UNITED STATE DISTRICT COURT
NORTHERN DISTRICT OF
CALIFORNIA

TRIAL EXHIBIT 440

CASE NO. C-08-4238-CRB
DATE ENTERED
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the Fiscal Year Ended December 31, 2006

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

For the transition period from ______ to ______

Commission File Number 000-30293

EMBARCADERO TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**68-0310015** *(I.R.S. Employer Identification No.)*

100 CALIFORNIA STREET, SUITE 1200
SAN FRANCISCO, CA 94111
(Address of principal executive offices, zip code)

(415) 834-3131
(Registrant's telephone number, including area code)

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

Common Stock, $0.001 Par Value *(Title of Class)*	**NASDAQ Global Select Market** *(Names of Each Exchange on which Registered)*

Securities registered pursuant to Section 12 (g) of the Act:
NONE

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

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

Indicate by check mark whether the registrant (1) 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 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 Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

Indicate by check mark if the registrant is a shell company as defined in Rule 12b-2 of the Act. ☐ Yes ☒ No

Aggregate market value of the voting stock held on June 30, 2006 by non-affiliates of the registrant was approximately $116,513,000 based on the last sales price reported for such date on the Nasdaq National Market (now known as the Nasdaq Global Select Market). Number of shares of Common Stock outstanding at May 1, 2007: 26,134,970.

DOCUMENTS INCORPORATED BY REFERENCE

Not applicable.

EMBARCADERO TECHNOLOGIES, INC.
ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2006

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All statements contained in this Annual Report on Form 10-K that are not historical facts are forward-looking statements within the meaning of the federal securities laws that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "intend," "potential," or "continue" or the negative of these terms or other comparable terminology. Such statements are only predictions. Risks and uncertainties and the occurrence of other events could cause actual results to differ materially from these predictions. The risks and uncertainties discussed below under Item 1A. Risk Factors and elsewhere in this report should be considered carefully in evaluating our business. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. Moreover, we assume no responsibility for the accuracy and completeness of these statements. We are under no duty to update any of the forward-looking statements after the date of this report or to adjust these statements to reflect actual results.

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PART I

Explanatory Note

In this Form 10-K, Embarcadero Technologies, Inc. is restating its consolidated balance sheet as of December 31, 2005 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years ended December 31, 2005 and 2004 and for each quarter of 2005 and the first two quarters of 2006. The Company's decision to restate is the result of an independent review of the Company's historical stock option practices and related accounting that was conducted by a Special Committee of the Board of Directors (the "Special Committee").

The Special Committee undertook a comprehensive analysis of the Company's historical stock option practices, including all option grants from the Company's initial public offering in April 2000 to August 2006, option vesting practices and option exercises. The Special Committee concluded that about half of the grants under review, or two thirds of the number of shares covered under option grants, were misdated and mispriced from the time of the initial public offering until March 2005. The Special Committee also concluded that certain options that were granted to consultants for services had different vesting schedules than were originally used to calculate the fair value of these options. In addition, the Special Committee found that one option was reported to have been exercised on a date that pre-dated the actual exercise date, giving the optionee preferential tax treatment.

The Special Committee found instances in which incorrect measurement dates were used to account for certain option grants. In addition, the Company found that it did not appropriately account for certain other aspects of stock compensation, but this did not result in a material adjustment to our historical consolidated financial statements. The total cumulative adjustment to stock compensation expense through December 31, 2005 resulting from these findings is $14.6 million. In addition to the stock-based compensation expense adjustment, the Company also elected to restate prior year results from fiscal year 2003 to 2005 for its sales tax liability from sales in various states where the Company had established sales tax nexus. The total cumulative adjustment to sales tax expense through December 31, 2005 is $0.7 million. Accordingly, this Form 10-K includes restatements of the following previously filed financial statements and data (and related disclosures): (1) our consolidated financial statements as of and for the fiscal years ended December 31, 2005 and 2004; (2) our selected consolidated financial data as of December 31, 2005 and for the fiscal years ended December 31, 2005, 2004, 2003 and 2002; and (3) our unaudited quarterly financial data for all quarters of fiscal 2005 and the first and second quarter of fiscal 2006. See Note 3, "Restatement of Consolidated Financial Statements," and Note 18 "Unaudited Quarterly Results of Operations," to the consolidated financial statements included in this Form 10-K for a detailed discussion of the effect of the restatements.

Previously filed annual reports on Form 10-K and quarterly reports on Form 10-Q for the periods affected by the restatements have not been amended and, as such, should not be relied upon. On December 18, 2006, we issued a press release announcing that, although we had not yet concluded which specific periods would require restatement, the Audit Committee of our Board had concluded that our previously issued financial statements should no longer be relied upon.

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Stock Option Review

In November 2006, the Company announced that the Audit Committee had retained independent legal counsel and accounting advisors to assist in an independent review of two option grants from 2001. After an initial review of the evidence suggested that there might be issues with other grants, the Audit Committee expanded the scope of the investigation to include all grants from April 20, 2000 (the date of the Company's initial public offering) through August 2006 (the "Investigation Period"). As part of the expanded scope, the Audit Committee's advisors determined that there were potential issues with one of the grants to outside directors, including directors who currently serve on the Board and/or the Audit

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Committee. As a result, on December 8, 2006, the Board decided to form an independent Special Committee of the Board to review the Company's options practices.

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During the Investigation Period, the Company made 1,086 individual stock option grants on 119 different dates, representing more than 6.5 million shares of common stock. After reviewing the evidence, the Special Committee concluded that for about half of these grants, the record grant date was not the date of determination as defined by the Company's stock option plans and applicable accounting rules. Under Accounting Principles Board Opinion No. 25 ("APB No. 25") and other applicable accounting rules, for options granted before 2006, when the exercise price is less than the fair market value on the measurement date, the Company must recognize a compensation expense over the options' vesting period in an amount equal to the difference in the two prices multiplied by the number of options granted. For those grants where the record date was not the date of determination, the Special Committee sought to identify recommended measurement dates by ascertaining when the following were established: (1) the identity of the specific grantee, (2) the number of shares to be granted to each grantee, and (3) the exercise price that would apply to such option grant. In almost every instance where there was a discrepancy between the record grant date and the date of determination, the stock price on the record grant date was lower than the price on the date of determination.

Also, on several occasions during the Investigation Period, the Company modified or canceled and subsequently regranted options at lower prices. Under APB No. 25 and related accounting literature, modifying the exercise price of options may result in a variable award, which requires the Company to periodically remeasure the intrinsic value of the award and adjust compensation expense for changes in the intrinsic value until exercise, forfeiture or expiration.

To determine the correct measurement dates for these options under applicable accounting principles, we followed the guidance in APB No. 25, which deems the "measurement date" as the first date on which all of the following are known: (1) the individual employee who is entitled to receive the option grant; (2) the number of options that an individual employee is entitled to receive; and (3) the option's exercise price. In addition, the "measurement date" cannot be earlier than the date on which the grant is approved. In instances where we determined we could not rely on the original grant date for an option, we determined corrected measurement dates based on our ability to establish or confirm, in our reasonable judgment, whether through other documentation, consistent or established Company practice or processes, or credible circumstantial information, that all requirements for the proper granting of the option had been satisfied under applicable accounting principles.

The Company has determined that the total cumulative pre-tax stock compensation expense through December 31, 2005 resulting from the errors described above was $14.6 million. In this Form 10-K, we recorded pre-tax stock compensation expense of $0.2 million and $0.3 million for the years ended December 31, 2005 and 2004, respectively, and $14.1 million prior to fiscal 2004. There was no impact on revenues or net cash provided by operating activities during any of these periods as a result of this additional stock compensation expense.

Sales Tax Liability Accrual

In August 2006, the Company identified states where the Company has established sales tax nexus and had not registered to file sales tax in those states. The sales tax nexus rules dictate that the hiring of sales employees in the state would result in sales tax nexus even if there were no physical office in that state and the employee worked from his/her home office.

In some states, the Company filed for amnesty under the Streamline Sales Tax Project ("SSTP") which relieved the Company from past due sales tax liability but committed the Company to report and file in all of the states in the SSTP. For the non-SSTP states, with the assistance of an outside consultant, the Company filed voluntary disclosure agreements to get current with past due amounts and to start to collect and remit sales taxes in states where the Company has established sales tax nexus. The cumulative pre-tax expense through December 31, 2005 resulting from the failure to register and file sales tax in various states was $0.7 million. In this Form 10-K, we recorded sales tax expense of $0.3 million, $0.3 million, and $0.1 million for the years ended December 31, 2005, 2004, and 2003 respectively. There was no impact on revenues or net cash provided by operating activities during any these periods as a result of this sales tax expense.

Tax Impact of Restatement

Our deferred tax asset was previously reported as $2.9 million; however the restatement resulted in a total increase to our gross deferred tax assets of approximately $2.4 million as of December 31, 2005. As a result, there is a tax benefit of approximately $0.3 million for 2000, $1.6 million for 2001, $1.5 million for 2002, $1.3 million for 2003, $0.2 million for 2004, and $0.2 million for 2005 relating to the additional stock compensation expense recorded by us. Additionally, there is no material impact on our consolidated financial statements arising from the impact of Section 409A of the Internal Revenue Code (the "Code") or the limitations on deduction of executive stock compensation expense in Section 162(m) of the Code. See "Impact of Section 409A" in "Management's Discussion and Analysis of Financial Condition and Results of

Operations," Item 7 of this Form 10-K, for a discussion of the potential prospective impact of Section 409A on the Company's future results of operations.

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Additional Information

The address of our internet website is www.embarcadero.com. We make available, free of charge through our website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Section 16 filings, and other periodic SEC reports, along with amendments to all of those reports, as soon as reasonably practicable after we file the reports with the SEC.

Item 1A. Risk Factors

In addition to other information in this report, the following factors should be considered carefully in evaluating the Company. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of or currently deem immaterial may also become important factors that may harm our business..

We may not be able to complete the proposed merger with affiliates of Thoma Cressey Bravo, Inc. on the terms previously announced or other acceptable terms.

On April 5, 2007, we signed a merger agreement to be acquired by affiliates of Thoma Cressey Bravo, Inc. for a cash purchase price of $7.20 per share. Although we currently expect the transaction will close during the second quarter of 2007, we may not be able to complete the proposed merger as a result of various factors, including:

- failure to obtain stockholder approval;
- the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement;
- failure to satisfy the closing conditions of the merger before July 16, 2007 or at all; or
- failure of the merger to close for any other reason.

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In December 2006, we and affiliates of Thoma Cressey Bravo mutually terminated a previous merger agreement because we concluded that we could not proceed with a stockholder vote while the Special Committee's review was pending and our financial statements could not be relied upon. If we are not able to complete the proposed merger, our stock price would be adversely affected and our business and operating results could be harmed. In addition, we believe that the amount of costs, fees, expenses and charges related to the merger could cause actual results to differ materially from forward-looking statements contained under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report.

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Whether or not the proposed merger is completed, the announcement of the merger may cause disruption in our business.

Whether or not the proposed merger is completed, the announcement of the merger could be disruptive to our business and operations. Our customers, suppliers, distributors, employees and other business partners may adversely change or terminate their relationship with us in response to the announcement of the merger. In addition, management's attention could be diverted from our sales plan and business plan by the proposed merger.

Our quarterly operating results may fluctuate in future periods, and, as a result, our stock price may fluctuate or decline.

Our operating results have fluctuated from quarter to quarter. We believe that quarter-to-quarter comparisons of our historical results of operations are not indicative of our future performance. Our revenues and operating results may continue to vary significantly from quarter to quarter due to a number of factors, including the factors discussed below. Seasonal variations in orders for our products also contribute to fluctuations in our quarterly operating results. These fluctuations are likely to cause corresponding volatility in our stock price, particularly if our operating results vary from analysts' expectations.

We have experienced declining license revenue in recent periods and license revenue in future periods may fluctuate substantially.

Our business depends in large part on our ability to generate license revenues from new and existing customers. In recent periods, our license revenue has declined. License revenue decreased to $6.9 million in the fourth quarter of 2006 compared to $7.8 million in the fourth quarter of 2005 and decreased to $26.6 million for the twelve months ended December 31, 2006 compared to $27.5 million for the twelve months ended December 31, 2005. License revenue for the first quarter of 2007 decreased even more significantly to $4.8 million compared to $6.6 million in the first quarter of 2006. We expect that license revenue in future periods, including the rest of fiscal 2007, will fluctuate substantially from quarter to quarter and

may continue to decline.

Our license revenues in any quarter are substantially dependent on orders booked and delivered in that quarter. Our revenues in a given quarter could be adversely affected if we are unable to complete one or more large license agreements, or if the contract terms were to prevent us from recognizing revenue during that quarter. Variations in the size and timing of our customer orders could expose us to substantial revenue fluctuations and higher operating costs. Further, we have often booked a large amount of our sales in the last

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month, weeks or days of each quarter and delays in the closing of sales near the end of a quarter could cause quarterly revenue to fall short of anticipated levels. These factors may cause significant periodic variation in our license revenues. In addition, we incur or commit to operating expenses based on anticipated revenue levels, and generally do not know whether revenues in any quarter will meet expectations until the end of that quarter.

Historically, we have not placed significant reliance on large sales transactions in any given quarter, with a substantial volume of our revenues being driven from smaller transactions. However, if we encounter difficulty and cannot generate a sufficient number of large customer orders, or if customers delay or cancel such orders in a particular quarter, our revenues and operating results may be adversely affected.

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The matters relating to the review by a Special Committee of the Board of our historical stock option grant practices and the restatement of our consolidated financial statements have required us to incur substantial expenses, have resulted in litigation, and may result in additional litigation and future government enforcement actions.

In November 2006, the Company announced that the Audit Committee of the Company's Board of Directors, with the assistance of independent legal counsel, was conducting a review of our stock option grant practices covering the time from the Company's initial public offering in 2000 through August 2006. In December 2006, the Company's Board of Directors formed a Special Committee to continue this review. As described in the Explanatory Note immediately preceding Item 1, and in Note 3 "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, the Special Committee reached a conclusion that incorrect measurement dates and exercise prices were used for financial accounting purposes for stock option grants in certain prior periods. As a result, the Company has recorded additional non-cash stock-based compensation expense, and related tax effects, related to certain stock option grants, and the Company has restated certain previously filed financial statements included in this Annual Report on Form 10-K.

This review of our historical stock option grant practices has required us to incur substantial expenses for legal, accounting, tax and other professional services, has diverted our management's attention from our business, and could in the future adversely affect our business, financial condition, results of operations and cash flows.

SEC

Our historical stock option grant practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation and regulatory proceedings. Several derivative complaints have been filed pertaining to allegations relating to stock option grants. The conduct and resolution of these matters will be time consuming, expensive and distract management from the conduct of our business.

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In November 2006, we voluntarily contacted the SEC regarding the stock option review. Shortly thereafter, the SEC requested that the Company produce certain documents relating to the Company's stock option practices. In December 2006, the Company responded to the SEC's document production request. In March 2007, special independent counsel to the Special Committee met with the enforcement staff of the SEC and provided them with a report of the Special Committee's review and findings. There can be no assurance that the SEC will not commence an enforcement action against the Company, or commence proceedings against our directors and officers as individuals, which, in each case, could further divert our management's attention from our business, and could in the future adversely affect our business, financial condition, results of operations and cash flows.

The finding of the Special Committee's review are more fully described in the Explanatory Note immediately preceding Item 1, and in Note 3 "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements in this Annual Report on Form 10-K.

Our common stock may be delisted from the NASDAQ Global Select Market, which may reduce the price of our common stock and levels of liquidity available to our stockholders and cause confusion among investors.

On November 13, 2006, we submitted to the SEC a Notification of Late Filing pursuant to Rule 12b-25 of the Securities Exchange Act of 1934 in respect of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (the "Third Quarter 10-Q"). On November 15, 2006, we received a Staff Determination Letter from NASDAQ, stating that we were not in compliance with NASDAQ Marketplace Rule 4310(c)(14), because we had not filed the Third Quarter 10-Q in a timely manner. The Staff Determination Letter indicated that our securities would be delisted from NASDAQ unless we timely requested a hearing before a NASDAQ Listing Qualifications Panel (the "Panel"). We timely requested such a hearing, and on January 18, 2007, we appeared before the Panel to appeal the Staff's determination and present a plan to cure our filing deficiencies and regain compliance. On February 9, 2007, the Panel notified us that the Panel had determined to continue the

PARTIES AGREE

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listing of our securities on NASDAQ, provided that we met certain requirements. Those requirements were that we (i) provide NASDAQ with specified information regarding the results of the Special Committee's review of stock option grant practices on or about March 1, 2007, (ii) file the Third Quarter 10-Q, any other delinquent periodic reports, and any required restatements on or before April 18, 2007, and (iii) comply with all other requirements for continued listing on NASDAQ. On March 1, 2007, we provided NASDAQ with certain information regarding the results of the Special Committee's review, as requested. On March 16, 2007, we submitted to the SEC an additional Notification of Late Filing pursuant to

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Rule 12b-25 of the Securities Exchange Act of 1934 in respect of this Annual Report on Form 10-K. On March 21, 2007, we received an additional Staff Determination Letter from NASDAQ stating that we were not in compliance with NASDAQ Marketplace Rule 4310(c)(14) because we had not filed this Annual Report on Form 10-K in a timely manner. The additional Staff Determination Letter indicated that we were required to present our views with respect to the additional deficiency to the Panel in writing no later than March 28, 2007. On March 28, 2007, we responded to the Panel in writing regarding the additional deficiency and our plan to cure our filing deficiencies by April 18, 2007. On April 12, 2007, we requested a further extension of the April 18 deadline for filing the Third Quarter 10-Q and this Annual Report on Form 10-K. On April 18, 2007, the Panel granted an extension of the deadline to May 10, 2007. On May 8, 2007, we informed NASDAQ that we would not be able to meet this deadline for filing the Third Quarter 10-Q and this Annual Report on Form 10-K. On May 10, 2007, the NASDAQ Listing and Hearing Review Council (the "Listing Council") called for review and determined to stay the April 18 decision of the Panel pending further action by the Listing Council. On May 11, 2007, we submitted to the SEC a Notification of Late Filing pursuant to Rule 12b-25 of the Securities Exchange Act of 1934 in respect of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 (the "First Quarter 10-Q"). On May 14, 2007, we received an additional Staff Determination Letter from NASDAQ stating that we are not in compliance with NASDAQ Marketplace Rule 4310(c)(14) because we have not filed the First Quarter 10-Q in a timely manner. The additional Staff Determination Letter indicated that we were required to make a submission with respect to the additional deficiency to the Listing Council in writing no later than May 21, 2007. On May 21, 2007, we responded to the Listing Council in writing regarding the additional deficiency and our plan to cure our filing deficiencies. The Listing Council has also requested that we submit any additional information that we wish the Listing Council consider regarding the continued listing of our securities on NASDAQ by June 29, 2007. We intend to timely provide such additional information to the Listing Council. The Listing Council has indicated that, following receipt of additional information from us and from the Panel, it will review the written record and make a determination regarding the continued listing of our securities on NASDAQ.

There can be no assurance that the Listing Council will determine to continue the listing of our securities on NASDAQ or that we will be able to satisfy any conditions to continued listing set forth by the Listing Council. In the event that we are unable to satisfy any such conditions, or if the Listing Council so determines following its review, our securities will be delisted from NASDAQ. In addition, if we are unable to become current in our SEC filings, our securities could be delisted from NASDAQ. If our common stock is delisted, it may become more difficult for our stockholders to sell our stock in the public market and the price of our common stock may be adversely affected because of the anticipated decreased liquidity. Delisting from NASDAQ could also result in other negative implications including the potential loss of confidence by customers, suppliers and employees, the loss of investor interest, an increase in investor confusion, and fewer business development opportunities, any of which could materially adversely affect our financial condition and results of operations.

PARTIES AGREE

Claims and litigation based on the Special Committee's review may require that we incur substantial additional expenses and expend significant additional management time.

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On February 9, 2007, a complaint was filed in the United States District Court for the Northern District of California captioned Murray v. Wong et al., C07-00872 SBA. The complaint, which names the Company as a nominal defendant, relates to the Company's historical stock option grant practices and seeks to bring derivative claims on behalf of the Company against its directors and certain current and former executive officers. The complaint asserts claims under federal and state law including breaches of fiduciary duties, unjust enrichment, statutory violations and other violations of law. The Company is evaluating the lawsuit and intends to respond appropriately. We cannot estimate the ultimate outcome of this case at this preliminary stage.

On February 26, 2007, a complaint was filed in the Superior Court of the State of California, County of San Francisco, captioned Loeb v. Wong et al., CGC-07-460779. The complaint, which was amended on April 10, 2007, names the Company as a nominal defendant, relates to the Company's historical stock option grant practices and seeks to bring derivative claims on behalf of the Company against its directors and certain current and former executive officers and agents. The amended complaint also seeks to bring direct claims against the Company and the other named defendants. The complaint asserts claims under state law including breaches of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment and violations of the California Corporations Code. The amended complaint also asserts direct putative class claims relating to the proposed merger with affiliates of Thoma Cressey Bravo, Inc. The Company is evaluating the lawsuit and intends to respond appropriately. We cannot estimate the ultimate outcome of this case as this preliminary stage.

On March 9, 2007, a complaint was filed in the United States District Court for the Northern District of California captioned Redwing v. Wong et al., C07-01401. The complaint, which names the Company as a nominal defendant, relates to the

PARTIES AGREE

Company's historical stock option grant practices and seeks to bring derivative claims on behalf of the Company against its directors and certain current and former executive officers. The complaint asserts claims under federal and state law including breaches of fiduciary duties, unjust enrichment, statutory violations and other violations of law. The Company is evaluating the lawsuit and intends to respond appropriately. We cannot estimate the ultimate outcome of this case at this preliminary stage.

We may be named as a defendant in additional securities litigation or derivative lawsuits by current or former stockholders based on the restated financial statements. Further, we may be subject to claims relating to adverse tax consequences with respect to stock options covered by the restatement. Defending against potential claims would likely require significant attention and resources of management and could result in significant legal expenses.

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Moreover, we cannot assure you that we will not be subject to regulatory actions by government agencies. Any such proceeding would divert the resources of management, could result in significant expenses and could cause our customers, employees and investors to lose confidence in our company.

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We have identified a material weakness in our internal control over financial reporting as of December 31, 2006 that, if not remediated effectively, could result in material misstatements in our financial statements for future periods.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for our Company, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2006 and identified one material weakness, which was a failure to maintain an effective control environment that resulted in incorrect accounting for and disclosure of our stock-based compensation expense relating to options granted prior to March 2005. This lack of an effective control environment also resulted in the restatement of certain of our consolidated financial statements. Company management began efforts in the second quarter of 2005 and continuing throughout 2006 to improve controls relating to our option grant practices, and, as a result, management believes that the likelihood that a material error in our financial statements could have originated during fiscal 2006 and not have been detected as of December 31, 2006 was remote. However, management has concluded that the improved controls were not effective to detect and correct for deficiencies for options granted in periods prior to March 2005. Because of this material weakness, our management concluded, as of December 31, 2006, that our internal control over financial reporting was not effective. This material weakness is further described in "Item 9A. Controls and Procedures" in this Annual Report on Form 10-K.

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A material weakness is defined by the Public Company Accounting Oversight Board (United States) as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

We have implemented remedial measures designed to address this material weakness. If these remedial initiatives are insufficient to address the identified material weakness, or if additional material weaknesses or significant deficiencies in our internal control are discovered in the future, we may fail to meet our future reporting obligations on a timely basis, our financial statements may contain material misstatements, we could be required to restate our prior period financial results, our operating results may be harmed, we may be subject to class action litigation, and our common stock may be delisted from The NASDAQ Global Select Market. Any failure to address the identified material weakness or any additional material weaknesses or significant deficiencies in our internal controls could also adversely affect the results of the periodic management evaluations regarding the effectiveness of our internal control over financial reporting that are required to be included in our Annual Reports on Form 10-K. Internal control deficiencies could also cause investors to lose confidence in our reported financial information. We can give no assurance that the measures we have taken to date or any future measures will remediate the material weakness identified or that any additional material weaknesses or additional restatements of financial results will not arise in the future due to a failure to implement and maintain adequate internal control over financial reporting or circumvention of these controls. In addition, even if we are successful in strengthening our controls and procedures, those controls and procedures may not be adequate to prevent or identify irregularities, or errors or facilitate the fair presentation of our financial statements or SEC reports.

We have experienced changes in our senior management team that could affect our business and operations.

We have experienced significant changes in our senior management team, including the resignation of Stephen R. Wong, our former Chairman, Chief Executive Officer and President in January 2007. In October 2006 we hired Scott B. Schoonover as our Vice President, Worldwide Sales, following the resignation of Robert Lamvik, our former Vice President, Worldwide Field Operations. Because of these significant changes, our management team may not be able to work together effectively to successfully develop and implement our business strategies and financial operations. In addition, management will need to devote significant attention and resources to preserve and strengthen relationships with employees, customers and the investor community. As announced in January 2007, the Board of Directors formed a Management Oversight Committee following Mr. Wong's resignation, to assist the Company's management team on business and operational matters until the proposed merger is completed. If our management team, with assistance from this Management Oversight Committee, is unable to achieve these goals, our ability to grow our business and successfully meet operational challenges could be impaired. If the proposed merger with affiliates of Thoma Cressey Bravo, Inc. is not completed, we will need to recommence

our search for a new Chief Executive Officer, our Senior Vice President of Operations, Raj Sabhlok, will either resign or be terminated, and there would likely be other changes in our senior management team that could adversely affect our business and operations.

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We have recently implemented changes in our sales force that may affect our revenues in future periods.

We have recently restructured and made other adjustments to our sales force in response to management changes, product changes, performance issues and other internal considerations. Additionally, we currently are seeking to fill the open position of vice president of EMEA Sales. We have also recently increased headcount in our telesales groups. These changes to our sales force require a transition phase prior to full productivity. This could have a temporary negative effect on our license revenues.

If we do not generate new business from our existing customers and add new customers from our new or existing products, we will not be able to sustain or increase our revenues.

Our license arrangements generally do not provide for substantial ongoing license or maintenance payments. Therefore, our future revenue growth depends on our success in expanding our relationships with existing customers and attracting new customers. Further, the expiration or termination of OEM agreements could adversely affect our channel sales. Our ability to expand our relationships with existing customers and attract new customers will depend on a variety of factors, including the performance, quality, breadth, and depth of our current and future products and maintenance. Our failure to expand relationships with existing customers or to add new customers would reduce our future license and maintenance revenues. In addition, if our existing customers do not renew their support contracts, our future maintenance revenues will be adversely affected.

If our products do not perform as expected, we may lose customers, our costs will increase and revenues may be delayed or lost.

Computer software such as ours often contains undetected errors and may contain design flaws. Errors may be found in current versions, new versions, or enhancements of our products after we make commercial shipments. If our software contains undetected errors, performs unreliably, or if we otherwise fail to meet our customers' expectations, we may suffer:

- loss of revenues, market share or customers;
- negative publicity and harm to our reputation;
- diversion of research and development and management resources;
- increased maintenance and warranty costs;
- legal actions by customers against us; and
- increased insurance costs.

Our operating results would be harmed if overall information technology spending were to decrease.

The markets into which we sell our products are cyclical and are subject to general economic conditions. The information technology market has generally improved since the second half of 2003. However, economic conditions remain uncertain and this market may decline in the future. Any renewed slowdown in the database market or in general economic conditions would likely result in a reduction in demand for our products and our results of operations would be harmed.

If we are not able to attract and retain qualified personnel, our business will not be able to grow.

Our success depends on the continued service of our executive officers and other key administrative, sales and marketing, research and development, and support personnel. None of our executive officers or key employees is bound by an employment agreement for any specific term, and we do not maintain any key person life insurance policies. The loss of these officers or personnel would adversely affect our operations.

PARTIES AGREE

Given the lengthy financial restatement process, the related SEC and internal investigations and the potential delisting of our common stock from NASDAQ, it has become more difficult to retain key personnel, including members of our finance team. In addition, we have recently experienced increased employee turnover, especially in our sales and marketing and research and development departments. OUT We will need to continue to recruit new personnel into our organizations. Our business will not be able to grow if we cannot continue to fill these positions and attract, retain, and motivate other qualified personnel. Competition for qualified employees remains intense and we may not be able to attract, assimilate, or retain highly qualified personnel in the future. There has been in the past and there may also be in the future a shortage of personnel that possess the technical background necessary to sell, support, and develop our products effectively. It has also become more difficult to recruit qualified financial personnel since the implementation of the new laws, regulations and standards relating to corporate

governance, public disclosure and financial reporting.

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infrastructure are based in large part on expectations about expected future revenues. If we hire personnel and enter into facilities contracts based on our expectations about future revenues, and then fail to meet those revenue expectations, we would likely have lower than expected earnings, which would negatively affect our stock price.

International political instability may increase our cost of doing business and disrupt our business.

Continued international political instability, evidenced by the threat or occurrence of terrorist attacks, enhanced national security measures, sustained military action in Afghanistan and Iraq, strained international relations with foreign governments and other international conflicts, may halt or hinder our ability to do business, may increase our costs, and may adversely affect our stock price. This continued instability may, for example, negatively impact the reliability and cost of transportation, negatively affect the desire of our employees and customers to travel, adversely affect our ability to obtain adequate insurance at reasonable rates, or require us to take extra security precautions for our domestic and international operations. In addition, this international political instability has had and may continue to have negative effects on financial markets, including significant price and volume fluctuations in securities markets. If this international political instability continues or escalates, our business and results of operations could be harmed and the market price of our common stock could decline.

We may have future non-recurring charges in the event of goodwill impairment.

We adopted SFAS No. 142 on January 1, 2002, and, as a result, we ceased to amortize goodwill. We now test our goodwill for impairment on an annual basis or in the event of a significant change in our business. We performed our impairment test as of September 30, 2006 and determined that there had been no impairment to our goodwill. As of December 31, 2006, our goodwill balance was $14.3 million. In the future, if we determine that this goodwill has been impaired, we will be required to take a non-recurring charge to write down this asset, which would adversely affect our earnings and book value.

Increased costs associated with corporate governance compliance may significantly impact our results of operations.

PARTIES AGREE

Changing laws, regulations and standards relating to corporate governance, public disclosure and compliance practices, including the Sarbanes-Oxley Act of 2002, new SEC regulations and NASDAQ Global Select Market rules, are creating uncertainty for companies such as ours in understanding and complying with these laws, regulations and standards. As a result of this uncertainty and other factors, devoting the necessary resources to comply with evolving corporate governance and public disclosure standards has resulted in increased general and administrative expenses and a diversion of management time and attention to compliance activities. Our compliance costs in 2006 were lower than in 2005, as we were able to better control our costs in our third year of compliance with the requirements of the Sarbanes-Oxley Act of 2002. However, these costs could increase in 2007 or in the future, if the proposed merger with an affiliate of Thoma Cressey Bravo is not completed. In addition, these developments, as well as the litigation we confront based on the Special Committee's review of our stock option grant practices and the resulting restatements, may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain such coverage. Moreover, we may not be able to comply with these more stringent rules and regulations on a timely basis. These developments could make it more difficult for us to attract and retain qualified members of our board of directors or qualified executive officers.

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Additionally, in fiscal year 2006, we have incurred $1.4 million of additional legal, accounting and consulting costs in connection with the Special Committee's review of our historical stock option grant practices. As a result of the review, our results of operations for 2006 were adversely affected. We expect these costs to be significantly higher in fiscal 2007, which would also have an adverse effect on our results of operations for 2007.

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Our proprietary rights may be inadequately protected and infringement claims or independent development of competing technologies could harm our competitive position.

We rely on copyright and trademark laws, trade secrets, confidentiality procedures, and contractual provisions to establish and protect our proprietary rights. We also enter into confidentiality agreements with employees and consultants and attempt to restrict access to proprietary information on a need-to-know basis. Despite such precautions, unauthorized third parties may be able to copy aspects of our products or obtain and use information that we consider as proprietary. Further, the protection of our proprietary rights may be more difficult in countries like Romania, where we are expanding our development activities.

We license our software products primarily under shrink-wrap licenses delivered electronically with our software products.

Shrink-wrap licenses are not negotiated with or signed by individual licensees and purport to take effect upon installation of the product or downloading of the product from the Internet. These measures afford only limited protection. Policing unauthorized use of our products is difficult and we are unable to determine the extent to which piracy of our software exists. In addition, the laws of some foreign countries do not protect our proprietary rights as well as the laws of the United States. We may have to enter into litigation to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others with respect to our

rights. Litigation is generally very expensive and can divert the attention of management from daily operations. Accordingly, any
intellectual property litigation could disrupt our operations and harm our operating results. Further, the cost we may need to incur in connection with the defense of such lawsuits, if significant, could harm our financial condition.

We are not aware of any case in which we are infringing the proprietary rights of others. However, third parties may bring infringement claims against us. Any such claim is likely to be time consuming and costly to defend, could cause product delays and could force us to enter into unfavorable royalty or license agreements with third parties. A successful infringement claim against us could require us to enter into a license or royalty agreement with the claimant or develop alternative technology. However, we may not be able to negotiate favorable license or royalty agreements, if any, in connection with such claims and we may fail to develop alternative technology on a timely basis. Accordingly, a successful product infringement claim against us could harm our business and operating results.

We are susceptible to business interruptions that could harm our business.

Our operations are vulnerable to damage or interruption from computer viruses, human errors, natural disasters, telecommunications failures, intentional acts of vandalism, and other similar events. In particular, our corporate headquarters are located in San Francisco, which is known for its seismic activities. Although we have a disaster recovery plan for critical data and business applications, this does not provide assurance that we would not suffer a business interruption. A significant business interruption would result to losses or damages to our operation and harm our business. Our business interruption insurance may not be adequate to compensate us for losses that might occur, which would result in increased expenses and harm our operating results.

Certain persons have substantial control over us, which could impede stockholder approval of certain transactions.

Our executive officers and directors, in the aggregate, beneficially held more than 27% of our outstanding common stock as of December 31, 2006. Following the January 2007 resignation of Stephen R. Wong, our former Chairman, Chief Executive Officer and President, our executive officers and directors, in the aggregate, beneficially held approximately 5% of our outstanding common stock as of March 31, 2007. These stockholders, if acting together, and Mr. Wong, if acting individually or together with other stockholders, can significantly influence all matters requiring approval by our stockholders, including the approval of equity compensation plans, the election of directors and the approval of mergers or other business combination transactions.

On April 5, 2007, in connection with the execution of the merger agreement relating to the proposed merger with affiliates of Thoma Cressey Bravo, Inc., each of Stephen Wong, Raj Sabhlok, our Senior Vice President of Operations, Michael Shahbazian, our Chief Financial Officer, Wayne Williams, our Chief Technology Officer, and Scott Schoonover, our Vice President, Worldwide Sales, executed a voting agreement pursuant to which each has agreed to vote, or cause to be voted or consented, all of his shares of our common stock and those acquired after the date of the voting agreements, if any, in favor of adoption of the merger agreement. These voting agreements only relate to the adoption of the merger agreement and no other matters, and in the event that the merger agreement is terminated or our board of directors withdraws or modifies its approval or recommendation of the proposed merger, the voting agreements will automatically terminate. The voting agreements cover an aggregate of 4,782,658 shares of our common stock, representing approximately 18.3% of the shares of our common stock entitled to vote upon the adoption of the merger agreement.

We expect the price of our common stock to remain volatile, making it difficult for our stockholders to predict the return on their investment.

Since our initial public offering, the market price of our common stock has fluctuated significantly in response to a number of factors, including:

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- the announcement of our proposed merger;
- the announcement of the termination of the previously proposed merger;
- market reaction to our announcement of the non-reliability of our financial statements and related communications for the periods commencing on or after January 1, 2000 through the present, the inability of the investing public to rely on our previously issued financial statements for those periods, and the delayed filing of our Form 10-Q for the quarter ended September 30, 2006, our Form 10-K for the fiscal year ended December 31, 2006 and our Form 10-Q for the quarter ended March 31, 2007;

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- market reaction to our announcement of the delayed filing of our Form 10-Q for the quarter ended December 31, 2004, and the inability of the investing public to rely on our previously issued financial statements for the quarters and year ended December 31, 2004;
- market reactions to our announcement of the restatements of our financial statements for the years 2000, 2001, 2002 and 2003, the inability of the investing public to rely on our previously issued financial information for those years ended December 31, and December 31, 2004 and 2003, and the delayed filing of the Form 10-K for 2004;
- changes in market valuation of software and technology companies;
- quarterly variations in our operating results;
- global and domestic economic and political conditions;
- changes in financial estimates by securities analysts;
- announcements that we or our competitors make related to significant contracts, acquisitions, capital commitments, strategic partnerships or product introductions or enhancements;
- additions or departures of key personnel;
- stock market price and volume fluctuations, which are particularly volatile among securities of software and Internet companies; and
- sales of significant amounts of our common stock or other securities in the open market.

If we are not able to complete the merger for any reason, we expect that the price of our stock would decline to historical levels at or below those before we announced the signing of our initial merger agreement on September 6, 2006.

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Provisions of our charter and bylaws and Delaware law could deter takeover attempts that might be beneficial to our stockholders.

Provisions of our amended and restated certificate of incorporation and bylaws as well as Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. We are subject to the provisions of Delaware law that restrict business combinations with interested stockholders, which may have the effect of inhibiting a non-negotiated merger or other business combinations.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our headquarters currently occupy approximately 24,300 square feet in San Francisco, California, pursuant to a lease we executed in April 2004, and which expires in June 2009. Ongoing costs associated with our former San Francisco facilities are included in our restructuring reserve, as discussed in Note 10 of the Notes to our Consolidated Financial Statements, included in Item 8 hereof. Our Colorado office occupies approximately 8,000 square feet in Littleton and Colorado Springs, Colorado pursuant to leases that expire in August 2006 and February 2007, respectively. In addition, we maintain a research and development facility of approximately 6,500 square feet in Monterey, California pursuant to a lease that expired in November 2005 and that was extended month-to-month. Subsequently, we have negotiated a new lease for our Monterey, California office for 6,100 square feet of space starting in March 2006 and expiring in March 2011. We have additional field sales and software development offices in the United States, Canada, the United Kingdom, Romania and Australia.

We believe that our facilities are adequate and that, if required, we would be able to lease additional space to accommodate expansion.

Item 3. Legal Proceedings

As of December 31, 2006, we had no material pending legal proceedings.

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On February 9, 2007, a complaint was filed in the United States District Court for the Northern District of California captioned Murray v. Wong et al., C07-00872 SBA. The complaint, which names the Company as a nominal defendant, relates to the Company's historical stock option grant practices and seeks to bring derivative claims on behalf of the Company against its directors and certain current and former executive officers. The complaint asserts claims under federal and state law including breaches of fiduciary duty, unjust enrichment, statutory violations and other violations of law. The Company is evaluating the lawsuit and intends to respond appropriately. We cannot estimate the ultimate outcome of this case at this preliminary stage.

On February 26, 2007 a complaint was filed in the Superior Court of the State of California, County of San Francisco, captioned Loeb v. Wong et al., CGC-07-460779. The complaint, which was amended on April 10, 2007, names the Company as a nominal defendant, relates to the Company's historical stock option grant practices and seeks to bring derivative claims on behalf of the Company against its directors and certain current and former executive officers and agents. The amended complaint also seeks to bring direct claims against the Company and the other named defendants. The complaint asserts claims under state law including breaches of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment and violations of the California Corporations Code. The amended complaint also asserts direct putative class claims relating to the proposed merger with affiliates of Thoma Cressey Bravo, Inc. The Company is evaluating the lawsuit and intends to respond appropriately. We cannot estimate the ultimate outcome of this case at this preliminary stage.

On March 9, 2007, a complaint was filed in the United States District Court for the Northern District of California captioned Redwing v. Wong et al., C07-01401. The complaint, which names the Company as a nominal defendant, relates to the Company's historical stock option grant practices and seeks to bring derivative claims on behalf of the Company against its directors and certain current and former executive officers. The complaint asserts claims under federal and state law including breaches of fiduciary duties, unjust enrichment, statutory violations and other violations of law. The Company is evaluating the lawsuit and intends to respond appropriately. We cannot estimate the ultimate outcome of this case at this preliminary stage.

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We may be named as a defendant in additional securities litigation or derivative lawsuits by current or former stockholders based on the restated financial statements. Further, we may be subject to claims relating to adverse tax consequences with respect to stock options covered by the restatement. Defending against potential claims would likely require significant attention and resources of management and could result in significant legal expenses.

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From time to time, we may also become a party to other legal proceedings arising in the normal course of our business. We may also be indirectly affected by administrative or court proceedings or actions in which we are not involved but which have general applicability.

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

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2006.

PART II

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

Common Stock Market Price

Our common stock is traded on the NASDAQ Global Select Market ("NASDAQ") under the symbol "BMBT." Our common stock began trading on NASDAQ on April 20, 2000, the date of our initial public offering.

On November 13, 2006, we submitted to the SEC a Notification of Late Filing pursuant to Rule 12b-25 of the Securities Exchange Act of 1934 in respect of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (the "Third Quarter 10-Q"). On November 15, 2006, we received a Staff Determination Letter from NASDAQ, stating that we were not in compliance with NASDAQ Marketplace Rule 4310(c)(14), because we had not filed the Third Quarter 10-Q in a timely manner. The Staff Determination Letter indicated that our securities would be delisted from NASDAQ unless we timely requested a hearing before a NASDAQ Listing Qualifications Panel (the "Panel"). We timely requested such a hearing, and on January 18, 2007, we appeared before the Panel to appeal the Staff's determination and present a plan to cure our filing deficiencies and regain compliance. On February 9, 2007, the Panel notified us that the Panel had determined to continue the listing of our securities on NASDAQ, provided that we met certain requirements. Those requirements were that we

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(i) provide NASDAQ with specified information regarding the results of the Special Committee's review of stock option grant practices on or about March 1, 2007, (ii) file the Third Quarter 10-Q, any other delinquent periodic reports, and any required restatements on or before April 18, 2007, and (iii) comply with all other requirements for continued listing on NASDAQ. On March 1, 2007, we provided NASDAQ with certain information regarding the results of the Special Committee's review, as requested. On March 16, 2007, we submitted to the SEC an additional Notification of Late Filing pursuant to Rule 12b-25 of the Securities Exchange Act of 1934 in respect of this Annual Report on Form 10-K. On March 21, 2007, we received

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included in this Annual Report on Form 10-K. This report contains forward-looking statements that involve risks and uncertainties. All of these statements are based on information available to us as of the date hereof, and we assume no obligation to update any forward- looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of certain risk factors including, but not limited to, those discussed above under Item 1A. Risk Factors.

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Restatement of Financial Statements

Past Stock Option Grant Activity

We delayed the filing of this Form 10-K, pending completion of a previously announced review of our past stock option grant practices being conducted by a Special Committee of the Board of Directors.

On November 10, 2006, the Company announced that the Audit Committee had begun a review of stock option grant practices. In December 2006, the Board formed a Special Committee to complete the investigation. The Special Committee's review covered all option grants to directors, executive officers and other employees from the Company's initial public offering in April 2000 to August 2006. The Special Committee's investigation included an extensive review of hard copy and electronic documents as well as interviews with current and former employees and members of the Board. The Special Committee's review identified circumstances where the record grant date was not the correct measurement date for accounting purposes. The Special Committee determined that the misdated and mispriced grants occurred from May 2000 until March 2005. The Special Committee concluded that the last intentional selection of a favorable price occurred in September 2004, and that, subsequent to September 2004, the mispriced grants were attributable to administrative error or delay in documentation.

SEC

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To determine the correct measurement dates for these options under applicable accounting principles, the Company followed the guidance in Accounting Principles Board Opinion No. 25 ("APB No. 25"), which deems the "measurement date" as the first date on which all of the following are known: (1) the individual employee who is entitled to receive the option grant; (2) the number of options that an individual employee is entitled to receive; and (3) the option's exercise price. In addition, the "measurement date" cannot be earlier than the date on which the grant is approved. In instances where we determined we could not rely on the original grant date for an option, we determined corrected measurement dates based on our ability to establish or confirm, in our reasonable judgment, whether through other documentation, consistent or established Company practice or processes, or credible circumstantial information, that all requirements for the proper granting of the option had been satisfied under applicable accounting principles.

SEC

In addition to accounting adjustments due to measurement date changes, the Company found accounting errors relating to: "repricing" of grants after declines in the stock price; grants to non-employees for which an incorrect amount of stock compensation expense had been recognized; modifications of grants for which an incorrect amount of stock compensation expense had been recognized; one grant of a discounted option for which no stock compensation expense had been recognized; and one option was reported to have been exercised on a date that pre-dated the actual exercise date, giving the optionee preferential tax treatment. The accounting adjustments resulting from these errors represent less than 10% of the total cumulative adjustment to stock compensation expense.

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The Special Committee did not find any misdated or mispriced grants after the first quarter of 2005. Beginning in July 2005, the Company moved to a fixed date grant procedure for new hire option grants. Although the procedure evolved over time, since July 2005 the Company has consistently used either a fixed date, such as the end of the month, or a verifiable date, such as an employee's date of hire, to award options.

We have determined that the total cumulative pre-tax stock compensation expense through December 31, 2005 resulting from the errors described above was $14.6 million. In this Form 10-K, we recorded pre-tax stock compensation expense of $0.2 million and $0.3 million for the years ended December 31, 2005 and 2004, respectively, and $14.1 million prior to fiscal 2004. There was no impact on revenues or net cash provided by operating activities during any of these periods as a result of this additional stock compensation expense.

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If any 409A Affected Options are amended, the Company may choose to approve bonuses payable to holders of the amended options to compensate them for the resulting increase in their option exercise price. The amount of these bonuses would be effectively repaid to the Company if and when the amended options are exercised as the increased exercise price is paid, but there can be no assurance that holders will actually exercise such amended options. The Company may also choose to compensate those option holders who have already exercised 409A Affected Options for the additional taxes they incur under Section 409A of the Code and, as applicable, under California and other state tax laws.

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Cost of Restatement and Legal Activities

The legal and other professional expenses related to the stock option review and restatement incurred during the fourth quarter of 2006 were approximately $1.4 million. We expect to incur significant expenses of the same nature in the first and second quarters of 2007 in connection with the stock option review and restatement, which would adversely affect our results of operations and cash flows in the period incurred.

SEC

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In connection with the review of our stock option grant practices, we have voluntarily continued to keep the SEC advised of the issues identified by the review, its progress and our conclusions. On November 21, 2006, the SEC requested that the Company produce certain documents relating to the Company's stock option practices. Although no formal inquiry has been made by the SEC or any other regulatory agency, we are unable to predict whether any such formal inquiry will be initiated or the consequences, if any, that any such further inquiry may have on us. Any SEC or other regulatory agency inquiry could result in substantial legal and accounting expenses, divert management's attention from other business concerns and harm our business. If the SEC or other regulatory agency were to commence legal action, it is possible that we could be required to pay significant penalties and/or fines and could become subject to administrative orders. Any regulatory action could result in the filing of additional restatements of our prior financial statements or require that we take other actions.

Executive Overview

Embarcadero Technologies, Inc. is a leading provider of strategic data management solutions that help companies to improve the availability, integrity, accessibility, and security of corporate data. The company develops, markets, sells and supports software that helps customers manage corporate databases more effectively. Since its founding in 1993, Embarcadero has built a broad customer base with over 12,000 customers and over 90 of the Fortune 100. The company is headquartered in San Francisco, CA and distributes its software in the U.S. and abroad through its sales force as well as through distributors and resellers.

Our products support the most widely used database and OS platforms, which include a combination of Oracle ®, IBM ®DB2 ®UDB, Microsoft ® SQL Server ®, Sybase ®, and MySQL ® databases.

In 2005, we saw a year over year growth in total revenues primarily due to the increase in maintenance revenues. In the first half of the year 2006, we experienced growth in total revenues compared to the same period in 2005 due to improvements in the international sector. However in the second half of the year 2006, total revenues remained flat as a result of lower sales volume and decreased numbers of large deals domestically which is offset by higher maintenance revenues worldwide.

Most of our operating expenses are related to personnel and related overhead costs, facilities, outside research and development contractors, and legal and other professional service costs. Operating expenses for the three and twelve months ended December 31, 2006 were $12.2 million and $50.0 million, respectively, compared to $13.2 million and $48.8 million for the three and twelve months ended December 31, 2005, respectively. Included in the twelve month period ended 2006 are stock option restatement expenses of $1.4 million and included in the twelve month period ended 2005 is a litigation settlement charge of $0.6 million.

Our cash flow from operations was approximately $0.4 million and $11.4 million for the three and twelve months ended December 31, 2006, respectively. Cash and cash equivalents and short-term investments were $71.2 million at December 31, 2006.

Our license and maintenance revenues, results of operations, cash flows from operations, and financial condition could be adversely affected in future periods by a renewed downturn in global economic conditions, increased competitive pressures or our own inability to execute on our sales plans.

In December 2006, we terminated the Agreement and Plan of Merger with affiliates of Thoma Cressey Equity Partners, Inc., EMB Holding Corp., a Delaware corporation, and EMBT Merger Corp., a Delaware corporation, entered into in September

2006.

On April 5, 2007, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with EMB Holding Corp., a Delaware corporation ("Parent") and EMBT Merger Corp., a Delaware corporation and a wholly-owned subsidiary of Parent ("Merger Sub"), pursuant to which Merger Sub will merge with and into the Company (the "Merger"), and the Company will survive as a wholly-owned subsidiary of Parent. Parent and Merger Sub are affiliates of Thoma Cressey Bravo, Inc. Pursuant to the Merger Agreement, at

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Operating Expenses

Total Operating Expense. Total operating expenses were $50.0 million, $48.8 million, and $50.1 million for 2006, 2005, and 2004, respectively, representing an increase of 2.5% from 2005 to 2006 and a decrease of 2.6% from 2004 to 2005.

Year ended December 31,	2006	2005 As Restated	Change Amount	Percent	2004 As Restated	Change Amount	Percent
Operating expenses:							
Research and development	$16,596	$ 16,369	$ 227	1.4%	$ 16,027	$ 342	2.1%
Purchased research and development	—	—	—	0.0%	—	—	0.0%
Sales and marketing	21,924	22,956	(1,032)	-4.5%	20,718	2,238	10.8%
General and administrative	11,457	8,876	2,581	29.1%	9,301	(425)	-4.6%
Purchased in process research and development	—	573	(573)	-100.0%	—	573	0.0%
Restructuring and impairment charges	—	—	—	0.0%	4,032	(4,032)	-100.0%
Total operating expenses	$49,977	$ 48,774	$ 1,203	2.5%	$ 50,078	$(1,304)	-2.6%

(1) See Note 3, "Restatement of Consolidated Financial Statements," of the Notes to the Consolidated Financial Statements

Research and Development. Research and development expenses consist primarily of personnel and related expenses, including payroll, employee benefits, allocated overhead, and non-cash stock-based compensation, as well as expenses related to outside software development contractors. The increase of 1.4% from 2005 to 2006 was a result of $714,000 in increased salaries and related costs from increases in headcount in our Canadian development team, offset by a reduction of $300,000 in outsourced development costs. The increase of 2.1% from 2004 to 2005 was a result of increased headcount and recruiting related in both domestic and Canadian development teams as well as a write-off of $280,000 of in-progress R&D acquired as part of the Ambeo acquisition completed in October 2005. Research and develop expenses increased 0.2% as headcount shifted to Canada. We anticipate that we will continue to invest significant resources into research and development activities in order to develop new products and advance the technology of our existing products. We believe that continued investment in research and development is critical to attaining our strategic objectives and, as such, we expect that spending on research and development in 2007 will be consistent in absolute dollars with 2006. In 2006, we opened a development center in Iasi, Romania to leverage the growing technical talent and the lower associated wages in Romania. At the end of 2006, we had 7 developers in our Romanian development center. We intend to increase our development resources in Romania in 2007. However, we expect that increased costs associated with our Romanian development center will be offset by cost reductions through anticipated personnel attrition in our other development centers in the U.S. and Canada.

Sales and Marketing. Sales and marketing expenses consist primarily of personnel and related expenses, commissions earned by sales personnel, non-cash stock-based compensation, trade shows, travel, and other marketing communication costs, such as advertising and other marketing programs. The decrease in 2006 from 2005 was primarily due to a decrease in salaries and commission expense due to decreased headcount in 2006 and lower license revenue. This decrease is partially offset by increases in marketing program spending to generate sales leads. The increase in absolute dollars from 2004 to 2005 was primarily due to increase in sales wages and related costs, $100,000 increase in marketing program spending, $180,000 in increased travel expenses resulting from market expansion, $250,000 increase in meetings and promotional expenses.

We expect that sales and marketing expenditures will decline in 2007 compared to 2006.

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General and Administrative. General and administrative expenses consist primarily of salaries and related personnel expenses, general operating expenses, and non-cash stock-based compensation. The increase of $2.6 million in 2006 from 2005 is due to an increase of $1.4 million of legal, accounting and professional services related to the stock option review and the related restatement, $1.2 million in professional services related to the proposed merger we announced in September 2006 that was terminated in December 2006, and a $800,000 increase in stock based compensation expense resulting from the adoption of FAS 123(R) in January 2006. The decrease in absolute dollars from 2004 to 2005 was primarily due to a decrease of $1.5 million in the costs incurred in the Audit Committee investigation that was completed in January 2005, offset by increases in higher salaries and related costs of $730,000, increased tax consulting fees of $189,000, increased legal fees of $194,000, higher franchise tax and property taxes of $96,000 and increased travel costs of $60,000.

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that we (i) provide NASDAQ with specified information regarding the results of the Special Committee's review of stock option grant practices on or about March 1, 2007, (ii) file the Third Quarter 10-Q, any other delinquent periodic reports, and any required restatements on or before April 18, 2007, and (iii) comply with all other requirements for continued listing on NASDAQ. On March 1, 2007, we provided NASDAQ with certain information regarding the results of the Special Committee's review, as requested. On March 16, 2007, we submitted to the SEC an additional Notification of Late Filing pursuant to Rule 12b-25 of the Securities Exchange Act of 1934 in respect of this Annual Report on Form 10-K. On March 21, 2007, we received an additional Staff Determination Letter from NASDAQ stating that we were not in compliance with NASDAQ Marketplace Rule 4310(c)(14) because we had not filed this Annual Report on Form 10-K in a timely manner. The additional Staff Determination Letter indicated that we were required to present our views with respect to the additional deficiency to the Panel in writing no later than March 28, 2007. On March 28, 2007, we responded to the Panel in writing regarding the additional deficiency and our plan to cure our filing deficiencies by April 18, 2007. On April 12, 2007, we requested a further extension of the April 18 deadline for filing the Third Quarter 10-Q and this Annual Report on Form 10-K. On April 18, 2007, the Panel granted an extension of the deadline to May 10, 2007. On May 8, 2007, we informed NASDAQ that we would not be able to meet this deadline for filing the Third Quarter 10-Q and this Annual Report on Form 10-K. On May 10, 2007, the NASDAQ Listing and Hearing Review Council (the "Listing Council") called for review and determined to stay the April 18 decision of the Panel pending further action by the Listing Council. On May 11, 2007, we submitted to the SEC a Notification of Late Filing pursuant to Rule 12b-25 of the Securities Exchange Act of 1934 in respect of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 (the "First Quarter 10-Q"). On May 14, 2007, we received an additional Staff Determination Letter from NASDAQ stating that we are not in compliance with NASDAQ Marketplace Rule 4310(c)(14) because we have not filed the First Quarter 10-Q in a timely manner. The additional Staff Determination Letter indicated that we were required to make a submission with respect to the additional deficiency to the Listing Council in writing no later than May 21, 2007. On May 21, 2007, we responded to the Listing Council in writing regarding the additional deficiency and our plan to cure our filing deficiencies. The Listing Council has also requested that we submit any additional information that we wish the Listing Council consider regarding the continued listing of our securities on NASDAQ by June 29, 2007. We intend to timely provide such additional information to the Listing Council. The Listing Council has indicated that, following receipt of additional information from us and from the Panel, it will review the written record and make a determination regarding the continued listing of our securities on NASDAQ. There can be no assurance that the Listing Council will determine to continue the listing of our securities on NASDAQ or that we will be able to satisfy any conditions to continued listing set forth by the Listing Council. In the event that we are unable to satisfy any such conditions, or if the Listing Council so determines following its review, our securities will be delisted from NASDAQ. In addition, if we are unable to become current in our SEC filings, our securities could be delisted from NASDAQ.

Upon the filing of this Annual Report on Form 10-K for the year ended December 31, 2006 and our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, we will be current with our filing requirements under the Securities Exchange Act of 1934. As a result, we expect that our securities will no longer be subject to delisting from NASDAQ, however, final determination of this matter is within the discretion of the Listing Council, and there can be no assurance that the Listing Council will agree with our position.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measures"* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), expands disclosures about fair value measurements, and applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the FASB anticipates that for some entities, the application of SFAS 157 will change current practice. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We do not expect the adoption of SFAS No. 157 will have a material impact on our financial position, results of operations, or cash flows.

In September 2006, the SEC Staff released Staff Accounting Bulletin ("SAB") No. 108, "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*." SAB No. 108 provides guidance on the process of quantifying materiality of financial statement misstatements. SAB No. 108 is effective for fiscal years ending after November 15, 2006, with early application for the first interim period ending after November 15, 2006. The adoption of SAB No. 108 did not have a material impact on our financial position, results of operations, or cash flows.

In July 2006, FASB issued FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109*" ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. This Interpretation

requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. As a result, the Company will increase its reserves for uncertain tax positions by $0.2 million including interest and penalties as a cumulative adjustment to the beginning balance of retained earnings. At the adoption date of January 1, 2007, the Company will have approximately $2.0 million of unrecognized tax benefits, $1.8 million of which would affect our income tax expense if recognized and the remaining balance of the unrecognized tax benefits would be an adjustment to goodwill.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Embarcadero Technologies, Inc.

We have completed integrated audits of Embarcadero Technologies, Inc.'s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Embarcadero Technologies, Inc. and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 13 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of accounting for stock-based compensation.

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As discussed in Note 3 to the consolidated financial statements, the Company has restated its 2005 and 2004 consolidated financial statements.

Internal control over financial reporting

Also, we have audited management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A, that Embarcadero Technologies, Inc. did not maintain effective internal control over financial reporting as of December 31, 2006, because of the effect of an ineffective control environment, based on the criteria established in the COSO framework. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate

because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment.

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As of December 31, 2006, the Company did not maintain an effective control environment based on the criteria established in the COSO framework. Specifically, the Company did not maintain an effective emphasis on controls designed to maintain an appropriate level of management integrity, as certain of the Company's senior executive officers as of December 31, 2006, (i) had knowledge of the practice of recording favorable grant dates for stock options granted prior to March 2005; (ii) knew or should have known that the Company had not properly accounted for such option grants; and (iii) failed to disclose the Company's improper historical option granting practices and related accounting to the Board of Directors and the Company's independent registered public accountants. This material weakness resulted in the Company incorrectly accounting for and disclosing its stock-based compensation expense and income tax provision or benefit relating to options granted prior to March 2005, as well as (i) the restatement of the Company's consolidated financial statements for the fiscal years ended December 31, 2005, 2004, 2003 and 2002, and the Company's unaudited quarterly consolidated financial statements for all quarters of fiscal 2005 and the first and second quarters of fiscal 2006; and (ii) adjustments to the Company's consolidated financial statements for the third quarter of fiscal 2006 and for the year 2006. Additionally, this material weakness could result in a material misstatement of any of the Company's annual or interim consolidated financial statements and related disclosures that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.

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This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2006 consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements.

In our opinion, management's assessment that Embarcadero Technologies, Inc. did not maintain effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Embarcadero Technologies, Inc. has not maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO.

/s/ PRICEWATERHOUSECOOPERS LLP
PricewaterhouseCoopers LLP

San Jose, California
May 23, 2007

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In July 2006, FASB issued FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109*" ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. As a result, the Company will increase its reserves for uncertain tax positions by $0.2 million including interest and penalties as a cumulative adjustment to the beginning balance of retained earnings. At the adoption date of January 1, 2007, the Company will have approximately $2.0 million of unrecognized tax benefits, $1.8 million of which would affect our income tax expense if recognized and the remaining balance of the unrecognized tax benefits would be an adjustment to goodwill.

In June 2005, the FASB issued SFAS No. 154, "*Accounting Changes and Error Corrections*." This new standard replaces APB Opinion No. 20, "*Accounting Changes in Interim Financial Statements*", and SFAS No. 3, "*Reporting Accounting Changes in Interim Financial Statements*", and represents another step in the FASB's goal to converge its standards with those issued by the International Accounting Standards Board ("IASB"). Among other changes, SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS 154 also provides that (1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) a correction of errors in previously issued financial statements should be termed a "restatement." The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The adoption of SFAS No. 154 as of May 1, 2006 did not have a material impact on our consolidated financial statements.

NOTE 3—Restatement of Consolidated Financial Statements

Stock Options

On November 10, 2006, the Company announced that Audit Committee had begun a review of two past stock option grants. The scope of the Audit Committee's investigation expanded after an initial review of the evidence suggested that there might be problems with other option grants. As part of the expanded scope, the Audit Committee's advisors determined that there were potential issues with one of the grants to outside directors, including directors who currently serve on the Board and/or the Audit Committee. As a result, on December 8, 2006, the Board formed the Special Committee. The Special Committee's review covered all option grants made to employees, directors and consultants from the Company's initial public offering in April 2000 to August 2006. During this period, the Company issued 1,086 individual option grants on 119 separate dates. As part of its investigation, the Special Committee reviewed documents (both hard copy and electronic) and conducted interviews of directors and employees (current and past) and others with knowledge of the Company's options practices. The Special Committee concluded that about half of the grants under review were misdated and mispriced. The misdated grants occurred from the time of the initial public offering until March 2005.

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To determine the correct measurement dates for these options under applicable accounting principles, the Company followed the guidance in Accounting Principles Board Opinion No. 25 ("APB No. 25"), which deems the "measurement date" as the first date on which all of the following are known: (1) the individual employee who is entitled to receive the option grant; (2) the number of options that an individual employee is entitled to receive; and (3) the option's exercise price. In addition, the "measurement date" cannot be earlier than the date on which the grant is approved. In instances where we determined we could not rely on the original grant date for an option, we determined corrected measurement dates based on our ability to establish or confirm, in our reasonable judgment, whether through other documentation, consistent or established Company practice or processes, or credible circumstantial information, that all requirements for the proper granting of the option had been satisfied under applicable accounting principles.

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In addition to accounting adjustments due to measurement date changes, the Company found accounting errors relating to: "repricing" of grants; grants to non-employees for which an incorrect amount of stock compensation expense had been recognized; modifications of grants for which an incorrect amount of stock compensation expense had been recognized; and one grant of a discounted option for which no stock compensation expense had been recognized. The accounting adjustments resulting from these errors represent less than 10% of the total cumulative adjustment to stock compensation expense.

We have determined that the total cumulative pre-tax stock compensation expense through December 31, 2005 resulting from the errors described above was $14.6 million. In this Form 10-K, we recorded pre-tax stock compensation expense of $0.2 million and $0.3 million for the years ended December 31, 2005 and 2004, respectively, and $14.1 million prior to fiscal 2004. There was no impact on revenues or net cash provided by operating activities during any of these periods as a result of this additional stock compensation expense.

Sales Tax Liability Accrual

In August 2006, the Company identified states where the Company has established sales tax nexus and had not registered to file sales tax in those states. The sales tax nexus rules dictate that the hiring of sales employees in the state would result in sales tax nexus even if there were no physical office in that state and the employee worked from his/her home office.

In some states, the Company filed for amnesty under the Streamline Sales Tax Project ("SSTP") which relieved the Company from past due sales tax liability but committed the Company to report and file in all of the states in the SSTP. For the non-SSTP states, with the assistance of an outside consultant, the Company filed voluntary disclosure agreements to get current with past due amounts and to start to collect and remit sales taxes in states where the Company has established sales tax nexus. The cumulative net pre-tax expense through December 31, 2005 resulting from the failure to register and file sales tax in various states was $0.7 million. In this Form 10-K, we recorded pre-tax sales tax expense of $0.3 million, $0.3 million, and $0.1 million for the years ended December 31, 2005, 2004, and 2003 respectively. There was no impact on revenue or net cash provided by operating activities during any these periods as a result of this sales tax accrual expense.

Tax Impact of Restatement

The Company's deferred tax asset was previously reported as $2.9 million; however the restatement resulted in a total increase to the Company's gross deferred tax assets of approximately $2.4 million as of December 31, 2005. As a result, there is a tax benefit of approximately $0.3 million for 2000, $1.6 million for 2001, $1.5 million for 2002, $1.3 million for 2003, $0.2 million for 2004, and $0.2 million for 2005 relating to the additional stock compensation expense recorded by the Company. Additionally, there is no material impact on our consolidated financial statements arising from the impact of Section 409A of the Internal Revenue Code (the "Code") or the limitations on deduction of executive stock compensation expense in Section 162(m) of the Code. See "Impact of Section 409A" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," Item 7 of this Form 10-K, for a discussion of the potential prospective impact of Section 409A on the Company's future results of operations.

The cumulative effect of the restatement adjustments on our consolidated balance sheet at December 31, 2005 was an increase in deferred tax assets, an increase in accrued liabilities, an increase in additional paid-in capital, offset by a corresponding increase in the accumulated deficit and deferred stock-based compensation, which results in a net increase of $1.6 million in stockholders' equity. The adjustments decreased previously reported net income per share by $0.01 for the years ended December 31, 2005 and 2004.

The following table sets forth the effect of the restatement for each of the applicable fiscal years (in thousands):

	Total cummulative effect at December 31, 2005	December 31, 2005	December 31, 2004	Total cummulative effect at December 31, 2003	December 31, 2003	December 31, 2002	December 31, 2001	December 31, 2000
Net Income, as reported		$ 4,337	$ 1,988					
Additional compensation expense	$ (14,571)	(152)	(306)	$ (14,113)	$ (3,123)	$ (4,333)	$ (5,042)	$ (1,615)
Additional								

sales tax expense	(724)	(322)	(266)	(136)	(136)	—	—	—
Tax effect	5,036	188	217	4,631	1,262	1,519	1,561	289
Total decrease to net income	$ (10,259)	(286)	(355)	$ (9,618)				
Net Income, as restated		$ 4,051	$ 1,633					

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

Not applicable.

Item 9A. Controls and Procedures.

Background Findings and Restatement

On November 10, 2006, the Company announced that the Audit Committee of the Board of Directors had commenced an independent review of two stock option grants made by the Company in 2001. The Audit Committee retained O'Melveny & Myers LLP as special independent legal counsel, as well as other accounting advisors, to assist with the review. The Audit Committee's initial review of evidence suggested that there were potential problems with the dating, pricing, and accounting for these option grants. The initial review also suggested that there might be similar problems associated with other grants, and the Audit Committee, based on the initial findings, decided to expand the scope of the review to include all grants from April 20, 2000 (the date of the Company's initial public offering) through August 2006 (the "Investigation Period"). As part of the expanded scope, the Audit Committee and its advisors determined that there were potential problems with one stock option grant made to outside directors, including directors currently serving on the Audit Committee. As a result, on December 8, 2006, the Board formed an independent Special Committee to continue the review that had been commenced by the Audit Committee.

The Special Committee's review covered all option grants made to employees, directors and consultants during the Investigation Period, which included 1,086 individual stock option grants on 119 different dates, representing more than 6.5 million shares of common stock. The Special Committee's review included a review of over 20,000 pages of hard copy documents and over 180,000 electronic documents, as well as interviews with current and former employees and members of the Board and others with knowledge of the Company's option practices. The review focused on, among other things, whether options granted during the Investigation Period were correctly dated and priced and, if the options were not correctly dated and priced, what the correct dates and exercise prices should have been.

After reviewing the evidence, the Special Committee concluded that, for about half of the grants made during the Investigation Period, the record grant date was not the date of determination, as defined by the Company's stock option plans and applicable accounting rules. For those grants where the record date was not the date of determination, the Special Committee sought to identify recommended measurement dates by ascertaining when the following were established: (1) the identity of the specific grantee, (2) the number of shares to be granted to each grantee, and (3) the exercise price that would apply to such option grant. The Special Committee found that in almost every instance where there was a discrepancy between the record grant date and the date of determination, the stock price on the record grant date was lower than the price on the date of determination. The Special Committee further found evidence that there was a practice within the Company of retrospectively pricing grants (primarily employee grants) at the low prices for a particular fiscal quarter.

The Special Committee also concluded, among other things:

- that on several occasions, the Company modified or canceled and subsequently regranted options at lower prices following a decline in the Company's stock price;
- that the Company's Chief Executive Officer granted certain options in excess of authority delegated by the Compensation Committee of the Board of Directors;
- that on two occasions, it appears that grants were made in the name of former employees with the purpose of allowing the Company to reallocate the options, with the original price, to other employees later in time; and
- that on at least one occasion, an exercise of a stock option was backdated to a date when the Company's stock price was lower than at the actual exercise date.

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The Special Committee concluded that the last intentional selection of a favorable price occurred in September 2004, and that, subsequent to September 2004, mispriced grants were attributable to administrative error or delay in documentation. The Special Committee did not find any misdated or mispriced grants after March 2005.

In its report to the Board of Directors, the Special Committee also concluded that there had been inadequate controls and a lack of sufficient oversight in the issuance of stock options and the administration of the Company's stock option programs. The Special Committee concluded that these inadequate controls had allowed management to exercise discretion without sufficient oversight by the Compensation Committee of the Board of Directors. The Special Committee further concluded that certain current and former members of Company management, including the Company's former Chief Executive Officer and the Company's Senior Vice President of Operations, had knowledge of the practice of recording favorable grant dates; that, at some point no later than 2006, such individuals knew or should have known that the Company had not properly accounted for such option grants, particularly the grants that had been retrospectively priced and dated; and that such individuals failed to disclose the Company's option granting practices to the Board of Directors and the Company's independent registered public accountants. The Special Committee concluded that there was no evidence that members of the Compensation Committee were aware of, or participated in, approving misdated or mispriced grants. The Special Committee also found evidence that Company management had begun efforts in the second quarter of 2005 and continuing throughout 2006 to improve controls relating to the Company's option grant practices, and that there were no misdated or mispriced grants after March 2005. Management believes that the measures that were put in place strengthened the transactional level controls surrounding the processing of stock option grants and also increased the likelihood that the controls would be effective in preventing the option practices identified in the Special Committee's report.

In light of the Special Committee's conclusions, in January 2007, the Special Committee recommended, and the Compensation Committee approved and formalized the policies and procedures that management implemented during 2005 and 2006 that require systematic authorization to ensure that all stock option transactions adhere to the Company's approved plans and policies and that all transactions are reflected in the Company's stock administration systems and have appropriate supporting documentation. The Special Committee also recommended that members of the Compensation Committee re-familiarize themselves with the terms of the Company's stock option plans, and that finance and human resources personnel receive training on the Company's option plans and the applicable accounting rules relating thereto.

In its report to the Board of Directors, the Special Committee further recommended that Raj Sabhlok, the Company's Senior Vice President of Operations, either resign or be terminated, and the Board of Directors accepted this recommendation. As previously disclosed by the Company, EMB Holding Corp. required the Company to continue to employ Mr. Sabhlok as a condition to entering into the Agreement and Plan of Merger with the Company executed on April 5, 2007, pursuant to which EMBT Merger Corp., a wholly-owned subsidiary of EMB Holding Corp., will merge with and into the Company and the Company will survive as a wholly-owned subsidiary of EMB Holding Corp. EMB Holding Corp. also required the Company to enter into a new employment agreement with Mr. Sabhlok that will become effective upon consummation of the proposed merger. Subsequently, on May 23, 2007, the Board of Directors determined that Mr. Sabhlok should either resign or be terminated upon the earlier of the termination of the Agreement and Plan of Merger or July 16, 2007, in the event that the proposed merger has not been consummated by that date. This remediation measure is in addition to certain other remediation measures that the Company had adopted in January 2007, which included weekly meetings between Mr. Sabhlok and the Management Oversight Committee and restricting Mr. Sabhlok's ability to undertake any material decisions affecting the general management, business or operations of the Company, particularly in respect of employment and compensation matters as well as his authority to bind the Company contractually.

Concurrent with the Special Committee's investigation, Company management, under the oversight of the Audit Committee, completed a review in order to prepare the restated consolidated financial statements which included evaluations of the previous accounting and led to adjustments for: (a) the correct date of determination and the correct fair market value of certain option grants; (b) certain stock options granted to non-employees; (c) cancellation and re-issuance of stock options for certain employees; and (d) the assumptions, models and data used in connection with the Company's pro forma disclosures pursuant to SFAS No. 123. This review included the evaluation of information and a number of transactions from 2000 to August 2006. During the course of completing this work, Company management also identified another error in accounting determinations and judgments related to sales taxes occurring in fiscal years 2005, 2004 and 2003 that, although immaterial, management has included in the restated consolidated financial statements. Restatement adjustments are further described in Note 3 of the Notes to the Consolidated Financial Statements.

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Evaluation of Disclosure Controls and Procedures

We conducted an evaluation of the effectiveness of our "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of December 31, 2006, the end of the period covered by this Annual Report on Form 10-K. The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Financial Officer, who, for purposes of this evaluation has been designated as our principal executive officer following the January 2007 resignation of Stephen R. Wong, our former Chairman, President and Chief Executive Officer. Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified under SEC rules and forms, and that information is accumulated and communicated to our management, including our Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on the evaluation as of the end of the period covered by this Annual Report on Form 10-K, management, including our Chief Financial Officer, has concluded that our disclosure controls and procedures were not effective due to the material weakness described in Management's Report on Internal Control Over Financial Reporting below. Notwithstanding the material weakness described below, our management, based upon the substantial work performed during the restatement process, has concluded that the Company's consolidated financial statements for the periods covered by and included in this Annual Report on Form 10-K are fairly stated in all material respects in accordance with generally accepted accounting principles in the United States of America for each of the periods presented herein.

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Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Our management, including our Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2006 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control — Integrated Framework*. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or a combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected.

Our management identified the following material weakness in our internal control over financial reporting as of December 31, 2006. We did not maintain an effective control environment based on the criteria established in the COSO framework. Specifically, the Company did not maintain an effective emphasis on controls designed to maintain an appropriate level of management integrity, as certain of the Company's senior executive officers as of December 31, 2006, (i) had knowledge of the practice of recording favorable grant dates for stock options granted prior to March 2005; (ii) knew or should have known that the Company had not properly accounted for such option grants; and (iii) failed to disclose the Company's improper historical option granting practices and related accounting to the Board of Directors and the Company's independent registered public accountants.

This material weakness resulted in the Company incorrectly accounting for and disclosing its stock-based compensation expense and income tax provision or benefit relating to options granted prior to March 2005, as well as (i) the restatement of the Company's consolidated financial statements for the fiscal years ended December 31, 2005, 2004, 2003 and 2002, and the Company's unaudited quarterly consolidated financial statements for all quarters of fiscal 2005 and the first and second quarters of fiscal 2006; and (ii) adjustments to the Company's consolidated financial statements for the third quarter of fiscal 2006 and for the year 2006. Additionally, this material weakness could result in a material misstatement of any of the Company's annual or interim consolidated financial statements and related disclosures that would not be prevented or detected.

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As a result of the above described material weakness, management has concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2006 based on the criteria in *Internal Control — Integrated Framework* issued by the COSO.

Our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report included in this Annual Report on Form 10-K.

Remediation of the Material Weakness in Internal Control Over Financial Reporting

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Management is committed to remediating the material weakness identified above by implementing changes to the Company's internal control over financial reporting. Management, along with our Board of Directors, has implemented, or is in the process of implementing, the following changes to the Company's internal control over financial reporting:

- In January 2007, our Board of Directors put in place a process for weekly meetings between the Management Oversight Committee and Mr. Sabhlok. The Board also restricted Mr. Sabhlok's ability to undertake any material decisions affecting the general management, business or operations of the Company, particularly in respect of employment and compensation matters as well as his authority to bind the Company contractually. Subsequently, on May 23, 2007, the Board determined that Mr. Sabhlok should either resign or be terminated upon the earlier of the termination of the Agreement and Plan of Merger referred to above or July 16, 2007, in the event that the proposed merger has not been consummated by that date.

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- Our Board of Directors and management have re-committed to achieving transparency through effective corporate governance, a strong control environment, the standards reflected in our Code of Conduct, and financial reporting and disclosure completeness and integrity.
- Members of the Compensation Committee have re-familiarized themselves with the terms of the Company's stock option plans, and finance and human resources personnel will receive training on the Company's option plans and the applicable accounting rules relating thereto.

Additionally, management is investing in ongoing efforts to continuously improve the control environment and has committed valuable resources to the continuous improvement of the design, implementation, documentation testing and monitoring of our internal controls.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part III

Item 10. Directors, Executive Officers and Corporate Governance

Directors of the Registrant

Pursuant to the Company's Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws, the Company's Board of Directors (the "Board") is divided into three classes — Class I, II and III Directors. The size of the Board of Directors is presently set at six members, with five directors currently serving and one vacancy. Each director is elected for a three-year term of office, with one class of directors being elected at each annual meeting of stockholders. Each director holds office until his successor is elected and qualified or until his earlier death, resignation or removal.