CENTRA SOFTWARE INC
Form 10-Q
November 09, 2004
Table of Contents

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED September 30, 2004

OR

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM ______ TO ______

Commission File Number: 000-27861

Centra Software, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**04-3268918**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**

430 Bedford Street, Lexington, MA 02420

(Address of Principal Executive Offices)

(781) 861-7000

(Registrant s Telephone Number, Including Area Code)

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

The number of shares outstanding of the registrant s common stock as of November 5, 2004 was 27,591,468.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

CENTRA SOFTWARE, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(in thousands, except share and per share data)

(unaudited)

	December 31, 2003	September 30, 2004
Assets		
Current Assets:		
Cash and cash equivalents	$ 13,357	$ 12,193
Short-term investments	15,531	14,453
Restricted cash		233
Accounts receivable, net of reserves of $441 and $367 at December 31, 2003 and September 30, 2004, respectively	7,832	5,714
Prepaid expenses	618	1,102
Other current assets	361	183
Total current assets	37,699	33,878
Property and equipment, at cost:		
Computers and equipment	9,601	10,352
Furniture and fixtures	963	1,164
Leasehold improvements	649	675
	11,213	12,191
Less: Accumulated depreciation and amortization	9,549	10,633
	1,664	1,558
Long-term investments	5,888	
Restricted cash	433	400
Other assets	111	31
Intangible assets, net of amortization	233	
Total assets	$ 46,028	$ 35,867
Liabilities and Stockholders Equity		
Current Liabilities:		
Current maturities of long-term debt	$ 1,711	$ 1,068
Accounts payable	904	649

Accrued expenses	6,195	5,623
Deferred revenue	12,340	12,297
Total current liabilities	21,150	19,637
Long-term debt, net of current maturities	553	1,017
Commitments and contingencies (Note 4)		
Stockholders Equity:		
Preferred stock, $0.001 par value; Authorized-10,000,000 shares, no shares issued at December 31, 2003 and September 30, 2004		
Common stock, $0.001 par value; Authorized-100,000,000 shares as of December 31, 2003 and September 30, 2004;		
Issued-27,787,573 shares at December 31, 2003 and 28,183,032 at September 30, 2004; Outstanding-27,047,310 shares at December 31, 2003 and 27,442,769 shares at September 30, 2004	28	28
Additional paid-in capital	112,489	113,126
Accumulated deficit	(88,106)	(97,890)
Deferred compensation	(47)	
Accumulated other comprehensive income	22	10
Treasury stock; 740,263 shares of common stock at December 31, 2003 and September 30, 2004, at cost	(61)	(61)
Total stockholders equity	24,325	15,213
Total liabilities and stockholders equity	$ 46,028	$ 35,867

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

CENTRA SOFTWARE, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Revenues:				
License	$ 5,447	$ 2,829	$ 14,424	$ 7,972
Software services	2,113	2,670	6,049	7,671
Maintenance and professional services	3,549	4,202	10,711	11,951
Total revenues	11,109	9,701	31,184	27,594
Cost of Revenues:				
License	153	63	426	194
Amortization of acquired developed technology	175		525	233
Software services	590	555	1,731	1,784
Maintenance and professional services	1,055	1,208	3,171	3,244
Total cost of revenues	1,973	1,826	5,853	5,455
Gross profit	9,136	7,875	25,331	22,139
Operating Expenses:				
Sales and marketing	5,213	4,763	16,158	16,815
Product development	2,811	2,313	8,763	7,889
General and administrative	2,911	2,443	7,493	6,583
Restructuring charges		241		788
Total operating expenses	10,935	9,760	32,414	32,075
Operating loss	(1,799)	(1,885)	(7,083)	(9,936)
Interest income	82	88	311	273
Interest expense	(30)	(23)	(106)	(60)
Other income (expense), net	1	13	6	(61)
Net loss	$ (1,746)	$ (1,807)	$ (6,872)	$ (9,784)
Basic and diluted net loss per share	$ (0.07)	$ (0.07)	$ (0.26)	$ (0.36)
Basic and diluted weighted average shares outstanding	26,619	27,410	26,371	27,299

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

CENTRA SOFTWARE, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2003	2004
Cash Flows from Operating Activities:		
Net loss	$ (6,872)	$ (9,784)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,169	1,333
Provision for bad debt	71	(59)
Stock compensation charges	613	17
Changes in assets and liabilities:		
Accounts receivable	(71)	2,185
Prepaid expenses and other current assets	147	(262)
Accounts payable	49	(259)
Accrued expenses	(87)	(584)
Deferred revenue	666	(56)
Net cash used in operating activities	(3,315)	(7,469)
Cash Flows from Investing Activities:		
Purchase of property and equipment	(511)	(1,001)
Purchase of investments	(50,814)	(38,119)
Maturities of investments	39,462	45,087
Restricted cash	100	(200)
Other assets	30	38
Net cash (used in) provided by investing activities	(11,733)	5,805
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	498	667
Proceeds from term loans	255	1,382
Payments on term loans	(1,522)	(1,562)
Net cash (used in) provided by financing activities	(769)	487
Effect of foreign exchange rate changes on cash and cash equivalents	124	13
Net decrease in cash and cash equivalents	(15,693)	(1,164)
Cash and cash equivalents, beginning of period	25,891	13,357
Cash and cash equivalents, end of period	$ 10,198	$ 12,193

Supplemental Disclosure of Cash Flow Information:				
Cash paid during the period for interest	$	107	$	58

The accompanying notes are an integral part of these consolidated financial statements.

CENTRA SOFTWARE, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

(1) Operations and Significant Accounting Policies

Centra Software, Inc., together with its wholly-owned subsidiaries (Centra or the Company), is a leading provider of specialized solutions delivering software and services for online business collaboration. Its products and services augment operational business processes to enable real-time, group-oriented human interaction over corporate networks and the Internet to accelerate product introductions, deliver hands-on software application deployments, effect change-management initiatives, expand training and certification to employees and external channel partners, facilitate customer interaction and online selling and support project management activities.

Centra is subject to certain business risks that could affect future operations and financial performance. These risks include, but are not limited to, risks associated with our ability to successfully execute our strategic plan, the effects of our recent cost-cutting measures on our results of operations, product demand for and market acceptance of our current and future products, our ability to achieve profitability, our ability to execute our marketing, sales and distribution initiatives, the impact of competitive products and pricing, the effects of changes in the senior management team, system failures that could disrupt our hosted and Application Service Provider (ASP) services, the effect of economic conditions generally on the market for IT spending and for our products, the results of our future research and development activities, reliance on third-party technology, technological difficulties and/or other factors outside our control.

The accompanying consolidated financial statements reflect the application of certain accounting policies, as described in this note and more fully in the notes to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2003.

(a) Basis of Presentation

The consolidated financial statements include the accounts of Centra and its wholly-owned subsidiaries, Centra Software Europe Limited, which was incorporated in the United Kingdom, Centra Software Securities Corporation, a Massachusetts securities corporation, Centra RTP, Inc., a Delaware corporation, Centra Software Southern Europe SAS, which was incorporated in France and Centra Software Australia Pty. Ltd, which was incorporated in Australia. Centra Software Nordic ApS, which was incorporated in Denmark and included in the consolidated financial statements for the year ended December 31, 2003, was dissolved in February 2004. All significant intercompany transactions and balances have been eliminated in consolidation.

The accompanying consolidated financial statements for the three and nine months ended September 30, 2003 and 2004 are unaudited, have been prepared on a basis consistent with the December 31, 2003 audited consolidated financial statements, and include normal recurring adjustments that are, in the opinion of management, necessary for the fair presentation of the results of these periods. These unaudited interim consolidated financial statements do not include all of the footnote disclosures required in audited financial statements for the full year and, accordingly, should be read in conjunction with our audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2003. The results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of results to be expected for the entire year or any other period.

Certain amounts in the prior year financial statements have been reclassified to conform with the current year s presentation.

(b) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

Table of Contents

(c) Revenue Recognition

Centra follows the specific guidelines of the Securities Exchange Commission Staff Accounting Bulletin No. 104 (SAB 104), *Revenue Recognition in Financial Statements*, American Institute of Certified Public Accountants Statement of Position (SOP) 97-2 *Software Revenue Recognition*, and SOP 98-9 Modification of SOP 97-2, *Software Revenue Recognition, with Respect to Certain Transactions,* and related authoritative literature.

Centra derives its revenues from the sale of software licenses, ASP and hosting services, maintenance (post-contract support) and professional services. Maintenance includes telephone support, error correction or bug fixes and rights to upgrades and enhancements on a when-and-if available basis. Centra executes contracts that govern the terms and conditions of each software license, each ASP and hosting agreement, each maintenance and support arrangement and other professional services arrangements. These contracts may be elements in a multiple-element arrangement. Revenue under multiple-element arrangements, which may include several different software products and services sold together, is allocated to each element based on the residual method in accordance with SOP 98-9. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Management analyzes various factors, including a review of specific transactions, historical experience, creditworthiness of customers and current market and economic conditions. Changes in judgments based upon these factors could impact the timing and amount of revenue and cost recognized and thus affect the Company s results of operations and financial condition.

Centra, generally, licenses its software products on a perpetual basis. Centra applies the provisions of SOP 97-2, as amended by SOP 98-9, to all transactions involving the sale of software products. Centra recognizes revenue from the sale of software licenses when persuasive evidence of an arrangement exists, the product has been delivered, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. This policy is applicable to all direct sales to end-users. License sales to distributors or to value-added resellers are recognized when an end-user customer has been identified and all other revenue recognition criteria above have been met. License sales to U.S. government agencies through teaming arrangements with third-party partners are recognized when a signed order from the partner and evidence of a purchase order from the government agency to the partner is received and all other revenue recognition criteria above have been met. The Company does not offer a right of return on its products.

For all sales, except those to U.S. government agencies as described above, Centra uses a binding purchase order and/or a signed sales order and a signed license or service agreement as evidence of an arrangement. For arrangements with multiple elements (for example: the sale of a product license along with the sale of maintenance and support, training and consulting to be delivered later), Centra allocates revenue to each component of the arrangement using the residual value method. Under the residual value method, revenue is recognized in a multiple element arrangement in which vendor-specific objective evidence of fair value exists for all of the undelivered elements in the arrangement, but does not exist for one or more of the delivered elements in the arrangement. Centra defers revenue from the arrangement equivalent to the fair value of the undelivered elements and recognizes the remaining amount at the time of shipment or when all other revenue recognition criteria have been met. Vendor-specific objective evidence of fair values for the ongoing maintenance and support obligations are based upon separate sales of renewals of maintenance contracts. Vendor-specific objective evidence of fair value of services, such as training or consulting, is based upon separate sales of these services to other customers.

Centra also sells its suite of products and services in a bundled package on a multi-year subscription basis for broader use by its customers. In the third quarter 2004, the Company began to offer a bundled package of products and services for an annual fee based on a multi-year commitment of two to three years. The annual fee, which is typically paid at the beginning of each year, provides for unlimited use of the products within a specific department or division of a corporation or for use by the entire enterprise. The suite of products and services may include a term license for the software products, ASP hosting services, maintenance and support, including upgrades and enhancements and professional services. Centra recognizes revenue from these multi-year subscriptions either ratably over the entire length of the subscription term or over each annual payment term according to SOP 97-2 and for classification purposes in the statement of operations, allocates revenue to each of the license, software services, maintenance and professional services based on their relative fair values supported by vendor specific objective evidence if available or a reasonable estimate of fair value made by management based on the average discount offered on products or services when sold separately. Our customers may choose to purchase the enterprise wide subscription without a term license for the software and instead utilize our ASP service over the term of the agreement. Centra recognizes revenue for ASP enterprise wide subscriptions ratably over the subscription term according to SAB 104. Revenue is allocated for classification purposes to software services, and maintenance and professional services based on their relative fair values supported by verifiable objective evidence.

At the time of the transaction, Centra assesses whether the fee associated with the transaction is fixed or determinable based on the payment terms associated with the transaction. Billings to customers are generally due within 30 to 90 days. However, in certain circumstances, Centra has offered extended payment terms greater than 90 days but less than 365 days to certain customers for which license revenue is recognized upon shipment. These customers are well capitalized and

Table of Contents

typically have entered into larger scale license arrangements with us. Centra believes that it has sufficient history of collecting all amounts within the stated terms under these types of arrangements to conclude that the fee is fixed or determinable at the time the product is delivered. In addition, Centra assesses whether collection is probable based on the creditworthiness of the customer. Initial creditworthiness is assessed through Dun & Bradstreet, similar credit rating agencies or the customer s SEC filings. Creditworthiness for transactions to existing customers is assessed through a review of their prior payment history. Centra does not request collateral from its customers. If the Company determines that collection of a fee is not reasonably assured, the Company will defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon the receipt of payment.

Revenues from start-up fees associated with our ASP service are recognized over the contract period or estimated life of the ASP relationship, whichever is greater. Revenues related to ASP services are recognized ratably on a straight-line basis over the period that the ASP services are provided, or on an as-used basis if defined in the contract. Revenues for hosting services are recognized ratably on a straight-line basis over the term that the hosting services are provided. Also, in instances where Centra hosts a customer s purchased software on our server and network, Centra provides the customer a copy of the software in addition to one that is kept on the Centra server and recognizes the license revenue for the purchased software in accordance with our revenue recognition policy for licensed software as discussed above and in accordance with EITF 00-3, *Application of SOP 97-2 to Arrangements that Include the Rights to Use Software Stored on Another Entity s Hardware.*

Revenues from maintenance and support services are recognized ratably on a straight-line basis over the term that the maintenance service is provided. Revenues from consulting and education services are recognized either as the services are performed, ratably over a subscription period or upon completing a project milestone if defined in the agreement. Consulting and education services, including implementation, are not considered essential to the functionality of our products as these services do not alter the product capabilities, do not require specialized skills and may be performed by the customer or other vendors.

Centra records as deferred revenues any billed amounts due from customers in excess of revenues recognized. Deferred revenues consist principally of maintenance and support, ASP and hosting services, consulting and education services and term license fees.

(d) Stock-Based Compensation

The Company grants stock options to its employees and outside directors. Such grants are for a fixed number of shares with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for stock-based employee compensation using the intrinsic value method under the recognition and measurement principles of the Accounting Principals Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations and has elected the disclosure-only alternative under Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure An Amendment of FASB Statement No. 123* . The fair value of the Company s stock options was estimated using the Black-Scholes option-pricing model. This model was developed for use in estimating fair value of traded options that have no vesting restrictions and are fully transferable. However, this model requires the input of highly subjective assumptions including the expected stock price volatility. Because the Company s stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, in management s opinion, the Black-Scholes model does not necessarily provide a reliable single measure of the fair value of its stock options. The following table illustrates the effect on net loss and loss per share on a pro forma basis as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (in thousands, except per share data):

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2004**	**2003**	**2004**
Net loss, as reported	$ (1,746)	$ (1,807)	$ (6,872)	$ (9,784)
Add back: Stock-based compensation included in net loss, as reported	393	2	613	17
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	(1,022)	(758)	(3,780)	(3,046)
Pro forma net loss	$ (2,375)	$ (2,563)	$ (10,039)	$ (12,813)
Basic and diluted net loss per share				
As reported	$ (0.07)	$ (0.07)	$ (0.26)	$ (0.36)
Pro forma	$ (0.09)	$ (0.09)	$ (0.38)	$ (0.47)

The Company has computed the pro forma disclosures required under SFAS No. 123 for stock options granted to employees and directors using the Black-Scholes option pricing model using the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2004**	**2003**	**2004**
Risk free interest rate	2.9% 3.2 %	3.4% 3.7 %	2.2% 3.4 %	3.1% 3.5 %
Expected dividend yield				
Expected lives	5.0 years	5.0 years	5.0 years	5.0 years
Expected volatility	89% 95%	77% 79%	89% 99 %	77% 81 %
Weighted average fair value of options granted during the period	$1.90	$0.96	$1.55	$1.23

(e) Cash, Cash Equivalents and Short-Term and Long-Term Investments

Centra considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. Cash equivalents consist of money market accounts. Centra considers investments purchased with maturities at the balance sheet date of more than three months but less than 12 months to be short-term investments and investments purchased with maturities at the balance sheet date of 12 months or more to be long-term investments. Centra accounts for its short-term and long-term investments in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Under SFAS No. 115, investments for which Centra has the positive intent and the ability to hold to maturity are reported at amortized cost, which approximated fair market value at September 30, 2004. Cash, cash equivalents and short-term and long-term investments consisted of the following at December 31, 2003 and September 30, 2004 (in thousands):

Table of Contents

	December 31, 2003	September 30, 2004
Cash, cash equivalents and short-term investments:		
Cash	$ 3,489	$ 8,424
Money market accounts	9,868	3,769
Government bonds (average 276 and 129 days remaining to maturity at December 31, 2003 and September 30, 2004, respectively)	15,531	14,453
Total cash, cash equivalents and short-term investments	28,888	26,646
Long-term investments:		
Federal agency notes (average 429 days remaining to maturity at December 31, 2003)	5,888	
Total cash, cash equivalents, short-term and long-term investments	$ 34,776	$ 26,646

(f) Comprehensive Loss

The Company applies the provisions of SFAS No. 130, *Reporting Comprehensive Income*, which establishes standards for reporting and displaying comprehensive income (loss) and its components in the consolidated financial statements. Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The only components of comprehensive loss reported by the Company are net loss and foreign currency translation adjustment and are as follows for the three and nine months ended September 30, 2003 and 2004 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Net loss	$ (1,746)	$ (1,807)	$ (6,872)	$ (9,784)
Foreign currency translation adjustment	3	9	24	(12)
Comprehensive loss	$ (1,743)	$ (1,798)	$ (6,848)	$ (9,796)

(g) Net Loss Per Share

Basic and diluted net loss per share is presented in conformity with SFAS No. 128, *Earnings Per Share,* for all periods presented. In accordance with SFAS No. 128, basic and diluted net loss per share has been computed by dividing the weighted average number of shares of common stock outstanding during the period, less shares subject to repurchase, into the net loss attributable to common stockholders.

Table of Contents

Basic and diluted net loss per share are as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Net loss attributable to common stockholders	$ (1,746)	$ (1,807)	$ (6,872)	$ (9,784)
Basic and diluted shares:				
Weighted average shares of common stock outstanding	26,623	27,410	26,375	27,299
Less: Weighted average shares subject to repurchase	(4)		(4)	
Weighted average shares of common stock outstanding used in computing basic and diluted net loss per share	26,619	27,410	26,371	27,299
Basic and diluted net loss per share	$ (0.07)	$ (0.07)	$ (0.26)	$ (0.36)

Options issued and outstanding to purchase a total of 7,612,000 and 7,952,000 common shares have not been included in the computation of diluted net loss per share as of September 30, 2003 and 2004, respectively. These shares are considered anti-dilutive, as Centra has recorded a net loss for all periods presented.

(2) Segment Information

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information,* establishes standards for reporting information regarding operating segments and establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions regarding resource allocation and assessing performance.

Centra operates solely in one segment; the development, sales and marketing of software products and related services. Centra s revenues by geographic area are as follows (based on location of customer):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
United States	82 %	79 %	81 %	82 %
Europe	12 %	16 %	12 %	14 %
Other	6 %	5 %	7 %	4 %

There are no significant long-lived assets located outside of the United States.

(3) Significant Customer

No one customer accounted for more than 10% of total revenues during the three and nine-month period ended September 30, 2004. Sales to one customer, National Micrographics Systems, Inc., a full-service integration company and the Company s third-party partner for U.S. government sales, accounted for approximately 26% and 10% of total revenues for the three and nine-month period ended September 30, 2003, respectively. No one customer equaled more than 10% of the Company s accounts receivable at December 31, 2003 and September 30, 2004.

Table of Contents

(4) Commitments and Contingencies

Securities Class Action Lawsuit

Centra, certain of its officers and directors and the managing underwriters of Centra s initial public offering were named as defendants in an action filed in the United States District Court for the Southern District of New York. The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve the Centra defendants on or about March 18, 2002. The original complaint has been superseded by an amended complaint (complaint) filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, which is being coordinated with an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92, is purportedly brought on behalf of the class of persons who purchased Centra s common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The complaint alleges that, in connection with Centra s initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the after-market at pre-determined prices. The complaint asserts that Centra s registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. The underwriter defendants and the Centra defendants joined in motions to dismiss the above-reference action on July 3 and July 15, 2002, respectively. On October 9, 2002, the plaintiffs dismissed, without prejudice, the claims against the named Centra officers and directors in the above-referenced action. On February 19, 2003, the court issued an order denying the motion to dismiss as to Centra and other defendants. On June 7, 2003, the plaintiffs announced a proposed settlement with all issuers, including Centra. On June 25, 2004, the plaintiffs filed a motion with the United States District Court for the Southern District of New York requesting preliminary approval of the settlement. The court has not yet ruled on this motion. Centra plans to participate in this settlement, which has been negotiated, and will be fully funded directly to the plaintiffs, by Centra s insurers. The settlement is subject to court approval. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred.

EdiSync Patent Claim

On August 19, 2003, a complaint was filed against the Company and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. The Company has filed an answer to the complaint denying all of the allegations. The Company believes it has meritorious defenses and intends to vigorously defend this action. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred. The Company filed a request for re-examination of the patents at issue with the U.S. Patent and Trademark Office as patent counsel to the Company is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the District Court has approved the parties motion to stay the court proceedings during the re-examination proceedings. The Company believes that it has meritorious defenses and the Company intends to vigorously defend this action.

Employment Claim

On September 3, 2004, a former employee of the Company filed a complaint with the Massachusetts Superior Court (civil action no. 04-3479) against the Company and two of its executive officers alleging wrongful termination and discrimination against the employee on the basis of age, race and gender in connection with the employee s employment with the Company and subsequent termination. The complaint seeks remedies including damages in an unspecified amount. The Company has filed a motion to dismiss certain of the claims in the complaint as well as an answer to the complaint, which it believes is without merit. The Company intends to vigorously defend this action.

Software Indemnifications

We enter into standard indemnification agreements in our ordinary course of business. Pursuant to these agreements, we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally our business partners or customers, in connection with any patent or any copyright or other intellectual property infringement claim by any third party with respect to our products. The term of these indemnification agreements is generally perpetual. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We have never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. Accordingly, we have no liabilities recorded for these agreements as of September 30, 2004.

We warrant that our software products will perform in all material respects in accordance with our standard published specifications in effect at the time of delivery of the licensed products to the customer for 90 days. Additionally, we warrant that our maintenance services will be performed consistent with generally accepted industry standards through completion of the agreed upon services. If necessary, we would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history, however, we have never incurred any significant expenses under our product or service warranties. Accordingly, we have no liabilities recorded for these agreements as of September 30, 2004.

(5) Restructuring Charges

In June 2004, we incurred a restructuring charge of $547,000 related to an 18% reduction in our worldwide workforce and the closing of the Company s product development facility in Morrisville, North Carolina. The restructuring charge consisted of severance payments, health benefits and outplacement services. In the quarter ended September 30, 2004, we completed the closure of the Morrisville facility resulting in an additional $241,000 restructuring charge, consisting of additional facility closure costs, severance, health benefits and outplacement services. All employees had been informed of their termination benefits as of June 30, 2004; however, some employees were required to complete a period of service through September 2004 and thus, the cost of their severance was recognized over the period of their required continued employment. The accrued and unpaid amount of these charges at September 30, 2004 was $315,000, which we expect to pay out through May 2005.

The restructuring charges recorded in the second and third quarter of fiscal 2004 and the reserve activity since that time, are summarized as follows (in thousands):

	Original Restructuring Charge	Payments	Accrual Balance at June 30, 2004	Additional Restructuring Charge	Payments	Accrual Balance at September 30, 2004
Workforce reduction	$ 522	$ 88	$ 434	$ 142	$ 376	$ 200
Facility closure and certain other costs	25		25	99	9	115
Total	$ 547	$ 88	$ 459	$ 241	$ 385	$ 315

(6) Leases

On July 30, 2004, Centra extended the lease for its worldwide headquarters and operational facilities located in Lexington, Massachusetts. The original lease, which would have expired on June 30, 2005, was extended 36 months and now expires on June 30, 2008. The minimum payments under the existing lease and the lease extension are $996,000, $1,049,000, $1,103,000 and $565,000 for years 2005, 2006, 2007 and 2008, respectively.

(7) Credit Facility

In September 2004, the Company amended its equipment line of credit agreement to allow for additional borrowings of $2.5 million through September 2005. The Company had made a $1.4 million drawing under the amended line of credit in September 2004, which is payable in thirty six monthly principal payments of approximately $38,000 plus interest maturing in September 2007. Interest is payable monthly based on the prime rate (4.75% at September 30, 2004) plus 0.5%. The current amended equipment line of credit requires Centra to maintain a minimum balance of cash, cash equivalents and investments of $10 million and, as of October 31, 2004, to hold all of the Company s cash, cash equivalents and investments in operating, deposit and investment accounts at the bank. At September 30, 2004, approximately $1.1 million remained available for borrowings under the line.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

Certain statements in Management s Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, plans, expects, anticipates, and similar expressions identify such forward-looking statements. The forward-looking statements contained herein are based on current expectations and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward-looking statements. Factors that might cause such a difference include, among other things, those set forth under Overview, Critical Accounting Policies, Liquidity and Capital Resources, and Factors That Could Affect Future Results and those appearing elsewhere in this report. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis only as of the date hereof. The Company assumes no obligation to update these forward-looking statements to reflect actual results or changes in factors or assumptions affecting forward-looking statements.

Overview

We are a leading provider of specialized solutions delivering software and services for online business collaboration. Our products and services augment operational business processes to enable real-time, group-oriented human interaction over corporate networks and the Internet. These real-time, live group sessions can range from ad hoc, one-on-one online meetings to highly interactive, structured, collaborative learning sessions to prescheduled Web seminars for larger audiences and are key elements to business processes that include collaborative learning, Web marketing, online selling and other interactive activities. We integrate these real-time, live group sessions with: (1) workflow tools we have developed such as desktop integration software; (2) professional services capabilities that we or others provide, such as content development and (3) leading third-party enterprise software suites such as learning management systems. Furthermore, our products and services support content and user management around the online session to integrate more tightly with these strategic processes across the extended enterprise. Our customers use Centra s products and solutions to accelerate product introductions, deliver hands-on deployment of software applications, effect change-management initiatives, expand training and certification to employees and external channel partners, facilitate customer interaction and online selling and support project management activities. In addition, we offer consulting, education and support services that enable our customers to successfully implement, deploy and support our products and solutions throughout their organizations.

Our products are available as packaged software applications, hosted services, and through our application service provider, or ASP, offerings. Based on a common collaboration framework, our products and services support a wide range of convenient business interactions online, including real-time virtual learning, large scale Web conferences and live, interactive Web meetings. Each real-time collaboration interface includes capabilities for Voice-Over-Internet-Protocol, or VoIP, audio, Web-based video, software application sharing, real-time data exchange, and facilities for session recording and playback. These products and services allow organizations to increase the productivity of their members and enhance the effectiveness of knowledge transfer while reducing travel, facilities and telecommunications costs.

At the end of 2003, we conducted a thorough and critical evaluation of the collaboration marketplace and our competitive position. Following this evaluation, we decided to implement a new business strategy focused on growing our leadership position in the collaborative learning market segment of application software, services and solutions for online business communications and collaboration, and leverage that leadership to increase penetration of other collaboration market segments and to broaden usage of our products throughout the enterprise with the goal of significantly growing our annual revenues and achieving profitability. In furtherance of these objectives, we developed a plan to spend an additional $8 million in 2004 over our 2003 expenditure rate for sales and marketing to develop new channel partnerships, enhance our relationships with existing customers, expand international operations, implement new initiatives that improve sales execution and consistency and attract new customers with targeted messaging, print advertising, public relations efforts and lead generation marketing programs. In addition, we have started to realign the field sales representative territories to geographic areas with the highest concentration of our target customers (Global 5000 companies, government agencies and higher education institutions), introduce new enterprise multi-year subscription pricing and focus our sales and marketing efforts toward developing and selling, on an enterprise-wide basis, specialized solutions that accelerate enterprise application rollouts, improve collaborative learning and increase sales effectiveness and customer acquisition initiatives. However, our strategic initiatives will take time to translate into higher revenues and profitability, and our

Table of Contents

results in the first half of 2004 were below our initial expectations due to the size and quality of our sales pipeline of opportunities at the beginning of 2004. We now anticipate that it will take longer than we previously thought before we begin to see significant annual revenue growth as a result of our efforts. Therefore, during the quarter ended June 30, 2004, we decided to scale back our planned increases in sales and marketing expenses until such time as our new solutions begin to achieve market acceptance, and we implemented initiatives to reduce our costs by $3 million to $4 million annually by closing our development facility in North Carolina and by reducing our worldwide workforce by 18%. We will continue to review and assess our execution of our strategic plan, and we may make adjustments in the level of our expenditures and investment as may be necessary until such time as we determine whether our new sales strategy will yield the desired results. However, we can give no assurance that we will achieve our strategic objectives, including successfully developing our solutions and effectively marketing them to our target customers. See Factors That Could Affect Future Results We may not successfully execute our strategic plan.

Critical Accounting Policies

The preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition and the valuation of long-lived assets. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Centra s critical accounting policies are summarized in our Annual Report on Form 10-K for the year ended December 31, 2003, in the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations under the caption Critical Accounting Policies. We have reviewed those policies and determined that they remain our critical accounting policies for the nine months ended September 30, 2004. We did not make any changes to those policies during this period.

Table of Contents

Results of Operations

The following table sets forth operating data expressed as percentages of total revenues for each period indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Consolidated Statements of Operations Data:				
Revenues:				
License	49 %	29 %	46 %	29 %
Software services	19	28	20	28
Maintenance and professional services	32	43	34	43
Total revenues	100	100	100	100
Cost of Revenues:				
License	1	1	1	1
Amortization of acquired developed technology	2		2	1
Software services	5	6	6	6
Maintenance and professional services	10	12	10	12
Total cost of revenues	18	19	19	20
Gross profit	82	81	81	80
Operating Expenses:				
Sales and marketing	47	49	52	61
Product development	25	24	28	28
General and administrative	26	25	24	24
Restructuring charges		3		3
Total operating expenses	98	101	104	116
Operating loss	(16)	(20)	(23)	(36)
Other income, net		1	1	1
Net loss	(16)%	(19)%	(22)%	(35)%

Comparison of three months ended September 30, 2003 and 2004

Revenues. Total revenues decreased by $1.4 million, or 13%, to $9.7 million for the three months ended September 30, 2004, from $11.1 million for the three months ended September 30, 2003. The decrease was primarily attributable to a lower amount of sales from the U.S. federal government sector, the on-going transition of the sales force towards our new strategy of selling solutions, and the impact on license revenue from our new multi-year subscription pricing program. Partially offsetting the decline in revenues were increases in software services revenues resulting from increased usage during the quarter of our ASP service by customers under a usage based pricing contract and an increase in revenues from both maintenance support contracts and from professional services delivered. While we continue to make progress with the transition of selling solutions by our sales force, the effect of the changes that we implemented during the first nine months of this year negatively impacted the amount of sales completed during this quarter. Overall, we expect revenues to increase next quarter based on our historical upward trend in sales reflecting the seasonally strong purchasing activity by corporations in the fourth quarter. However, the size of the increase will depend upon the mix of sales between subscription based offerings, in which the revenue is deferred and recognized over time, and perpetual license sales, in which the revenue is typically recognized immediately upon shipment.

Table of Contents

Software license revenue decreased by $2.6 million, or 48%, to $2.8 million for the three months ended September 30, 2004, from $5.4 million for the three months ended September 30, 2003. The decrease partially reflects a decline in license sales to the U.S. federal government sector. Software license revenue for the third quarter of last year included a large sale to the U.S Army, accounting for $1.6 million or 30% of total license revenues. In comparison, there were no sales to the U.S. federal government this quarter which were of similar size as the U.S Army sale. Also, to a lesser extent, the decrease resulted from initial license sales in the quarter under our new multi-year subscription pricing program, which we believe customers selected instead of purchasing perpetual licenses, and therefore, reduced the amount of revenue we were able to recognize in the quarter. Under this multi-year subscription offering, the license revenue is deferred and recognized ratably over the subscription period as compared with our perpetual license contracts for which the revenue from these contracts have generally been recognized immediately upon the shipment of the software. We expect license sales will vary in future periods depending on whether our customers choose to purchase a subscription-based offering or a perpetual license. Software license revenue represented 29% and 49% of total revenues for the three months ended September 30, 2004 and 2003, respectively.

Software services revenues, which include our ASP and hosting services, increased by $557,000, or 26%, to $2.7 million for the three months ended September 30, 2004, from $2.1 million for the three months ended September 30, 2003. The increase was attributable to higher revenues from our usage-based pricing contracts due to increased volume of usage and, to a lesser extent, increased ASP subscription revenues, reflecting higher ASP subscription renewal rates this quarter as compared to the same quarter last year. In the future, we expect ASP renewal rates to remain at current levels and the total dollar value of ASP sales to increase. We believe a significant percentage of our customers will prefer to purchase an ASP service to lower their initial purchase cost and/or to provide greater flexibility of an outsourced service that does not require the customer to maintain an IT infrastructure or have available IT resources to deploy as compared with software licenses installed on a customer s premises. As a result, we expect software services revenues will grow at moderate rates in future quarters. However, we can give no assurances that we will continue to achieve similar rates of ASP renewals or that our ASP service revenues will grow in future periods. Software services revenues represented 28% and 19% of total revenues for the three months ended September 30, 2004 and 2003, respectively.

Maintenance and professional services revenues, which includes our maintenance and support, consulting and education services, increased by $653,000, or 18%, to $4.2 million for the three months ended September 30, 2004, from $3.5 million for the three months ended September 30, 2003. The increase was primarily due to an increase in both the total number and dollar value of renewals of annual maintenance and support contracts and from the sales of new maintenance and support contracts associated with the sales of new licenses. Also, the increase was due to higher consulting and education services revenues attributable to longer client engagements resulting in increased productivity rates of our consulting personnel and an increase in effective billing rates by delivering more technical consulting work, which has a higher rate as compared to general business consulting, during the quarter. We expect total maintenance and professional services revenues to continue to increase in future periods as our installed base of license users grows and new maintenance contracts are added. The rate of the increase may vary from period to period, depending primarily upon the value of new maintenance contracts added and the productivity rates of professional services. Any increases may be offset by non-renewals of maintenance contracts. Maintenance and professional services revenues represented 43% and 32% of total revenues for the three months ended September 30, 2004 and 2003, respectively.

We expect that the transition to our new sales strategy will continue over the next several quarters as we increase the number of sales representatives with the capabilities to sell solutions. Also, we believe that the investments we made in sales and marketing during the first three quarters of 2004 have begun to yield positive results as the migration towards our new strategy gains momentum throughout the balance of 2004 and into 2005. However, we can give no assurance that the transition to our new sales strategy of selling solutions will be completed this year, that the sales force will be effective in selling solutions, whether the expanded version of the solutions will be available to sell by early 2005, whether customers will buy these solutions once they are available and whether our new multi-year subscription price offering will continue to be attractive to customers. See Factors That Could Affect Future Results - We may not successfully execute our strategic plan.

Cost of license revenue. Our costs of license fees are driven by the amount of products sold. They consist of royalty fees paid to third parties and costs for fulfillment and materials. Cost of license revenues decreased by $90,000, or 59%, to $63,000 for the three months ended September 30, 2004, from $153,000 for the three months ended September 30, 2003. The decrease was attributable to lower fixed royalty costs due to the fulfillment of royalty obligations with one vendor, as well as lower variable royalty costs resulting from a lower amount of license sales for the quarter compared with the same quarter last year. Since a portion of our license costs represent royalties that we pay to third parties on a per unit rate of

product sold, we expect that cost of license revenues will vary in the future based upon the unit volume of products sold and to the extent that we incorporate additional third-party technologies into our products and solutions. Cost of license revenues was 2% of license revenues for the three months ended September 30, 2004 and was 3% of license revenues for the three months ended September 30, 2003.

Amortization of acquired developed technology. In connection with our acquisition of MindLever in April 2001, we allocated approximately $2.1 million to acquired developed technology, which has been amortized over a three-year estimated useful life. Amortization of acquired developed technology was $175,000 for the three months ended September 30, 2003. No amortization charge was incurred in the three months ended September 30, 2004 and no further amortization costs will be incurred as the asset has been fully amortized.

Cost of software services revenues. Our cost of software services revenues includes (1) salaries and related expenses for our ASP and hosted services organizations, (2) an overhead allocation consisting primarily of that portion of our facilities, communications and depreciation expenses that is attributable to providing these services, (3) a technical support allocation consisting primarily of a portion of our technical support expenses that is attributable to providing such support to our ASP customer base and (4) direct costs related to our hosting and ASP service offerings. Cost of software services revenues decreased by $35,000 to $555,000 for the three months ended September 30, 2004, from $590,000 for the three months ended September 30, 2003. The decrease was primarily due to (1) a lower percentage of total support costs allocated to ASP technical support based on decreased spending in our technical support groups, (2) a decline in depreciation expense as capital equipment used in our ASP service became fully depreciated and (3) a decline in personnel-related expenses. Cost of software services revenues was 21% and 28% of software services revenues for the three months ended September 30, 2004 and 2003, respectively, reflecting the growth in software services revenues combined with a proportionally lower amount of ASP service costs incurred during the quarter. We expect that the cost of software services revenues will increase in absolute dollars to the extent that usage increases and we continue to expand the capacity of our ASP service beyond its current capacity to meet demand, existing equipment used in our ASP operations is replaced or costs are incurred to outsource first level (help desk) technical support for our ASP service to a third party.

Cost of maintenance and professional services revenues. Our cost of maintenance and professional services revenues includes (1) salaries and related expenses for our consulting, education and technical support services organizations and (2) an overhead allocation consisting primarily of that portion of facilities, communications and depreciation expenses that is attributable to providing these services. Cost of maintenance and professional services revenues increased by $153,000 or 15%, to $1.2 million for the three months ended September 30, 2004 from $1.1 million for the three months ended September 30, 2003. The increase was primarily related to an increase in reimbursable travel expenses and employment fees related to the hiring of our new senior vice president of Professional Services. Cost of maintenance and professional services revenues was 29% and 30% of maintenance and professional services revenues for the three months ended September 30, 2004 and 2003, respectively, reflecting the growth in maintenance and professional services revenues this quarter. We anticipate that the cost of maintenance and professional services revenues will continue to increase in absolute dollars as we intend to add additional revenue-producing personnel to support an increased backlog of work resulting from growth in overall sales of consulting and education services.

Sales and marketing expenses. Sales and marketing expenses decreased by $450,000, or 9% to $4.8 million for the three months ended September 30, 2004, from $5.2 million for the three months ended September 30, 2003. The decrease was attributed to (1) a decrease in commissions and bonuses due to the decline this quarter in U.S. federal government sales and a reduction of the overall effective commission rate, (2) a decrease in marketing programs, including Web marketing, product literature, public relations and tradeshows, (3) a decrease in the amount of expenses allocated from the professional services organization based on a decline in the amount of time spent supporting presales activities and (4) a decrease in salaries, bonuses and travel, due to a decline in sales and marketing personnel as a result of workforce reductions implemented last quarter. Partially offsetting these decreases was an increase in advertising costs to support our new sales strategy. Sales and marketing expenses were 49% and 47% of total revenues for the three months ended September 30, 2004 and 2003, respectively. We expect sales and marketing expenses to increase slightly in dollar terms in the fourth quarter due to an increase in commissions generated from both seasonally higher quarterly sales based on historical performance and additions to our direct sales force, offset by a planned reduction in marketing program costs.

Product development expenses. Product development expenses decreased by $498,000, or 18%, to $2.3 million for the three months ended September 30, 2004, from $2.8 million for the three months ended September 30, 2003. The decrease was primarily attributed to lower personnel-related expenses as a result of a reduction in headcount from the closing our development facility in North Carolina. Product development expenses were 24% and 25% of total

18

Table of Contents

revenues for the three months ended September 30, 2004 and 2003, respectively. We expect product development expenses for the fourth quarter to remain relatively flat with the third quarter, reflecting ongoing cost savings from both the facility closing and from the previous reduction in the development workforce.

General and administrative expenses. General and administrative expenses decreased by $468,000, or 16%, to $2.4 million for the three months ended September 30, 2004 from $2.9 million in the quarter ended September 30, 2003. The decrease was primarily related to stock compensation charges incurred in the third quarter 2003, related to the departure of our former President and Chief Operating Officer and a decrease in executive salaries and bonuses over the same period last year. Partially offsetting these reductions were substantial increases in audit expenses to comply with Section 404 of the Sarbanes-Oxley Act of 2002. General and administrative expenses were 25% and 26% of total revenues for the three months ended September 30, 2004 and 2003, respectively. We expect general and administrative expenses to decline next quarter, primarily due to the absence of severance charges and personnel-related expenses incurred during the third quarter related to the departure of our founder and former Chief Strategy Officer.

Restructuring charges. During the third quarter of 2004, we incurred additional restructuring charges of $241,000 related to the completion of the restructuring that began in the previous quarter consisting of the closing of our product development facility located in Morrisville, North Carolina and the related workforce reduction of product development personnel. The workforce reduction completed this quarter included eight employees that had been notified in the prior quarter, but were required to complete a period of service through September 2004. The restructuring charges consisted primarily of severance payments, health benefits, outplacement services and facility closure costs.

Interest income. Interest income increased by $6,000 to $88,000 for the three months ended September 30, 2004, from $82,000 for the three months ended September 30, 2003. Interest income consists of interest on our cash, cash equivalents and short-term investments. The increase reflects an increase in interest rates which was partially offset by declines in the balances of cash, cash equivalents and short-term investments held during the quarter compared with the same quarter last year.

Interest expense. Interest expense decreased by $7,000 to $23,000 for the three months ended September 30, 2004, from $30,000 for the three months ended September 30, 2003. The decline was primarily attributed to a decrease in interest on our term loans as the result of a decline in the average balances on our outstanding debt during the quarter compared with the third quarter of last year. We expect interest expense to increase in future quarters due to the drawing of $1.4 million in September 2004 and any other additional borrowings under on our credit facility. (See Note 7)

Other income or expense, net. Other income or expense, net, changed by $12,000 as the result of changes in net foreign exchange gains and losses.

Comparison of nine months ended September 30, 2003 and 2004

Revenues. Total revenues decreased by $3.6 million, or 12%, to $27.6 million for the nine months ended September 30, 2004, from $31.2 million for the nine months ended September 30, 2003. The decrease was the result of a decline in software license revenue of approximately $6.4 million, or 45%, from the corresponding period of 2003, which was partially offset by an increase in both software services and maintenance and professional services revenues.

Software license revenue decreased by $6.4 million, or 45%, to $8.0 million for the nine months ended September 30, 2004, from $14.4 million for the nine months ended September 30, 2003. The decrease was attributable to (1) a decline in license sales to the U.S. federal government sector, (2) the effects of the change in our sales strategy and the subsequent negative and disruptive impact this change had on our sales force s ability to complete sales during the first nine months of 2004 and (3) the limited size and poor quality of the sales pipeline of opportunities at the beginning of 2004. Software license revenue represented 29% and 46% of total revenues for the nine months ended September 30, 2004 and 2003, respectively.

Software services revenues, which include our ASP and hosting services, increased by $1.7 million, or 27%, to $7.7 million for the nine months ended September 30, 2004, from $6.0 million for the nine months ended September 30, 2003. The increase resulted from an increase in revenues related to higher usage under our ASP usage-based pricing contracts, an increase in subscription sales, and the recognition of revenues related to time expired ASP minutes on certain customer contracts. Software services revenues represented 28% and 20% of total revenues for the nine months ended September 30, 2004 and 2003, respectively.

Maintenance and professional services revenues, which includes our maintenance and support, consulting and education services, increased by $1.3 million, or 12%, to $12.0 million for the nine months ended September 30, 2004, from $10.7 million for the nine months ended September 30, 2003. The increase was attributable to high renewal rates on our annual

Table of Contents

maintenance and support contracts combined with new maintenance contracts added in the last year on software license sales. Also, to a lesser extent, the increase was due to higher revenues from consulting and education services due to improved productivity rates of consulting personnel, increased effective billing rates and an increase in reimbursable travel costs. Maintenance and professional services revenues represented 43% and 34% of total revenues for the nine months ended September 30, 2004 and 2003, respectively.

Cost of license revenue. Cost of license revenues decreased by $232,000, or 55%, to $194,000 for the nine months ended September 30, 2004, from $426,000 for the nine months ended September 30, 2003. The decrease was attributable to lower variable royalty costs due to a lower amount of license sales for the first nine months of 2004 as compared to the same period a year ago and lower fixed royalty costs. Cost of license revenues was 2% and 3% of license revenues for the nine months ended September 30, 2004 and 2003, respectively.

Amortization of acquired developed technology. In connection with our acquisition of MindLever in April 2001, we allocated approximately $2.1 million to acquired developed technology, which has been amortized over a three-year estimated useful life. Amortization of acquired developed technology was $233,000 and $525,000 for the nine months ended September 30, 2004 and 2003, respectively. No further amortization costs will be incurred as the asset has been fully amortized.

Cost of software services revenues. Cost of software services revenues increased by $53,000 to $1.8 million for the nine months ended September 30, 2004, from $1.7 million for the nine months ended September 30, 2003. The slight increase was due to a higher percentage of total support costs allocated to ASP technical support based on growth in customer call volume and an increase in teleconferencing. Cost of software services revenues was 23% and 29% of software services revenues for the nine months ended September 30, 2004 and 2003, respectively.

Cost of maintenance and professional services revenues. Cost of maintenance and professional services revenues increased by $73,000 to $3.2 million for the nine months ended September 30, 2004 from $3.2 million for the nine months ended September 30, 2003. The slight increase was primarily related to employment fees associated with the hiring of our new senior vice president of Professional Services in September 2004 and an increase in reimbursable travel costs. Cost of maintenance and professional services revenues was 27% and 30% of maintenance and professional services revenues for the nine months ended September 30, 2004 and 2003, respectively.

Sales and marketing expenses. Sales and marketing expenses increased by $657,000, or 4% to $16.8 million for the nine months ended September 30, 2004, from $16.2 million for the nine months ended September 30, 2003. The increase was due to a larger investment in our advertising and marketing partner programs to support our new sales strategy, an increase in personnel-related expenses attributable to the hiring of several new managers during the first half of 2004 and an increase in severance charges. Offsetting these increases were (1) reductions in sales commissions and bonuses due to lower sales for the first nine months of 2004, (2) a lower amount of expenses allocated from the professional services organization due to a decrease in the amount of time spent on presales activities, (3) a reduction in stock compensation charges related to stock options issued in 1999 and 2000 and (4) a decrease in bad debt expense reflecting a lower amount of accounts receivable at September 30, 2004 compared to the same date last year. Sales and marketing expenses were 61% and 52% of total revenues for the nine months ended September 30, 2004 and 2003, respectively.

Product development expenses. Product development expenses decreased by $874,000, or 10%, to $7.9 million for the nine months ended September 30, 2004, from $8.8 million for the nine months ended September 30, 2003. The decrease was primarily due to declines in personnel-related expenses and overhead costs as a result of the closing of our North Carolina product development facility and the subsequent workforce reduction associated with it. Product development expenses were 28% of total revenues in each of the nine month periods ended September 30, 2004 and 2003, respectively.

General and administrative expenses. General and administrative expenses decreased by $910,000, or 12%, to $6.6 million for the nine months ended September 30, 2004, from $7.5 million for the nine months ended September 30, 2003. The decrease was primarily the result of reductions in (1)stock compensation charges related to the departure of our former President and Chief Operating Officer and to stock options issued in 1999 and 2000, (2) a decrease in executive bonuses over the same period last year, (3) lower personnel-related expenses due to the reduction in workforce in the second quarter as well as the departure of our former President and Chief Operating Officer in October 2003 whom was not replaced and (4) employment fees incurred in prior year related to the executive search for our Chief Executive Officer. General and administrative expenses were 24% of total revenues for both of the nine months ended September 30, 2004 and 2003.

Restructuring charges. During the first nine months of 2004, we incurred restructuring charges totaling $788,000 related to cost reduction initiatives. These initiatives included the closing of our product development facility located in Morrisville, North Carolina and a reduction in headcount by 18%, or 48 employees. The charges consisted primarily of severance payments, health benefits, outplacement services and facility closure costs.

Table of Contents

Interest income. Interest income decreased by $38,000 to $273,000 for the nine months ended September 30, 2004, from $311,000 for the nine months ended September 30, 2003. Interest income consists of interest on our cash, cash equivalents and short-term investments. The decrease primarily reflects declines in the balances of cash, cash equivalents and short-term investments held during the period compared with same period last year.

Interest expense. Interest expense decreased by $46,000 to $60,000 for the nine months ended September 30, 2004, from $106,000 for the nine months ended September 30, 2003. The decrease was attributed to a reduction in interest on our term loans as the result of a decrease in the average balances on our outstanding debt and a decrease in the bank s prime interest rate.

Other income or expense, net. Other income or expense, net, changed by $67,000 to reflect a net expense of $61,000 for the nine months ended September 30, 2004, from a net income of $6,000 for the nine months ended September 30, 2003, as the result of changes in net foreign exchange gains and losses.

Liquidity and Capital Resources

As of September 30, 2004, we had cash and cash equivalents of $12.2 million and short-term investments of $14.5 million, a decrease of $1.2 million of cash and cash equivalents from $13.4 million at December 31, 2003, and a decrease of $1.0 million of short-term investments from $15.5 million as of December 31, 2003. The net combined decrease of $2.2 million for cash, cash equivalents and short-term investments for the nine-month period ended September 30, 2004, resulted primarily from cash used to fund operations of $7.5 million, repayment of debt of $1.6 million and purchases of fixed assets of $1.0 million, partially offset by the maturity of long term investments of $5.9 million in the first quarter of 2004, a drawing under our credit facility of $1.4 million during the third quarter of 2004 and proceeds from the issuance of common stock of $667,000. Our working capital defined as our current assets less our current liabilities, as of September 30, 2004 was $14.2 million, compared to $16.5 million as of December 31, 2003.

Cash used in operating activities of $7.5 million for the nine months ended September 30, 2004, was primarily the result of a net loss of $9.8 million, a decrease in accrued expenses of $584,000, an increase in prepaid expenses of $262,000, and a decrease in accounts payable of $259,000, offset by a decrease in accounts receivable of $2.2 million and non-cash charges for depreciation and amortization and stock based compensation, with an offsetting decrease in the provision for bad debts, in the aggregate of $1.3 million. For the nine months ended September 30, 2003, our operating activities had resulted in net cash outflows of $3.3 million primarily due to a net loss $6.9 million, offset by non-cash charges, including depreciation and amortization, stock-based compensation and an increase in the provision for bad debts in the aggregate of $2.9 million, and an increase in deferred revenue of $666,000.

Cash provided by investing activities of $5.8 million for the nine months ended September 30, 2004 consisted of maturities of short- and long-term investments of $45.1 million offset by purchases of short-term investments of $38.1 million and purchases of $1.0 million of property and equipment, primarily computer equipment and software, for support of current operations. For the nine months ended September 30, 2003, our investing activities had resulted in net cash flows outflows of $11.7 million resulting from purchases of short-term investments of $50.8 million and the purchase of $511,000 of property and equipment for support of current operations, offset by maturities of short-term investments of $39.5 million.

Cash provided by financing activities of $487,000 for the nine months ended September 30, 2004, related to a drawing of $1.4 million in September 2004 under our credit facility and $667,000 of proceeds from issuance of common stock in connection with the employee stock purchase plan and the exercise of stock options, offset by principal payments of $1.6 million on term loans under a credit facility. For the nine months ended September 30, 2003, cash used in financing activities was $769,000 due to payments made on term loans offset by receipts from the issuance of common stock in connection with the employee stock purchase plan, the exercise of stock options and drawings under our credit facility.

Days sales outstanding, or DSO (calculated as net accounts receivable divided by revenue per day for the previous 90 days), at September 30, 2004 was 53 days, a decline of 6 days compared to DSO of 59 days at December 31, 2003. Any increase or decrease in our accounts receivable balance will affect our cash flow from operations and liquidity. Our accounts receivable balance and DSO may increase due to changes in factors such as the timing of when sales are invoiced and the length of our customer s payment cycle. Historically, international customers and resellers pay at a slower rate than

Table of Contents

domestic customers and indirect channel partners. An increase in revenue generated from international customers and resellers may increase our DSO and accounts receivable balance. To the extent that our accounts receivable balance increases, we may incur increased bad debt expense and will be subject to greater general credit risks.

At September 30, 2004, $701,000 in term loans was outstanding under a previously existing equipment line of credit as compared to $2.3 million outstanding at December 31, 2003. The balance outstanding, representing three separate loan advances, is payable in fixed monthly payments of principal and interest of $35,000, $9,000 and $8,000, maturing at different times through June 2006. Interest was charged at prime plus 0.5% at the initiation of each of the loan advances, or 5.25%, 4.75% and 4.75%, respectively. All borrowings are secured by substantially all of Centra s assets.

In September 2004, the Company amended its equipment line of credit agreement to allow for additional borrowings of $2.5 million through September 2005. The Company had made a drawing under the amended line of credit of $1.4 million in September 2004, which is payable in thirty-six monthly principal payments of approximately $38,000 plus interest maturing in September 2007. Interest is payable monthly based on the prime rate (4.75% at September 30, 2004) plus 0.5%. The amended equipment line of credit requires Centra to maintain a minimum balance of cash, cash equivalents and investments of $10 million and, as of October 31, 2004, to hold all of the Company s cash, cash equivalents and investments in operating, deposit and investment accounts at the bank. At September 30, 2004, the company was in compliance with the covenants under the equipment line of credit and approximately $1.1 million remained available for borrowings.

Capital expenditures totaled $1.0 million and $511,000 for the nine months ended September 30, 2004 and 2003, respectively. Our capital expenditures consisted of purchases of assets to manage our internal operations and our ASP service, including computer hardware and software. Purchases of computer equipment represent the largest component of our capital expenditures. We expect capital expenditures to increase over the next twelve months as we continue to expand our ASP service infrastructure and improve and expand our internal information systems. Since inception, we have generally funded capital expenditures either through the use of working capital or with equipment bank loans.

In June 2004, we incurred a restructuring charge of $547,000 related to an 18% reduction in our worldwide workforce and the closing of the Company s product development facility in Morrisville, North Carolina. The restructuring charge consisted of severance payments, health benefits and outplacement services. In the quarter ended September 30, 2004, we completed the closure of the Morrisville facility resulting in an additional $241,000 restructuring charge, consisting of additional plant closure costs, severance, health benefits and outplacement services. The accrued and unpaid amount of these charges at September 30, 2004 was $315,000, which we expect to pay out through May 2005.

Over the past two years, in response to business challenges and economic conditions, we have made considerable efforts to reduce our operating expenses through constrained spending and reductions in workforce. This has resulted in a decrease in our cash used in operations; however, as of September 30, 2004, we still use more cash to operate our business than we generate in revenues. As discussed above, we anticipate that our overall operating expenses for the remainder of 2004 will decline on a percentage basis of total revenues. We anticipate that such operating expenses, along with capital expenditures, will constitute the most significant use of our cash resources. However, if we have the opportunity, we may also use our cash resources to fund acquisitions or investments in complementary businesses, technologies, products or services. We believe that our existing cash, cash equivalents and short-term investments, which totaled $26.6 million at September 30, 2004, will be sufficient to meet our anticipated cash requirements for operating expenses, capital expenditures and any strategic efforts for at least the next 12 months. Thereafter, we may need to raise additional funds to support our operations, particularly if our strategic sales and marketing efforts do not produce the desired results. We might also need to seek additional financing if we were to identify a strategic opportunity that required more cash than we had available at such time. If we did seek to raise additional funds, though, we may not be able to obtain them on terms that are favorable or acceptable to us. See Factors That Could Affect Future Results We may require additional funds in this Item 2.

Commitments and Contingencies

As of September 30, 2004, our primary financial commitments consisted of obligations outstanding under long-term debt, operating leases and other contractual obligations. In our Annual Report on Form 10-K for the year ended December 31, 2003, we included under the heading Commitments and Contingencies a table setting forth the Company s commitments and contingencies as of that date.

Table of Contents

Factors That Could Affect Future Results

As defined under the safe harbor provisions of The Private Securities Litigation Reform Act of 1995, some of the matters discussed in this report contain forward-looking statements, including but not limited to statements about the beliefs and expectations of management regarding the Company s future performance, the Company s strategic initiatives, its ability to achieve and maintain a leadership position in real-time conferencing and collaboration, demand for the Company s software services and management s goals and objectives regarding future results of operations. These statements reflect management s beliefs and expectations as of the date of this report, and involve risk and uncertainties that may cause actual results, events and performance to differ materially. These risk factors include, but are not limited to: risks associated with our ability to successfully execute our strategic plan, the effects of our recent cost-cutting measures on our results of operations, product demand for and market acceptance of our current and future products, our ability to achieve profitability, our ability to execute our marketing, sales and distribution initiatives, the impact of competitive products and pricing, the effects of changes in the senior management team, system failures that disrupt our hosted and ASP services, the effect of economic conditions generally on the market for IT spending and for our products, the results of our future research and development activities, reliance on third-party technology, technological difficulties and/or other factors outside our control. If any of the events described below were to actually occur, then our business, financial condition or results of operations could be seriously harmed and the trading price of our common stock could decline. There is no assurance that we will be able to implement our operating plans as anticipated or achieve projected revenue and earnings goals.

Important factors that could cause our actual results to differ from the forward-looking statements described above include, but are not limited to, the factors outlined below.

We may not successfully execute our strategic plan.

Earlier in 2004, we decided to implement a new business strategy focused on growing our leadership position in the collaborative learning market segment of application software, services and solutions for online business communications and collaboration, and leveraging that leadership to increase penetration of other collaboration market segments and to broaden usage of our products throughout the enterprise with the goal of significantly growing our annual revenues and achieving profitability. Our strategic initiatives include the enhancement of our solutions. We can give no assurance as to whether and when we can successfully make the transition to this new sales strategy of selling specialized solutions or when the expanded version of the solutions will be available to sell, that our sales force can effectively sell solutions on an enterprise-wide basis, and whether our target customers will purchase the expanded version of these solutions once they are available. If we are not successful in achieving our strategic objectives, then our liquidity and working capital will be materially diminished and the value of our stockholders investments could decline significantly.

Our cost cutting efforts could impede our ability to successfully execute our strategic plan

In furtherance of the objectives of our new business strategy, we developed a plan to spend an additional $8 million in 2004 over our 2003 expenditure rate for sales and marketing to develop new channel partnerships, enhance our relationships with existing customers, expand international operations, implement new initiatives that improve sales execution and consistency and attract new customers with targeted messaging, print advertising, public relations efforts and lead generation marketing programs. However, our strategic initiatives will take time to translate into higher revenues and profitability, and our results in the first half of 2004 were below our initial expectations due to the limited size and poor quality of our sales pipeline of opportunities at the beginning of 2004. We now anticipate that it will take longer than we previously thought before we begin to see significant annual revenue growth as a result of our efforts. Therefore, during the quarter ended June 30, 2004, we decided to scale back our planned increases in sales and marketing expenses until such time that our new solutions begin to achieve market acceptance, and we implemented initiatives to reduce our costs by $3 million to $4 million annually by closing our development facility in North Carolina and reducing our worldwide workforce by 18%. Our cost cutting efforts, including our delay in increasing sales and marketing expenses could impede our ability to successfully execute our strategic plan.

We have incurred substantial losses in the past and may not achieve profitability in the future.

We incurred net losses of $7.9 million in the year ended December 31, 2003 and $9.8 million for the nine months ended September 30, 2004. We had an accumulated deficit of $97.9 million at September 30, 2004. We cannot predict when we

Table of Contents

will become profitable, if at all, and if we do, we may not remain profitable for any substantial period of time. If we fail to achieve and maintain profitability, then our investors expectations may not be met and the market price of our common stock may fall.

Our success depends on our ability to execute our marketing, sales and distribution initiatives.

To increase our revenues, we must increase our brand awareness through advertising and other marketing initiatives, and improve the effectiveness of our direct field sales force and current distribution channels and partner programs, including value-added resellers, integrated technology solution partners and marketing partners. We will continue to focus on improving the productivity and effectiveness of our direct sales organizations through training and focused marketing programs. Early in 2004 we announced that we planned to increase sales and marketing expenses by approximately $8 million in 2004. However, we recently decided to scale back our planned expenditures as part of our cost-cutting measures following our performance during the first half of 2004. Also, we cannot be sure that we will be successful in hiring, training and motivating our sales staff to increase productivity or in retaining qualified sales personnel. In addition, we must effectively leverage our relationships with our indirect channel partners. Our existing, or future, indirect channel partners may choose to devote greater resources to marketing and supporting the products of other companies including our competitors. Also, we may face conflicts between our sales force and our indirect channel partners. Our inability to effectively optimize the efforts of our marketing initiatives, our direct sales organization, our partners and our indirect distribution channel could limit our future revenue growth and hurt our future operating results. See We may not successfully execute our strategic plan.

Our future success depends to a significant degree on our senior management team.

Since June 2003, we have effected a number of significant changes to our senior management team, including the departure of our founder and Chief Strategy Officer, Leon Navickas in September 2004. Our future success will depend in part on our ability to carry out the transition in senior management and to integrate the new people and positions into our operations, as well as on the efforts of our other senior managers. Changes in our management team or the inability of our executive officers and key employees to work effectively as a team could have a material adverse effect on our business, operating results and financial condition.

Delays in sales could cause significant variability in our revenues and operating results for any particular period.

We generally need to educate potential customers regarding the benefits of our real-time conferencing, collaboration and learning products and services before they will commit to the purchase of our products. Our sales cycle varies depending on the size and type of customer contemplating a purchase, the complexity of the customer s purchasing process and whether we have conducted business with the customer in the past. Both new and existing customers frequently need to obtain approvals from multiple decision makers within their organization prior to making purchase decisions. We expect that the sales cycle will continue to be characterized by these features as we move towards selling broader enterprise-based solutions and larger, multi-year contracts.

We face significant competition from other technology companies and we may not be able to compete effectively.

The markets for real-time conferencing, collaboration and learning products and services are highly competitive. We expect that our competition in this market will intensify in the future, which will likely result in price reductions, reduced gross margins and loss of market share, any one of which could seriously harm our business. Competitors vary in size and in the scope and breadth of the products and services offered. We encounter competition with respect to different aspects of our real-time conferencing, collaboration and learning solutions from a variety of software and services vendors. In addition, larger companies with more resources than we have could enter our market and either reduce our sales or require us to lower our prices, or both.

Some of our competitors have longer operating histories, significantly greater financial, technical, marketing and other resources than we do. Some have significantly greater name recognition and a larger installed base of customers. In addition, many of our competitors have well-established relationships with our current and potential customers. In the past, we have lost potential customers to competitors for various reasons, including lower prices and other incentives not matched by us. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address customer needs. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

Table of Contents

We may lose customers or incur losses if we experience system failures that significantly disrupt the availability and quality of our hosted and ASP services.

While our products can be deployed at a customer s premises or on its network as a packaged software application, we also deliver our products as an ASP or hosted service utilizing our network. Our hosted services and ASP services depend on the efficient and continued operation of our internal and outsourced computer and communications hardware and software systems and our ability to avoid and mitigate any interruptions in service or reduced capacity. Some of our communications hardware and software is hosted at third-party facilities. These third-party providers are vulnerable to business and economic uncertainties as well as damage or interruption from human error, telecommunications failures, computer viruses, sabotage, and intentional acts of vandalism, all of which may affect their ability to continue to provide services. Interruptions in service or performance problems, for whatever reason, could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones. In addition, any significant interruption in our service could result in losses to our customers. Although we attempt contractually to disclaim liability for any such losses, a court might not enforce a limitation on our liability, which could expose us to financial loss.

We may require additional funds.

We expect that our current cash, cash equivalents and short-term investments will be adequate to provide us with sufficient working capital for at least the next 12 months. However, our current plans and projections may prove to be inaccurate or our expected cash flow may prove to be insufficient to fund our operations because of difficulties in executing our sales and marketing strategy, demand for our new products, delays in developing new products and improvements, unanticipated expenses or other unforeseen difficulties. Therefore, we may need to raise additional capital to continue to fund our operations, particularly if our strategic sales and marketing efforts do not produce the desired results. We might also need to seek additional financing if we were to identify a strategic opportunity or desirable technology to acquire that required more cash than we had available at the time.

Our ability to obtain any additional financing that may be needed will depend on a number of factors, including market conditions, our operating performance and investor interest, particularly in real-time conferencing, collaboration and learning software companies. These factors may make the timing, amount, terms and conditions of any financing unattractive. They may also result in our incurring additional indebtedness or accepting stockholder dilution. If adequate funds are not available or are not available on acceptable terms, we may have to forego strategic acquisitions or investments, defer our product development activities, or delay our continued rollout of new products and product versions. Any of these actions may seriously harm our business and operating results.

If we are unable to complete our assessment as to the adequacy of our internal controls over financial reporting as of December 31, 2004 as required by Section 404 of the Sarbanes-Oxley Act of 2002, or if material weaknesses are identified and reported, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our common stock.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission adopted rules requiring public companies to include in their annual reports on Form 10-K a report of management on the company s internal control over financial reporting, including management s assessment of the effectiveness of the company s internal control over financial reporting as of the company s year end. In addition, the accounting firm auditing a public company s financial statements must also attest to and report on management s assessment of the effectiveness of the company s internal control over financial reporting as well as the operating effectiveness of the company s internal controls. While Centra has expended significant resources in developing the necessary documentation and testing procedures, 2004 will be the first year for which we must complete the assessment and undergo the attestation process required by Section 404 and there is a risk that we may not comply with all of its requirements. If we do not timely complete our assessment or if our internal controls are not designed or operating effectively as required by Section 404, our accounting firm may either disclaim an opinion as it relates to management s assessment of the effectiveness of its internal controls or may issue a qualified opinion on the effectiveness of the company s internal controls. In addition, although no known material weaknesses exist at this time, it is possible that material weaknesses in our internal controls could be found. If we are unable to remediate such material weaknesses arising by December 31, 2004, our accounting firm would be required to issue an adverse opinion on our internal controls. If our account firm disclaims an opinion as to the effectiveness of our internal controls or if they render an adverse opinion due to material weaknesses in our internal controls, then investors may lose confidence in the reliability of our financial statements, which could cause the market price of our common stock to decline.

Future regulations could be enacted that either directly restrict our business or indirectly impact our business by limiting the growth of Internet-based business and services.

As commercial use of the Internet increases, federal, state and foreign agencies could enact laws or adopt regulations covering issues such as user privacy, content, taxation of products and services, encryption, network and information security, and the convergence of telephone and other traditional communication services with Internet communications such as voice-over Internet telephony. If enacted, such laws or regulations could limit the market for our products and services. Any inconsistencies between state, federal and non-U.S. laws and regulations could affect distribution of our products and/or increase our costs. Such legislation or regulation could also dampen the growth in Web usage and decrease its acceptance as a medium of communications and commerce.

Our future success will depend on our ability to respond effectively to technological changes and new industry standards and developments in new versions of our products.

As with any software technology, we expect that the demand and product specifications continue to change and therefore our future success will depend in large part on our ability to stay current with any technology shifts and meet the evolving needs of the market by timely introduction of new products or product releases. In the past, we have experienced delays in the introduction of new products. In addition, our product enhancements must meet the requirements of our current and prospective customers and must achieve significant market acceptance. We could also incur substantial costs if we need to modify our products, services or information technology infrastructure to adapt to these changes, standards and developments.

Table of Contents

We face business risks relating to our international operations.

Our success is focused on sales to multinational corporations, which requires us to have international operations and incur risks associated with those operations. In addition to our North American operations, we have established sales, marketing and service operations in Europe, Asia and Australia and we sell through distributors and resellers in a number of countries around the world. We cannot be sure that our international operations will be successful. Our international operations require resources and management attention beyond those required for our domestic operations and subject us to additional regulatory, economic and political risks, including:

- longer payment cycles and problems in collecting accounts receivable;
- adverse changes in trade and tax regulations;
- the absence or significant lack of legal protection for intellectual property rights;
- the adoption of data privacy or other laws or regulations which restrict or regulate the use of our products or the Internet;
- provisions of local laws governing our contracts in other countries;
- difficulties in managing an organization spread over several countries, including complications arising from cultural, language and time differences that may lengthen sales and implementation cycles;
- challenges relating to localization of technology;
- political and economic instability; and
- currency risks, including fluctuations in exchange rates.

We cannot assure our investors that we will be able to manage these risks effectively or that our international efforts will be successful.

The success of our strategy depends on our ability to license and integrate third-party technology to enhance our products.

Our ability to enhance and deliver our solutions is dependent upon our ability to license, under commercially reasonable terms, third-party software that enhances, enables or provides additional functionality for our expanded solutions. If we are not able to successfully license third-party software to incorporate into our products we may not be able to timely deliver more robust versions of our solutions. In addition, the third-party software which we intend to license may or may not continue to be available on commercially reasonable terms or with acceptable levels of support or functionality, or at all. Failure to obtain or maintain these license arrangements, failure of the third-party vendors to provide updates, modifications or future versions of their software or defects and errors in, or infringement claims against, those third-party products could delay or impair our ability to develop and sell our products and execute against our strategic plan.

Our success depends on our ability to protect our proprietary rights.

Our success depends to a significant degree upon the protection of our software and other proprietary technology. If we fail to protect our proprietary rights, other companies might use our technology to introduce competing products or services that compete with ours, without paying us for our technology. This could have a material adverse effect on our business, operating results and financial condition. Our proprietary technology and intellectual property includes one pending U.S. patent application, which has not yet been approved, and the Centra ® trademark, among others. We depend upon a combination of patent and trademark laws, license agreements, non-disclosure and other contractual provisions to protect proprietary and distribution rights of our products. In addition, we attempt to protect our proprietary information and those of our vendors and partners through confidentiality and license agreements with our employees and others. Although we have taken steps to protect our proprietary technology, they may be inadequate. Existing trade secret, copyright and trademark laws offer only limited protection. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our intellectual property. If we resorted to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome and expensive, even if we were to prevail.

Table of Contents

Claims by other companies that we infringe their proprietary technology could force us to redesign our products or otherwise hurt our financial condition.

If we were to discover that any of our products violated third-party proprietary rights, there can be no assurance that we would be able to reengineer the product or obtain a license on commercially reasonable terms, or at all, that would enable us to continue offering the product without substantial reengineering. Also, our product license agreement terms state that we will indemnify our customers for any of their costs as a result of our infringement on other s technology, if any. Such costs could be substantial. We do not conduct comprehensive patent searches to determine whether the technology used in our products infringes patents held by third parties. In addition, product development is inherently uncertain in a rapidly developing technology environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies. Any claim of infringement could cause us to incur substantial costs defending against the claim, even if the claim is invalid, and could distract our management from our business. Furthermore, a party making such a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our products or cause our customers to stop using our products. On August 19, 2003, EdiSync Systems, LLC filed a complaint against us in federal court in Denver, Colorado, alleging infringement of two patents for a remote multiple user editing system and method and seeking to enjoin us from continuing to sell our products, as well as unspecified compensatory damages. Although we believe we have meritorious defenses and intend to vigorously defend this action, we can give no assurance that we will be able to achieve a satisfactory outcome. See Legal Proceedings.

Our business could be adversely affected if our products contain errors.

Software products as complex as ours may contain undetected errors or bugs that result in product failures. From time to time we have identified errors in our products after commercial introduction of the products. While we have not been materially harmed by errors in the past, the occurrence of errors in the future could result in loss of or delay in revenues, loss of market share, diversion of product development resources, injury to our reputation or damage to our efforts to build brand awareness, any of which could have a material adverse effect on our business, operating results and financial condition.

We could incur substantial costs resulting from product liability claims relating to our customers use of our products and services.

Many of the business interactions supported by our products and services are critical to our customers businesses. Any failure in a customer s business interaction or other collaborative activity caused or allegedly caused by our products and services could result in a claim for substantial damages against us, regardless of our responsibility for the failure. Although we maintain general liability insurance, including coverage for errors and omissions, and contractually attempt to limit liability, there can be no assurance that our existing coverage will continue to be available on reasonable terms or will be available in amounts sufficient to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim.

The market price of our common stock has been and may continue to be volatile.

Our stock price, like that of other technology companies, has been extremely volatile. The announcement of new products, services, technological innovations, customers or distribution partners by us or our competitors, quarterly variations in our operating results, changes in revenues or earnings estimates by securities analysts, speculation in the press or investment community and overall economic conditions are among the factors affecting our stock price.

In addition, the stock market in general and the market prices for technology companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our operating performance. Recently, when the market price of a stock has been volatile, holders of that stock have often instituted securities class action litigation against the company that issued the stock. If any of our stockholders brought a lawsuit against us, we could incur substantial costs defending the lawsuit. The lawsuit could also divert the time and attention of our management away from operating our business.

The general economic uncertainties in the United States and abroad continue to cause significant volatility in the stock markets. The continued threat of terrorism in the United States and abroad, the ongoing military action and heightened security measures undertaken in response to that threat can be expected to cause continued volatility in securities markets. In addition, foreign political unrest may continue to adversely affect the economy.

Table of Contents

Certain provisions of our charter and of Delaware law make a takeover of our company more difficult.

Our corporate documents and Delaware law contain provisions that might enable our management to resist a takeover of our company. These provisions, including our stockholder rights plan, might discourage, delay or prevent a change in the control of Centra or a change in our management. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. Additionally, we have entered into agreements with certain employees and executive officers, which, among other things, include certain severance and change of control provisions.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk related to foreign currency exchange rates and to changes in interest rates. We do not use derivative financial instruments for speculative or trading purposes.

Foreign Currency

We develop products in the United States and sell them worldwide. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. International sales are typically denominated in euros, British pounds, Australian dollars or in U.S. dollars. Since some of our sales internationally are currently priced in U.S. dollars, a strengthening of the U.S. dollar could make our products less competitive in foreign markets. We generated approximately 19% and 18% of our revenues outside of the United States in the nine months ended September 30, 2003 and 2004, respectively. Our foreign subsidiaries incur most of their expenses in the local currency. Accordingly, all foreign subsidiaries use the local currency as their functional currency. Translation gains and losses are deferred and accumulated as a separate component of stockholders equity (accumulated other comprehensive loss) in the consolidated balance sheets. Realized and unrealized gains and losses resulting from foreign exchange transactions are netted and included in other expense, net, in the accompanying consolidated statements of operations. A 10% change in the valuation of the functional currencies relative to the U.S. dollar as of September 30, 2004, would not have a material impact on the Company s results of operations for the nine months ended September 30, 2004.

Interest Rates

We maintain a short-term investment portfolio consisting mainly of fixed rate U.S. government-backed federal agency notes and highly liquid money market instruments, with an average maturity of less than 12 months, in accordance with our investment policy approved by the Company s board of directors. Our general investing policy is to limit the risk of principal loss and seeks to ensure the safety of invested funds by limiting market and credit risk. We currently use a registered investment manager to place our investments, which are typically held to maturity. These investments are denominated in U.S. dollars. Cash balances in foreign currencies overseas are operating balances and are only invested in short-term deposits of the local operating bank. All highly liquid investments with original maturities of three months or less are considered to be cash equivalents.

Investments in fixed rate interest earning financial instruments are subject to interest rate risk and would decrease in value if market interest rates were to increase. However, due to the conservative nature of our investment portfolio, a sudden change in interest rates would not have a material effect on the fair value of the portfolio. If market interest rates were to decline, the interest earned on our investment portfolio would decrease. We estimate that if the average yield of our investments had decreased by 100 basis points, our interest income for the nine months ended September 30, 2004, would have decreased by less than $160,000. This estimate assumes that the decrease occurred on the first day of the period and reduced the yield of each investment instrument by 100 basis points. The impact on our future interest income and future changes in investment yields will largely depend on the gross amount of our portfolio.

Our long-term debt and available line of credit require interest payments calculated at variable interest rates. If interest rates were to increase, the interest payments on our long-term debt would also increase. The effect of any such increase in interest expense would be partially offset by any resulting increase in interest income from our investment portfolio.

Item 4. Controls and Procedures

As required under the Sarbanes-Oxley Act of 2002, our chief executive officer and chief financial officer conducted a review of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(e) and 15d-14(e)) in connection with the preparation of this report. Based on such evaluation, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures, as of the end of the period covered by this report, were adequate and effective to provide reasonable assurance 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 in the Securities and Exchange Commission s rules and forms.

There were no changes in our internal control over financial reporting identified in connection with the above-referenced evaluation that occurred during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, management will evaluate our internal controls over financial reporting as of December 31, 2004, and our independent auditor will report on management s evaluation process as well as provide their own assessment of our internal controls over financial reporting as of December 31, 2004. In preparation for this evaluation, management has increased certain documentation and testing of our internal controls over financial reporting, although we have not made any substantive changes.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we have been, and expect to continue to be, subject to legal proceedings and claims in the ordinary course of our business. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Except for the lawsuits identified below in this section, we are not presently a party to any legal proceedings, the adverse outcome of which, in management s opinion, would have a material adverse effect on our results of operations or financial position.

Securities Class Action Lawsuit

Centra, certain of its officers and directors and the managing underwriters of Centra s initial public offering were named as defendants in an action filed in the United States District Court for the Southern District of New York. The plaintiffs filed an initial complaint on December 6, 2001 and purported to serve the Centra defendants on or about March 18, 2002. The original complaint has been superseded by an amended complaint (complaint) filed in April 2002. The action, captioned in re Centra Software, Inc. Initial Public Offering Securities Litigation, No. 01 CV 10988, which is being coordinated with an action captioned in re Initial Public Offering Securities Litigation, No. 21 MC 92, is purportedly brought on behalf of the class of persons who purchased Centra s common stock between February 3, 2000 and December 6, 2000. The complaint asserts claims under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The complaint alleges that, in connection with Centra s initial public offering in February 2000, the underwriters received undisclosed commissions from certain investors in exchange for allocating shares to them and also agreed to allocate shares to certain customers in exchange for the agreement of those customers to purchase additional shares in the after-market at pre-determined prices. The complaint asserts that Centra s registration statement and prospectus for the offering were materially false and misleading due to their failure to disclose these alleged arrangements. The complaint seeks damages in an unspecified amount against Centra and the named individuals. The underwriter defendants and the Centra defendants joined in motions to dismiss the above-reference action on July 3 and July 15, 2002, respectively. On October 9, 2002, the plaintiffs dismissed, without prejudice, the claims against the named Centra officers and directors in the above-referenced action. On February 19, 2003, the court issued an order denying the motion to dismiss as to Centra and other defendants. On June 7, 2003, the plaintiffs announced a proposed settlement with all issuers, including Centra. On June 25, 2004, the plaintiffs filed a motion with the United States District Court for the Southern District of New York requesting preliminary approval of the settlement. The court has not yet ruled on this motion.

Centra plans to participate in this settlement, which has been negotiated, and will be fully funded directly to the plaintiffs, by Centra s insurers. The settlement is subject to court approval. No amount has been accrued related to this matter and legal costs incurred in the defense of the matter are being expensed as incurred.

EdiSync Patent Claim

On August 19, 2003, a complaint was filed against the Company and two other defendants by EdiSync Systems, LLC, in the United States District Court for the District of Colorado (No. 03-D-1587 (OES)). The complaint alleges infringement of two patents for a remote multiple user editing system and method and seeks permanent injunctive relief against continuing infringement, compensatory damages in an unspecified amount, and interest, costs and expenses associated with the litigation. The Company has filed an answer to the complaint denying all of the allegations. The Company believes it has meritorious defenses and intends to vigorously defend this action. The Company filed a request for re-examination of the patents at issue with the U.S. Patent and Trademark Office as patent counsel to the Company is of the opinion that claims of the patents involved in the suit are invalid. The re-examination request was accepted by the Patent Office and the District Court has approved the parties motion to stay the court proceedings during the re-examination proceedings. The Company believes that it has meritorious defenses and the Company intends to vigorously defend this action.

Employment Claim

On September 3, 2004, a former employee of the Company filed a complaint with the Massachusetts Superior Court (civil action no. 04-3479) against the Company and two of its executive officers alleging wrongful termination and discrimination against the employee on the basis of age, race and gender in connection with the employee s employment with the Company and subsequent termination. The complaint seeks remedies including damages in an unspecified amount. The Company has filed a motion to dismiss certain of the claims in the complaint as well as an answer to the complaint, which it believes is without merit. The Company intends to vigorously defend this action.

Item 2. Changes in Securities and Use of Proceeds

(a) Use of Proceeds from Sales of Registered Securities

On February 8, 2000, we closed the initial public offering of our common stock. The shares of common stock sold in the offering were registered under the Securities Act of 1933, as amended, on a Registration Statement on Form S-1 (the Registration Statement) (Registration No. 333-89817) that was declared effective by the Securities and Exchange Commission on February 3, 2000. Our net proceeds from the offering were approximately $73.2 million. From the effective date through September 30, 2004, we used approximately $6.5 million for payments of dividends to preferred shareholders, $37.4 million to fund operations, $1.5 million for capital expenditures, $1.7 million for payment of MindLever debt, $3.3 million for the MindLever acquisition and $6.3 million to pay amounts outstanding under our loans. As of September 30, 2004, we had approximately $16.5 million of net proceeds remaining, and pending use of these proceeds, we intend to invest such proceeds primarily in highly liquid money market accounts and government-backed securities as defined in our current investment policy.

Item 5. Other Information

In September 2004, the Company amended its equipment line of credit agreement to allow for additional borrowings of $2.5 million through September 2005. The Company had made a $1.4 million drawing under the amended line of credit in September 2004, which is payable in thirty six monthly principal payments of approximately $38,000 plus interest maturing in September 2007. Interest is payable monthly based on the prime rate (4.75% at September 30, 2004) plus 0.5%. The current amended equipment line of credit requires Centra to maintain a minimum balance of cash, cash equivalents and investments of $10 million and, as of October 31, 2004, to hold all of the Company s cash, cash equivalents and investments in operating, deposit and investment accounts at the bank. At September 30, 2004, approximately $1.1 million remained available for borrowings under the line.

Table of Contents

Item 6. Exhibits

(a) Exhibits

Exhibit	Description
3.1	Amended and Restated Certificate of Incorporation (filed as exhibit 3.2 to the Company s Registration Statement, on Form S-1, File No. 333-89817 and incorporated herein by reference)
3.2	Certificate of Designation, Preferences and Rights of Series A Participating Cumulative Preferred Stock of Centra Software, Inc. (filed as exhibit 4.2 to our Current Report on Form 8-K filed April 22, 2002, and incorporated herein by reference)
3.3	Amended and Restated By-Laws (filed as exhibit 3.4 to the Company s Registration Statement, on Form S-1, File No. 333-89817 and incorporated herein by reference)
10.1	Sixth loan modification agreement dated September 28, 2004, between Centra Software, Inc. and Silicon Valley Bank.
10.2	Fourth Amendment to Lease, dated as of July 30, 2004, between Centra Software, Inc. and Trustees of Elandzee Trust (filed as exhibit 99.1 to our Current Report on Form 8-K filed August 5, 2004, and incorporated herein by reference).
10.3	Consulting and Confidentiality agreement dated September 30, 2004 between Centra Software, Inc. and Leon Navickas.
31.1	Form of Section 302 Certification signed by Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
31.2	Form of Section 302 Certification signed by Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
32.1	Form of Certification signed by Chief Executive Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
32.2	Form of Certification signed by Chief Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, as of November 9, 2004.

Centra Software, Inc.

By: /s/ Stephen A. Johnson

Stephen A. Johnson

Chief Financial Officer,

Treasurer, and Secretary (duly

authorized officer and principal

financial and accounting officer)

32

Table of Contents

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