



Mossberg's Investor Digest Idea Profile

KANA Software Inc. (OTCBB: KANA.OB)

DESCRIPTION:

Kana provides multi-channel customer relationship management (CRM) software and services to large customers, which include Dell, Verizon, Target, and 600 others. Essentially, the company's software helps customers deliver customer service via chat, email, call centers and web self-service. The company is headquartered in the San Francisco Bay area, and does business in North America (75% of total), Europe and Asia (25% of total).

KEY INVESTMENT CONSIDERATIONS:

Recurring maintenance base provides support for the downside – More than 35% of Kana's revenue comes from maintenance services. This revenue will continue to recur each year, assuming the installed base of customers continue to use Kana's software.

IBM relationship allows Kana to compete for large deals – Kana has 600 customers worldwide including half of the Global 100. It's 7-year-old relationship with IBM, gives customers confidence in dealing with the relatively small company and gives Kana the ability to compete for large deals. According to the company, 40% of Kana's new license transactions are over \$1 million and a similar amount of deals in the pipeline are led by IBM.

In tough economic times customers focus on IT investments with a high impact, high return projects – Kana's products allow customers to get the right answers to customer service personnel, quickly and easily. This lowers costs by increasing first-call resolution rates and can also increase customer satisfaction and provide competitive differentiation. In the current economic environment, customers focus more on applications, such as CRM that can provide cost savings and rapid paybacks. License revenue growth of 36% in the 1H08 and a positive outlook for the remainder of the year provide evidence that Kana's products continue to be valuable despite tough economic times.

KEY RISKS:

Reliance on IBM – With approximately 40% of the large deals in the pipeline dependent on one channel partner, a change by IBM would have significant adverse affect on the company.

Competition – Oracle and other large players have competing offerings.

VALUATION:

The company appears to be turning the corner operationally. They have delivered 32% top line growth in the first half of 2008 and three quarters of year-over-year improvement in profitability. The stock trades at just 13x the 2009 consensus EPS estimate of \$0.13. Earnings multiples should expand as the company continues to deliver more stable financial performance.

Buy the maintenance revenue, get the license revenue for free – While Kana does not break out the exact mix of maintenance revenue, it does say that the largest component of service revenue comes from its maintenance services. If we apply a 3x to 4x multiple on a conservative estimate of annual maintenance revenue of \$24 million (35% x TTM revenue of \$69 million), the valuation would be \$72 million to \$96 million. Given the current enterprise value of \$70 million, essentially the market is placing no value on the company's licensing business. This seems like a bargain, considering licensing revenue grew 36% during the first half of the year.

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Investment Data (as of 8/25/08)

| | |
|--------------------------------|----------------|
| Recent Price | \$1.65 |
| 52-Week Range | 1.07 - 3.64 |
| Fiscal Year End | Dec |
| Dividend | NA |
| Yield | NA |
| Shares Outstanding | 41.2 MM |
| Average Trading Volume (3 mos) | 334,000 |
| Market Capitalization | 68.0 MM |
| Cash | 3.9 MM |
| Long Term Debt | 2.3 MM |
| Enterprise Value (EV) | 66.4 MM |
| LT Debt/ Equity | 0.77 |
| Tangible BV/ Share | N/A |
| TTM Revenue | 69.3 MM |
| EV/ Revenue | 1.0x |
| TTM EPS | -0.02 |
| P/ EPS | NA |
| TTM EBITDA | 1.7 MM |
| EV/ TTM EBITDA | 39.1x |

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