate the challenged intellectual property;
- pay damages;
- enter into licensing or royalty agreements, which may be unavailable on acceptable terms; or
- redesign products or services that incorporate infringing technology, which we might not be able to do at an acceptable price, in a timely fashion or at all.

Our products may suffer from defects or errors, which could result in loss of revenues, delayed or limited market acceptance of our products, increased costs and reputational damage.

Software products as complex as ours frequently contain errors or defects, especially when first introduced or when new versions are released. Our customers are particularly sensitive to such defects and errors because of the importance of our solution to the day-to-day operation of their businesses. We have had to delay commercial release of past versions of our products until software problems were corrected, and in some cases have provided product updates to correct errors in released products. Our new products or releases may not be free from errors after commercial shipments have begun. Any errors that are discovered after commercial release could result in loss of revenues or delay in market acceptance, diversion of development resources, damage to our reputation, increased service and warranty costs or claims against us.

In addition, the operation of our products could be compromised as a result of errors in the third-party software we incorporate into our software. It may be difficult for us to correct errors in third-party software because that software is not in our control.

You may be unable to resell your shares at or above the price at which you purchased them, and our stock price may be volatile.

Since our initial public offering in February 1999, the price of our common stock has been volatile, particularly in the last year. Our common stock, on a split-adjusted basis, reached a high of $176.00 per share on March 6, 2000 and traded as low as $2.24 per share on April 30, 2003. As a result of fluctuations in the price of our common stock, you may be unable to sell your shares at or above the price at which you purchased them. The trading price of our common stock could be subject to fluctuations for a number of reasons, including

- future announcements concerning us or our competitors;
- actual or anticipated quarterly variations in operating results;
- changes in analysts' earnings projections or recommendations;
- announcements of technological innovations;
- the introduction of new products;
- changes in product pricing policies by us or our competitors;
- proprietary rights litigation or other litigation;
- changes in accounting standards that adversely affect our revenues and earnings; or
- significant trading activity by shareholders with large holdings in our common stock.

In addition, future sales of substantial numbers of shares of our common stock in the public market, or the perception that these sales could occur, could adversely affect the market price of our common stock.

Stock prices for many technology companies fluctuate widely for reasons that may be unrelated to operating results of these companies. These fluctuations, as well as general economic, market and political conditions, such as national or international currency and stock market volatility, recessions or military conflicts, may materially and adversely affect the market price of our common stock, regardless of our operating performance and may expose us to class action securities litigation which, even if unsuccessful, would be costly to defend and distracting to management.

Our articles of incorporation and bylaws and Washington law contain provisions that could discourage a takeover.

Certain provisions of our restated articles of incorporation and bylaws, our shareholder rights plan and Washington law would make it more difficult for a third party to acquire us, even if doing so would be beneficial for our shareholders. This could limit the price that certain investors might be willing to pay in the future for shares of our common stock. For example, certain provisions of our articles of incorporation or bylaws

- stagger the election of our board members so that only one-third of our board is up for reelection at each annual meeting;

- allow our board to issue preferred stock without any vote or further action by the shareholders;
- eliminate the right of shareholders to act by written consent without a meeting, unless the vote to take the action is unanimous;
- eliminate cumulative voting in the election of directors;
- specify a minimum threshold for shareholders to call a special meeting;
- specify that directors may be removed only with cause; and
- specify a supermajority requirement for shareholders to change those portions of our articles that contain the provisions described above.

In October 1999, we adopted a shareholder rights plan, which is triggered upon commencement or announcement of a hostile tender offer or when any one person or group acquires 15% or more of our common stock. Once triggered, the rights plan would result in the issuance of preferred stock to the holders of our common stock other than the acquirer. The holders of this preferred stock would be entitled to ten votes per share on corporate matters. In addition, these shareholders receive rights under the rights plan to purchase our common stock, and the stock of the entity acquiring us, at reduced prices.

We are also subject to certain provisions of Washington law that could delay or make more difficult a merger, tender offer or proxy contest involving us. In particular, Chapter 23B.19 of the Washington Business Corporation Act prohibits corporations based in Washington from engaging in certain business combinations with any interested shareholder for a period of five years unless specific conditions are met.

These provisions of our articles of incorporation, bylaws and rights plan and Washington law could have the effect of delaying, deferring or preventing a change in control of Onyx, including, without limitation, discouraging a proxy contest or making more difficult the acquisition of a substantial block of our common stock. The provisions could also limit the price that investors might be willing to pay in the future for shares of our common stock.

ITEM 2. PROPERTIES

Our principal administrative, sales, marketing, support and research and development facilities are located in approximately 60,000 square feet of space in Bellevue, Washington. This facility is leased to us through December 2013. We currently lease other domestic sales and support offices in California, Colorado, Georgia, Illinois, Massachusetts, New Jersey, New York and Texas. We maintain international offices in Australia, Germany, Hong Kong, Japan, Malaysia, Singapore and the United Kingdom.

ITEM 3. LEGAL PROCEEDINGS

We, several of our officers and directors and Dain Rauscher Wessels have been named as defendants in a series of related lawsuits filed in the United States District Court for the Western District of Washington on behalf of purchasers of publicly traded Onyx common stock during various time periods. The consolidated amended complaint in these lawsuits alleges that we violated the Securities Act and the Exchange Act, and seeks certification of a class action for purchasers of Onyx common stock in Onyx's February 12, 2001 public offering and on the open market during the period January 23, 2001 through July 24, 2001. The parties have executed an agreement to settle the matter on terms that will not require a payment by any of the defendants, inasmuch as the settlement consideration will be paid entirely by insurance proceeds. The court has preliminarily approved the settlement and has set a final approval hearing for September 9, 2004. None of the complaints or claims specifies the amount of damages to be claimed.

Onyx's directors and some of its officers have been named as defendants in a shareholder derivative lawsuit filed in the Superior Court of Washington in and for King County. The complaint alleges that the individual defendants breached their fiduciary duty and their duty of care to Onyx by allegedly failing to supervise Onyx's public statements and public filings with the SEC. The complaint alleges that, as a result of these breaches, misinformation about Onyx's financial condition was disseminated into the marketplace and filed with the SEC. The complaint asserts that these actions have exposed Onyx to harmful and costly securities litigation that could potentially result in an award of damages against Onyx, and seeks to recover on behalf of Onyx any amounts the company is required to pay in that litigation. The parties have executed an agreement to settle the matter on terms that will not require a payment by any of the defendants, inasmuch as the settlement consideration will be paid entirely by insurance proceeds. The settlement agreement will be presented to the court for approval. The settlements of both the derivative action and the putative class action described above are contingent on both settlements receiving final court approval.

Onyx, one of its officers and one of its former officers have also been named as defendants in a lawsuit filed in the United States District Court for the Southern District of New York on behalf of purchasers through December 6, 2000 of Onyx common stock sold under the February 12, 1999 registration statement and prospectus for our initial public offering. The complaint alleges that Onyx and the individual defendants violated the Securities Act by failing to disclose excessive commissions allegedly obtained by our underwriters pursuant to a secret arrangement whereby the underwriters allocated initial public offering shares to certain investors in exchange for the excessive commissions. The complaint also asserts claims against the underwriters under the Securities Act and the Exchange Act in connection with the allegedly undisclosed commissions. The parties have agreed in principle to settle the matter, along with similar lawsuits against more than 300 other issuers. The terms of the settlement, which are in the process of being definitively documented, would require Onyx and the other issuers to contribute to the settlement, which is being funded by a consortium of insurance carriers for the various issuers, only in the event that their carriers become insolvent or their insurance coverage is exhausted. We believe it is unlikely that any such contribution by Onyx will be required.

In the event any of the above settlements do not receive final court approval, Onyx intends to vigorously defend itself and, where applicable, its officers and directors against these lawsuits and claims, and believes it has several meritorious defenses and, in certain instances, counterclaims. If we are not successful in our defense of these claims, however, we could be forced to make significant payments to the plaintiffs and their lawyers and such payments, if not covered by our insurance carriers, could harm our financial condition, operating results and cash flows. Even if these claims are not successful, the litigation could result in substantial costs to Onyx and could divert management's time and attention away from business operations. The uncertainty associated with this unresolved litigation may also impair our relationships with existing customers and our ability to obtain new customers.

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2003.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

Market Information

Our common stock began trading under the symbol ONXS on the Nasdaq National Market on February 12, 1999 at an initial public offering price of $26.00 per share (split adjusted). The table below lists the high and low closing prices per share of our common stock for each quarterly period during the past two years as reported on the Nasdaq National Market (split adjusted).

	Price Range of Common Stock	
	High	Low
Year Ended December 31, 2002		
First Quarter	$20.32	$11.16
Second Quarter	17.04	12.60
Third Quarter	13.72	6.96
Fourth Quarter	8.80	5.64
Year Ended December 31, 2003		
First Quarter	$ 6.00	$ 3.52
Second Quarter	4.76	2.40
Third Quarter	5.78	3.20
Fourth Quarter	5.54	3.32

Holders

As of February 27, 2004, there were approximately 152 holders of record of our common stock. This does not include the number of persons whose stock is in nominee or "street name" accounts through brokers.

Dividends

We have never paid cash dividends on our common stock. We currently intend to retain any future earnings to fund the development and growth of our business and therefore do not anticipate paying any cash dividends in the foreseeable future. In addition, the terms of our credit facility with SVB prohibit us from paying any cash dividends.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected financial data have been derived from Onyx's consolidated financial statements, and should be read in conjunction with the consolidated financial statements and related notes included in this report, as well as the section of this report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations." Historical results are not necessarily indicative of future results.

	Year Ended December 31,				
	1999	2000	2001	2002	2003
	(In thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenue:					
License	$38,122	$73,701	$ 37,584	$ 22,633	$12,143
Support and service	23,380	47,566	62,116	46,751	46,230
Total revenues	61,502	121,267	99,700	69,384	58,373
Cost of revenue:					
License	2,243	3,520	2,006	1,140	848
Amortization of acquired technology	500	820	751	498	255
Support and service	12,198	25,510	35,662	20,128	20,711
Total cost of revenues	14,941	29,850	38,419	21,766	21,814
Gross margin	46,561	91,417	61,281	47,618	36,559
Operating expenses:					
Sales and marketing	29,614	59,182	53,254	27,947	20,629
Research and development	10,432	21,046	21,968	14,745	11,838
General and administrative	5,720	11,120	14,623	9,449	8,205
Restructuring and other related charges	—	—	51,806	8,491	1,422
Amortization and impairment of goodwill and other acquisition-related intangibles(1)	1,064	4,332	13,695	836	836
Stock-based compensation	882	548	904	248	70
Total operating expenses	47,712	96,228	156,250	61,716	43,000
Loss from operations	(1,151)	(4,811)	(94,969)	(14,098)	(6,441)
Other income (expense), net	1,224	788	377	(119)	78
Change in fair value of outstanding warrants	—	—	—	—	355
Investment losses and impairment	—	(500)	(2,500)	—	—
Income (loss) before income taxes	73	(4,523)	(97,092)	(14,217)	(6,008)
Income tax provision (benefit)	517	404	(294)	585	264
Minority interest in loss of consolidated subsidiary	—	(216)	(1,283)	(1,032)	(118)
Net loss	$ (444)	$(4,711)	$(95,515)	$(13,770)	$(6,154)
Basic and diluted net loss per share(2)(3)	$ (0.06)	$ (0.54)	$ (9.46)	$ (1.10)	$ (0.46)
Shares used in calculation of basic and diluted net loss per share(2)(3)	7,804	8,731	10,092	12,481	13,442

	December 31,				
	1999	2000	2001	2002	2003
			(In thousands)		
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 3,691	$ 11,492	$15,868	$17,041	$10,127
Restricted cash	—	—	—	2,238	1,723
Working capital (deficit)	30,147	25,252	(4,718)	3,706	2,315
Total assets	73,180	109,040	64,511	54,787	41,425
Long-term obligations, less current portion	133	428	10,178	2,677	405
Long-term obligations — warrants	—	—	—	920	565
Shareholders' equity	51,838	66,086	8,135	16,828	16,299

(1) Effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets," or SFAS 142. Under SFAS 142, goodwill is no longer amortized, beginning January 1, 2002. See Notes 1 and 12 of Notes to Consolidated Financial Statements for further explanation of the impact of SFAS 142.

(2) See Notes 1 and 12 of Notes to Consolidated Financial Statements for an explanation of the method used to calculate basic and diluted net loss per share. The 1999 amounts are calculated on a pro forma basis.

(3) On July 23, 2003, the Company's shareholders approved a one-for-four reverse stock split which became effective on that date. All share and per share amounts in the accompanying consolidated financial statements have been adjusted to reflect this reverse stock split.

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

Overview

Onyx Software Corporation is a leading provider of enterprise-wide CRM solutions designed to promote strategic business improvement and revenue growth by enhancing the way businesses market, sell and service their products. We focus on our customers' success as the prime criterion for how we judge our own success. Using the Internet in combination with traditional forms of interaction, including phone, mail, fax and e-mail, our solution helps enterprises to more effectively acquire, manage and maintain customer, partner and other relationships. We market our solution to companies that want to merge new, online business processes with traditional business processes to enhance their customer-facing operations, such as marketing, sales, customer service and technical support. Our solution is Internet-based, which means companies can take advantage of lower costs and faster deployment associated with accessing CRM software with a simple browser. Our solution uses a single data model across all customer interactions, resulting in a single repository for all marketing, sales and service information. It is fully integrated across all customer-facing departments and interaction media. Our solution is designed to be easy to use, widely accessible, rapidly deployable, scalable, flexible, customizable and reliable, which can result in a comparatively low total cost of ownership and rapid return on investment.

Overview of the Results for the Year Ended December 31, 2003

Key financial data points relating to our performance include:

- Revenue for 2003 of $58.4 million, down 16% from 2002 and down 41% from 2001;
- License revenue for 2003 of $12.1 million, down 46% from 2002 and down 68% from 2001;
- Service revenue for 2003 of $46.2 million, down 1% from 2002 and down 26% from 2001;
- Service margins for 2003 of 55%, down from 57% in 2002 and up from 43% in 2001;

- Total operating expenses for 2003 of $43.0 million, down from $61.7 million in 2002 and $156.3 million in 2001. Operating expenses, excluding acquisition-related amortization, stock compensation and restructuring charges, in 2003 of $40.7 million, down from $52.1 million in 2002 and $89.8 million in 2001;

- Restricted and unrestricted cash balances of $11.9 million at December 31, 2003, compared to $19.3 million at December 31, 2002;

- Days sales outstanding, based on end-of-period receivable balances and most recent quarters' annualized revenues, of 86 days at December 31, 2003, compared to 76 days at December 31, 2002;

- Current and long-term restructuring-related liabilities of $3.7 million at December 31, 2003, compared to $13.7 million at December 31, 2002; and

- Deferred revenue of $16.1 million at December 31, 2003, compared to $16.3 million at December 31, 2002.

We believe that continued adverse economic conditions have affected our ability to generate license revenue during 2003. Our service revenue, service margins and operating expense management, however, continued to be steady during this same time period.

Although recent published reports are signaling modest improvement in the global economy, we are cautious as to the speed at which macroeconomic conditions will improve, particularly as it relates to the information technology and communications industries, and believe our ability to generate new license sales will continue to be challenged in the near term. The majority of our revenue has been generated from customers in the high-technology, financial services and healthcare industries. Accordingly, our business is affected by the economic and business conditions of these industries and the demand for information technology within these industries. Macroeconomic conditions were extremely challenging during 2001, 2002 and 2003, and we expect them to continue to impact capital spending initiatives of our targeted new and existing customer base in the near term.

As a result of current economic uncertainties, we will be focused on the following objectives in the near term:

- successful rebuilding of our direct sales force;

- managing our costs to allow our return to profitability and allow us to preserve our cash;

- focusing our resources and efforts on the sales opportunities with the highest probability of success;

- maximizing the value of our partnerships with key system integration and technology vendors, particularly as it relates to our Embedded CRM initiative and our key vertical industries;

- aggressive marketing of our recent major product releases on the Windows NT/Microsoft BackOffice and Oracle/Unix platforms; and

- maintaining high customer satisfaction levels.

We hope that, by focusing our efforts on these key objectives, we will be able to return to profitability in challenging economic times and successfully grow our business, although we cannot offer any assurance regarding when, or whether, this will occur. We continue to align costs and expenses to our expected revenues. We may, however, continue to experience losses and negative cash flows in the near term, unless sales of our products and services grow.

Critical Accounting Policies and Estimates

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

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

Revenue recognition rules for software companies are very complex and often subject to interpretation. We follow very specific and detailed guidelines in measuring revenue; however, certain judgments affect the application of our revenue policy. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in future operating losses.

We recognize revenue in accordance with accounting standards for software companies, including Statement of Position, or SOP, 97-2, "Software Revenue Recognition," as amended by SOP 98-9 and related interpretations, including Technical Practice Aids.

We generate revenue through two sources: (a) software license revenue and (b) support and service revenue. Software license revenue is generated from licensing the rights to use our products directly to end-users and vertical service providers, or VSPs, and indirectly through value-added resellers, or VARs, and, to a lesser extent, through third-party products we distribute. Support and service revenue is generated from sales of customer support services (maintenance contracts), consulting services and training services performed for customers that license our products.

License revenue is recognized when a noncancellable license agreement becomes effective as evidenced by a signed contract, the product has been shipped, the license fee is fixed or determinable, and collection is probable.

In software arrangements that include rights to multiple software products and/or services, we allocate the total arrangement fee among each of the deliverables using the residual method, under which revenue is allocated to undelivered elements based on vendor-specific objective evidence of fair value of such undelivered elements and the residual amounts of revenue are allocated to delivered elements. Elements included in multiple-element arrangements could consist of software products, maintenance (which includes customer support services and unspecified upgrades), or consulting services. Vendor-specific objective evidence is based on the price charged when an element is sold separately or, in the case of an element not yet sold separately, the price established by authorized management, if it is probable that the price, once established, will not change once the element is sold separately.

Standard terms for license agreements call for payment within 90 days. Probability of collection is based on the assessment of the customer's financial condition through the review of its current financial statements or credit reports. For follow-on sales to existing customers, prior payment history is also used to evaluate probability of collection. Revenue from distribution agreements with VARs is typically recognized upon the earlier of receipt of cash from the VAR or identification of an end user. In the latter case, probability of collection is evaluated based on the creditworthiness of the VAR. Our agreements with customers, VSPs and VARs do not contain product return rights.

Revenue from maintenance arrangements is recognized ratably over the term of the contract, typically one year. Consulting revenue is primarily related to implementation services performed on a time-and-materials basis or, in certain situations, on a fixed-fee basis, under separate service arrangements. Implementation services are periodically performed under fixed-fee arrangements and, in such cases, consulting revenue is recognized on a percentage-of-completion basis. Revenue from consulting and training services is recognized as services are performed. Standard terms for renewal of maintenance arrangements, consulting services and training services call for payment within 30 days.

Revenue consisting of fees from licenses sold together with consulting services is generally recognized upon shipment of the software, provided that the above criteria are met, payment of the license fees do not depend on the performance of the services, and the consulting services are not essential to the functionality of the licensed software. If the services are essential to the functionality of the software, or payment of the license fees depends on the performance of the services, both the software license and consulting fees are recognized under the percentage of completion method of contract accounting.

If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. If a nonstandard acceptance period is provided, revenue is recognized upon the earlier of customer acceptance and the expiration of the acceptance period.

Allowance for Doubtful Accounts

A considerable amount of judgment is required when we assess the ultimate realization of receivables, including assessing the probability of collection and the current creditworthiness of each customer. Although no expenses were required in 2002 and we recorded a net benefit in 2003, significant expenses were recorded to increase our allowance for doubtful accounts in prior years due to the rapid downturn in the economy, and in the technology sector in particular, and we may record additional expenses in the future.

Impairment of Intangible Assets

We periodically evaluate intangible asset valuations of businesses we acquired as impairment indicators arise. Our judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operational performance of our acquired businesses. Future events could cause us to conclude that impairment indicators exist and that goodwill and other intangible assets associated with our acquired businesses are impaired.

Restructuring

During 2001 and 2002, we recorded significant write-offs and accruals in connection with our restructuring program under Emerging Issues Task Force, or EITF, Issue No. 94-3. These write-offs and accruals include estimates pertaining to employee separation costs and the settlements of contractual obligations related to excess leased facilities and other contracts. Although we believe that we have made reasonable estimates of our restructuring costs in calculating these write-offs and accruals, the actual costs could differ from these estimates. With the contractual settlement of the majority of our excess facilities, the range of outcomes that must be estimated has narrowed significantly, except for the value assigned to the warrants issued in connection with the settlement, which will fluctuate in the future based on our stock price.

In June 2002, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities, and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This statement requires that a liability for a cost associated with an exit or disposal activity be recognized at fair value when the liability is incurred. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of SFAS No. 146 has not had a material effect on our consolidated financial statements.

Contingencies and Litigation

We are subject to proceedings, lawsuits and other claims related to class action lawsuits and other matters. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of loss accrual required, if any, for these contingencies are made after careful analysis of each individual issue. The required accruals may change in the future due to new developments in each matter.

Results of Operations

We believe that period-to-period comparisons of our operating results may not be a meaningful basis to predict our future performance. You should consider our prospects in light of the risks, expenses and difficulties frequently encountered by young technology companies, particularly companies in rapidly evolving markets. We may not be able to successfully address these risks and difficulties. Our future operating results will depend on many factors, including:

- general economic conditions, which may affect our customers' capital investment levels in management information systems and the timing of their purchases;
- rate of market acceptance of our CRM solution;
- budget and spending decisions by our prospective and existing customers;
- customers' and prospects' decisions to defer orders or implementations, particularly large orders or implementations, from one quarter to the next, or to proceed with smaller-than-forecasted orders or implementations;
- level of purchases by our existing customers, including additional license and maintenance revenues;
- our ability to enable our products to operate on multiple platforms;
- our ability to compete in the highly competitive CRM market;
- the loss of any key technical, sales, customer support or management personnel and the timing of any new hires;
- our ability to develop, introduce and market new products and product versions on a timely basis;
- variability in the mix of our license versus service revenue, the mix of our direct versus indirect license revenue and the mix of services that we perform versus those performed by third-party service providers;
- our ability to successfully expand our operations, and the amount and timing of expenditures related to this expansion; and
- the cost and financial accounting effects of any acquisitions of companies or complementary technologies that we may complete.

The following table presents financial data for the years indicated as a percentage of total revenues:

	Year Ended December 31,		
	2001	2002	2003
Consolidated Statement of Operations Data:			
Revenue:			
License	37.7%	32.6%	20.8%
Support and service	62.3	67.4	79.2
Total revenue	100.0	100.0	100.0
Cost of revenue:			
License	2.0	1.6	1.5
Amortization of acquired technology	0.8	0.7	0.4

	Year Ended December 31,		
	2001	2002	2003
Support and service	35.8	29.0	35.5
Total cost of revenue	38.5	31.4	37.4
Gross margin	61.5	68.6	62.6
Operating expenses:			
Sales and marketing	53.4	40.3	35.3
Research and development	22.0	21.3	20.3
General and administrative	14.7	13.6	14.1
Restructuring and other related charges	52.0	12.2	2.4
Amortization of acquisition-related intangibles	13.7	1.2	1.4
Amortization of stock-based compensation	0.9	0.4	0.1
Total operating expenses	156.7	88.9	73.6
Loss from operations	(95.3)	(20.3)	(11.0)
Other income (expense), net	0.4	(0.2)	0.1
Change in fair value of outstanding warrants	0.0	0.0	0.6
Investment losses and impairment	(2.5)	0.0	0.0
Loss before income taxes	(97.4)	(20.5)	(10.3)
Income tax provision (benefit)	(0.3)	0.8	0.5
Minority interest in loss of consolidated subsidiary	(1.3)	(1.5)	(0.2)
Net loss	(95.8)%	(19.8)%	(10.6)%

Revenue

Total revenue, which consists of software license and service revenue, decreased from $99.7 million in 2001 to $69.4 million in 2002, a decrease of 30%, and decreased to $58.4 million in 2003, a decrease of 16%. No single customer accounted for more than 10% of our revenues in any of these periods.

Our license revenue decreased from $37.6 million in 2001 to $22.6 million in 2002, a decrease of 40%, and decreased to $12.1 million in 2003, a decrease of 46%. We believe the decreases in license revenue from 2001 to 2002 and from 2002 to 2003 was primarily due to the progressive weakening of the global economy, which has caused a delay in the capital-spending initiatives of our prospective and existing customers, particularly in the middle market. Macroeconomic conditions were extremely challenging during 2001, 2002 and 2003. We believe that macroeconomic conditions will continue to be challenging in the near term which may delay capital spending initiatives of our prospective and existing customers. Our competitors' inconsistency in delivering successful CRM solutions has also resulted in more cautious buying behavior of prospective customers.

Support and service revenue decreased from $62.1 million in 2001 to $46.8 million in 2002, a decrease of 25%, and decreased to $46.2 million in 2003, a decrease of 1%. The decrease from 2001 to 2002 was the result of a decrease in consulting and training services of $15.4 million, offset by an increase in maintenance and support revenue of $0.1 million. The decrease from 2002 to 2003 was the result of an increase in consulting and training services of $1.0 million, offset by a decrease in maintenance and support revenue of $1.6 million. Service revenue represented 62% of our total revenue in 2001, 67% in 2002 and 79% in 2003. We expect to see a reduction in absolute dollars in our support and service revenue in future quarters due to the reduction in demand for our consulting services resulting from the decrease in our license revenue in recent quarters. In addition, we may experience a decline in maintenance revenue as customers elect not to renew annual maintenance contracts in part or as a whole, primarily due to specific economic circumstances facing each of our customers and fewer new licenses sold in 2003. We expect the proportion of support and service revenue to total revenue to fluctuate in the future, depending in part on our customers' direct use of third-party consulting and implementation service providers, the degree to which we provide opportunities for our partners to engage with our customers and the ongoing renewals of customer support contracts, as well as our overall sales of software licenses to new and existing customers.

Revenue outside of North America decreased from $29.6 million in 2001 to $24.8 million in 2002, and decreased to $22.9 million in 2003. We believe the decrease in revenue from 2001 to 2002 and from 2002 to 2003 outside of North America was primarily due to an adverse shift in the buying behavior of our targeted new and existing customer base as a result of economic conditions.

Included in license revenue for the year ended December 31, 2001 is a sale to Softbank Commerce for approximately $572,000 for software licenses that will be internally deployed to support customer and business partner relations. Softbank Commerce is a related party to Softbank Investments Corporation, an entity which owns 14% of Onyx Japan.

Cost of Revenue

Cost of license revenue

Cost of license revenue consists of license fees for third-party software, product media, product duplication and manuals. Cost of license revenue decreased from $2.0 million in 2001 to $1.1 million in 2002, a decrease of 43%, and decreased to $848,000 in 2003, a decrease of 26%. Cost of license revenue as a percentage of related license revenues was 5% in 2001, 5% in 2002 and 7% in 2003. The changes in dollar amount during these periods in cost of license revenue was primarily due to changes in license revenue. The increase in cost of license revenue as a percentage of related license revenue in 2003 compared to the prior years was primarily the result of a higher concentration of license revenue subject to third-party product royalty costs coupled with the impact of certain fixed third-party product royalty agreements which do not vary directly with license revenue.

Amortization of acquired technology

Amortization of acquired technology represents the amortization of capitalized technology associated with our acquisitions of EnCyc in 1998 and Versametrix and Market Solutions in 1999. Amortization of acquired technology decreased from $751,000 in 2001 to $498,000 in 2002, a decrease of 34%, and decreased to $255,000 in 2003, a decrease of 49%. The decrease from 2001 to 2002 to 2003 was the result of an impairment recorded in the third quarter of 2001 relating to the carrying value of the acquired technology asset associated with Versametrix, coupled with the completion of the amortization of acquired technology for Market Solutions in the third quarter of 2002 and the completion of the amortization of acquired technology for EnCyc in the fourth quarter of 2003. The acquired technology intangibles were fully amortized as of December 31, 2003 and as a result, there will be no further amortization of acquired technology in future periods, unless we complete additional acquisitions.

Cost of support and service revenue

Cost of support and service revenue consists of personnel and third-party service provider costs related to consulting services, customer support and training. Cost of support and service revenue decreased from $35.7 million in 2001 to $20.1 million in 2002, a decrease of 44%, and increased to $20.7 million in 2003, an increase of 3%. The decrease in dollar amount from 2001 to 2002 resulted primarily from a reduction in consulting personnel during 2001 to more closely align with our service revenue, as well as a decrease in the use of third-party service providers, which have a higher cost structure than our internal resources. The increase in dollar amount from 2002 to 2003 is due to a higher concentration of professional service revenue, which has a higher cost structure and contributes lower margins than support revenue. Full-time headcount in our professional services organization was: 205 at the end of 2000, 160 at the end of 2001, 123 at the end of 2002 and 112 at the end of 2003.

Cost of support and service revenue as a percentage of related support and service revenues was 57% in 2001, 43% in 2002 and 45% in 2003. The decrease in cost of service revenue as a percentage of related service revenue from 2001 to 2002 was due to a higher proportion of maintenance revenue, which has a lower direct cost structure and therefore contributes higher margins than our consulting and training services, coupled with a lower percentage use of third-party service providers in our consulting engagements, which historically contributed significantly lower margins than internal resources. The increase in cost of service revenue as a percentage of related service revenue from 2002 to 2003 primarily reflects a higher proportion of service revenue from consulting and training services, which have a higher direct cost structure and therefore contribute lower margins than our customer support services. The cost of services as a percentage of service revenue may vary between periods primarily for two reasons: (1) the mix of services we provide (consulting, customer support, training), which have different direct cost structures, and (2) the resources we use to deliver these services (internal versus third parties).

Costs and Expenses

Sales and marketing

Sales and marketing expenses consist primarily of salaries, commissions and bonuses earned by sales and marketing personnel, travel and promotional expenses and facility and communication costs for direct sales offices. Sales and marketing expenses decreased from $53.3 million in 2001 to $27.9 million in 2002, a decrease of 48%, and decreased to $20.6 million in 2003, a decrease of 26%. The decrease in dollar amount from 2001 to 2002 and from 2002 to 2003 was primarily due to restructuring activities and reductions in sales and marketing headcounts, along with a decrease in sales commissions and bonuses. Full-time headcount in our sales and marketing organization was: 319 at the end of 2000, 130 at the end of 2001, 131 at the end of 2002 and 95 at the end of 2003.

Sales and marketing expenses represented 53% of our total revenue in 2001, 40% in 2002 and 35% in 2003. The decrease in sales and marketing expenses as a percentage of total revenue during these periods is primarily the result of cost cutting initiatives and lower license revenue as a percentage of total revenue.

We expect our sales and marketing expenses to remain flat in dollars in 2004 relative to 2003. To fully realize our long-term sales growth opportunity, we believe that we may need to significantly increase our sales and marketing efforts, particularly in support of our vertical and embedded CRM strategies, to expand our market position and further increase acceptance of our products.

Research and development

Research and development expenses consist primarily of salaries, benefits and equipment for software developers, quality assurance personnel, program managers and technical writers and payments to outside contractors. Research and development expenses decreased from $22.0 million in 2001 to $14.7 million in 2002, a decrease of 33%, and decreased to $11.8 million in 2003, a decrease of 20%. The decrease from 2001 to 2002 was primarily due to a decrease in the use of outside contractors upon the release of our application on the Oracle platform and our election to retain full-time employees in lieu of contractors in our restructuring plan and, to a lesser extent, to a decrease in the number of development personnel. The decrease from 2002 to 2003 was primarily due to a decrease in the use of outside contractors, and to a lesser extent, due to a decrease in the number of development personnel. Expenses associated with the use of outside contractors totaled $7.6 million in 2001, $2.8 million in 2002 and $1.0 million in 2003. Full-time headcount in our research and development organization was: 111 at the end of 2000, 98 at the end of 2001, 88 at the end of 2002 and 77 at the end of 2003. Research and development costs represented 22% of our total revenue in 2001, 21% in 2002 and 20% in 2003.

Although research and development expenses were affected by our restructuring efforts, we believe that those development projects that are most essential to our long-term growth were least affected. We believe that our research and development investments are essential to our long-term strategy. We expect our research and development expenses to remain flat in dollars in 2004 relative to 2003. To fully realize our long-term sales growth opportunity, we believe that we may need to increase our research and development investment in dollars in the future.

General and administrative

General and administrative expenses consist primarily of salaries, benefits and related costs for our executive, finance, human resource and administrative personnel, professional services fees and allowances for doubtful accounts. General and administrative expenses decreased from $14.6 million in 2001 to $9.4 million in 2002, a decrease of 35%, and decreased to $8.2 million in 2003, a decrease of 13%. The decrease in general and administrative expenses from 2001 to 2002 was primarily due to restructuring activities and reductions in executive, finance, human resource and administrative personnel, along with a decrease in professional fees and allowances for doubtful accounts. The decrease in general and administrative expenses from 2002 to 2003 was due to reductions in executive and administrative personnel, along with a decrease in professional services fees and the benefit from collections of accounts previously believed to be uncollectible during the first and second quarters of 2003. Full-time headcount in our general and administrative organization was: 97 at the end of 2000, 61 at the end of 2001, 61 at the end of 2002 and 46 at the end of 2003. General and administrative costs represented 15% of our total revenue in 2001, 14% in 2002 and 14% in 2003.

Although general and administrative expenses have been reduced through our restructuring efforts in recent periods, our general and administrative expenses may increase slightly in 2004 relative to 2003 as we incur additional professional services fees related to the satisfaction of new compliance requirements under the Sarbanes-Oxley Act of 2002 and incur costs associated with the recruitment and hiring of a new Chief Executive Officer. We also believe that we may need to expand our administrative staff, domestically and internationally, in the future to pursue our long-term sales growth opportunities.

Restructuring and other related charges

Restructuring and other related charges represent our efforts to reduce our overall cost structure. In April 2001 and again in September 2001, Onyx approved a restructuring plans to reduce headcount, reduce infrastructure and eliminate excess and duplicate facilities. In April 2003, Onyx approved a restructuring plan to reduce additional headcount. During 2001, we recorded approximately $51.8 million in restructuring and other related charges. During 2002, we recorded approximately $8.5 million in restructuring and other related charges. During 2003, we recorded approximately $1.4 million in restructuring and other related charges.

The components of the charges recorded for the years ended December 31, 2001, 2002 and 2003, are as follows (in thousands):

	Excess Facilities	Excess Facilities — Warrants	Employee Separation Costs	Asset Impairments	Other	Total
Charge for the Year Ended December 31, 2001	$ 31,948	$ —	$ 3,724	$ 14,747	$1,387	$ 51,806
Cash Payments & Write-offs	(7,653)	—	(3,474)	(14,747)	(618)	(26,492)
Balance at December 31, 2001	24,295	—	250	—	769	25,314
Charge for the Year Ended December 31, 2002	4,361	920	1,266	2,204	(260)	8,491
Cash Payments & Write-offs	(16,522)		(880)	(2,204)	(455)	(20,061)
Balance at December 31, 2002	12,134	920	636	—	54	13,744
Charge for the Year Ended December 31, 2003	444		769	209		1,422
Cash Payments & Write-offs	(9,486)		(1,334)	(209)	(54)	(11,083)
Fair Value Adjustment		(355)	—	—	—	(355)
Balance at December 31, 2003	$ 3,092	$ 565	$ 71	$ —	$ —	$ 3,728

The excess facility charges recorded in 2001 and 2002 are the result of our decision to reduce our utilization of certain facilities and to terminate usage of certain domestic and international facilities altogether. The most significant portion of the excess facility charges relates to our leases for 262,000 square feet of office space in Bellevue, Washington, which commenced in April and June of 2001 and were originally contracted to expire in 2011 and 2013.

The partial lease termination agreement reached with Bellevue Hines Development, L.L.C., or Hines, in December 2003 reduced our excess facilities in Bellevue, Washington by approximately 202,000 square feet. Onyx continues to lease approximately 60,000 square feet at this facility, which began serving as our new corporate headquarters effective at the end of January 2003. The new lease for 60,000 square feet expires in December 2013. The partial lease termination requires cash outflows of approximately $1.4 million over the 4-month period ending April 2004, which is included in current restructuring-related liabilities at December 31, 2003. In addition to cash payments, Onyx issued three five-year warrants to Hines for the purchase of up to an aggregate of 198,750 shares of Onyx common stock. The warrant value as of December 31, 2002 was estimated at $920,000 based on (a) the estimated value of the warrants using the Black-Scholes model with an expected dividend yield of 0.0%, a risk-free interest rate of 5.0%, volatility of 85% and an expected life of five years and (b) the estimated value of the cash cancellation payments in the event of a change in control. The warrants are subject to variable accounting and we are required to mark the warrants to market at each reporting period. At December 31, 2003, the warrant value was estimated at $565,000 using similar assumptions to those used at December 31, 2002, and is included in long-term liabilities.

The accounting for excess facilities is complex and, as a result, may result in adjustments to our current restructuring charge. In particular, based on the terms of the warrants issued in connection with the partial lease termination of excess facilities in Bellevue, Washington, the warrants are subject to variable accounting and will be marked to market at each reporting period. Future cash outlays are anticipated through July 2006 unless estimates and assumptions change or we are able to negotiate to exit certain leases at an earlier date.

The current portion of restructuring-related liabilities totaled $2.8 million at December 31, 2003, the long-term portion of restructuring-related liabilities totaled $405,000 at December 31, 2003 and the value of the warrants issued in connection with the termination of certain facility lease obligations was $565,000 at December 31, 2003.

We are continuing to align our operations with our expected revenues and review our restructuring efforts. We may, however, be unable to achieve these expense reductions without adversely affecting our business and operating results. We may continue to experience losses and negative cash flows in the near term, unless sales of our products and services grow.

Amortization and impairment of goodwill and other acquisition-related intangibles

Amortization and impairment of acquired intangibles consists of intangible amortization associated with our acquisitions of EnCyc in 1998, Versametrix and Market Solutions in 1999, CSN Computer Consulting in 2000 and RevenueLab in 2001. Amortization and impairment of acquired intangibles totaled $13.7 million in 2001, $0.8 million in 2002 and $0.8 million in 2003. Amortization and impairment of acquired intangibles decreased from 2001 to 2002, due to the full impairment of the carrying value of intangibles associated with the acquisitions of CSN, Versametrix and RevenueLab during the third and fourth quarters of 2001, coupled with the elimination of goodwill amortization expense in 2002 as the result of the required adoption of new accounting pronouncements effective January 1, 2002, as more fully described in Note 1 to the accompanying consolidated financial statements.

Deferred stock-based compensation

We recorded deferred stock-based compensation of $2.2 million in 1998, representing the difference between the exercise prices of options granted to acquire shares of common stock during 1997 and 1998, prior to our initial public offering, and the deemed fair value for financial reporting purposes of our common stock on the grant dates. We recorded an additional $1.8 million in deferred compensation in connection with the options granted to new employees in conjunction with the acquisition of RevenueLab in January 2001.

Deferred compensation is amortized over the vesting periods of the options. We amortized stock-based compensation expense of $904,000 in 2001, $248,000 in 2002 and $30,000 in 2003. In 2003, we also recognized $38,000 of stock compensation expense associated with restricted stock awarded to a non-employee consultant and $2,000 of stock-based compensation expense associated with options granted to a non-employee consultant. Approximately $1.1 million of deferred compensation that was recorded in January 2001 in connection with options granted to employees of RevenueLab was reversed within shareholders' equity during 2001, 2002 and 2003 upon the employees' termination. Option-related deferred compensation recorded at our initial public offering was fully amortized as of December 31, 2002. The deferred stock-based compensation balance in connection with the acquisition of RevenueLab was fully amortized at December 31, 2003.

Other Income (Expense), Net

Other income (expense), net consists of earnings on our cash and cash equivalent and short-term investment balances, offset by interest expense and bank fees associated with debt obligations and credit facilities. Other income (expense), net was income of $377,000 in 2001, expense of $119,000 in 2002 and income of $78,000 in 2003. The decrease in other income (expense), net from 2001 to 2002 was primarily the result of an increase in bank fees and equity transaction-related expenses that were not associated with the sale of securities recorded during 2002, coupled with lower interest rates on marketable securities. The increase in other income (expense), net from 2002 to 2003 was primarily the result of equity transaction-related expenses which were not associated with the sale of securities recorded during 2002 which was not recurring in 2003, coupled with an increase in foreign currency gains during 2003, offset in part by a decrease in interest income.

Investment Losses and Impairment

During 2001, we recorded impairment losses totaling $2.5 million relating to other-than-temporary declines in three of our cost-basis equity investments, based on a review of qualitative and quantitative factors surrounding the financial condition of the investees. These impairment losses were recorded to reflect each investment at its estimated fair value. At December 31, 2003, the remaining carrying value of private equity investments totaled $500,000 and is included in other assets in the consolidated balance sheets.

Income Taxes

We recorded an income tax benefit of $294,000 in 2001, a provision of $585,000 in 2002 and a provision of $264,000 in 2003. The benefit recorded in 2001 resulted from the reduction of the deferred tax liability associated with the intangibles in connection with our acquisition of CSN, which was fully impaired during 2001. The significant provision recorded in 2002 was primarily due to withholding taxes associated with the settlement of royalties due to our U.S. entity by Onyx Japan, our Japanese joint venture. Although these withholding taxes generate foreign tax credits, we have recorded a valuation allowance for nearly all of the deferred tax asset as a result of uncertainties regarding the realization of the asset balance. Our income tax provision or benefit in all periods presented is primarily the net result of income taxes in connection with our foreign operations, offset by the deferred tax benefit recorded as we amortize the intangibles associated with our international acquisitions. We made only insignificant provisions and recorded no benefit for federal or state income taxes in 2001, 2002 or 2003 due to our historical operating losses, which resulted in deferred tax assets. We have recorded a valuation allowance for all but $362,000 of our deferred tax assets as a result of uncertainties regarding the realization of the asset balance.

Minority Interest in Loss of Consolidated Subsidiary

Softbank Investments Corporation and Prime Systems Corporation together own 42% of Onyx Japan, our Japanese joint venture. We have a controlling interest and, therefore, Onyx Japan has been included in our consolidated financial statements. The minority shareholders' interest in Onyx Japan's earnings or losses is accounted for in the statement of operations for each period. In 2001, 2002 and 2003, the minority shareholders' interest in Onyx Japan's losses totaled $1.3 million, $1.0 million and $118,000. At December 31, 2003, the minority shareholders' remaining interest in Onyx Japan totaled $119,000. Any future losses of Onyx Japan will be shared by the minority shareholders to the extent of their interest in the joint venture. As a result, additional Onyx Japan losses above approximately $283,000 in the aggregate will be absorbed 100% by Onyx, as compared to 58% in prior periods.

Quarterly Results of Operations

The following tables present our unaudited quarterly results of operations both in dollar amounts and expressed as a percentage of total revenues in 2002 and 2003. The trends discussed in the annual comparisons of operating results from 2001 to 2003 generally apply to the comparison of operating results for each of the quarters in 2002 and 2003. Our quarterly operating results have varied widely in the past, and we expect that they will continue to fluctuate in the future as a result of a number of factors, many of which are outside our control.

You should read these tables in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this report. We have prepared this unaudited information on the same basis as the audited Consolidated Financial Statements. This table includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of our financial position and operating results for the quarters presented. You should not draw any conclusions about our future results from the results of operations for any quarter.

	Three Months Ended							
	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003
	(In thousands, except per share data)							
Consolidated Statement of Operations Data:								
Revenue:								
License	$ 3,054	$ 6,509	$ 7,265	$ 5,805	$ 2,619	$ 3,122	$ 3,633	$ 2,769
Support and service	11,561	12,001	11,763	11,426	11,588	12,688	11,767	10,187
Total revenue	14,615	18,510	19,028	17,231	14,207	15,810	15,400	12,956
Cost of revenue:								
License	171	226	270	473	285	197	175	191
Amortization of acquired technology	138	138	138	84	84	84	84	3
Support and service	5,208	5,051	4,922	4,947	5,435	5,443	5,251	4,582
Total cost of revenue	5,517	5,415	5,330	5,504	5,804	5,724	5,510	4,776
Gross margin	9,098	13,095	13,698	11,727	8,403	10,086	9,890	8,180
Operating expenses:								
Sales and marketing	5,997	7,062	7,882	7,006	6,483	5,082	4,460	4,604
Research and development	3,953	4,023	3,530	3,239	3,129	3,147	2,798	2,764
General and administrative	2,539	2,437	2,382	2,091	2,253	1,842	2,158	1,952
Restructuring and other related charges	2,617	3,941	1,171	762	340	754	162	166
Amortization of other acquisition-related intangibles	209	209	209	209	209	209	209	209
Stock-based compensation	87	65	51	45	13	15	4	38
Total operating expenses	15,402	17,737	15,225	13,352	12,427	11,049	9,791	9,733
Income (loss) from operations	(6,304)	(4,642)	(1,527)	(1,625)	(4,024)	(963)	99	(1,553)
Other income (expense), net	(373)	31	269	(46)	9	111	(117)	75
Change in fair value of outstanding warrants	—	—	—	—	242	15	(123)	221
Loss before income taxes	(6,677)	(4,611)	(1,258)	(1,671)	(3,773)	(837)	(141)	(1,257)
Income tax provision (benefit)	14	398	(29)	202	(214)	135	86	257
Minority interest in income (loss) of consolidated subsidiary	(133)	(339)	(345)	(215)	(157)	(75)	32	82
Net loss	$(6,558)	$(4,670)	$ (884)	$(1,658)	$(3,402)	$ (897)	$ (259)	$(1,596)
Basic and diluted net loss per share(1)(2)	$ (0.55)	$ (0.37)	$ (0.07)	$ (0.13)	$ (0.27)	$ (0.07)	$ (0.02)	$ (0.11)
Shares used in calculation of basic and diluted net loss per share(1)	12,030	12,605	12,641	12,642	12,698	13,238	13,902	13,914

(1) See Notes 1 and 12 of Notes to Consolidated Financial Statements for an explanation of the method used to calculate basic and diluted net loss per share.

(2) The sum of the quarterly per share amounts may not equal per share amounts reported for year-to-date periods. This is due to changes in the number of weighted-average shares outstanding and the effects of rounding for each period.

	Three Months Ended							
	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003
Consolidated Statement of Operations Data:								
Revenue:								
License	20.9%	35.2%	38.2%	33.7%	18.4%	19.7%	23.6%	21.4%
Support and service	79.1	64.8	61.8	66.3	81.6	80.3	76.4	78.6
Total revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cost of revenue:								
License	1.2	1.2	1.4	2.7	2.0	1.3	1.1	1.5
Amortization of acquired technology	0.9	0.7	0.7	0.5	0.6	0.5	0.6	0.0
Support and service	35.6	27.3	25.9	28.7	38.3	34.4	34.1	35.4
Total cost of revenue	37.7	29.2	28.0	31.9	40.9	36.2	35.8	36.9
Gross margin	62.3	70.8	72.0	68.1	59.1	63.8	64.2	63.1
Operating expenses:								
Sales and marketing	41.0	38.2	41.4	40.7	45.6	32.1	29.0	35.5
Research and development	27.1	21.7	18.6	18.8	22.0	19.9	18.2	21.3
General and administrative	17.4	13.2	12.5	12.1	15.9	11.7	14.0	15.1
Restructuring and other related charges	17.9	21.3	6.1	4.4	2.4	4.8	1.0	1.3
Amortization of other acquisition-related intangibles	1.4	1.1	1.1	1.2	1.5	1.3	1.4	1.6
Stock-based compensation	0.6	0.4	0.3	0.3	0.1	0.1	0.0	0.3
Total operating expenses	105.4	95.9	80.0	77.5	87.5	69.9	63.6	75.1
Income (loss) from operations	(43.1)	(25.1)	(8.0)	(9.4)	(28.4)	(6.1)	0.6	(12.0)
Other income (expense), net	(2.6)	0.2	1.4	(0.3)	0.1	0.7	(0.7)	0.6
Change in fair value of outstanding warrants	—	—	—	—	1.7	0.1	(0.8)	1.7
Loss before income taxes	(45.7)	(24.9)	(6.6)	(9.7)	(26.6)	(5.3)	(0.9)	(9.7)
Income tax provision (benefit)	0.1	2.2	(0.2)	1.2	(1.5)	0.9	0.6	2.0
Minority interest in income (loss) of consolidated subsidiary	(0.9)	(1.8)	(1.8)	(1.2)	(1.1)	(0.5)	0.2	0.6
Net loss	(44.9)%	(25.3)%	(4.6)%	(9.7)%	(24.0)%	(5.7)%	(1.7)%	(12.3)%

Liquidity and Capital Resources

At December 31, 2003, we had unrestricted cash and cash equivalents of $10.1 million, a decrease of $6.9 million from unrestricted cash and cash equivalents held at December 31, 2002. At December 31, 2003, we also had restricted cash balances totaling $1.7 million, as compared to $2.2 million at December 31, 2002. We sometimes invest our cash in excess of current operating requirements in a portfolio of investment-grade securities. We did not hold any short-term marketable securities as of December 31, 2002 or December 31, 2003.

As of December 31, 2003, our principal obligations consisted of restructuring-related liabilities totaling $3.2 million, excluding the value assigned to warrants, of which $2.8 million is expected to be paid within the next 12 months, accrued liabilities of $2.4 million, trade payables of $883,000 and salaries and benefits payable of $946,000. The majority of the restructuring-related liabilities relate to excess facilities in domestic and international markets, the most significant portion of which relates to the termination agreement signed in December 2002 in connection with excess facilities in Bellevue, Washington. The majority of our accounts payable, salaries and benefits payable and accrued liabilities at December 31, 2003 will be settled during the next three months and will result in a corresponding decline in the amount of cash and cash equivalents, offset by liabilities associated with activity in the first quarter of 2004. Off-balance sheet obligations as of December 31, 2003 primarily consisted of operating leases associated with facilities in Bellevue, Washington and other domestic and international field office facilities.

As of December 31, 2003, our future fixed commitments are as follows (in thousands):

	2004	2005 to 2006	2007 to 2008	Thereafter	Total
Operating lease obligations not in restructuring	$3,866	$5,828	$4,665	$17,410	$31,769
Operating lease obligations in restructuring	3,154	2,349	1,795	598	7,896
Third-party royalty commitments	323	—	—	—	323
Total fixed commitments	$7,343	$8,177	$6,460	$18,008	$39,988

The amounts reflected in the above table only include the fixed, non-cancelable portion of our lease commitments. Any variable operating expenses associated with our lease commitments are not included in the above table, but have been included in annual rent expense as disclosed in Note 9 to our consolidated financial statements. In addition, the lease commitments designated as "Operating lease obligations in restructuring" only include the non-cancelable portion of lease commitments included in the restructuring liability and, accordingly, have not been reduced by estimated sublease income. However, as required by EITF Issue No. 88-10, "Costs Associated with Lease Modification or Termination," or EITF 88-10, we have reduced these lease commitments by estimated sublease income of $5.7 million and increased these commitments by estimated operating costs in determining the total restructuring obligations recorded in the accompanying balance sheet as of December 31, 2003. Please refer to Notes 3 and 9 to our consolidated financial statements for a further discussion of restructuring charges and our lease commitments and other contingencies, respectively.

Indemnification and warranty provisions contained within our customer license and service agreements are generally consistent with those prevalent in our industry. The duration of our product warranties generally does not exceed 90 days following delivery of our products. We evaluate estimated losses for such indemnifications under SFAS 5, "Accounting for Contingencies," as interpreted by FIN 45. We consider such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. We have not incurred significant obligations under customer indemnification or warranty provisions historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential customer indemnification or warranty-related obligations.

In documents dated March 28, 2003 and May 5, 2003, we amended our Loan and Security Agreement with Silicon Valley Bank, or SVB, which was originally entered into in February 2002, and entered into a second Loan and Security Agreement with SVB that is intended to take advantage of a loan guarantee by the Export Import Bank of the United States, or Exim Bank. The loan documents were further amended on January 12, 2004 to revise the tangible net worth covenant and the accounts receivable advance rates beginning with the month ended December 31, 2003. Under the terms of these agreements, we have a total $15.0 million working capital revolving line of credit with SVB, which is split between a $13.0 million domestic facility and a $2.0 million Exim Bank facility. Both are secured by accounts receivable, property and equipment and intellectual property. The domestic facility allows us to borrow up to the lesser of (a) 70% of eligible domestic and individually approved foreign accounts receivable and (b) $13.0 million. The Exim Bank facility allows us to borrow up to the lesser of (a) 75% of eligible foreign accounts receivable and (b) $2.0 million. If the borrowing base calculation falls below the outstanding standby letters of credit issued by SVB on our behalf, SVB may require us to cash secure the amount by which outstanding standby letters of credit exceed the borrowing base. The amount required to be restricted under the loan agreement was $1.7 million, measured as of December 31, 2003. Due to the variability in our borrowing base, we may be subject to restrictions on our cash at various times throughout the year. Any borrowings will bear interest at SVB's prime rate, which was 4.0% as of December 31, 2003, plus 1.5%, subject to a minimum rate of 6.0%. The loan agreements require us to maintain certain financial covenants based on its adjusted quick ratio and tangible net worth. We were in compliance with these covenants, as amended, at December 31, 2003. Absent the amendment, we would have been out of compliance with the loan agreement as of December 31, 2003. We are also prohibited under the loan and security agreements from paying dividends. The facilities expire in March 2004. Based on the outstanding standby letters of credit relating to long-term lease obligations totaling $8.0 million at December 31, 2003, no additional amounts are currently available under the credit facilities. As long as we continue to be in compliance with the terms of our termination agreement and the surviving lease agreement with Hines, the outstanding letter of credit with Hines will be reduced in five equal monthly reductions of $507,000 ending in May 2004. As of the date of this filing, we are in the process of renewing our Loan and Security Agreement with SVB and expect the agreement to be renewed with terms that are acceptable to us. If, however, we are unable to negotiate a new agreement with SVB that has terms acceptable to us, we are unable to maintain compliance with our covenants in the future, or if SVB decides to restrict our cash deposits, our liquidity would be further limited and our business, financial condition and operating results could be materially harmed.

Our operating activities resulted in net cash outflows of $21.3 million in 2001, $17.2 million in 2002 and $9.7 million in 2003. Our operating cash outflows in 2001 were primarily the result of our operating loss adjusted for non-cash amortization and impairment charges, decreases in accounts payable and accrued liabilities, decreases in deferred revenues, offset in part by cash provided by increases in prepaid expenses and other assets and collections on accounts receivable. Our operating cash outflows in 2002 were primarily the result of our operating loss adjusted for non-cash amortization and impairment charges, decreases in restructuring-related liabilities, decreases in accounts payable and accrued liabilities, decreases in deferred revenues, increases in prepaid expenses and other assets, offset in part by cash provided by collections on accounts receivable. Our operating cash outflows in 2003 were primarily the result of our operating loss for the period adjusted for non-cash amortization and impairment charges, decreases in accounts payable, salaries and benefits payable and accrued liabilities, decreases in restructuring-related liabilities, decreases in deferred revenues, offset in part by cash provided by collections on accounts receivable, decreases in prepaid expenses and other assets and increases in income taxes payable. The net cash outflow of $21.3 million in 2001 includes $11.3 million in cash paid for restructured items. The net cash outflow of $17.2 million in 2002 includes $18.1 million in cash paid for restructured items. The net cash outflow of $9.7 million in 2003 includes $10.9 million in cash paid for restructured items.

Investing activities used cash of $7.2 million in 2001, primarily for funding leasehold improvements and purchasing capital equipment associated with our new Bellevue, Washington facility, the lease for which 202,000 square feet has been terminated and an amended lease entered into for the approximate 60,000 square feet we currently occupy, coupled with cash used to acquire RevenueLab, offset in part by the net proceeds from the maturity of short-term marketable securities. Investing activities used cash of $3.3 million in 2002, primarily due to the restriction of cash used to secure our outstanding letters of credit and corporate card program and funding of capital expenditures associated with our relocation to our new corporate headquarters in January 2003. Investing activities used cash of $683,000 in 2003 primarily due to capital expenditures associated with the relocation of our corporate headquarters in January 2003 offset by the release of the restriction of cash used to secure outstanding letters of credit.

Financing activities provided cash of $33.6 million in 2001, primarily due to the proceeds from our public offering of common stock in February 2001. Additionally, proceeds from the exercise of stock options and the purchase of stock through our employee stock purchase plan, offset in part by payments on our long-term obligations, added to cash generated from financing activities in 2001. Financing activities provided cash of $21.2 million in 2002, primarily due to the proceeds from our public offering of common stock in February 2002. Additionally, proceeds from the exercise of stock options and shares issued under our employee stock purchase plan, offset in part by payments on our long-term obligations, added to cash generated from financing activities in 2002. Financing activities provided cash of $3.0 million in 2003 primarily due to the proceeds from our private offering of common stock in May 2003 and proceeds from our employee stock purchase plan and the exercise of stock options, offset in part by payments on our long-term obligations.

Our near-term restructuring costs related to the mitigation of our excess facilities liabilities will consume a material amount of our cash resources. The termination of approximately 202,000 square feet in Bellevue, Washington will result in cash outflows of approximately $1.4 million over the four-month period ending April 2004 and is included in current restructuring-related liabilities at December 31, 2003. Finally, it is also possible that we will use a portion of our cash resources to acquire or invest in complementary business, products or technologies; however, we currently have no commitments or agreements with respect to any transactions of this nature.

We believe our future revenue performance will be comparable to the most recent quarterly periods reported and that our existing cash and cash equivalents will be sufficient to meet our capital requirements for at least the next 12 months. Accordingly, we believe that we have sufficient resources to continue as a going concern through at least December 31, 2004. Should our revenue results for subsequent quarters fall below the results we achieved in the fourth quarter of 2003, we would likely take action to restructure our operations to preserve our cash. Such actions would primarily consist of reductions in headcount. Due to the fact that lower cash balances could negatively impact our sales efforts, we may seek additional funds in the future through public or private equity financing or from other sources to fund our operations and pursue our growth strategy. We may experience difficulty in obtaining funding on favorable terms, if at all. Any financing we might obtain may contain covenants that restrict our freedom to operate our business or may require us to issue securities that have rights, preferences or privileges senior to our common stock and may dilute current shareholders' ownership interest in Onyx.

Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," or FIN 46. In general, a variable interest entity is a corporation, partnership, trust or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. In December 2003, the FASB issued FIN 46R with respect to variable interest entities created before January 31, 2003, which among other things, revised the implementation date to the first fiscal year or interim period ending after March 15, 2004, with the exception of Special Purpose Entities. We do not expect the adoption of FIN 46 to have a material impact on our financial position or results of operations.

In December 2003, the SEC issued Staff Accounting Bulletin, or SAB, No. 104, "Revenue Recognition," which revises or rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on our financial position or results of operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates and foreign currencies.

Interest Rate Risk

We typically do not attempt to reduce or eliminate our market exposures on our investment securities because all of our investments are short-term in nature and are classified as cash equivalents as of December 31, 2003. Due to the short-term nature of these investments, their fair value would not be significantly impacted by either a 100 basis point increase or decrease in interest rates. We do not use any hedging transactions or any financial instruments for trading purposes and we are not a party to any leveraged derivatives.

Foreign Currency Risk

In 2003, international revenue accounted for 39% of our consolidated revenues compared to 36% in 2002 and 30% in 2001. International revenue, as well as most of the related expenses incurred, is denominated in the functional currencies of the corresponding country. Results of operations from our foreign subsidiaries are exposed to foreign currency exchange rate fluctuations as the financial results of these subsidiaries are translated into U.S. dollars upon consolidation. As exchange rates vary, revenues and other operating results, when translated, may differ materially from expectations. The effect of foreign exchange transaction gains and losses were not material to Onyx during 2003 or in the prior two fiscal years.

At December 31, 2003, we were also exposed to foreign currency risk related to the assets and liabilities of our foreign subsidiaries, in particular, our United Kingdom operation denominated in British pounds and our consolidated Japanese joint venture denominated in Yen. Cumulative unrealized translation gains related to the consolidation of Onyx UK, including the goodwill and other intangible assets resulting from the acquisition of Market Solutions amounted to $1.8 million at December 31, 2003. The unrealized gain in 2003 specifically associated with the goodwill and other acquisition-related intangibles of Market Solutions amounted to $1.4 million. Cumulative unrealized translation losses related to the consolidation of Onyx Japan amounted to $473,000 at December 31, 2003. These unrealized translation gains and losses combined with the cumulative unrealized translation gains related to the consolidation of our other foreign subsidiaries, resulted in net consolidated cumulative unrealized translation gains of $1.8 million.

Although we have not engaged in foreign currency hedging to date, we may do so in the future.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF KPMG LLP, INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Onyx Software Corporation:

We have audited the consolidated balance sheets of Onyx Software Corporation and subsidiaries as of December 31, 2002 and 2003 and the related consolidated statements of operations, shareholders' equity and comprehensive loss, and cash flows for the years then ended. In connection with our audits of the consolidated financial statements, we have also audited the related 2002 and 2003 financial statement schedule as listed in the index at Item 15(a). These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule 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 Onyx Software Corporation and subsidiaries as of December 31, 2002 and 2003, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related 2002 and 2003 financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for goodwill and other intangible assets as of January 1, 2002.

/s/ KPMG LLP

Seattle, Washington
January 30, 2004

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Onyx Software Corporation

We have audited the accompanying consolidated statements of operations, shareholders' equity and comprehensive loss, and cash flows for the year ended December 31, 2001. Our audit also includes the financial statement schedule listed in the index at Item 15(a). These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated results of operations and cash flows of Onyx Software Corporation for the year ended December 31, 2001 in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Seattle, Washington
January 29, 2002

ONYX SOFTWARE CORPORATION

CONSOLIDATED BALANCE SHEETS

	December 31, 2002	December 31, 2003
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,041	$ 10,127
Restricted cash	2,238	1,723
Accounts receivable, less allowances of $1,039 in 2002 and $488 in 2003	14,408	12,245
Current deferred tax asset	273	362
Prepaid expenses and other	3,374	1,666
Total current assets	37,334	26,123
Property and equipment, net	6,474	4,277
Purchased technology, net	253	—
Other intangibles, net	1,461	675
Goodwill, net	8,180	9,508
Other assets	1,085	842
Total assets	$ 54,787	$ 41,425
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,484	$ 883
Salary and benefits payable	1,675	946
Accrued liabilities	3,147	2,373
Income taxes payable	660	770
Current portion of capital-lease obligations	180	—
Current portion of restructuring-related liabilities	10,224	2,758
Deferred revenue	16,258	16,078
Total current liabilities	33,628	23,808
Capital-lease obligations, less current portion	77	—
Long-term restructuring-related liabilities, less current portion	2,600	405
Long-term restructuring-related liabilities — warrants	920	565
Deferred tax liabilities	497	229
Minority interest in joint venture	237	119
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $0.01 par value:		
Authorized shares — 20,000,000; Issued and outstanding shares — none	—	—
Common stock, $0.01 par value:		
Authorized shares — 80,000,000; Issued and outstanding shares — 12,696,739 in 2002 and 13,969,503 in 2003	139,459	142,682
Deferred stock-based compensation	(84)	—
Accumulated deficit	(122,061)	(128,215)
Accumulated other comprehensive income (loss)	(486)	1,832
Total shareholders' equity	16,828	16,299
Total liabilities and shareholders' equity	$ 54,787	$ 41,425

See accompanying notes to consolidated financial statements.

ONYX SOFTWARE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2001	2002	2003
	(In thousands, except per share data)		
Revenue:			
License	$ 37,584	$ 22,633	$12,143
Support and service	62,116	46,751	46,230
Total revenue	99,700	69,384	58,373
Cost of revenue:			
License	2,006	1,140	848
Amortization of acquired technology	751	498	255
Support and service	35,662	20,128	20,711
Total cost of revenue	38,419	21,766	21,814
Gross margin	61,281	47,618	36,559
Operating expenses:			
Sales and marketing	53,254	27,947	20,629
Research and development	21,968	14,745	11,838
General and administrative	14,623	9,449	8,205
Restructuring and other related charges	51,806	8,491	1,422
Amortization of other acquisition-related intangibles	13,695	836	836
Stock-based compensation	904	248	70
Total operating expenses	156,250	61,716	43,000
Loss from operations	(94,969)	(14,098)	(6,441)
Other income (expense), net	377	(119)	78
Change in fair value of outstanding warrants	—	—	355
Investment losses and impairment	(2,500)	—	—
Loss before income taxes	(97,092)	(14,217)	(6,008)
Income tax provision (benefit)	(294)	585	264
Minority interest in loss of consolidated subsidiary	(1,283)	(1,032)	(118)
Net loss	$(95,515)	$(13,770)	$(6,154)
Net loss per share:			
Basic and diluted	$ (9.46)	$ (1.10)	$ (0.46)
Shares used in calculation of net loss per share:			
Basic and diluted	10,092	12,481	13,442

See accompanying notes to consolidated financial statements.

ONYX SOFTWARE CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE LOSS
(In thousands, except share data)

	Common Stock		Common Stock Issuable in Acquisition	Note Receivable from Officer for Common Stock	Deferred Stock-Based Compensation	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity (Deficit)
	Shares	Amount						
Balance at January 1, 2001	9,399,417	$ 75,416	$4,320	$(157)	$ (413)	$ (12,776)	$ (304)	$66,086
Common stock issued in connection with acquisitions	604,986	9,979	(4,320)	—	(1,840)	—	—	3,819
Amortization of deferred stock compensation	—	—	—	—	904	—	—	904
Reversal of deferred stock-based compensation associated with terminated employees	—	(540)	—	—	540	—	—	—
Shareholder loan repayment	—	—	—	157	—	—	—	157
Exercise of stock options	298,680	912	—	—	—	—	—	912
Issuance of common stock under ESPP	59,385	1,265	—	—	—	—	—	1,265
Proceeds from public offering, net of offering costs of $2,225	625,000	31,525	—	—	—	—	—	31,525
Comprehensive loss:								
Cumulative translation loss	—	—	—	—	—	—	(1,045)	
Unrealized gains on marketable securities	—	—	—	—	—	—	27	
Net loss	—	—	—	—	—	(95,515)	—	
Total comprehensive loss								(96,533)
Balance at December 31, 2001	10,987,468	118,557	—	—	(809)	(108,291)	(1,322)	8,135
Amortization of deferred stock compensation	—	—	—	—	248	—	—	248
Reversal of deferred stock-based compensation associated with terminated employees	—	(477)	—	—	477	—	—	—
Exercise of stock options	47,224	240	—	—	—	—	—	240
Issuance of common stock under ESPP	77,891	558	—	—	—	—	—	558
Proceeds from public offering, net of offering costs of $1,606	1,581,250	20,531	—	—	—	—	—	20,531
Issuance of common stock to vendor for services rendered	2,906	50	—	—	—	—	—	50
Comprehensive loss:								
Foreign currency translation gain	—	—	—	—	—	—	836	
Net loss	—	—	—	—	—	(13,770)	—	
Total comprehensive loss								(12,934)
Balance at December 31, 2002	12,696,739	139,459	—	—	(84)	(122,061)	(486)	16,828
Amortization of deferred stock compensation	—	—	—	—	30	—	—	30
Reversal of deferred stock-based compensation associated with terminated employees	—	(54)	—	—	54	—	—	—
Exercise of stock options	20,643	56	—	—	—	—	—	56
Issuance of common stock under ESPP	109,340	366	—	—	—	—	—	366
Proceeds from private placement, net of offering costs of $200	1,135,697	2,815	—	—	—	—	—	2,815
Issuance of options to third-party consultant	—	2	—	—	—	—	—	2
Issuance of common stock to third-party consultant	7,084	38	—	—	—	—	—	38
Comprehensive loss:								
Foreign currency translation gain	—	—	—	—	—	—	2,318	
Net loss	—	—	—	—	—	(6,154)	—	
Total comprehensive loss								(3,836)
Balance at December 31, 2003	13,969,503	$142,682	$ —	$ —	$ —	$(128,215)	$ 1,832	$16,299

See accompanying notes to consolidated financial statements.

ONYX SOFTWARE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2001	2002	2003
	(In thousands)		
OPERATING ACTIVITIES			
Net loss	$(95,515)	$(13,770)	$(6,154)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	12,917	6,505	4,182
Accretion of premium on investments	5	—	—
Deferred income taxes	(1,129)	(461)	(357)
Noncash stock-based compensation expense	904	248	70
Change in fair value of outstanding warrants	—	—	(355)
Impairment on intangible assets	7,812	—	—
Impairment on property and equipment	13,821	2,290	284
Minority interest in loss of consolidated subsidiary	(1,283)	(1,032)	(118)
Investment losses and impairment	2,500	—	—
Changes in operating assets and liabilities:			
Accounts receivable	20,916	5,887	2,594
Prepaid expenses and other assets	1,905	(494)	1,951
Accounts payable and accrued liabilities	(9,244)	(1,812)	(2,104)
Restructuring-related liabilities	25,314	(11,570)	(9,661)
Deferred revenue	(135)	(2,933)	(180)
Income taxes	(113)	(35)	110
Net cash used in operating activities	(21,325)	(17,177)	(9,738)
INVESTING ACTIVITIES			
Purchases of securities	(4,900)	—	—
Proceeds from maturity of securities	10,417	—	—
Acquisitions, net of cash acquired	(869)	—	—
Restricted cash	—	(2,238)	515
Proceeds on disposal of equipment	—	204	—
Purchases of property and equipment, net	(11,817)	(1,255)	(1,198)
Net cash used in investing activities	(7,169)	(3,289)	(683)
FINANCING ACTIVITIES			
Net proceeds from sale of common stock	31,525	20,531	—
Net proceeds from private placement	—	—	2,815
Proceeds from exercise of stock options	912	240	56
Proceeds from shares issued through employee stock purchase plan	1,265	558	366
Proceeds from repayment of shareholder notes	157	—	—
Payments on capital lease obligations	(249)	(164)	(257)
Net cash provided by financing activities	33,610	21,165	2,980
Effect of exchange rate changes on cash	(740)	474	527
Net increase (decrease) in cash and cash equivalents	4,376	1,173	(6,914)
Cash and cash equivalents at beginning of year	11,492	15,868	17,041
Cash and cash equivalents at end of year	$ 15,868	$ 17,041	$10,127
SUPPLEMENTAL CASH FLOW DISCLOSURES			
Interest paid	$ 191	$ 118	$ 139
Income taxes paid, net	797	1,092	565
Payment of obligation with common stock	—	50	38
Issuance of common stock and stock options in connection with acquisitions	9,439	—	—

See accompanying notes to consolidated financial statements.

ONYX SOFTWARE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of the Company and Summary of Significant Accounting Policies

Description of the Company

Onyx Software Corporation and subsidiaries (Company) is a leading provider of enterprise-wide customer relationship management (CRM) solutions designed to promote strategic business improvement and revenue growth by enhancing the way businesses market, sell and service their products. Using the Internet in combination with traditional forms of interaction, including phone, mail, fax and e-mail, the Company's solution helps enterprises to more effectively acquire, manage and maintain customer, partner and other relationships. The Company markets its solution to companies that want to merge new, online business processes with traditional business processes to enhance their customer-facing operations, such as marketing, sales, customer service and technical support. The Company's solution uses a single data model across all customer interactions, resulting in a single repository for all marketing, sales and service information. It is fully integrated across all customer-facing departments and interaction media. The Company's solution is designed to be easy to use, widely accessible, rapidly deployable, scalable, flexible, customizable and reliable, which can result in a low total cost of ownership and rapid return on investment. The Company was incorporated in the state of Washington on February 23, 1994 and maintains its headquarters in Bellevue, Washington.

Reverse Stock Split

On July 23, 2003, the Company's shareholders approved a one-for-four reverse stock split which became effective on that date. All share and per share amounts in the accompanying consolidated financial statements have been adjusted to reflect this reverse stock split.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements. Changes in these estimates and assumptions may have a material impact on the financial statements. The Company has used estimates in determining certain provisions, including uncollectible trade accounts receivable, useful lives for property and equipment, intangibles, tax liabilities and restructuring liabilities.

Revenue Recognition

The Company recognizes revenue in accordance with accounting standards for software companies including Statement of Position (SOP) 97-2, "Software Revenue Recognition", as amended by SOP 98-9, and related interpretations, including Technical Practice Aids.

The Company generates revenue through two sources: (a) software license revenue and (b) support and service revenue. Software license revenue is generated from licensing the rights to use the Company's products directly to end-users and vertical service providers (VSPs) and indirectly through value-added resellers (VARs) and, to a lesser extent, through third-party products the Company distributes. Support and service revenue is generated from sales of customer support services, consulting services and training services performed for customers that license the Company's products.

License revenue is recognized when a noncancellable license agreement becomes effective as evidenced by a signed contract, the product has been shipped, the license fee is fixed or determinable, and collectibility is probable.

In software arrangements that include rights to multiple software products and/or services, the Company allocates the total arrangement fee among each of the deliverables using the residual method, under which revenue is allocated to undelivered elements based on vendor-specific objective evidence of fair value of such undelivered elements and the residual amounts of revenue are allocated to delivered elements. Elements included in multiple element arrangements could consist of software products, maintenance (which includes customer support services and unspecified upgrades), or consulting services. Vendor-specific objective evidence is based on the price charged when an element is sold separately or, in the case of an element not yet sold separately, the price established by authorized management, if it is probable that the price, once established, will not change once the element is sold separately.

Standard terms for license agreements call for payment within 90 days. Probability of collection is based on the assessment of the customer's financial condition through the review of its current financial statements or credit reports. For follow-on sales to existing customers, prior payment history is also used to evaluate probability of collection. Revenue from distribution agreements with VARs is typically recognized on the earlier of receipt of cash from the VAR or identification of an end-user. In the latter case, probability of collection is evaluated based upon the credit worthiness of the VAR. The Company's agreements with its customers, VSPs and VARs do not contain product return rights.

Revenue from maintenance arrangements is recognized ratably over the term of the contract, typically one year. Consulting revenue is primarily related to implementation services performed on a time-and-materials basis, or in certain situations on a fixed-fee basis, under separate service arrangements. Revenue from consulting and training services is recognized as services are performed. Standard terms for renewal of maintenance arrangements, consulting services and training services call for payment within 30 days.

Fees from licenses sold together with consulting services are generally recognized upon shipment of the software, provided that the above criteria are met, payment of the license fees do not depend on the performance of the services, and the consulting services are not essential to the functionality of the licensed software. If the services are essential to the functionality of the software, or payment of the license fees depends on the performance of the services, both the software license and consulting fees are recognized under the percentage of completion method of contract accounting.

If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. If a nonstandard acceptance period is provided, revenue is recognized upon the earlier of customer acceptance and the expiration of the acceptance period.

Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with a remaining maturity of three months or less at the date of purchase to be cash equivalents. At December 31, 2002 and 2003, the Company's cash equivalents consisted of money market funds.

Separately, the Company had $2.2 million and $1.7 million in restricted cash at December 31, 2002 and 2003, respectively, which was security for its credit line with Silicon Valley Bank that supports its outstanding letters of credit and its corporate card program as of December 31, 2002 and security for its credit line as of December 31, 2003.

Fair Values of Financial Instruments

At December 31, 2003, the Company had the following financial instruments: cash and cash equivalents, accounts receivable, cost method equity instruments, accounts payable, salaries and benefits payable and accrued liabilities. The carrying value of cash and cash equivalents, accounts receivable, accounts payable, salaries and benefits payable, and accrued liabilities approximates their fair value based on the liquidity of these financial instruments or based on their short-term nature. Refer to the disclosures regarding *Investment Losses and Impairment* in Note 1 for details of how cost method equity investments are valued.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization is provided using the straight-line method over the estimated useful lives of the related assets (or over the lease term if it is shorter for leasehold improvements), which range from two to seven years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life.

Intangible Assets and Goodwill

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets," in July 2001. SFAS No. 141 requires that all business combinations be accounted for using the purchase method, thereby prohibiting the pooling-of-interests method. SFAS No. 141 also specifies criteria for recognizing and reporting intangible assets apart from goodwill; however, assembled workforce must be recognized and reported in goodwill. SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles. Under a non-amortization approach, goodwill and certain intangibles are no longer amortized into results of operations, but instead are reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles is more than their fair value.

The Company adopted the provisions of SFAS No. 142 as of January 1, 2002. The Company reclassified an assembled workforce intangible asset with an unamortized balance of $1.2 million (along with a deferred tax liability of $387,000) to goodwill on January 1, 2002. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets."

In connection with SFAS No. 142's transitional goodwill impairment evaluation, the Statement required the Company to perform an assessment of whether there was an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company was required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of January 1, 2002. The Company was required to determine the fair value of each reporting unit and compare it to the carrying amount of the reporting unit. To the extent the carrying amount of a reporting unit exceeded the fair value of the reporting unit, the Company would be required to perform the second step of the transitional impairment test, as this is an indication that the reporting unit goodwill may be impaired. The second step, which requires a comparison of the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill, was not required because the carrying amount of goodwill did not exceed the fair value of the reporting unit. In the fourth quarters of 2002 and 2003, the Company performed a similar test to that described above, in connection with its annual impairment test required under SFAS No. 142 and, again, the implied fair value of the reporting units exceeded their respective carrying amounts and the Company was not required to recognize any impairment loss.

Prior to the adoption of SFAS No. 142, goodwill was amortized on a straight-line basis over the expected periods to be benefited, generally three to five 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 of the acquired operation. All other intangible assets were amortized on a straight-line basis from three to five years .The amount of goodwill and other intangible asset impairment, if any, was measured based on projected discounted future operating cash flows.

As required by SFAS No. 142, the Company has ceased amortization of goodwill effective January 1, 2002. Prior to January 1, 2002, the Company amortized goodwill over three to five years using the straight-line method. Identifiable intangibles are currently amortized over two to five years using the straight-line method.

Impairment of Long-Lived Assets

On January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes certain provisions of Accounting Principles Board (APB) Opinion No. 30, "Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," and supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." In accordance with SFAS No. 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Prior to the adoption of SFAS No. 144, the Company accounted for long-lived assets in accordance with SFAS No. 121, "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of."

Investment Losses and Impairment

During 1999 and 2000, the Company invested in a small number of private companies. One of these investments was accounted for using the equity method of accounting due to the Company's ability to exercise significant influence, but not control, over the investee and losses were recorded to the extent of our investment in 2000. The remaining private equity investments are accounted for on a cost basis since the Company does not have the ability to exercise significant influence over the investee and the Company's ownership interest is less than 20%. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value. The Company periodically evaluates whether any declines in fair value of its investments are other-than-temporary. This evaluation consists of a review of qualitative and quantitative factors by members of senior management, including a review of the investee's financial condition, results of operations, operating trends and other financial ratios. The Company considers the implied value from any recent rounds of financing completed by the investee, as well as market prices of comparable public companies for purposes of determining estimated fair value. The Company generally requires its private investees to deliver monthly, quarterly and annual financial statements to assist in reviewing relevant financial data and to assist in determining whether such data may indicate other-than-temporary declines in fair value below the Company's accounting basis. The Company generally considers a decline to be other-than-temporary if the estimated value is less than its accounting basis for two consecutive quarters, absent evidence to the contrary.

Research and Development Costs

Research and development costs, which consist primarily of software development costs, are expensed as incurred. Financial accounting standards provide for the capitalization of certain software development costs after technological feasibility of the software is established. Under the Company's current practice of developing new products and enhancements, the technological feasibility of the underlying software is not established until the development of a working model. To date, the period between achieving technological feasibility and the general availability of such software has been short; therefore, software development costs qualifying for capitalization have been immaterial.

Accounts Receivable and Concentration of Credit Risk

The Company's customer base is dispersed across many different geographic areas throughout North America, Europe, Asia Pacific and Latin America. Accounts receivable are recorded at the invoiced amount and do not bear interest. 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 determines the allowance based on historical write-off experience by industry and national economic data. The majority of the Company's customers are in the financial services, healthcare and high technology industries and are affected by decreased corporate and consumer spending. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and above a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis. 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 Company does not have any off-balance-sheet credit exposure related to its customers.

During 2001, 2002 and 2003, no single customer accounted for 10% or more of total revenues. At December 31, 2002 and 2003, no single customer accounted for more than 10% of accounts receivable. The Company does not require collateral or other security to support credit sales, but provides an allowance for doubtful accounts based on historical experience applied against its aged receivables and specifically identified risks.

Foreign Currency Translation

The functional currency of the Company's foreign subsidiaries is the local currency in the country in which the subsidiary is located. Assets and liabilities denominated in foreign currencies are translated to U.S. dollars at the exchange rate in effect on the balance sheet date. Revenues and expenses are translated at the average monthly rates of exchange prevailing throughout the year. The translation adjustment resulting from this process is shown within accumulated other comprehensive income (loss) as a component of shareholders' equity. At December 31, 2003, the most significant foreign currency translation adjustments related to the assets and liabilities of our United Kingdom operation denominated in British pounds and our consolidated Japanese joint venture denominated in Yen. Cumulative unrealized translation gains related to the consolidation of Onyx UK, including the goodwill and other intangible assets resulting from the acquisition of Market Solutions Limited (MSL), amounted to $1.8 million at December 31, 2003. The unrealized gain in 2003 specifically associated with the goodwill and other acquisition-related intangibles of MSL amounted to $1.4 million. Cumulative unrealized translation losses related to the consolidation of Onyx Software Co., Ltd. (Onyx Japan) amounted to $473,000 at December 31, 2003. These unrealized translation gains and losses, combined with the cumulative unrealized translation gains related to the consolidation of our other foreign subsidiaries, resulted in net consolidated cumulative unrealized translation gains of $1.8 million.

Gains and losses on foreign currency transactions are included in the consolidated statement of operations as incurred. To date, foreign exchange transaction gains and losses have not been significant.

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 the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and 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.

Stock-Based Compensation

The Company applies the intrinsic-value-based method of accounting prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions involving Stock Compensation," an interpretation of APB Opinion No. 25, issued in March 2000, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Under APB Opinion No. 25, because the exercise price of the Company's employee stock options generally equals the fair value of the underlying stock on the date of grant, no compensation expense is generally recognized. Deferred compensation expense of $2,153,000 was recorded during 1998 for those situations where the exercise price of an option was lower than the deemed fair value for financial reporting purposes of the underlying common stock. No deferred compensation expense was recorded in 1999 or 2000. In 2001, the Company recorded deferred compensation expense of $1,840,000 in connection with the acquisition of RevenueLab, representing the excess of the fair value of the underlying common stock over the exercise price for the options assumed by Onyx. Deferred compensation is being amortized over the vesting period of the underlying options. Approximately $1.1 million of the deferred compensation that was recorded in January 2001 in connection with options granted to employees of RevenueLab was reversed within shareholders' equity during 2001, 2002 and 2003 upon the employees' termination. Option-related deferred compensation recorded at our initial public offering was fully amortized as of December 31, 2002. The deferred stock-based compensation balance in connection with the acquisition of RevenueLab was fully amortized at December 31, 2003.

SFAS No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net loss if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

	Year Ended December 31,		
	2001	2002	2003
	(In thousands, except per share data)		
Net loss:			
As reported	$ (95,515)	$(13,770)	$ (6,154)
Add: stock-based employee expense included in reported net loss(1)	904	248	30
Deduct: stock-based employee compensation expense determined under fair-value-based method for all awards(2)	(16,874)	(8,935)	(5,281)
Pro forma	$(111,485)	$(22,457)	$(11,405)
Net loss per share:			
As reported	$ (9.46)	$ (1.10)	$ (0.46)
Pro forma	$ (11.05)	$ (1.80)	$ (0.85)

(1) Excludes $38,000 in stock compensation expense associated with the restricted stock awarded to a non-employee consultant and $2,000 of stock compensation expense associated with options granted to a non-employee consultant in 2003.

(2) See Note 11 for details of the assumptions used to arrive at the fair value of each option grant.

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution of securities by including other common stock equivalents, including stock options and warrants, in the weighted average number of common shares outstanding for a period, if dilutive.

Other Comprehensive Income

SFAS No. 130, "Reporting Comprehensive Income," establishes standards for reporting and display of comprehensive income and its components in the financial statements. The only items of other comprehensive income (loss) that the Company currently reports are foreign currency translation adjustments and unrealized gains (losses) on marketable securities.

Advertising

Advertising costs, which include hired services, collateral and event-related costs, are expensed as the related promotional materials are released or activities occur. Advertising expense was $7.6 million, $3.0 million and $2.1 million during the years ended December 31, 2001, 2002 and 2003, respectively.

Interest Expense

Interest expense, which primarily relates to interest on the Company's outstanding letters of credit and capital lease obligations, was $191,000, $118,000 and $139,000 during the years ended December 31, 2001, 2002 and 2003, respectively.

Business Segments

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," establishes standards for reporting information about operating segments in annual financial statements. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Information related to segment disclosures is contained in Note 15.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no impact on the results of operations or shareholders' equity for any year presented.

Recently Issued Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" (FIN 46). In general, a variable interest entity is a corporation, partnership, trust or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. In December 2003, the FASB issued FIN 46R with respect to variable interest entities created before January 31, 2003, which among other things, revised the implementation date to the first fiscal year or interim period ending after March 15, 2004, with the exception of Special Purpose Entities. The Company does not expect the adoption of FIN 46 to have a material impact on its financial position or results of operations.

In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition," which revises or rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's financial position or results of operations.

2. Acquisitions, Purchased Technology, Other Intangible Assets and Goodwill

Market Solutions

On October 1, 1999, the Company acquired MSL, a corporation formed under the laws of England. Pursuant to the terms of the original sale and purchase agreement, at closing the Company paid $5.0 million in cash and issued 33,012 shares of common stock valued at $1.0 million in exchange for all the outstanding capital stock of MSL. On October 1, 2000, the Company issued 40,678 shares valued at $3.6 million and on October 1, 2001, the Company issued 558,621 shares valued at $4.32 million in accordance with the amended sale and purchase agreement. The additional consideration has been accounted for as additional purchase price related to goodwill. The transaction was accounted for using the purchase method of accounting, and, accordingly, the results of MSL's operations have been included in the consolidated financial statements from the date of acquisition.

RevenueLab

On January 5, 2001, the Company acquired RevenueLab, a privately held consulting company based in Stamford, Connecticut. In connection with the acquisition, the Company paid $1.3 million in cash, issued $1.7 million (46,366 shares) of its common stock and granted options to acquire 158,846 shares of common stock valued at $4.0 million. The Company recorded $1.9 million for the value allocated to deferred stock compensation, representing the excess of the fair value over the exercise price for the options assumed by Onyx. Total consideration, including $400,000 of acquisition-related costs, was valued at approximately $7.4 million. The purchase price, adjusted for deferred stock compensation, was approximately $5.5 million. The value of the deferred compensation is being amortized over the remaining stock options' vesting periods of 4.5 years using a graded vesting approach, adjusted for any terminated employees. Approximately $1.1 million of deferred compensation that was recorded in January 2001 in connection with options granted to employees of RevenueLab was reversed within shareholders' equity during 2001, 2002 and 2003 upon the employees' termination. The final remaining deferred stock-based compensation balance recorded in connection with options granted to employees of RevenueLab was reversed within shareholders' equity during the third quarter of 2003 due to the departure of the last eligible RevenueLab employee in August 2003. The transaction was accounted for using the purchase method of accounting, and, accordingly, the results of RevenueLab's operations have been included in the Company's consolidated financial statements from the date of acquisition.

The purchase price of these acquisitions was allocated as follows:

	MSL	RevenueLab
	(In thousands)	
Assets acquired	$ 1,030	$1,106
Liabilities assumed	(1,885)	(268)
Purchased technology	655	—
Goodwill and other intangibles	17,959	4,694
Deferred tax liability	(2,439)	—
	$15,320	$5,532

To determine the value of the developed technology, the expected future cash flows of the existing technology products were discounted, taking into account risks related to the characteristics and applications of each product, existing and future markets, and assessments of the life cycle stage of each product. Based on this analysis, the existing technology that had reached technological feasibility was capitalized. Amounts allocated to in-process research and development were immediately expensed in the period of acquisition because technological feasibility was not established and no alternative commercial use was identified. Amounts attributable to purchased technology and other intangibles are amortized over their estimated useful life of two and one-half to five years on a straight-line basis.

As a result of the Company's restructuring plans, the negative trends in the marketplace, and the negative trends within the software market sector in 2001, the Company performed a future cash flow analysis as required by SFAS No. 121, which was in effect for the year ended December 31, 2001. Based on this analysis, the Company determined that the cash flows for certain business units were inadequate to support the remaining carrying value of certain goodwill and intangibles and recorded an impairment write down during the third and fourth quarters of 2001 totaling $7.8 million. The impairment is included in amortization and impairment of goodwill and other acquisition-related intangibles on the consolidated statements of operations for the year ended December 31, 2001.

Prior to 2003, foreign currency translation gains and losses associated with the revaluation of intangible assets related to the acquisition of MSL were not material. However, due to the weakening of the U.S. dollar relative to the British pound in 2003, the translation adjustment associated with the acquisition-related intangibles of MSL was significant. During the fourth quarter of 2003, the Company recorded an unrealized translation gain associated with the acquisition-related intangibles of MSL totaling $1.4 million. At

December 31, 2003, the unrealized translation gain associated with goodwill totaled $1.3 million and the unrealized translation gain associated with other intangible assets totaled $49,000.

Purchased technology, intangible assets and goodwill consisted of the following (in thousands):

	December 31, 2002	December 31, 2003
Purchased technology	$ 2,328	$ 2,379
Less: accumulated amortization	(2,075)	(2,379)
Purchased technology, net	$ 253	$ 0
Other intangible assets	$ 4,175	$ 4,498
Less: accumulated amortization	(2,714)	(3,823)
Other intangible assets, net	$ 1,461	$ 675
Goodwill	$14,065	$16,235
Less: accumulated amortization	(5,885)	(6,817)
Goodwill, net	$ 8,180	$ 9,508

Amortization of acquired technology, goodwill and other acquisition-related intangibles was $6.6 million in 2001. With the adoption of SFAS No. 142 in 2002, amortization of acquired technology and other acquisition-related intangibles was $1.3 million in 2002 and $1.1 million in 2003. Impairment of acquired intangibles totaled $7.8 million in 2001. There were no impairments of acquired intangibles recorded in 2002 or 2003. Expected future amortization expense related to identifiable intangible assets is $675,000 in 2004.

Summarized below are the effects on net income and net income per share data, as if the Company had followed the amortization provisions of SFAS No. 142 for 2001 (in thousands, except per share data):

	Year Ended December 31, 2001
Net loss:	
As reported	$(95,515)
Add: goodwill and assembled workforce amortization, net of taxes	4,864
Adjusted net loss	$(90,651)
Basic and diluted net loss per share:	
As reported	$ (9.46)
Add: goodwill and assembled workforce amortization, net of taxes	0.48
Adjusted basic and diluted net loss per share	$ (8.98)

3. Restructuring and Other Related Charges

Restructuring and other related charges represent the Company's efforts to reduce its overall cost structure. In April and again in September 2001, the Company approved a restructuring plan to reduce headcount, reduce infrastructure and eliminate excess and duplicate facilities. In April 2003, the Company approved a restructuring plan to reduce additional headcount. During 2001, 2002, and 2003, the Company recorded approximately $51.8 million, $8.5 million and $1.4 million, respectively, in restructuring and other related charges.

The components of the charges recorded for the years ended December 31, 2001, 2002 and 2003, are as follows (in thousands):

	Excess Facilities	Excess Facilities — Warrants	Employee Separation Costs	Asset Impairments	Other	Total
Charge for the Year Ended December 31, 2001	$ 31,948	$ —	$ 3,724	$ 14,747	$1,387	$ 51,806
Cash Payments & Write-offs	(7,653)	—	(3,474)	(14,747)	(618)	(26,492)
Balance at December 31, 2001	24,295	—	250	—	769	25,314
Charge for the Year Ended December 31, 2002	4,361	920	1,266	2,204	(260)	8,491
Cash Payments & Write-offs	(16,522)		(880)	(2,204)	(455)	(20,061)
Balance at December 31, 2002	12,134	920	636	—	54	13,744
Charge for the Year Ended December 31, 2003	444		769	209		1,422
Cash Payments & Write-offs	(9,486)		(1,334)	(209)	(54)	(11,083)
Fair Value Adjustment		(355)	—	—	—	(355)
Balance at December 31, 2003	$ 3,092	$ 565	$ 71	$ —	$ —	$ 3,728

The excess facility charges recorded in 2001 and 2002 are the result of the Company's decision to reduce its utilization of certain facilities and to terminate usage of certain domestic and international facilities altogether. The most significant portion of the excess facility charges relates to its leases for 262,000 square feet of office space in Bellevue, Washington, which commenced in April and June of 2001 and were originally contracted to expire in 2011 and 2013.

In 2002, the Company made significant progress in its efforts to mitigate excess facility commitments. Specifically, in August 2002, the Company executed a sublease agreement on its 21,000 square foot facility in the United Kingdom that reduced its obligation on seven of the remaining 14 years on the lease, and in November 2002, the Company executed a lease termination agreement on its former 100,000-square-foot corporate headquarters facility in Bellevue, Washington. This lease termination resulted in accelerated cash outflows of approximately $2.0 million during the fourth quarter of 2002. The Company paid its monthly lease obligation of approximately $250,000 associated with this facility in January 2003, after which the Company relocated its corporate headquarters and no further obligations remained. The signing of this agreement, which required the Company to move its corporate headquarters, resulted in accelerated amortization of leasehold improvements and furniture, of which approximately $1.3 million was charged to expense in the fourth quarter of 2002. An additional $450,000 in accelerated amortization was charged to expense in January 2003.

The most significant mitigation of the Company's excess facility commitments was completed in December 2002 when the Company reached an agreement with the landlord, Bellevue Hines Development, L.L.C. (Hines), relating to its 262,000 square feet of office space in Bellevue, Washington. The partial lease termination reduces the Company's excess facilities in Bellevue, Washington by approximately 202,000 square feet. The Company continues to lease approximately 60,000 square feet at this facility, which began serving as its new corporate headquarters effective at the end of January 2003. The new lease for 60,000 square feet expires in December 2013. The partial lease termination will require cash outflows of approximately $1.4 million over the four-month period ending April 2004, which is included in current restructuring-related liabilities at December 31, 2003. In addition to cash payments, the Company issued three five-year warrants to Hines for the purchase of up to an aggregate of 198,750 shares of the Company's common stock, including a warrant to purchase 66,250 shares of common stock at an exercise price of $10.38 per share, a warrant to purchase 66,250 shares of common stock at an exercise price of $12.11 per share and a warrant to purchase 66,250 shares of common stock at an exercise price of $13.84 per share. If the Company either undergoes a change of control or issues securities with rights and preferences superior to the Company's common stock within two years after the warrants were issued, Hines will have the option of canceling any unexercised warrants and receiving a cash cancellation payment of $18.40 per share in the case of the $10.38 warrants, $16.00 per share in the case of the $12.11 warrants and $13.92 per share in the case of the $13.84 warrants. These contingent cash payments aggregate $3.2 million. The Company also entered into a registration rights agreement with Hines, pursuant to which the Company filed a registration statement on February 14, 2003 covering the resale of the shares of the Company's common stock subject to purchase by Hines under the warrants. The warrant value as of December 31, 2002 was estimated at $920,000 based on (a) the estimated value of the warrants using the Black-Scholes model with an expected dividend yield of 0.0%, a risk-free interest rate of 5.0%, volatility of 85% and an expected life of five years and (b) the estimated value of the cash cancellation payments in the event of a change in control. The warrants are subject to variable accounting and the Company is required to mark the warrants to market at each reporting period. At December 31, 2003, the warrant value was estimated at $565,000 using similar assumptions to those used at December 31, 2002, and is included in long-term liabilities.

The termination of the 202,000 square feet in Bellevue, Washington is contingent on the following conditions, among others, being met as of April 30, 2004: (a) the Company is current in its payments under the lease and (b) the Company has not filed a bankruptcy or other liquidation petition, or otherwise attempted to reject or contest the lease. If the Company is not in compliance with any of these conditions as of April 30, 2004, the original lease will not terminate and the Company will be required to continue making payments on the excess facilities subject to the original lease. The Company previously issued a letter of credit to Hines in the amount of approximately $6.6 million to guarantee its payment obligations to Hines. The letter of credit is secured by the Company's cash deposits. The letter of credit will secure its obligations under the original lease and the amended lease for the 60,000 square feet that the Company still occupies. The parties agreed to effect eight monthly reductions in the amount of the letter of credit of $507,000 which started in October 2003 and will continue through May 2004 if (i) the conditions precedent described above are satisfied and (ii) the Company has timely made all of the payments due under the original lease and the new lease for the 60,000 square feet that it still occupies. In no event will the letter of credit be reduced to an amount less than $2.5 million. The Company's right to reduce the amount of the letter of credit will be forfeited if, at any time before May 1, 2004, the Company makes any late payment under the original lease or the new lease for the 60,000 square feet that it still occupies, or if there is any default or material misrepresentation by the Company in any of the warrants or the registration rights agreement.

The accounting for excess facilities is complex and, as a result, may result in adjustments to the Company's current restructuring charge. In particular, based on the terms of the warrants issued in connection with the partial lease termination of excess facilities in Bellevue, Washington, the warrants are subject to variable accounting and will be marked to market at each reporting period. Future cash outlays are anticipated through July 2006 unless estimates and assumptions change or the Company is able to negotiate to exit certain leases at an earlier date.

The current portion of restructuring-related liabilities totaled $2.8 million at December 31, 2003, the long-term portion of restructuring-related liabilities totaled $405,000 at December 31, 2003 and the value of the warrants issued in connection with the termination of certain facility lease obligations was $565,000 at December 31, 2003.

4. Investment Losses and Impairment

During 1999 and 2000, the Company invested in a small number of private companies. The carrying value of these investments is included in other assets on the accompanying consolidated balance sheets and totaled $500,000 at December 31, 2002 and 2003.

The Company reported impairment losses, which totaled $2.5 million during the year ended December 31, 2001, relating to other-than-temporary declines in three of its cost basis equity investments based upon a review of qualitative and quantitative factors surrounding the financial condition of the investees. These other than temporary impairment losses were recorded to reflect each investment at its estimated fair value. No other than temporary impairment-related losses were incurred in 2002 or 2003.

5. Onyx Japan

In September 2000, the Company entered into a joint venture with Softbank Investment Corporation and Prime Systems Corporation to create Onyx Software Co., Ltd. (Onyx Japan), a Japanese corporation, for the purpose of distributing the Company's technology and product offerings in Japan. In October 2000, the Company made an initial contribution of $4.3 million in exchange for 58% of the outstanding common stock and the joint venture partners invested $3.1 million for the remaining 42% of the common stock of Onyx Japan. The Company has a controlling interest in Onyx Japan; therefore, Onyx Japan has been included in its consolidated financial statements. The minority shareholders' interest in Onyx Japan's earnings or losses is separately reflected in the statement of operations.

Under the terms of the joint venture agreement, Prime Systems may at any time after September 14, 2001, sell its shares after 90 days' notice to the Company. The Company has a right of first refusal to purchase any of Prime Systems' shares that are offered for resale at the same price for which those shares are being offered to a third party. Further, since Onyx Japan did not complete an initial public offering on or before July 31, 2003, either the Company or Prime Systems may terminate the joint venture agreement at its discretion. If Prime Systems exercises its right of termination for this reason, the Company has the right, at its election, to either (a) buy Prime Systems' shares at the current fair market value as determined by appraisal or (b) force a liquidation of Onyx Japan.

The Company has entered into a distribution agreement with Onyx Japan, which was approved by the minority shareholders, that provides for a fee to the Company based on license and maintenance revenues in Japan. During 2001, 2002 and 2003, fees charged under this agreement were $1.3 million, $733,000, and $690,000, respectively. The intercompany fees are eliminated in consolidation; however, the Company allocates 42% of the fees to the minority shareholders.

Included in license revenue for the year ended December 31, 2001 is a sale to Softbank Commerce for approximately $572,000 for software licenses internally deployed to support customer and business partner relations. Softbank Commerce is a related party to Softbank Investments Corporation, an entity which owns 14% of the Company's Japanese joint venture.

Although profitable in the third and fourth quarters of 2003, Onyx Japan incurred substantial losses in previous periods. The minority shareholders' capital account balance as of December 31, 2003 was $119,000. Additional Onyx Japan losses above approximately $283,000 in the aggregate will be absorbed 100% by the Company, as compared to 58% in prior periods.

Restructuring efforts carried out in the second half of 2002 significantly reduced the operating expenses of Onyx Japan and increased the probability that Onyx Japan can be cash flow positive, as evidenced by the profits generated by Onyx Japan in the third and fourth quarters of 2003. Nevertheless, additional funding may be required to continue the operation of the joint venture. If Onyx Japan continues to incur losses and no additional capital is invested, the Company may have to further restructure its operations in Japan.

6. Stock-Based Compensation

Stock-based compensation includes stock-based charges resulting from option-related deferred compensation recorded at the Company's initial public offering and the portion of acquisition-related consideration conditioned on the continued tenure of key employees of certain acquired businesses, which has been classified as compensation expense. It also includes the issuance of common stock and options to contractors in return for their services.

The following table shows the amounts of stock-based compensation that would have been recorded under the following income statement categories had stock-based compensation not been separately stated in the consolidated statements of operations:

	Year Ended December 31,		
	2001	2002	2003
	(In thousands)		
Support and service cost of sales	$218	$142	$30
Sales and marketing	575	49	—
Research and development	35	18	—
General and administrative	76	39	40
Total stock-based compensation	$904	$248	$70

7. Property and Equipment

Property and equipment consists of the following:

	December 31,	
	2002	2003
	(In thousands)	
Computer and office equipment	$ 9,249	$ 5,849
Purchased software	3,233	3,646
Furniture and fixtures	2,424	1,465
Leasehold improvements	3,492	2,994
	18,398	13,954
Less accumulated depreciation and amortization	(11,924)	(9,677)
	$ 6,474	$ 4,277

Included in property and equipment at December 31, 2002 are assets acquired under capital lease obligations with an original cost of approximately $610,000. Accumulated amortization on the leased assets was approximately $454,000 as of December 31, 2002.

8. Line of Credit

In documents dated March 28, 2003 and May 5, 2003, the Company amended its Loan and Security Agreement with Silicon Valley Bank (SVB), which was originally entered into in February 2002, and entered into a second Loan and Security Agreement with SVB that is intended to take advantage of a loan guarantee by the Export Import Bank of the United States (Exim Bank). The loan documents were further amended on January 12, 2004 to revise the tangible net worth covenant and the accounts receivable advance rates beginning with the month ended December 31, 2003. Under the terms of these agreements, the Company has a total $15.0 million working capital revolving line of credit with SVB, which is split between a $13.0 million domestic facility and a $2.0 million Exim Bank facility. Both are secured by accounts receivable, property and equipment and intellectual property. The domestic facility allows the Company to borrow up to the lesser of (a) 70% of eligible domestic and individually approved foreign accounts receivable and (b) $13.0 million. The Exim Bank facility allows the Company to borrow up to the lesser of (a) 75% of eligible foreign accounts receivable and (b) $2.0 million. If the borrowing base calculation falls below the outstanding standby letters of credit issued by SVB on the Company's behalf, SVB may require the Company to cash secure the amount by which outstanding standby letters of credit exceed the borrowing base. The amount required to be restricted under the loan agreement was $1.7 million, measured as of December 31, 2003. Due to the variability in the Company's borrowing base, the Company may be subject to restrictions on its cash at various times throughout the year. Any borrowings will bear interest at SVB's prime rate, which was 4.00% as of December 31, 2003, plus 1.5%, subject to a minimum rate of 6.0%. The loan agreements require that the Company maintain certain financial covenants based on its adjusted quick ratio and tangible net worth. The Company was in compliance with these covenants, as amended, at December 31, 2003. Absent the amendment, the Company would have been out of compliance with the loan agreement as of December 31, 2003. The Company is also prohibited under the loan and security agreements from paying dividends. The facilities expire in March 2004. Based on the outstanding standby letters of credit relating to long-term lease obligations totaling $8.0 million at December 31, 2003, no additional amounts are currently available under the credit facilities.

9. Long-Term Debt and Commitments

Leases

The Company leases its facilities under noncancelable operating lease agreements that expire on various dates through March 2016. The Company leases certain equipment and furniture under noncancelable operating leases that expire on various dates through June 2006.

Minimum future lease payments under noncancelable operating leases for the periods ended December 31 pursuant to leases outstanding as of December 31, 2003 are summarized as follows:

	Operating Leases (In thousands)
Year ending December 31:	
2004	$ 7,020
2005	4,469
2006	3,707
2007	3,389
2008	3,071
Thereafter	18,009
	$39,665

Rental expense was approximately $15.1 million, $19.0 million and $6.1 million in 2001, 2002 and 2003, respectively. Approximately $7.7 million, $14.3 million and $432,000 of the 2001, 2002 and 2003 rental expense was identified as excess facilities and included in restructuring and other related charges in the consolidated statements of operations.

As a result of the Company's restructuring efforts in 2001, 2002 and 2003, certain domestic and international facilities have been exited or reduced. Commitments related to all of the Company's operating leases are included in the table above. Excluding the value of warrants issued in connection with a partial lease termination, approximately $3.2 million in estimated losses associated with these lease commitments is included in restructuring-related liabilities in the consolidated balance sheet as of December 31, 2003, of which $2.8 million is classified as current and $405,000 is classified as long-term. Further information regarding the Company's restructuring-related charges is included in Note 3.

As of December 31, 2003, future minimum rental receipts under subleased facilities is:

	Operating Leases (In thousands)
Year ending December 31:	
2004	$1,353
2005	1,085
2006	898
2007	898
2008	898
Thereafter	598
	$5,730

Third-Party License Agreements

The Company has entered into various agreements that allow the Company to incorporate licensed technology into its products or that allow the Company the right to sell separately the licensed technology. The Company incurs royalty fees under these agreements that are based on a predetermined fee per license sold. Royalty costs incurred under these agreements are recognized as products are licensed and are included in cost of license revenues. These amounts totaled $1.8 million, $1.1 million and $748,000 in 2001, 2002 and 2003. As of December 31, 2003, future minimum commitments under these royalty arrangements are anticipated to be approximately $323,000.

10. Guarantees

Indemnification and warranty provisions contained within our customer license and service agreements are generally consistent with those prevalent in our industry. The duration of our product warranties generally does not exceed 90 days following delivery of our products. We have not incurred significant obligations under customer indemnification or warranty provisions historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential customer indemnification or warranty-related obligations.

11. Shareholders' Equity

Shareholder Rights Plan

On October 22, 1999, the Company's Board of Directors adopted a Shareholder Rights Plan (the Rights Plan) in which preferred stock purchase rights (Rights) were distributed as a dividend at the rate of one Right for each share of common stock held as of the close of business on November 9, 1999. The Company adopted the plan to guard against partial tender offers and other abusive tactics that might be used in an attempt to gain control of the Company without paying all shareholders a fair price for their shares. The Rights Plan, which expires on November 9, 2009, will not prevent takeovers, but it is designed to deter coercive takeover tactics and to encourage anyone attempting to acquire the Company to first negotiate with the board.

Each Right will entitle each shareholder to buy one one-hundredth of a newly issued share of Series A participating cumulative preferred stock of the Company at an exercise price of $60.00 per one one-hundredth of a preferred share. The Rights will be exercisable only if a person or group, other than an exempted person, makes a tender offer for, or acquires beneficial ownership, of 15% or more of the Company's then outstanding common stock.

If any person other than an exempted person becomes the beneficial owner of 15% or more of the Company's outstanding common stock, then each Right not owned by such person or certain related parties will entitle its holder to purchase, at the Right's then current exercise price, shares of the Company's common stock (or, in certain circumstances, cash, property or other securities of the Company) having a market value equal to twice the then current exercise price. In addition, if, after a person becomes the beneficial owner of 15% or more of the Company's outstanding common stock, the Company is acquired in a merger or other business combination transaction, or sells 50% or more of its assets or earning power to another person, each Right will entitle its holder to purchase, at the Right's then current exercise price, shares of common stock of such other person having a market value equal to twice the then current exercise price.

The Company's Board of Directors will generally be entitled to redeem the Rights at $.01 per Right at any time prior to a person or group acquiring 15% or more of the Company's common stock.

Firm Underwritten Offering

In February 2001, the Company completed a firm underwritten offering of 625,000 shares of its common stock at a price of $54.00 per share from its $100.0 million shelf registration. The offered shares generated net proceeds to the Company of approximately $31.5 million.

In February 2002, the Company completed a public offering of 1,581,250 shares of its common stock at a purchase price to the public of $14.00 per share from its $100.0 million shelf registration statement, including 150,000 shares issued pursuant to the exercise of the over-allotment option granted to Wells Fargo Securities, LLC, the sole underwriter for the offering. The proceeds to the Company totaled $20.5 million after deducting the costs of the offering.

Private Offering

In May 2003, the Company completed a private offering of 1,038,475 shares of its common stock at a purchase price of $2.60 per share with an existing institutional investor and 97,222 shares of its common stock at a purchase price of $3.22 per share with certain officers and directors of the Company. The proceeds to the Company totaled approximately $2.8 million after deducting the costs of the offering. In connection with the private offering the Company granted anti-dilution rights to the existing institutional investor whereby the Company would issue warrants to purchase common stock if additional shares of common stock had been sold at a price less than $2.60 per share before November 19, 2003. The Company did not sell any additional shares of common stock before November 19, 2003, and as such, no additional shares were issued pursuant to the anti-dilution provisions of the private offering.

Increase in Authorized Capital

On July 23, 2003, the Company's shareholders approved an amendment to the Company's restated articles of incorporation increasing the number of authorized shares of the Company's stock after the reverse stock split from 25,000,000 (including 20,000,000 shares of common stock and 5,000,000 shares of preferred stock) to 100,000,000 shares (including 80,000,000 shares of common stock and 20,000,000 shares of preferred stock).

Notes Receivable from Officers

In July 1998, certain officers exercised options to purchase 650,000 shares of common stock and paid the exercise price by issuing full recourse promissory notes to the Company totaling $212,000. In March 2000, $55,000 was repaid by one of the officers and the remaining $157,000 note was repaid in June 2001.

Warrants for Common Stock

As part of a lease termination agreement, the Company agreed to issue three five-year warrants to Hines, the landlord of its Bellevue, Washington facility, for the purchase of up to an aggregate of 198,750 shares of the Company's common stock, including a warrant to purchase 66,250 shares of common stock at an exercise price of $10.38 per share, a warrant to purchase 66,250 shares of common stock at an exercise price of $12.11 per share and a warrant to purchase 66,250 shares of common stock at an exercise price of $13.84 per share. If the Company either undergoes a change of control or issues securities with rights and preferences superior to the Company's common stock within two years after the warrants are issued, Hines will have the option of canceling any unexercised warrants and receiving a cash cancellation payment of $18.40 per share in the case of the $10.38 warrants, $16.00 per share in the case of the $12.11 warrants and $13.904 per share in the case of the $13.84 warrants, which, in the aggregate, totals $3.2 million. The Company agreed to enter into a registration rights agreement with Hines, pursuant to which the Company filed a registration statement on February 14, 2003 covering the resale of the shares of the Company's common stock subject to purchase by Hines under the warrants. The warrant value as of December 31, 2002 was estimated at $920,000 based on (a) the estimated value of the warrants using the Black-Scholes model with an expected dividend yield of 0.0%, a risk-free interest rate of 5.0%, volatility of 85% and an expected life of five years and (b) the estimated value of the cash cancellation payments in the event of a change in control. The warrants are subject to variable accounting and we are required to mark the warrants to market at each reporting period. At December 31, 2003, the warrant value was estimated at $565,000 using similar assumptions to those used at December 31, 2002, and is included in long-term liabilities.

1994 Combined Incentive and Nonqualified Stock Option Plan

Under the terms of the 1994 Combined Incentive and Nonqualified Stock Option Plan (the 1994 option plan), the Board of Directors may grant incentive and nonqualified stock options to employees, officers, directors, agents, consultants, and independent contractors of the Company. There were 2,500,000 shares of common stock reserved under the 1994 option plan. Generally, the Company grants stock options with exercise prices equal to the fair market value of the common stock on the date of grant, as determined by the Company's Board of Directors. Options generally vest over a four and one-half year period; 25% vest after 18 months, with 12.5% vesting every six months thereafter. Options generally expire ten years from the date of grant. In October 1998, the Board of Directors suspended the 1994 option plan and determined that no further grants shall be made pursuant to the 1994 option plan.

1998 Stock Incentive Compensation Plan

The 1998 Stock Incentive Compensation Plan (the 1998 option plan) provides for both stock options and restricted stock awards to employees, officers, directors, agents, advisors, consultants and independent contractors of the Company. There were 750,000 shares of common stock reserved under the 1998 option plan and the plan provides that any options cancelled and returned to the 1994 option plan shall become available for future grant under the 1998 option plan. The 1998 option plan provides for an annual increase to be added on the first day of each fiscal year beginning in 2000 equal to the lesser of (a) 837,882 shares or (b) 5% of the average common shares outstanding used to calculate fully diluted earnings per share, as reported for the preceding year. Accordingly, on January 1, 2001, 2002 and 2003, the 1998 option plan pool was increased by 436,525 shares, 504,600 shares and 624,139, respectively. On January 1, 2004, the 1998 option plan pool was increased by 672,100 shares. Options granted under the 1998 option plan generally vest and become exercisable over a four-year period. Initial option grants are typically structured with 25% vesting after 12 months, with 2.0833% vesting every month thereafter; additional option grants are typically structured with 2.0833% vesting monthly over a four-year period.

2001 Nonofficer Employee Stock Compensation Plan

The 2001 Nonofficer Employee Stock Compensation Plan (the NOE plan) provides for both stock options and restricted stock awards to employees, agents, advisors, consultants and independent contractors of the Company, but does not allow for grants to any directors or officers of the Company. The Board of Directors initially reserved 250,000 shares for issuance under the NOE plan in January 2001, and reserved an additional 625,000 shares in April 2001. Additional shares may be reserved for issuance under the NOE plan through authorization by the Board of Directors. Options granted to new employees under the NOE plan generally vest and become exercisable over a four-year period with 25% vesting after 12 months and an additional 2.083% vesting every month thereafter. Options granted to existing employees under the NOE plan generally vest and become exercisable over a four-year period with 2.083% vesting every month.

Stock Option Activity

A summary of stock option activity follows:

		Outstanding Options	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Prices
Outstanding at December 31, 2000 (exercisable — 456,111)	101,332	2,111,199	$44.28
1998 option plan increase	436,525	—	
2001 nonofficer employee stock plan increase	875,000	—	
Non plan grant increase	63,821	—	
Options granted	(1,708,575)	1,708,575	$25.08
Options cancelled	1,026,724	(1,026,724)	$47.76
Options exercised	—	(298,680)	$ 2.96
Outstanding at December 31, 2001 (exercisable — 736,922)	794,827	2,494,370	$34.60
1998 option plan increase	504,600	—	
Options granted	(772,505)	772,505	$14.84
Options cancelled	762,978	(762,978)	$37.08
Options exercised	—	(47,224)	$ 4.64
Outstanding at December 31, 2002 (exercisable — 1,249,105)	1,289,900	2,456,673	$28.20
1998 option plan increase	624,139	—	
Options granted	(1,691,405)	1,691,405	$ 4.34
Options cancelled	885,227	(885,227)	$27.65
Options exercised	—	(20,643)	$ 2.72
Outstanding at December 31, 2003 (exercisable — 1,517,796)	1,107,861	3,242,208	$16.09

The following table summarizes information concerning currently outstanding and exercisable options at December 31, 2003:

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Option	Weighted Average Exercise Prices	Weighted Average Remaining Contractual Life (Years)	Number of Options	Weighted Average Exercise Prices
\$ 0.40 - \$ 3.00	137,110	\$ 0.99	3.09	135,859	\$ 0.98
\$ 3.28 - \$ 4.16	741,258	4.14	9.40	117,117	4.16
\$ 4.25 - \$ 4.48	717,644	4.48	9.07	160,574	4.48
\$ 4.72 - \$ 12.12	364,331	9.33	6.95	234,874	9.51
\$12.13 - \$ 15.96	456,030	14.82	7.95	198,238	15.06
\$16.20 - \$ 24.28	378,354	16.70	7.16	277,995	16.68
\$26.00 - \$152.38	447,481	65.41	5.96	393,139	65.60
\$ 0.40 - \$152.38	3,242,208	16.09	7.84	1,517,796	24.37

The weighted average price of exercisable options was \$34.80 at December 31, 2001 and \$32.68 at December 31, 2002.

1998 Employee Stock Purchase Plan

The 1998 Employee Stock Purchase Plan (the ESPP) permits eligible employees of the Company and its subsidiaries to purchase common stock through payroll deductions of up to 10% of their compensation. The Company authorized the issuance under the ESPP of a total of 250,000 shares of common stock, plus an automatic annual increase, to be added on the first day of the fiscal year beginning in 2000, equal to the lesser of (a) 100,000 shares, (b) 1.2% of the average common shares outstanding as used to calculate fully diluted earnings per share as reported in the annual report for the preceding year, or (c) a lower amount determined by the Board of Directors.

The ESPP provides for six-month offering periods, beginning on each January 1 and July 1. The price of the common stock purchased under the ESPP is the lesser of 85% of the fair market value on the first day of an offering period and 85% of the fair market value on the last day of an offering period. The ESPP does not have a fixed expiration date, but the Company's Board of Directors may terminate it at any time.

In April 2001, the board of directors adopted an amendment to the purchase plan, which was approved by the shareholders on June 7, 2001. The amended purchase plan is being implemented by a series of offerings that commence on January 1 and July 1 of each year and end on the second December 31 and June 30, respectively, occurring after such date, each referred to as an amended offering period; provided, however, that the offering period that began on January 1, 2001 ended on June 30, 2001. Each offering period after the amendment will consist of four consecutive six-month purchase periods; provided, however, that the offering period that began on January 1, 2001 consisted of one six-month purchase period.

During the years ended December 31, 2001, 2002 and 2003, 59,385 shares, 77,891 shares and 109,340 shares of common stock were purchased under the ESPP, respectively. At December 31, 2003, the Company had a total of 323,769 shares of common stock reserved for future issuance under its ESPP. On January 1, 2004, an additional 100,000 shares became available for issuance pursuant to the automatic plan increase.

Fair Value of Stock Options and Employee Stock Purchase Rights Under SFAS No. 123

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model for periods after the Company's initial public offering and the minimum value option pricing model for periods prior to the initial public offering. Subsequent to the Company's initial public offering, the volatility of the Company's stock was based on actual prices subsequent to the initial month of trading. The following weighted average assumptions were utilized in arriving at the fair value of each option grant:

	December 31,		
	2001	2002	2003
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	4.1%	3.0%	3.0%
Volatility	125%	85%	72% to 85%
Expected life	3 years	5 years	5 years

For purposes of the pro forma disclosures, the estimated weighted average fair value of the options granted, estimated to be $17.84, $10.00 and $2.80 at December 31, 2001, 2002 and 2003, respectively, is amortized to expense over the options' vesting period.

The fair value of employees' stock purchase rights under the ESPP at December 31, 2001 was estimated using the Black-Scholes model with the same assumptions as the table above, except the expected life is six months. The fair value of employees' stock purchase rights under the ESPP at December 31, 2002 was estimated using the Black-Scholes model with an expected dividend yield of 0.0%, a risk-free interest rate of 1.5%, volatility of 85% and an expected life of 1.25 years. The fair value of employees' stock purchase rights under the ESPP at December 31, 2003 was estimated using the Black-Scholes model with an expected dividend yield of 0.0%, a risk-free interest rate of 1.5%, volatility of 72% and an expected life of 1.25 years.

Common Shares Reserved for Future Issuance

The Company has reserved shares of common stock as of December 31, 2003 as follows:

Stock options	4,350,069
Employee Stock Purchase Plan	323,769
	4,673,838

12. Earnings (Loss) Per Share

The following represents the calculations for net loss per share:

	Year Ended December 31,		
	2001	2002	2003
	(In thousands, except per share data)		
Net loss (A)	$(95,515)	$(13,770)	$(6,154)
Weighted average number of common shares(1)(B)	10,092	12,481	13,442
Effect of dilutive securities:			
Stock options	*	*	*
Warrants	**	**	**
Adjusted weighted average shares and assumed conversions(C)	10,092	12,481	13,442
Earnings (loss) per share:			
Basic(A)/(B)	$ (9.46)	$ (1.10)	$ (0.46)
Diluted(A)/(C)	$ (9.46)	$ (1.10)	$ (0.46)

(1) For purposes of determining the weighted average number of common shares outstanding, shares of restricted common stock issued through the July 1998 exercise of stock options in exchange for promissory notes to the Company are only considered in the calculation of diluted earnings per share. The outstanding promissory note was paid in full during the second quarter of 2001 and the related 400,000 shares of common stock were released from restriction. If the Company had been profitable during 2001, the approximate number of restricted shares included in the computation of diluted earnings per share would have been 195,000 based on the average number of days the promissory note was outstanding during the period.

* The effect of stock options are excluded from the computation of diluted earnings per share because the effects are antidilutive. Outstanding stock options of 2,494,370, 2,456,673, and 3,242,208 at December 31, 2001, 2002 and 2003, respectively, were excluded from the computation of diluted earnings per share because their effect was antidilutive (see Note 11 for additional stock option information). Outstanding options will be included in the computation of diluted earnings per share in future periods to the extent their effects are dilutive. If the Company had been profitable during any of the periods reported, based on the average price of the Company's common stock during each period using the treasury stock method, the approximate number of dilutive options included in the computation of diluted earnings per share would have been 568,000 shares, 210,000 shares and 111,000 shares, respectively, during the year ended December 31, 2001, 2002 and 2003.

** In January 2003, the Company issued warrants to purchase 198,750 shares of its common stock at exercise prices ranging from $10.38 to $13.84 per share in connection with the termination of excess facilities. There were no warrants outstanding prior to January 2003. Outstanding warrants were excluded from the computation of diluted earnings per share for the year ended December 31, 2003 because their effect was antidilutive. Outstanding warrants will be included in the computation of diluted earnings per share in future periods to the extent their effects are dilutive.

13. Income Taxes

Income (loss) before taxes consists of the following:

	Year Ended December 31,		
	2001	2002	2003
	(In thousands)		
U.S.	$(93,632)	$(13,452)	$(7,263)
Foreign	(3,460)	(765)	1,255
	$(97,092)	$(14,217)	$(6,008)

The provision for income taxes consists of the following:

	Year Ended December 31,		
	2001	2002	2003
	(In thousands)		
Current:			
Federal	$ 0	$ 0	$ 0
State and local	15	22	20
Foreign	820	1,024	601
Total current income taxes	835	1,046	621
Deferred — foreign	(1,129)	(461)	(357)
Income tax provision (benefit)	$ (294)	$ 585	$ 264

The effective rate differs from the U.S. federal statutory rate as follows:

	Year Ended December 31,		
	2001	2002	2003
	(In thousands)		
Income tax expense (benefit) at statutory rate of 34%	$(33,011)	$(4,834)	$(2,043)
State taxes, net of federal benefit	10	15	13
Losses producing no current tax benefit	32,707	5,404	2,294
Income tax provision	$ (294)	$ 585	$ 264

At December 31, 2003, the Company had federal, state and foreign net operating loss carryforwards of $106.6 million, $9.8 million and $8.0 million, respectively, which expire between 2004 and 2023. Additionally, the Company had capital loss, research and development and foreign tax credit carryforwards of $2.0 million, $2.7 million, and $1.4 million, respectively, which expire between 2004 and 2023. Utilization of these carryforwards depends on the recognition of future taxable income. The Company's ability to utilize net operating loss carryforwards may be limited in the event of a change in ownership, as defined in the Internal Revenue Code. To the extent that any single-year loss is not utilized to the full amount of the limitation, such unused loss is carried forward to subsequent years until the earlier of its utilization or the expiration of the relevant carryforward period. To the extent that net operating losses, when realized, relate to stock option deductions of approximately $7.3 million, the resulting benefits will be credited to shareholders' equity.

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

	December 31, 2002	December 31, 2003
	(In thousands)	
Deferred tax assets:		
U.S. net operating loss carryforwards	$ 33,029	$ 39,580
U.S. capital loss carryforwards	729	723
Foreign net operating loss carryforwards	2,039	2,721
Research and development credit carryforwards	2,900	2,690
Foreign tax credit carryforwards	1,256	1,435
Restructuring and other accrued liabilities	4,549	1,288
Other	2,139	1,210
Total gross deferred tax assets	46,641	49,647
Less valuation allowance	(46,368)	(49,285)
	273	362
Deferred tax liabilities:		
Purchased technology and other intangibles	(497)	(229)
	(497)	(229)
Net deferred tax (liabilities) assets	$ (224)	$ 133

Since the Company's utilization of these deferred tax assets depends on future profits, which are not assured, a valuation allowance equal to the net deferred tax assets has been provided, except for certain deferred tax assets related to foreign operations. The valuation allowance for deferred tax assets increased by $9.9 million during 2002 and by $2.9 million during 2003.

14. Employee Benefit Plan

The Company maintains a profit-sharing retirement plan for eligible employees under the provisions of Internal Revenue Code Section 401(k). Participants may defer up to 60% of their annual compensation on a pretax basis, subject to maximum limits on contributions prescribed by law. Contributions by the Company are at the discretion of the Board of Directors. Prior to 2000, no employer contributions were made. In 2001, the Company recorded $65,000 in employer matching contribution expenses. In 2002 and 2003, no employer contributions were made.

15. Segment and Geographic Information

The Company and its subsidiaries are principally engaged in the design, development, marketing and support of enterprise-wide CRM solutions designed to promote strategic business improvement and revenue growth by enhancing the way businesses market, sell and service their products. Substantially all revenue results from the licensing of the Company's software products and related consulting and customer support (maintenance) services. The Company's chief operating decision maker reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenue by geographic region for purposes of making operating decisions and assessing financial performance. Accordingly, the Company considers itself to be in a single industry segment, specifically the license, implementation and support of its software applications and to have only one operating segment. The Company does not prepare reports for, or measure the performance of, its individual software applications and, accordingly, the Company has not presented revenue or any other related financial information by individual software product.

The Company evaluates the performance of its geographic regions primarily based on revenues. In addition, the Company's assets are primarily located in its corporate office in the United States and not allocated to any specific region. The Company does not produce reports for, or measure the performance of, its geographic regions on any asset-based metrics. Therefore, geographic information is presented only for revenues.

Total revenues outside of North America for the years ended December 31, 2001, 2002 and 2003 were $29.6 million, $24.8 million and $22.9 million, respectively.

The following geographic information is presented for the years ended December 31, 2001, 2002 and 2003 (in thousands):

	North America	United Kingdom	Rest of World	Total
Year ended December 31, 2001:				
Revenue	$70,090	$ 9,889	$19,721	$99,700
Year ended December 31, 2002:				
Revenue	$44,556	$11,712	$13,116	$69,384
Year ended December 31, 2003:				
Revenue	$35,454	$ 8,002	$14,917	$58,373

16. Litigation and Contingencies

The Company, several of its officers and directors and Dain Rauscher Wessels have been named as defendants in a series of related lawsuits filed in the United States District Court for the Western District of Washington on behalf of purchasers of publicly traded Company common stock during various time periods. The consolidated amended complaint in these lawsuits alleges that the Company violated the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), and seeks certification of a class action for purchasers of Company common stock in the Company's February 12, 2001 public offering and on the open market during the period January 23, 2001 through July 24, 2001. The parties have executed an agreement to settle the matter on terms that will not require a payment by any of the defendants, inasmuch as the settlement consideration will be paid entirely by insurance proceeds. The court has preliminarily approved the settlement and has set a final approval hearing for September 9, 2004. None of the complaints or claims specifies the amount of damages to be claimed.

The Company's directors and some of its officers have been named as defendants in a shareholder derivative lawsuit filed in the Superior Court of Washington in and for King County. The complaint alleges that the individual defendants breached their fiduciary duty and their duty of care to the Company by allegedly failing to supervise the Company's public statements and public filings with the SEC. The complaint alleges that, as a result of these breaches, misinformation about the Company's financial condition was disseminated into the marketplace and filed with the SEC. The complaint asserts that these actions have exposed the Company to harmful and costly securities litigation that could potentially result in an award of damages against the Company, and seeks to recover on behalf of the Company any amounts the Company is required to pay in that litigation. The parties have executed an agreement to settle the matter on terms that will not require a payment by any of the defendants, inasmuch as the settlement consideration will be paid entirely by insurance proceeds. The settlement agreement will be presented to the court for approval. The settlements of both the derivative action and the putative class action described above are contingent on both settlements receiving final court approval.

The Company, one of its officers and one of its former officers have also been named as defendants in a lawsuit filed in the United States District Court for the Southern District of New York on behalf of purchasers through December 6, 2000 of the Company's common stock sold under the February 12, 1999 registration statement and prospectus for its initial public offering. The complaint alleges that the Company and the individual defendants violated the Securities Act by failing to disclose excessive commissions allegedly obtained by its underwriters pursuant to a secret arrangement whereby the underwriters allocated initial public offering shares to certain investors in exchange for the excessive commissions. The complaint also asserts claims against the underwriters under the Securities Act and the Exchange Act in connection with the allegedly undisclosed commissions. The parties have agreed in principle to settle the matter, along with similar lawsuits against more than 300 other issuers. The terms of the settlement, which are in the process of being definitively documented, would require the Company and the other issuers to contribute to the settlement, which is being funded by a consortium of insurance carriers for the various issuers, only in the event that their carriers become insolvent or their insurance coverage is exhausted. The Company believes it is unlikely that any such contribution by the Company will be required.

In the event any of the above settlements do not receive final court approval, the Company intends to vigorously defend itself and, where applicable, its officers and directors against these lawsuits and claims, and believes it has several meritorious defenses and, in certain instances, counterclaims. If the Company is not successful in its defense of these claims, however, the Company could be forced to make significant payments to the plaintiffs and their lawyers and such payments, if not covered by the Company's insurance carriers, could harm its financial condition, operating results and cash flows. Even if these claims are not successful, the litigation could result in substantial costs to the Company and could divert management's time and attention away from business operations. The uncertainty associated with this unresolved litigation may also impair the Company's relationships with existing customers and the Company's ability to obtain new customers.

17. Liquidity

The Company's near-term restructuring costs related to the mitigation of excess facilities liabilities will consume a material amount of its cash resources. The termination of approximately 202,000 square feet in Bellevue, Washington will result in cash outflows of approximately $1.4 million over the four-month period ending April 2004 and is included in current restructuring-related liabilities at December 31, 2003. The termination of these excess facilities commitments is contingent upon the following conditions, among others, being met as of April 30, 2004: (a) the Company is current in its payments under the lease and (b) the Company has not filed a bankruptcy or other liquidation petition, or otherwise attempted to reject or contest the lease. If the Company is not in compliance with any of these conditions as of April 30, 2004, its original lease will not terminate and the Company will be required to continue making payments on the excess facilities subject to the original lease. If this were to take place, the Company's business, financial condition and operating results would be materially adversely affected.

The Company currently has loan and security agreements with SVB that allow the Company to borrow up to the lesser (a) 70% of eligible domestic and individually approved foreign accounts receivable and (b) $13.0 million under a domestic line, plus up to the lesser of (a) 75% of eligible foreign accounts receivable and (b) $2.0 million under a line guaranteed by Exim Bank. The outstanding standby letters of credit relating to long-term lease obligations totaled $8.0 million at December 31, 2003. At the time of this filing, however, no additional amounts are available under the lines of credit based on the level of the Company's borrowing base and its outstanding letters of credit. As long as the Company continues to be in compliance with the terms of its termination agreement and the surviving lease agreement with Hines, the outstanding letter of credit with Hines will be reduced in five equal monthly reductions of $507,000 ending in May 2004. The Company was in compliance with the financial covenants of these facilities as of December 31, 2003, based on an amendment to the loan agreement on January 12, 2004, which was retroactively effective as of December 31, 2003. Absent the amendment, the Company would have been out of compliance with the loan agreement as of

December 31, 2003. The Company is in the process of renewing its loan and security agreement with SVB, which expires March 31, 2004. The Company expects the agreement to be renewed with terms that are acceptable to the Company. If the Company is unable to negotiate a new agreement with SVB that has terms acceptable to the Company, the Company is unable to maintain compliance with its covenants in the future or if SVB decides to restrict its cash deposits, the Company's liquidity would be further limited and its business, financial condition and operating results could be materially harmed.

The Company believes its revenue performance will be comparable to the most recent quarterly periods reported and that the Company's existing cash and cash equivalents will be sufficient to meet its capital requirements for at least the next 12 months. Accordingly, the Company believes that it has sufficient resources to continue as a going concern through at least December 31, 2004. Should the Company's revenue results for subsequent quarters fall below the results achieved in the fourth quarter of 2003, the Company would likely take action to restructure its operations to preserve its cash. Such actions would primarily consist of reductions in headcount. Due to the fact that lower cash balances could negatively impact the Company's sales efforts, the Company may seek additional funds in the future through public or private equity financing or from other sources to fund its operations and pursue its growth strategy. The Company may experience difficulty in obtaining funding on favorable terms, if at all. Any financing the Company might obtain may contain covenants that restrict the Company's freedom to operate its business or may require the Company to issue securities that have rights, preferences or privileges senior to its common stock and may dilute current shareholders' ownership interest in the Company.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Based on their evaluation as of the end of the period covered by this annual report on Form 10-K, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are effective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

To our knowledge, there were no significant changes in our internal controls during the fourth quarter of 2003 that have materially affected, or are reasonably likely to materially affect, our internal controls.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

(a) The information regarding our directors required by this item is incorporated into this annual report by reference to the section entitled "Election of Directors" in the proxy statement for our annual meeting of shareholders to be held on June 3, 2004.

(b) The information regarding our executive officers required by this item is incorporated into this annual report by reference to the section entitled "Executive Officers" in the proxy statement for our annual meeting of shareholders to be held on June 3, 2004.

(c) The information regarding our Code of Ethics required by this item is incorporated into this annual report by reference to the section entitled "Corporate Governance" in the proxy statement for our annual meeting of shareholders to be held on June 3, 2004.

We will file the proxy statement for our 2004 annual meeting of shareholders within 120 days of December 31, 2003, our fiscal year-end.

ITEM 11. EXECUTIVE COMPENSATION

The information regarding executive compensation required by this item is incorporated into this annual report by reference to the section entitled "Executive Compensation" in the proxy statement for our annual meeting of shareholders to be held on June 3, 2004. We will file the proxy statement for our 2004 annual meeting of shareholders within 120 days of December 31, 2003, our fiscal year-end.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information regarding beneficial ownership of our common stock required by this item is incorporated into this annual report by reference to the section entitled "Security Ownership of Certain Beneficial Owners and Management" and "Securities Authorized for Issuance Under Equity Compensation Plans" in the proxy statement for our 2004 annual meeting of shareholders to be held on June 3, 2004. We will file the proxy statement within 120 days of December 31, 2003, our fiscal year-end.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information regarding certain relationships and related transactions required by this item is incorporated into this annual report by reference to the section entitled "Certain Relationships and Related

Transactions" in the proxy statement for our 2004 annual meeting of shareholders to be held on June 3, 2004. We will file the proxy statement within 120 days of December 31, 2003, our fiscal year-end.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information regarding principal accountant fees and services required by this item is incorporated into this annual report by reference to the section entitled "Independent Auditors" in the proxy statement for our 2004 annual meeting of shareholders to be held on June 3, 2004. We will file the proxy statement within 120 days of December 31, 2003, our fiscal year-end.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) **Financial Statements and Financial Statement Schedules:**

1. Index to Consolidated Financial Statements

2. Index to Financial Statement Schedules

Schedules not listed above have been omitted because they are not applicable or are not required or the information required to be set forth in the schedules is included in the consolidated financial statements or related notes.

(b) **Reports on Form 8-K**

On October 27, 2003, we furnished a current report on Form 8-K to announce our financial results for the quarter ended September 30, 2003.

On November 12, 2003, we filed a current report on Form 8-K regarding our announcement of our proposal to acquire Pivotal Corporation.

(c) **Exhibits**

Number	Description
3.1	Restated Articles of Incorporation of the registrant (exhibit 3.1) (o)
3.2	Amended and Restated Bylaws of the registrant (exhibit 3.2) (f)
4.1	Rights Agreement dated October 25, 1999 between the registrant and ChaseMellon Shareholder Services, L.L.C. (exhibit 2.1) (b)
4.2	Amendment No. 1 to Rights Agreement dated March 5, 2003 between the registrant and Mellon Investor Services LLC (exhibit 4.1) (n)

Number	Description
10.1*	Lease Termination Agreement dated November 7, 2002 between EOP-Sunset North Bellevue, L.L.C. and the registrant (exhibit 10.2) (k)
10.2	Amended and Restated Investors' Rights Agreement dated December 14, 1998 among the registrant, Foundation Capital, L.P., Foundation Capital Entrepreneurs Fund, L.L.C., TCV II, VOF, Technology Crossover Ventures II, L.P., TCV II (Q), L.P., TCV II Strategic Partners, L.P., Technology Crossover Ventures II, C.V., Hillman/Dover Limited Partnership, Brent Frei, Brian Janssen, Todd Stevenson, Mary Forler, Ronald Frei, Glenda Frei, Barbara Stevenson, Leon Stevenson, Michael Racine, Mary Winifred Racine, Bettie Ruzicka, Larry L. Ruzicka, Colleen Chmelik, James Chmelik, J. Michael Ellis and Barbara S. Ellis (exhibit 10.1) (a)
10.3	Form of Indemnification Agreement between the registrant and each director and officer of the registrant (exhibit 10.12) (a)
10.4	Amended and Restated 1994 Stock Option Plan (exhibit 10.7) (a)
10.5†	1998 Stock Incentive Compensation Plan as amended and restated on March 21, 2003
10.6	2001 Nonofficer Employee Stock Compensation Plan as amended and restated April 27, 2001 (exhibit 10.1) (f)
10.7	1998 Employee Stock Purchase Plan as amended and restated April 6, 2001 (exhibit 10.1) (h)
10.8	Office Building Lease dated June 6, 2000 between the registrant and Bellevue Hines Development, L.L.C. and First Amendment to Lease dated June 20, 2000 (exhibit 10.1) (c)
10.9	Second Amendment to Lease dated August 6, 2000 between the registrant and Bellevue Hines Development, L.L.C. (exhibit 10.8) (e)
10.10	Third Amendment to Lease dated December 20, 2002 between the registrant and Bellevue Hines Development, L.L.C. (exhibit 10.2) (l)
10.11	Office Building Lease dated December 20, 2002 between the registrant and Bellevue Hines Development, L.L.C. (exhibit 10.1) (l)
10.12	Form of Registration Rights Agreement entered into by the registrant and Bellevue Hines Development, L.L.C. (exhibit 10.3) (l)
10.13	Form of Warrant LT-1 issued to Bellevue Hines Development, L.L.C. (exhibit 10.4) (l)
10.14	Form of Warrant LT-2 issued to Bellevue Hines Development, L.L.C. (exhibit 10.5) (l)
10.15	Form of Warrant LT-3 issued to Bellevue Hines Development, L.L.C. (exhibit 10.6) (l)
10.16*	Joint Venture Agreement dated September 14, 2000 between the registrant and Prime Systems Corporation (exhibit 10.1) (d)
10.17	Loan and Security Agreement dated February 14, 2002 by and between the registrant and Silicon Valley Bank (exhibit 10.11) (j)
10.18	Amendment to Loan Documents dated July 10, 2002 by and between the registrant and Silicon Valley Bank (exhibit 10.1) (m)
10.19	Amendment to Loan Documents dated December 27, 2002 by and between the registrant and Silicon Valley Bank (exhibit 10.19) (n)
10.20	Amendment to Loan Documents dated March 28, 2003 by and between the registrant and Silicon Valley Bank (exhibit 10.1) (p)
10.21	Amendment to Loan Documents dated May 5, 2003 by and between the registrant and Silicon Valley Bank (exhibit 10.2) (p)
10.22	Loan and Security Agreement (Exim Program) dated May 5, 2003 by and between the registrant and Silicon Valley Bank (exhibit 10.3) (p)
10.23†	Amendment to Loan Documents dated January 12, 2004 by and between the registrant and Silicon Valley Bank
10.24†	Amendment to Loan Documents (Exim Program) dated January 12, 2004 by and between the registrant and Silicon Valley Bank
10.25	Intellectual Property Security Agreement dated November 8, 2000 between the registrant and Silicon Valley Bank (exhibit 10.7) (e)

10.26 Employment Agreement dated March 14, 2001 by and between the registrant and Brian C. Henry (exhibit 10.1) (g)

10.27 Stock Option Agreement dated April 4, 2001 by and between the registrant and Brian C. Henry (exhibit 10.3) (g)

10.28 Stock Option Agreement dated April 4, 2001 by and between the registrant and Brian C. Henry (exhibit 10.4) (g)

10.29 Revised Stock Option Agreement dated April 18, 2001 by and between the registrant and Brian C. Henry (exhibit 10.3) (f)

10.30 Amendment to Employment Agreement dated November 14, 2001 by and between the registrant and Brian C. Henry (exhibit 10.2) (i)

10.31 Second Amendment to Employment Agreement dated April 16, 2003 by and between the registrant and Brian C. Henry (exhibit 10.5) (p)

10.32 Letter Agreement dated January 7, 2002, between the registrant and Ramius Securities, LLC (exhibit 10.1) (i)

10.33 Employment Agreement dated June 26, 2002 by and between the registrant and Benjamin E. Kiker, Jr. (exhibit 10.29) (n)

10.34 First Amendment to Employment Agreement dated April 16, 2003 by and between the registrant and Benjamin E. Kiker, Jr. (exhibit 10.6) (p)

10.35† Employment Agreement dated February 19, 2004 by and between the registrant and Brent R. Frei

10.36 Letter Agreement dated March 5, 2003 by and between the registrant and Mazama Capital Management, Inc. (exhibit 10.30) (n)

21.1† Subsidiaries of the Registrant

23.1† Consent of KPMG LLP, Independent Auditors

23.2† Consent of Ernst & Young LLP, Independent Auditors

24.1† Power of Attorney (contained on signature page)

31.1† Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended

31.2† Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended

32.1† Certification of Chief Executive Officer furnished pursuant to Rules 13a-14(b) and 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2† Certification of Chief Financial Officer furnished pursuant to Rules 13a-14(b) and 15d-14(b) under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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* Confidential treatment has been granted for portions of this document.

† Filed herewith.

(a) Incorporated by reference to the designated exhibit to the registrant's Registration Statement on Form S-1 (No. 333-68559) filed on December 8, 1998, as amended.

(b) Incorporated by reference to the designated exhibit to the registrant's Registration Statement on Form 8-A (No. 0-25361) filed on October 28, 1999.

(c) Incorporated by reference to the designated exhibit to the registrant's Quarterly Report on Form 10-Q (No. 0-25361) for the quarter ended June 30, 2000.

(d) Incorporated by reference to the designated exhibit to the registrant's Current Report on Form 8-K (No. 0-25361) filed October 23, 2000.

(e) Incorporated by reference to the designated exhibit to the registrant's second Current Report on Form 8-K (No. 0-25361) filed February 6, 2001.

(f) Incorporated by reference to the designated exhibit to the registrant's Quarterly Report on Form 10-K (No. 0-25361) for the quarter ended March 31, 2001.

(g) Incorporated by reference to the designated exhibit to the registrant's Current Report on Form 8-K (No. 0-25361) filed April 12, 2001.

(h) Incorporated by reference to the designated exhibit to the registrant's Quarterly Report on Form 10-Q (No. 0-25361) for the quarter ended June 30, 2001.

(i) () Incorporated by reference to the designated exhibit to the registrant's first Current Report on Form 8-K (No. 0-25361) filed January 29, 2002.

(j) Incorporated by reference to the designated exhibit to the registrant's Annual Report on From 10-K (No. 0-25361) for the year ended December 31, 2001.

(k) Incorporated by reference to the designated exhibit to the registrant's Quarterly Report on Form 10-Q (No. 0-25361) for the quarter ended September 30, 2002.

(l) Incorporated by reference to the designated exhibit to the registrant's Current Report on Form 8-K (No. 0-25361) filed January 13, 2003.

(m) Incorporated by reference to the designated exhibit to the registrant's Quarterly Report on Form 10-Q (No. 0-25361) for the quarter ended June 30, 2002.

(n) Incorporated by reference to the designated exhibit to the registrant's Annual Report on Form 10-K (No. 0-25361) for the year ended December 31, 2002.

(o) Incorporated by reference to the designated exhibit to the registrant's Quarterly Report on Form 10-Q (No. 0-25361) for the quarter ended September 30, 2003.

(p) Incorporated by reference to the designated exhibit to the registrant's Quarterly Report on Form 10-Q (No. 0-25361) for the quarter ended March 31, 2003.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of Bellevue, state of Washington, on March 12, 2004.

ONYX SOFTWARE CORPORATION

By: /s/ BRENT R. FREI

Brent R. Frei
Chief Executive Officer

POWER OF ATTORNEY

Each person whose individual signature appears below hereby authorizes and appoints Brent R. Frei and Brian C. Henry, and each of them, with full power of substitution and resubstitution and full power to act without the other, as his or her true and lawful attorney-in-fact and agent to act in his or her name, place and stead and to execute in the name and on behalf of each person, individually and in each capacity stated below, and to file, any and all amendments to this report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing, ratifying and confirming all that said attorneys-in-fact and agents or any of them or their or his substitute or substitutes may lawfully do or cause to be done by virtue thereof.

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

Name	Title	Date
/s/ BRENT R. FREI Brent R. Frei	Chief Executive Officer and Chairman of the Board (Principal Executive Officer)	March 12, 2004
/s/ BRIAN C. HENRY Brian C. Henry	Chief Financial Officer and Executive Vice President (Principal Financial Officer)	March 12, 2004
/s/ AMY E. KELLERAN Amy E. Kelleran	Vice President Finance, Corporate Controller and Assistant Secretary (Principal Accounting Officer)	March 12, 2004
/s/ H. RAYMOND BINGHAM H. Raymond Bingham	Director	March 12, 2004
/s/ TERESA A. DIAL Teresa A. Dial	Director	March 12, 2004
/s/ WILLIAM B. ELMORE William B. Elmore	Director	March 12, 2004
/s/ DANIEL R. SANTELL Daniel R. Santell	Director	March 12, 2004

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

ONYX SOFTWARE CORPORATION
December 31, 2003

Column A	Column B	Column C Additions		Column D	Column E
Description	Balance at Beginning of Period	Charged to Costs and Expenses(1)	Charged to Other Accounts — Describe(2)	Deductions — Describe(3)	Balance at End of Period
			(In thousands)		
Year ended December 31, 2001					
Deducted from asset accounts:					
Allowance for doubtful accounts . .	$1,732	$2,527	$400	$(2,580)	$2,079
Year ended December 31, 2002					
Deducted from asset accounts:					
Allowance for doubtful accounts . .	$2,079	$ —	$ —	$(1,040)	$1,039
Year ended December 31, 2003					
Deducted from asset accounts:					
Allowance for doubtful accounts . .	$1,039	$ (225)	$ —	$ (326)	$ 488

(1) In 2003, net benefit recorded due to collections of accounts previously believed to be uncollectible

(2) In 2001, amounts charged against revenue ($200) and deferred revenue ($200) primarily, for billed but uncollected maintenance revenues.

(3) Uncollectible accounts written off, net of recoveries.