UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED MARCH 31, 2001

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 0-26130

SELECTICA, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	77-0432030 (I.R.S. EMPLOYER IDENTIFICATION NO.)
3 WEST PLUMERIA DRIVE, SAN JOSE, CALIFORNIA (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	95134-2111 (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (408) 570-9700

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: COMMON STOCK, $0.0001 PAR VALUE

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of May 31, 2001 was approximately $173,053,358.10. Shares of Common Stock held by each officer and director have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the registrant's common stock as of May 31, 2001 was 36,279,530.

DOCUMENTS INCORPORATED BY REFERENCE

Part III -- Portions of the registrant's definitive Proxy Statement to be issued in conjunction with the registrant's Annual Meeting of Stockholders to be held on September 14, 2001

SELECTICA, INC.

FORM 10-K ANNUAL REPORT
FOR THE FISCAL YEAR ENDED
MARCH 31, 2001

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In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those projected. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations" and "Certain Factors That May Affect Future Results of Operations." You should carefully review the risks described in other documents the Company files from time to time with the Securities and Exchange Commission, including the quarterly reports on Form 10-Q to be filed by the Company in 2001. Readers are cautioned not to place undue reliance on the forward-looking statements, including statements regarding the Company's expectations, beliefs, intentions or strategies regarding the future, which speak only as of the date of this annual report on Form 10-K. The Company undertakes no obligation to release publicly any updates to the forward-looking statements included herein after the date of this document.

PART I

ITEM 1. BUSINESS

BUSINESS OVERVIEW

Selectica is a leading provider of Interactive Selling System software and services that enable companies to efficiently sell complex products and services over intranets, extranets and the Internet. Using our Interactive Selling System, businesses can guide their customers, partners and employees through the selection, configuration, pricing, quotation and fulfillment processes. Our Interactive Selling System allows companies to use the Internet platform to deploy highly accurate selling applications to many points of contact, including personal computers, in-store kiosks and mobile devices, while offering customers, partners and employees an interface customized to their specific needs. Our product architecture has been designed specifically for the Internet and provides scalability, reliability, flexibility and ease of use. Additionally, our Interactive Selling System solution has been developed with an open architecture that leverages data in existing applications, such as enterprise resource planning, or ERP systems. This allows for an easy-to-install application and reduced deployment time. Our current customers include 3Com, Aetna, Asea Brown Boveri (ABB), Aspect Communications, Bell Canada, BMW, British Telecommunications, Cisco Systems, Cooper Cameron Valves, Dell Computer, Fireman's Fund Insurance Company, Fujitsu PC, Hewlett-Packard, Highmark Blue Cross Blue Shield, Juniper Networks, LG Electronics, Redback Networks, Rockwell Automation, Samsung and Watlow Electric.

INDUSTRY BACKGROUND

Evolution of Electronic Commerce

The Internet is transforming the business environment by increasing competition and enabling the development of new business models. People, businesses and other organizations are using the Internet as a platform to communicate, collaborate, access information and conduct business with greater speed, efficiency and accuracy. As a result, business-to-business, business-to-consumer and business-to-employee interactions are being fundamentally altered. In order to remain competitive, companies must find innovative new ways to sell, increase efficiencies in the sales cycle and deliver greater customer satisfaction. Forrester Research estimates that the combined value of business-to-consumer (B2C) and business-to-business (B2B) transactions conducted over the Internet will grow to over $1.4 trillion by 2003. A growing number of companies are attempting to leverage the Internet to market and sell their products and services. To date, many electronic commerce transactions have been simple purchases of products such as books, compact discs, stocks and toys. We believe, however, that the growth in B2B and B2C electronic commerce will be driven by the ability of companies to quickly and efficiently complete complex transactions involving multiple features, options or involving custom pricing or service options.

Complexity in Electronic Commerce

Complexity in the selling process manifests itself in numerous ways. One type is product complexity, where the product has many possible features, with factors interacting with one another and with other factors to influence the performance or manufacturability of that item. Examples of complex products include networking and telecommunications equipment, automobiles, and computers. A second type of complexity is needs complexity, in which the product or service itself may be relatively simple, such as an insurance policy or a printer, but the factors that go into evaluating a specific customer's needs and matching those needs with the optimal product or service may be complex. A third type of complexity comes from flexible or customized pricing and discount programs, including those based on the features of the product.

The completion of a complex sales transaction depends on a seller's ability to identify and satisfy the full range of a buyer's needs. In traditional sales, companies rely on trained salespeople to interact with customers, address customer needs, explain product features, and ultimately complete the sale. To date, many electronic commerce web sites have been static collections of non-interactive content, and have had limited capability for assisting and guiding customers or sales personnel through a complex purchasing decision. The Internet affords businesses the ability to centralize and simplify complex selling processes and deploy a platform for aggregating, bundling, and pricing complex products and services across all sales channels.

The Internet as an Emerging Platform for Business Applications

In addition to fueling the growth of electronic commerce, the Internet has become a technology platform for business application deployment. Traditionally, companies seeking to improve their operations have implemented applications such as enterprise resource planning (ERP), customer relationship management (CRM) or sales force automation (SFA) software based on client-server architectures that require a significant part of the application to be loaded on every user's computer. With the emergence of the Internet platform, companies are able to more broadly and cost-effectively deploy business applications to customers, partners and employees and make the most current application and information immediately available on Internet-enabled devices. We believe that a selling application based on the Internet platform offers significant advantages over one based on traditional client-server architectures. These advantages include the ability to be deployed on a broad range of browser-enabled devices, as well as easier integration with other Internet-based applications and legacy systems, including those running on relational database management systems, or RDBMS.

Limitations of Existing Solutions

Until recently, businesses have generally attempted to address the challenges of complexity in the selling process by building in-house solutions. These solutions often require significant up-front development costs and lengthy deployment periods. Furthermore, due to the rapid pace of change in products and business processes, companies often find it difficult and expensive to maintain these systems and integrate new functionality and technologies. As a result, businesses are seeking to implement third-party packaged applications.

Current commercially available software designed to help companies address the challenges of complexity in the selling process may have one or more of the following limitations. In general, the applications:

- have not been engineered for the Internet platform and, as a result, are not easily deployed across a broad range of Internet-enabled devices;

- require significant custom programming for deployment and maintenance;

- provide a limited interactive experience; or

- employ application architectures that limit their scalability and reliability.

We believe that there is a significant opportunity for an Interactive Selling System that leverages the Internet platform to enable companies to efficiently sell complex products and services using a broad range of Internet-enabled devices.

SELECTICA SOLUTIONS

Our ACE suite of products is a comprehensive Interactive Selling System solution that is designed to enable businesses to easily develop and rapidly deploy an Internet sales channel that interactively assists their customers, partners and employees through the selection, configuration, pricing, quoting and fulfillment processes. Our Interactive Selling System allows companies to use the Internet platform to deploy a selling application to many points of contact including personal computers, in-store kiosks and mobile devices, such as PDAs and cellular phones, while offering customers, partners and employees an interface customized to meet their specific needs. ACE is built using Java technology and utilizes a unique knowledge base business logic engine, repository, and a multi-threaded architecture. This design enables the ACE Enterprise server to reduce the amount of memory used to support new user sessions and to rapidly deploy without custom programming, a cost-effective, robust and highly scalable, Internet-enhanced sales channel.

Some of the major design benefits of our Interactive Selling System are described below:

Provides Comprehensive Solution

Our ACE suite of products provides the functionality for Internet selling in a single comprehensive solution. Our Interactive Selling System has been developed with an open architecture that leverages data in existing enterprise applications, such as ERP systems, to provide an easy to develop and deploy application that is designed to reduce deployment time.

Opportunity for Increased Sales

We enable sellers of complex products and services to reach and sell to additional customers by enabling them to use the Internet as an effective sales channel. Our Interactive Selling System is designed for the Internet platform and provides increased scalability that allows companies to sell over a broad range of Internet-enabled devices, including devices with limited processing power, such as mobile devices.

Shorten Sales Cycle

Generally, in a traditional sales environment for complex products and services, prospective buyers repeatedly interact with a seller's sales force to determine an appropriate configuration and pricing. Our ACE software is designed to enable companies to reduce the time required to convert interested prospects into customers in several ways. The advantages of this software include:

- providing comprehensive product information to the customer or sales person at the point of sale without requiring interaction with product experts; and

- automating the pricing and configuration of complex products and services, thereby providing customers with accurate, real-time information.

Improves Efficiency of the Indirect Sales Channel

Using our Interactive Selling System, companies can enable their channel partners, such as distributors and resellers, to access their selling tools and product information. This allows distributors and resellers to effectively sell complex products and services with less support from the company. It also improves order accuracy, which results in greater efficiency and increased customer satisfaction.

Opportunity for Greater Revenue per Customer

Sellers can use our Interactive Selling System to perform real-time analysis and optimization to identify cross-selling and up-selling opportunities, thereby increasing average order size. For example, a prospective buyer of a computer may be prompted to consider additional features such as increased memory, or complementary products such as a printer, based on specific selections made. In addition, by enabling companies to build an easy-to-use selling channel that is always available to their customers, we provide companies with the opportunity to capture a greater percentage of their customers' business.

Allows Selling Process to Support Key Business Goals

Our software also helps companies ensure that all orders conform to specific criteria. For example, if a company had a minimum gross margin requirement for a given product, ACE could ensure that the features and options chosen will result in a product that meets the company's margin objectives. ACE also improves inventory management. For example, the ACE applications can automatically promote the sale of a product for which there is excess inventory.

Enhances Customer Relations

Our ACE software enables a seller of complex products and services to present each customer with different options based upon the customer's specified needs. This customization of the selling process actively engages the customer in the decision-making process. ACE also ensures that customers arrive at a product configuration that meets the business and manufacturing guidelines of the company. We believe that ACE's functionality enhances customer loyalty and satisfaction, which may result in increased sales.

Rapid Deployment and Reduced Costs of Ownership

An effective selling system requires the user to build a knowledge base that captures all product configurations and selling rules. The ACE suite of applications allows users to build, tailor and maintain their knowledge base without custom programming. This enables users to rapidly deploy the software. It also reduces the need for expensive technical specialists and programmers to maintain and enhance their businesses' Interactive Selling Systems.

SELECTICA PRODUCTS

The following table provides a list of our products and a brief description of the features and benefits to our customers.

PRODUCT	FEATURES	BENEFITS
ACE Enterprise	Electronic commerce configuration engine	Enables customized, one-to-one selling on the Internet
	Highly scalable Internet-architecture	Designed to support millions of simultaneous users by simply installing more servers
	Java-based	Platform independence
	Supports open standard integration interfaces	Integrates with other Internet based applications and legacy systems
	Dynamic information update	Can update product information without stopping selling process
	Easy-to-use, dynamically generated interface	Maximizes sales for productivity by reducing sales training time
	Supports devices with limited processing power	Can be deployed on a broad range of devices
	HTML-based client	Designed to run on any device with a standard Internet browser
ACE Mobile	Includes the features of ACE Enterprise with the following additional features:	
	Complete stand-alone selling system that runs on laptop computers	Enables mobile users to access our customers' Interactive Selling Systems with the same user interface as a connected system

PRODUCT	FEATURES	BENEFITS
	Automatically synchronizes knowledge bases and quotes	Enables updated product and pricing information and orders
ACE Enterprise Manager	Administers multiple ACE Enterprise servers	Add and remove ACE Enterprise servers without stopping the selling process
	Dynamically scales the load distribution as more servers are added	Optimizes available CPU, or central processing unit, resources
ACE Quoter	Central server and storage facility for customer orders, configurations and pricing information	Enables users to generate, save and revise quotes online
	Provides easy access from remote devices to quote archives	Enables accurate quotes and orders
ACE Studio	Model, test and debug ISS applications using a single tool	Simplifies development process
	Graphical KnowledgeBase and user interface development tools	Enables application deployment and maintenance by non-technical personnel

ACE Repository	Database that stores knowledge base in readable, queryable format	Provides distributed team development of KnowledgeBases for easy development and maintenance
ACE Connector Products	Provides access to other enterprise applications	Enables easy integration and reduces costs and deployment time

SELECTICA'S TECHNOLOGY

We have developed an innovative architecture for creating a personalized, intuitive, interactive and scalable Interactive Selling System solution that includes selection, configuration, pricing, quoting and fulfillment processes. The four key technological advantages of our Interactive Selling System include:

- declarative constraint engine;

- integrated modeling environment;

- multi-threaded server; and

- scalable, thin-client architecture.

Declarative constraint engine

Most existing configurators are custom programs that were written specifically for the product or family of products being configured. This means both the configuration logic and the data describing product attributes are combined in a single computer program that requires significant reprogramming to reflect simple product changes. In contrast, our Interactive Selling System solution utilizes a constraint-based engine that is separate from the data describing the product attributes. This allows businesses to easily create and modify the knowledge base to reflect product changes utilizing our integrated modeling environment, thereby eliminating the need for expensive programming teams.

Our engine, written in Java, is easily deployed on various operating platforms. The use of Java allows us to support a range of deployment environments, including Java applications in a notebook computer and ACE Enterprise server generated browser-readable pages, with the same engine and the same knowledge base.

Integrated modeling environment

We have developed an integrated modeling environment that allows our customers to easily create a sophisticated Interactive Selling System solution without any programming. Our Interactive Selling System utilizes drag-and-drop tools that enable sales and marketing personnel, rather than expensive programmers, to maintain and enhance their businesses' Interactive Selling System. Using these drag-and-drop tools, businesses can:

- easily create and update knowledge bases containing product attributes;

- create HTML-based graphical user interface, or GUI applications;

- test the application interactively as the application is being built and conduct batch order checks;

- verify the semantics of the knowledge base and identify some semantic errors; and

- create flex models from individual models.

Multi-threaded server

We have a highly scalable server architecture for deploying our customers' applications. The n-tier architecture, an architecture that enables multiple servers to run at the same time, allows us to support a range of configurations from a single ACE Enterprise Server, or from several ACE Enterprise Servers managed via a single ACE Enterprise Manager running on an HTTP server or another server. ACE Enterprise Manager can manage a single server running ACE Enterprise or multiple servers all running ACE Enterprise. Our multi-threaded technologies enhance the performance for each buyer session because each session state is preserved as the buyer makes subsequent selections. Furthermore, ACE Enterprise supports a large number of concurrent user sessions because the engine uses a small amount of memory for each incremental user session.

Scalable thin-client architecture

Our software, employing a thin-client architecture, supports an Internet computing model enabling users to access an ISS with only an industry-standard browser on a broad range of Internet-enabled devices. Our ACE Enterprise servers use our engine to process the user request from an HTML session, using the knowledge base and legacy data as needed. This approach can enforce rules, eliminate incorrect choices and make calculations or suggest choices by generating the next HTML screen dynamically. Our servers can also be accessed by custom applications using our thin-client application programming interfaces. Our ACE Enterprise can communicate with our ACE Quoter or one or more database servers from other vendors, and other enterprise resources, including legacy resources using our ACE Connector Products.

COMPETITION

Although we are a leading provider of Interactive Selling System software and services, the market for software products that enable electronic commerce is intensely competitive, and we expect competition in the Interactive Selling System software and services market to increase substantially. We encounter competition from a number of different sources, including in-house and customized Internet-development companies, companies focused on Interactive Selling Systems and other enterprise software companies. We expect competition to persist and intensify, which could result in price reductions, reduced gross margins and loss of market share. Our principal competitors include Calico Commerce, FirePond, Trilogy Software, Oracle Corporation, SAP, I2, and Siebel Systems, all of which offer integrated solutions for electronic commerce incorporating some of the functionality of an Interactive Selling System. These competitors may intensify their efforts in our market. In addition, other enterprise software companies may offer competitive products in the future.

Competitors vary in size and in the scope and breadth of the products and services offered. Although we believe we have advantages over our competitors including the comprehensiveness of our solution, our use of

Java technology and our multi-threaded architecture, some of our competitors and potential competitors have significant advantages over us, including:

- a longer operating history;

- a preferred vendor status with our customers;

- more extensive name recognition and marketing power; and

- significantly greater financial, technical, marketing and other resources, giving them the ability to respond more quickly to new or changing opportunities, technologies and customer requirements.

Our competitors may also bundle their products in a manner that may discourage users from purchasing our products. Current and potential competitors may establish cooperative relationships with each other or with third parties, or adopt aggressive pricing policies to gain market share. Competitive pressures may require us to reduce the prices of our products and services. We may not be able to maintain or expand our sales if competition increases and we are unable to respond effectively.

OPERATIONS

SALES AND MARKETING

Our sales and marketing objective is to achieve broad penetration within our vertical markets through targeted sales and increased brand name recognition. As of March 31, 2001, our sales and marketing team consisted of 143 persons, with sales and field support personnel in California, Colorado, Connecticut, Delaware, Florida, Georgia, Illinois, Maryland, Massachusetts, Michigan, Minnesota, New Jersey, New York, North Carolina, Oklahoma, Pennsylvania, Texas, Virginia, Washington, Wisconsin, Canada, India, the United Kingdom, Germany, Australia, France, Japan, Mexico, and Sweden. We had 54 sales and marketing personnel located in San Jose, California.

We sell our ACE products and services primarily through a direct sales force supported by telesales, system engineering and integration support. We believe that the integration of these support networks assists in both the establishment and enhancement of customer relationships. We have developed programs to attract and retain high quality, motivated sales representatives that have the necessary technical skills and consultative sales experience.

Our marketing department is engaged in a wide variety of activities, such as awareness and lead generation programs and product management, public relations, advertising, speaking programs, seminars, sales collateral creation and production, direct mail, and events.

PROFESSIONAL SERVICES

Consulting Services

We maintain a highly qualified and experienced professional services organization to deliver quality Interactive Selling System solutions. Our professional services organization offers a broad range of services through its consulting, customer education and technical support groups. These services include product education, presales prototype development, training seminars, product implementation, application development, customizations, integration and a full range of education and technical support. This organization is also responsible for training our partners to provide professional services and technical support to our customers. The professional services organization consisted of 404 people as of March 31, 2001. Because significant portions of Interactive Selling System implementations can be performed away from the customer's site, we have the flexibility of being able to provide services from either our U.S. or India-based operations.

Customer Support

In addition to professional services, we offer various levels of product maintenance to our customers. We have generally provided maintenance services under an annual, renewable contract and our services have

generally been priced as a percentage of product license fees. Customers under maintenance contracts receive technical product support and product upgrades as they are released throughout the life of the maintenance contracts. We also provide a service called Select Onsite, which consists of specialized services provided at our customers' locations.

RESEARCH AND DEVELOPMENT

To date we have invested substantial resources in research and development. At March 31, 2001, we had approximately 148 full-time engineers and technical writing specialists that primarily work on product development, documentation, quality assurance and testing.

We expect that most of our new products and enhancements to existing products will be developed internally. However, we will evaluate on an ongoing basis externally developed technologies for integration into our suite of products. Enhancements to our existing products are released periodically to add new features, improve functionality and incorporate feedback and suggestions from our current customer base. These updates are usually provided as part of separate maintenance agreement sold with the product license.

PROPRIETARY RIGHTS

We rely on a combination of trademark, trade secret and copyright law and contractual restrictions to protect the proprietary aspects of our technology. These legal protections afford only limited protection for our technology. We currently hold two patents. We also currently have one pending U.S. patent application. In addition, we have one trademark registered in the U.S., one trademark registered in South Korea and have applied to register a total of eight trademarks in the United States, Canada, Europe, India and Korea. Our trademark and patent applications might not result in the issuance of any trademarks or patents. Our patents or any future issued patents or trademarks might be invalidated or circumvented or otherwise fail to provide us any meaningful protection. We seek to protect the source code for our software, documentation and other written materials under trade secret and copyright laws. We license our software pursuant to license agreements, which impose certain restrictions on the licensee's ability to utilize the software. We also seek to avoid disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. In addition, the laws of many countries do not protect our proprietary rights to as great an extent as do the laws of the United States. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets and to determine the validity and scope of the proprietary rights of others. Our failure to adequately protect our intellectual property could have a material adverse effect on our business and operating results.

Our success and ability to compete are dependent on our ability to operate without infringing upon the proprietary rights of others. Any intellectual property litigation could result in substantial costs and diversion of resources and could significantly harm our business and operating results. In the past, we received correspondence from two patent holders recommending that we license their respective patents. After review of these patents, we informed these patent holders that in our opinion, it would not be necessary to license these patents. However, we may be required to license either or both patents or incur legal fees to defend our position that such licenses are not necessary. We may not be able to obtain a license to use either patent on commercially reasonable terms, or at all.

Any threat of intellectual property litigation could force us to do one or more of the following:

- cease selling, incorporating or using products or services that incorporate the challenged intellectual property;

- obtain from the holder of the infringed intellectual property right a license to sell or use the relevant intellectual property, which license may not be available on reasonable terms;

- redesign those products or services that incorporate such intellectual property; or

- pay money damages to the holder of the infringed intellectual property right.

In the event of a successful claim of infringement against us and our failure or inability to license the infringed intellectual property on reasonable terms or license a substitute intellectual property or redesign our product to avoid infringement, our business and operating results would be significantly harmed. If we are forced to abandon use of our trademark, we may be forced to change our name and incur substantial expenses to build a new brand, which would significantly harm our business and operating results.

EMPLOYEES

At March 31, 2001, we had a total of 753 employees, of whom 364 were in India. Of the total 552 were in engineering, consulting and research and development, 143 were engaged in sales, marketing and business development and 58 were in administration and finance. None of our employees are represented by a labor union and we consider our relations with our employees to be good.

ITEM 2. PROPERTIES

FACILITIES

United States. Our principal administrative, sales, marketing, consulting, and research and development facility occupies approximately 80,000 square feet of office space in San Jose, California. The lease extends through November 2009. We believe the office space in this facility will be adequate to meet our needs through the end of calendar 2001.

India. We have offices in Pune and Chennai primarily for consulting and quality assurance. These facilities occupy approximately 22,500 and 16,600 square feet respectively.

ITEM 3. LEGAL PROCEEDINGS

On June 5, 2001, a number of securities class action complaints were filed against us, the underwriters of our initial public offering, and certain of our executives in the United States District Court for the Southern District of New York. The complaints allege that the underwriters of our initial public offering, Selectica and the other named defendants violated federal securities laws by making material false and misleading statements in the prospectus incorporated in our registration statement on Form S-1 filed with the SEC in March, 2000. The complaints allege, among other things, that Credit Suisse First Boston solicited and received excessive and undisclosed commissions from several investors in exchange for which Credit Suisse First Boston allocated to these investors material portions of the restricted number of shares of common stock issued in connection with our initial public offering. The complaints further allege that Credit Suisse First Boston entered into agreements with its customers in which Credit Suisse First Boston agreed to allocate the common stock sold in our initial public offering to certain customers in exchange for which such customers agreed to purchase additional shares of our common stock in the after-market at pre-determined prices.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE SECURITY HOLDERS

During the fiscal year of 2001, there were no matters submitted to the shareholders by written consent.

RISKS RELATED TO OUR BUSINESS

THE UNPREDICTABILITY OF OUR QUARTERLY REVENUES AND RESULTS OF OPERATIONS MAKES IT DIFFICULT TO PREDICT OUR FINANCIAL PERFORMANCE AND MAY CAUSE VOLATILITY OR A DECLINE IN THE PRICE OF OUR COMMON STOCK IF WE ARE UNABLE TO SATISFY THE EXPECTATIONS OF INVESTORS OR THE MARKET.

In the past, our quarterly operating results have varied significantly, and we expect these fluctuations to continue. Future operating results may vary depending on a number of factors, many of which are outside of our control.

Our quarterly revenues may fluctuate as a result of our ability to recognize revenue in a given quarter. We enter into arrangements for the sale of (1) licenses of our software products and related maintenance contract; (2) bundled license, maintenance, and services; and (3) services on a time and material basis. For each arrangement, we determine whether evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. If any of these criteria are not met, revenue recognition is deferred until such time as all of the criteria are met. Additionally, because we rely on a limited number of customers for our revenue, the loss or delay of one prospective customer may significantly affect our operating results.

For those contracts that consist solely of license and maintenance we recognize license revenues based upon the residual method after all elements other than maintenance have been delivered as we have vendor specific objective evidence of fair value of maintenance we recognize maintenance revenues over the term of the maintenance contract. For those contracts that bundle the license with maintenance, training, and/or consulting services, we assess whether the service element of the arrangement is essential to the functionality of the other elements of the arrangement. In those instances where we determine that the service elements are essential to the other elements of the arrangement, we account for the entire arrangement using contract accounting.

For those arrangements accounted for using contract accounting that do not include contractual milestones or other acceptance criteria we utilize the percentage of completion method based upon input measures of hours. For those contracts that include contract milestones or acceptance criteria we recognize revenue as such milestones are achieved or as such acceptance occurs.

In some instances the acceptance criteria in the contract requires acceptance after all services are complete and all other elements have been delivered. In these instances we recognize revenue based upon the completed contract method after such acceptance has occurred.

For those arrangements for which we have concluded that the service element is not essential to the other elements of the arrangement we determine whether the services are available from other vendors, do not involve a significant degree of risk or unique acceptance criteria, and whether we have sufficient experience in providing the service to be able to separately account for the service. When the service qualifies for separate accounting we have vendor specific objective evidence of fair value for the service.

Because we rely on a limited number of customers, the timing of customer acceptance or milestone achievement, or the amount of services we provide to a single customer can significantly affect our operating results. For example, our services and license revenues declined significantly in the quarters ended March 31, 2001 and June 30, 1999 due to the delay of milestone achievement of services under a particular contract. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Quarterly Results of Operations." Because these expenses are relatively fixed in the near term, any shortfall from anticipated revenues could cause our quarterly operating results to fall below anticipated levels.

We may also experience seasonality in revenues. For example, our quarterly results may fluctuate based upon our customers' calendar year budgeting cycles. These seasonal variations may lead to fluctuations in our quarterly revenues and operating results.

Based upon the foregoing, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and that such comparisons should not be relied upon as indications of future performance. In some future quarter, our operating results may be below the expectations of public market analysts and investors, which could cause volatility or a decline in the price of our common stock.

WE HAVE A HISTORY OF LOSSES AND EXPECT TO CONTINUE TO INCUR NET LOSSES IN THE NEAR-TERM.

We have experienced operating losses in each quarterly and annual period since inception. We incurred net losses applicable to common stockholders of approximately $49.9 million, $31.8 million and $7.5 million for the fiscal years ended March 31, 2001, 2000 and 1999, respectively. We had an accumulated deficit of approximately $93.0 million as of March 31, 2001. We intend to reduce our research and development, sales and marketing, and general and administrative expenses, and consequently expect our losses to be reduced in the future. We will need to generate significant increases in our revenues to achieve and maintain profitability.

If our revenue fails to grow or grows more slowly than we anticipate or our operating expenses exceed our expectations, our losses will significantly increase which would significantly harm our business and operating results.

A DECLINE IN GENERAL ECONOMIC CONDITIONS OR A DECREASE IN INFORMATION TECHNOLOGY SPENDING COULD HARM OUR RESULTS OF OPERATIONS.

The change in economic conditions may lead to revised budgetary constraints regarding information technology spending for our customers. For example, a potential customer which had selected our Interactive Selling System from a number of competitors recently decided not to implement any configuration system. That company had decided to reduce its expenditures for information technology. A general slowdown in information technology spending due to economic conditions or other factors could significantly harm our business and operating results.

IF THE MARKET FOR INTERACTIVE SELLING SYSTEM SOFTWARE DOES NOT DEVELOP AS WE ANTICIPATE, OUR OPERATING RESULTS WILL BE SIGNIFICANTLY HARMED, WHICH COULD CAUSE A DECLINE IN THE PRICE OF OUR COMMON STOCK.

The market for Interactive Selling System software, which has only recently begun to develop, is evolving rapidly and likely will have an increased number of competitors. Because this market is new, it is difficult to assess its competitive environment, growth rate and potential size. The growth of the market is dependent upon the willingness of businesses and consumers to purchase complex goods and services over the Internet and the acceptance of the Internet as a platform for business applications. In addition, companies that have already invested substantial resources in other methods of Internet selling may be reluctant or slow to adopt a new approach or application that may replace, limit or compete with their existing systems.

The acceptance and growth of the Internet as a business platform may not continue to develop at historical rates and a sufficiently broad base of companies may not adopt Internet platform-based business applications, either of which could significantly harm our business and operating results. The failure of the market for Interactive Selling System software to develop, or a delay in the development of this market, would significantly harm our business and operating results.

OUR LIMITED OPERATING HISTORY AND THE FACT THAT WE OPERATE IN A NEW INDUSTRY MAKES EVALUATING OUR BUSINESS PROSPECTS AND RESULTS OF OPERATIONS DIFFICULT.

We were founded in June 1996 and have a limited operating history. We began marketing our ACE suite of products in early 1997 and released ACE 4.5, the newest version of our software, in October 2000. Our business model is still emerging, and the revenue and income potential of our business and market are unproven. As a result of our limited operating history, we have limited financial data that you can use to evaluate our business. You must consider our prospects in light of the risks and difficulties we may encounter as an early stage company in the new and rapidly evolving market for Interactive Selling Systems.

FAILURE TO ESTABLISH AND MAINTAIN RELATIONSHIPS WITH SYSTEMS INTEGRATORS AND CONSULTING FIRMS, WHICH ASSIST US WITH THE SALE AND INSTALLATION OF OUR PRODUCTS, WOULD IMPEDE ACCEPTANCE OF OUR PRODUCTS AND THE GROWTH OF OUR REVENUES.

We rely in part upon systems integrators and consulting firms to recommend our products to their customers and to install and deploy our products. To increase our revenues and implementation capabilities, we must develop and expand our relationships with these systems integrators and consulting firms. If systems integrators and consulting firms develop, market or recommend competitive Interactive Selling Systems, our revenues may decline. In addition, if these systems integrators and consulting firms are unwilling to install and deploy our products, we may not have the resources to provide adequate implementation services to our customers and our business and operating results could be significantly harmed.

WE FACE INTENSE COMPETITION, WHICH COULD REDUCE OUR SALES, PREVENT US FROM ACHIEVING OR MAINTAINING PROFITABILITY AND INHIBIT OUR FUTURE GROWTH.

The market for software and services that enable electronic commerce is new, intensely competitive and rapidly changing. We expect competition to persist and intensify, which could result in price reductions, reduced gross margins and loss of market share. Our principal competitors include Calico Commerce, FirePond, Trilogy Software, Oracle Corporation, SAP, I2, and Siebel Systems, all of which offer integrated solutions for electronic commerce incorporating some of the functionality of an Interactive Selling System. These competitors may intensify their efforts in our market. In addition, other enterprise software companies may offer competitive products in the future.

Competitors vary in size and in the scope and breadth of the products and services offered. Some of our competitors and potential competitors have a number of significant advantages over us, including:

- a longer operating history;

- preferred vendor status with our customers;

- more extensive name recognition and marketing power; and

- significantly greater financial, technical, marketing and other resources, giving them the ability to respond more quickly to new or changing opportunities, technologies, and customer requirements.

Our competitors may also bundle their products in a manner that may discourage users from purchasing our products. Current and potential competitors may establish cooperative relationships with each other or with third parties, or adopt aggressive pricing policies to gain market share. Competitive pressures may require us to reduce the prices of our products and services. We may not be able to maintain or expand our sales if competition increases and we are unable to respond effectively.

OUR LENGTHY SALES CYCLE MAKES IT DIFFICULT FOR US TO FORECAST REVENUE AND AGGRAVATES THE VARIABILITY OF QUARTERLY FLUCTUATIONS, WHICH COULD CAUSE OUR STOCK PRICE TO DECLINE.

The sales cycle of our products has historically averaged between four and six months, and may sometimes be significantly longer. We are generally required to provide a significant level of education regarding the use and benefits of our products, and potential customers tend to engage in extensive internal reviews before making purchase decisions. In addition, the purchase of our products typically involves a significant commitment by our customers of capital and other resources, and is therefore subject to delays that are beyond our control, such as customers' internal budgetary procedures and the testing and acceptance of new technologies that affect key operations. In addition, because we intend to target large companies, our sales cycle can be lengthier due to the decision process in large organizations. As a result of our products' long sales cycles, we face difficulty predicting the quarter in which sales to expected customers may occur. If anticipated sales from a specific customer for a particular quarter are not realized in that quarter, our operating results for that quarter could fall below the expectations of financial analysts and investors, which could cause our stock price to decline.

IF WE DO NOT KEEP PACE WITH TECHNOLOGICAL CHANGE, INCLUDING MAINTAINING INTEROPERABILITY OF OUR PRODUCT WITH THE SOFTWARE AND HARDWARE PLATFORMS PREDOMINANTLY USED BY OUR CUSTOMERS, OUR PRODUCT MAY BE RENDERED OBSOLETE AND OUR BUSINESS MAY FAIL.

Our industry is characterized by rapid technological change, changes in customer requirements, frequent new product and service introductions and enhancements and emerging industry standards. In order to achieve broad customer acceptance, our products must be compatible with major software and hardware platforms used by our customers. Our products currently operate on the Microsoft Windows NT, Sun Solaris, IBM AIX, Linux, and Microsoft Windows 2000 Operating Systems. In addition, our products are required to interoperate with electronic commerce applications and databases. We must continually modify and enhance our products to keep pace with changes in these operating systems, applications and databases. Interactive Selling System technology is complex and new products and product enhancements can require long

development and testing periods. If our products were to be incompatible with a popular new operating system, electronic commerce application or database, our business would be significantly harmed. In addition, the development of entirely new technologies to replace existing software could lead to new competitive products that have better performance or lower prices than our products and could render our products obsolete and unmarketable.

WE HAVE RELIED AND EXPECT TO CONTINUE TO RELY ON A LIMITED NUMBER OF CUSTOMERS FOR A SIGNIFICANT PORTION OF OUR REVENUES, AND THE LOSS OF ANY OF THESE CUSTOMERS COULD SIGNIFICANTLY HARM OUR BUSINESS AND OPERATING RESULTS.

Our business and financial condition is dependent on a limited number of customers. Our five largest customers accounted for approximately 55%, 53% and 85% of our revenues for the fiscal years ended March 31, 2001, 2000 and 1999, respectively, and our ten largest customers accounted for 67%, 76% and 96% of our revenues for the fiscal years ended March 31, 2001, 2000 and 1999, respectively. Revenues from significant customers as a percentage of total revenues are as follows:

FISCAL YEAR ENDED MARCH 31, 2001	
Samsung, SDS	17%
Dell	16%
Cisco	14%

FISCAL YEAR ENDED MARCH 31, 2000	
LVMH	12%
Samsung, SDS	12%
3Com Corporation	10%
Fireman's Fund Insurance	10%

FISCAL YEAR ENDED MARCH 31, 1999	
BMW of North America	60%
Olicom	10%

We expect that we will continue to depend upon a relatively small number of customers for a substantial portion of our revenues for the foreseeable future. Contracts with our customers can generally be terminated on short notice by the customer. As a result, if we fail to successfully sell our products and services to one or more customers in any particular period, or a large customer purchases less of our products or services, defers or cancels orders, or terminates its relationship with us, our business and operating results would be harmed.

WE ARE THE TARGET OF SEVERAL SECURITIES CLASS ACTION COMPLAINTS AND ARE AT RISK OF SECURITIES CLASS ACTION LITIGATION, WHICH COULD RESULT IN SUBSTANTIAL COSTS AND DIVERT MANAGEMENT ATTENTION AND RESOURCES.

On June 5, 2001, a number of securities class action complaints were filed against us, the underwriters of our initial public offering, and certain of our executives in the United States District Court for the Southern District of New York. The complaints allege that the underwriters of our initial public offering, Selectica and the other named defendants violated federal securities laws by making material false and misleading statements in the prospectus incorporated in our registration statement on Form S-1 filed with the SEC in March, 2000. The complaints allege, among other things, that Credit Suisse First Boston solicited and received excessive and undisclosed commissions from several investors in exchange for which Credit Suisse First Boston allocated to these investors material portions of the restricted number of shares of common stock issued in connection with our initial public offering. The complaints further allege that Credit Suisse First Boston entered into agreements with its customers in which Credit Suisse First Boston agreed to allocate the common stock sold in our initial public offering to certain customers in exchange for which such customers agreed to purchase additional shares of our common stock in the after-market at pre-determined prices. We believe that the claims against us are without merit and intend to defend against the complaints vigorously.

Securities class action litigation could result in substantial costs and divert our management's attention and resources, which could seriously harm our business.

OUR FAILURE TO MEET CUSTOMER EXPECTATIONS ON DEPLOYMENT OF OUR PRODUCTS COULD RESULT IN NEGATIVE PUBLICITY AND REDUCED SALES, BOTH OF WHICH WOULD SIGNIFICANTLY HARM OUR BUSINESS AND OPERATING RESULTS.

In the past, our customers have experienced difficulties or delays in completing implementation of our products. We may experience similar difficulties or delays in the future. Our Interactive Selling System solution relies on defining a knowledge base that must contain all of the information about the products and services being configured. We have found that extracting the information necessary to construct a knowledge base can be more time consuming than we or our customers anticipate. If our customers do not devote the resources necessary to create the knowledge base, the deployment of our products can be delayed. Deploying our ACE products can also involve time-consuming integration with our customers' legacy systems, such as existing databases and enterprise resource planning software. Failing to meet customer expectations on deployment of our products could result in a loss of customers and negative publicity regarding us and our products, which could adversely affect our ability to attract new customers. In addition, time-consuming deployments may also increase the amount of professional services we must allocate to each customer, thereby increasing our costs and adversely affecting our business and operating results.

IF WE ARE UNABLE TO MAINTAIN AND EXPAND OUR DIRECT SALES FORCE, SALES OF OUR PRODUCTS AND SERVICES MAY NOT MEET OUR EXPECTATIONS AND OUR BUSINESS AND OPERATING RESULTS WILL BE SIGNIFICANTLY HARMED.

We depend on our direct sales force for all of our current sales and our future growth depends on the ability of our direct sales force to develop customer relationships and increase sales to a level that will allow us to reach and maintain profitability. If we are unable to retain qualified sales personnel, or if newly hired personnel fail to develop the necessary skills or to reach productivity when anticipated, we may not be able to increase sales of our products and services.

IF WE ARE UNABLE TO GROW AND MANAGE OUR PROFESSIONAL SERVICES ORGANIZATION, WE WILL BE UNABLE TO PROVIDE OUR CUSTOMERS WITH TECHNICAL SUPPORT FOR OUR PRODUCTS, WHICH COULD SIGNIFICANTLY HARM OUR BUSINESS AND OPERATING RESULTS.

As we increase licensing of our software products, we must grow our professional services organization to assist our customers with implementation and maintenance of our products. Because these professional services have been expensive to provide, we must improve the management of our professional services organizations to improve our results of operations. Improving the efficiency of our consulting services is dependent upon attracting and retaining experienced project managers. Competition for these project managers is intense, particularly in the Silicon Valley and in India where the majority of our professional services organization is based, and we may not be able to hire qualified individuals to fill these positions.

Although services revenues, which are primarily comprised of revenues from consulting fees, maintenance contracts and training, are important to our business, representing 56%, 43% and 52% of total revenues for the years ended March 31, 2001, 2000 and 1999, respectively, services revenues have lower gross margins than license revenues. Gross margins for services revenues were 9%, negative 113%, and 34% for the years ended March 31, 2001, 2000 and 1999, respectively, compared to gross margins for license revenues of 94%, 51% and 89% for the respective periods.

We anticipate that customers will increasingly utilize third-party consultants to implement and deploy our products. Additionally, in the future we intend to charge for our professional services on a time and materials rather than a fixed-fee basis. To the extent that customers are unwilling to utilize third-party consultants or require us to provide professional services on a fixed fee basis, our cost of services revenues could increase and could cause us to recognize a loss on a specific contract, either of which would adversely affect our operating results. In addition, if we are unable to provide these resources, we may lose sales or incur customer dissatisfaction and our business and operating results could be significantly harmed.

IF NEW VERSIONS AND RELEASES OF OUR PRODUCTS CONTAIN ERRORS OR DEFECTS, WE COULD SUFFER LOSSES AND NEGATIVE PUBLICITY, WHICH WOULD ADVERSELY AFFECT OUR BUSINESS AND OPERATING RESULTS.

Complex software products such as ours often contain errors or defects, including errors relating to security, particularly when first introduced or when new versions or enhancements are released. In the past, we have discovered defects in our products and provided product updates to our customers to address such defects. Our ACE products and other future products may contain defects or errors, which could result in lost revenues, a delay in market acceptance or negative publicity, which would significantly harm our business and operating results.

THE LOSS OF ANY OF OUR KEY PERSONNEL WOULD HARM OUR COMPETITIVENESS BECAUSE OF THE TIME AND EFFORT THAT WE WOULD HAVE TO EXPEND TO REPLACE SUCH PERSONNEL.

We believe that our success will depend on the continued employment of our senior management team and key technical personnel, none of whom, except Rajen Jaswa, our President and Chief Executive Officer, and Dr. Sanjay Mittal, our Chief Technical Officer and Vice President of Engineering, has an employment agreement with us. If one or more members of our senior management team or key technical personnel were unable or unwilling to continue in their present positions, these individuals would be difficult to replace. Consequently, our ability to manage day-to-day operations, including our operations in Pune, India, develop and deliver new technologies, attract and retain customers, attract and retain other employees and generate revenues would be significantly harmed.

A SUBSTANTIAL PORTION OF OUR OPERATIONS ARE CONDUCTED BY INDIA-BASED PERSONNEL, AND ANY CHANGE IN THE POLITICAL AND ECONOMIC CONDITIONS OF INDIA OR IN IMMIGRATION POLICIES, WHICH WOULD ADVERSELY AFFECT OUR ABILITY TO CONDUCT OUR OPERATIONS IN INDIA, COULD SIGNIFICANTLY HARM OUR BUSINESS.

We conduct quality assurance and professional services operations in India. As of March 31, 2001, there were 364 persons employed in India. We are dependent on our India-based operations for these aspects of our business and we intend to grow our operations in India. As a result, we are directly influenced by the political and economic conditions affecting India. Operating expenses incurred by our operations in India are denominated in Indian currency and accordingly, we are exposed to adverse movements in currency exchange rates. This, as well as any other political or economic problems or changes in India, could have a negative impact on our India-based operations, resulting in significant harm to our business and operating results. Furthermore, the intellectual property laws of India may not adequately protect our proprietary rights. We believe that it is particularly difficult to find quality management personnel in India, and we may not be able to timely replace our current India-based management team if any of them were to leave our company.

Our training program for some of our India-based employees includes an internship at our San Jose, California headquarters. Additionally, we provide services to some of our customers internationally with India-based employees. We presently rely on a number of visa programs to enable these India-based employees to travel and work internationally. Any change in the immigration policies of India or the countries to which these employees travel and work could cause disruption or force the termination of these programs, which would harm our business.

BECAUSE COMPETITION FOR QUALIFIED PERSONNEL IS INTENSE IN OUR INDUSTRY AND IN OUR GEOGRAPHIC REGION, WE MAY NOT BE ABLE TO RECRUIT OR RETAIN PERSONNEL, WHICH COULD IMPACT THE DEVELOPMENT OR SALES OF OUR PRODUCTS.

Our success depends on our ability to attract and retain qualified management, engineering, sales and marketing and professional services personnel. Competition for these types of personnel is intense, especially in the Silicon Valley. We do not have employment agreements with most of our key personnel. If we are unable to retain our existing key personnel, or attract and train additional qualified personnel, our growth may be limited due to our lack of capacity to develop and market our products.

Options to purchase our common stock are an important component of our employee compensation. Because of the decline in our stock price, some of our employees hold options with an exercise price substantially above the current market price. This could adversely affect our ability to attract and retain

employees. On April 27, 2001, we commenced an option exchange program in which our employees were offered the opportunity to exchange stock options with exercise prices of $8.50 and above for new stock options. Participants in the exchange program will receive new options to purchase one hundred and twenty percent (120%) of the number of shares of our common stock subject to the options that were exchanged and canceled. The new options will be granted more than six months and one day from May 28, 2001, the date the old options were cancelled. The exercise price of the new options will be the closing market price on the NASDAQ Stock Market on the grant date of the new options. The exchange offer was not available to executive officers or the members of our Board of Directors.

In addition, on May 30, 2001, we granted additional options to purchase an aggregate of approximately 4 million shares of our common stock to all our employees that did not participate in the option exchange offer. We will amortize approximately $350,000 in deferred compensation expense associated with these grants over the next four years. Although these programs have been designed to improve employee retention by creating additional incentives for our employees, they may not have the desired impact. This could adversely affect our ability to retain employees.

IF WE BECOME SUBJECT TO PRODUCT LIABILITY LITIGATION, IT COULD BE COSTLY AND TIME CONSUMING TO DEFEND AND COULD DISTRACT US FROM FOCUSING ON OUR BUSINESS AND OPERATIONS.

Since our products are company-wide, mission-critical computer applications with a potentially strong impact on our customers' sales, errors, defects or other performance problems could result in financial or other damages to our customers. Although our license agreements generally contain provisions designed to limit our exposure to product liability claims, existing or future laws or unfavorable judicial decisions could negate such limitation of liability provisions. Product liability litigation, even if it were unsuccessful, would be time consuming and costly to defend.

OUR FUTURE SUCCESS DEPENDS ON OUR PROPRIETARY INTELLECTUAL PROPERTY, AND IF WE ARE UNABLE TO PROTECT OUR INTELLECTUAL PROPERTY FROM POTENTIAL COMPETITORS OUR BUSINESS MAY BE SIGNIFICANTLY HARMED.

We rely on a combination of trademark, trade secret and copyright law and contractual restrictions to protect the proprietary aspects of our technology. These legal protections afford only limited protection for our technology. We currently hold two patents. We, also, currently have one pending U.S. patent application. In addition, we have one trademarks registered in the U.S. and one trademark registered in South Korea and have applied to register a total of eight trademarks in the United States, Canada, Europe, India and Korea. Our trademark and patent applications might not result in the issuance of any trademarks or patents. Our patent or any future issued patents or trademarks might be invalidated or circumvented or otherwise fail to provide us any meaningful protection. We seek to protect source code for our software, documentation and other written materials under trade secret and copyright laws. We license our software pursuant to signed license agreements, which impose certain restrictions on the licensee's ability to utilize the software. We also seek to avoid disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. In addition, the laws of many countries do not protect our proprietary rights to as great an extent as do the laws of the United States. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets and to determine the validity and scope of the proprietary rights of others. Our failure to adequately protect our intellectual property could significantly harm our business and operating results.

ANY ACQUISITIONS THAT WE MAY MAKE COULD DISRUPT OUR BUSINESS AND HARM OUR OPERATING RESULTS.

We may acquire or make investments in complementary companies, products or technologies. In the event of any such investments, acquisitions or joint ventures, we could:

- issue stock that would dilute our current stockholders' percentage ownership;

- incur debt;

- assume liabilities;

- incur amortization expenses related to goodwill and other intangible assets; or

- incur large and immediate write-offs.

These investments, acquisitions or joint ventures also involve numerous risks, including:

- problems combining the purchased operations, technologies or products with ours;

- unanticipated costs;

- diversion of managements' attention from our core business;

- adverse effects on existing business relationships with suppliers and customers;

- potential loss of key employees, particularly those of the acquired organizations; and

- reliance to our disadvantage on the judgment and decisions of third parties and lack of control over the operations of a joint venture partner.

Any acquisition or joint venture may cause our financial results to suffer as a result of these risks.

IF WE ARE SUBJECT TO INTELLECTUAL PROPERTY LITIGATION, WE MAY INCUR SUBSTANTIAL COSTS, WHICH WOULD HARM OUR OPERATING RESULTS.

Our success and ability to compete are dependent on our ability to operate without infringing upon the proprietary rights of others. Any intellectual property litigation could result in substantial costs and diversion of resources and could significantly harm our business and operating results. In the past, we received correspondence from two patent holders recommending that we licensed their respective patents. After review of these patents, we informed these patent holders that in our opinion, it would not be necessary to license these patents. However, we may be required to license either or both patents or incur legal fees to defend our position that such licenses are not necessary. We cannot assure you that if required to do so, we would be able to obtain a license to use either patent on commercially reasonable terms, or at all.

Any threat of intellectual property litigation could force us to do one or more of the following:

- cease selling, incorporating or using products or services that incorporate the challenged intellectual property;

- obtain from the holder of the infringed intellectual property right a license to sell or use the relevant intellectual property, which license may not be available on reasonable terms;

- redesign those products or services that incorporate such intellectual property; or

- pay money damages to the holder of the infringed intellectual property right.

In the event of a successful claim of infringement against us and our failure or inability to license the infringed intellectual property on reasonable terms or license a substitute intellectual property or redesign our product to avoid infringement, our business and operating results would be significantly harmed. If we are forced to abandon use of our trademark, we may be forced to change our name and incur substantial expenses to build a new brand, which would significantly harm our business and operating results.

RESTRICTIONS ON EXPORT OF ENCRYPTED TECHNOLOGY COULD CAUSE US TO INCUR DELAYS IN INTERNATIONAL PRODUCT SALES, WHICH WOULD ADVERSELY IMPACT THE EXPANSION AND GROWTH OF OUR BUSINESS.

Our software utilizes encryption technology, the export of which is regulated by the United States government. If our export authority is revoked or modified, if our software is unlawfully exported or if the United States adopts new legislation restricting export of software and encryption technology, we may experience delay or reduction in shipment of our products internationally. Current or future export regulations could limit our ability to distribute our products outside of the United States. While we take precautions

against unlawful exportation of our software, we cannot effectively control the unauthorized distribution of software across the Internet.

IF WE ARE UNABLE TO EXPAND OUR OPERATIONS INTERNATIONALLY OR ARE UNABLE TO MANAGE THE GREATER COLLECTIONS, MANAGEMENT, HIRING, LEGAL, REGULATORY, AND

CURRENCY RISKS FROM THESE INTERNATIONAL OPERATIONS, OUR BUSINESS AND OPERATING RESULTS WILL BE HARMED.

We intend to expand our operations internationally. This expansion may be more difficult or take longer than we anticipate, and we may not be able to successfully market, sell or deliver our products internationally. If successful in our international expansion, we will be subject to a number of risks associated with international operations, including:

- longer accounts receivable collection cycles;

- expenses associated with localizing products for foreign markets;

- difficulties in managing operations across disparate geographic areas;

- difficulties in hiring qualified local personnel;

- difficulties associated with enforcing agreements and collecting receivables through foreign legal systems;

- unexpected changes in regulatory requirements that impose multiple conflicting tax laws and regulations; and

- fluctuations in foreign exchange rates and the possible lack of financial stability in foreign countries that prevent overseas sales growth.

OUR RAPID GROWTH PLACES A SIGNIFICANT STRAIN ON OUR MANAGEMENT SYSTEMS AND RESOURCES, AND IF WE FAIL TO MANAGE THIS GROWTH, OUR BUSINESS WILL BE HARMED.

We have recently experienced a period of rapid growth and expansion, which places significant demands on our managerial, administrative, operational, financial and other resources. From December 31, 1998 to March 31, 2001, we expanded from 68 to 753 employees, including 31 employees from the acquisition of Wakely Software.

We will be required to manage an increasing number of relationships with customers, suppliers and employees, and an increasing number of complex contracts. If we are unable to initiate procedures and controls to support our future operations in an efficient and timely manner, or if we are unable to otherwise manage growth effectively, our business would be harmed.

OUR RESULTS OF OPERATIONS WILL BE HARMED BY CHARGES ASSOCIATED WITH OUR PAYMENT OF STOCK-BASED COMPENSATION, CHARGES ASSOCIATED WITH OTHER SECURITIES ISSUANCE BY US, AND CHARGES RELATED TO ACQUISITIONS.

We have in the past and expect in the future to incur a significant amount of amortization of charges related to securities issuances in future periods, which will negatively affect our operating results. Since inception we have recorded approximately $8.0 million in net deferred compensation charges. During the years ended March 31, 2001 and 2000, we amortized approximately $4.3 million and approximately $1.3 million of such charges, respectively. We expect to amortize approximately $2.6 million of stock-based compensation for the fiscal year ending March 31, 2002 and we may incur additional charges in the future in connection with grants of stock-based compensation at less than fair value. In January 2000, in connection with a license and maintenance agreement, we issued a warrant to purchase 800,000 shares of common stock for $800,000. The fair value of the warrant was approximately $16.4 million. In the quarter ended March 31, 2000, we recorded a charge of approximately $9.7 million related to the loss on the license and software maintenance contract, of which approximately $4.1 million was charged to cost of license revenues and approximately $5.6 million was charged to costs of services revenues, in relation to the issuance of these warrants. During the year ended March 31, 2001, revenues were reduced by amortization of approximately $5.5 million in connection with this

license and services agreement. As of March 31, 2001, we have fully amortized the amount associated with the fair value of this warrant. We accounted for the acquisition of Wakely as a purchase for accounting purposes and allocated approximately $13.1 million to identified intangible assets and goodwill. These assets are being amortized over a period of three to five years. We also expensed approximately $1.9 million of in-process research and development at the time of acquisition. See Note 10 of the Notes to consolidated financial statements for the year ended March 31, 2000 and Note 9 of Notes to condensed financial statements for the year ended March 31, 2001.

DEMAND FOR OUR PRODUCTS AND SERVICES WILL DECLINE SIGNIFICANTLY IF OUR SOFTWARE CANNOT SUPPORT AND MANAGE A SUBSTANTIAL NUMBER OF USERS.

Our strategy requires that our products be highly scalable. To date, only a limited number of our customers have deployed our ACE products on a large scale. If our customers cannot successfully implement large-scale deployments, or if they determine that we cannot accommodate large-scale deployments, our business and operating results would be significantly harmed.

RISKS RELATED TO THE INDUSTRY

IF USE OF THE INTERNET DOES NOT CONTINUE TO DEVELOP AND RELIABLY SUPPORT THE DEMANDS PLACED ON IT BY ELECTRONIC COMMERCE, THE MARKET FOR OUR PRODUCTS AND SERVICES MAY BE ADVERSELY AFFECTED, AND WE MAY NOT ACHIEVE ANTICIPATED SALES GROWTH.

Growth in sales of our products and services depends upon the continued and increased use of the Internet as a medium for commerce and communication. Growth in the use of the Internet is a recent phenomenon and may not continue. In addition, the Internet infrastructure may not be able to support the demands placed on it by increased usage and bandwidth requirements. There have also been well-publicized security breaches involving "denial of service" attacks on major web sites. Concerns over these and other security breaches may slow the adoption of electronic commerce by businesses, while privacy concerns over inadequate security of information distributed over the Internet may also slow the adoption of electronic commerce by individual consumers. Other risks associated with commercial use of the Internet could slow its growth, including:

- inadequate reliability of the network infrastructure;

- slow development of enabling technologies and complementary products; and

- limited accessibility and ability to deliver quality service.

In addition, the recent growth in the use of the Internet has caused frequent periods of poor or slow performance, requiring components of the Internet infrastructure to be upgraded. Delays in the development or adoption of new equipment and standards or protocols required to handle increased levels of Internet activity, or increased government regulation, could cause the Internet to lose its viability as a commercial medium. If the Internet infrastructure does not develop sufficiently to address these concerns, it may not develop as a commercial marketplace, which is necessary for us to increase sales.

INCREASING GOVERNMENT REGULATION OF THE INTERNET COULD LIMIT THE MARKET FOR OUR PRODUCTS AND SERVICES, OR IMPOSE GREATER TAX BURDENS ON US OR LIABILITY FOR TRANSMISSION OF PROTECTED DATA.

As electronic commerce and the Internet continue to evolve, federal, state and foreign governments may adopt laws and regulations covering issues such as user privacy, taxation of goods and services provided over the Internet, pricing, content and quality of products and services. If enacted, these laws and regulations could limit the market for electronic commerce, and therefore the market for our products and services. Although many of these regulations may not apply directly to our business, we expect that laws regulating the solicitation, collection or processing of personal or consumer information could indirectly affect our business.

Laws or regulations concerning telecommunications might also negatively impact us. Several telecommunications companies have petitioned the Federal Communications Commission to regulate Internet service providers and online service providers in a manner similar to long distance telephone carriers and to impose access fees on these companies. This type of legislation could increase the cost of conducting business over the Internet, which could limit the growth of electronic commerce generally and have a negative impact on our business and operating results.

PART II

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

Our common stock is traded over the counter on the Nasdaq National Market under the symbol "SLTC."

The following table sets forth, for the period indicated, the high and low closing prices per share of the common stock as reported on the Nasdaq National Market.

	HIGH	LOW
2001		
First Quarter	$86.50	$31.25
Second Quarter	$76.25	$38.00
Third Quarter	$40.31	$17.19
Fourth Quarter	$22.13	$ 4.40
2002		
First Quarter (through June 27, 2001)	$ 4.98	$ 3.53

The trading price of the Company's Common Stock could be subject to wide fluctuations in response to quarterly variations in operating results, announcements of technological innovations or new products by the Company or its competitors, changes in financial estimates or purchase recommendations by securities analysts and other events or factors. In addition, the stock market has experienced volatility that has affected the market prices of equity securities of many high technology companies and that often has been unrelated to the operating performance of such companies. These broad market fluctuations may adversely affect the market price of the Company's Common Stock.

As of May 31, 2001, there were approximately 410 holders of record of our common stock. Brokers and other institutions hold many of such shares on behalf of stockholders.

(b) Use of Proceeds

On March 15, 2000 Selectica completed the initial public offering of its common stock. The shares of the common stock sold in the offering were registered under the Securities Act of 1933, as amended, on a Registration Statement on Form S-1 (No. 333-92545). The Securities and Exchange Commission declared the Registration Statement effective on March 9, 2000.

The offering commenced on March 10, 2000 and terminated on March 15, 2000 after we had sold all of the 4,600,000 shares of common stock registered under the Registration Statement (including 450,000 shares sold by Selectica and 150,000 sold by one of our stockholders in connection with the exercise of the underwriters' over-allotment option). The managing underwriters in the offering were Credit Suisse First Boston, Thomas Weisel Partners LLC, U.S. Bancorp Piper Jaffray and E*Offering. The initial public offering price was $30.00 per share for an aggregate initial public offering of approximately $138.0 million. We paid a total of approximately $11.3 million in underwriting discounts, commissions, and other expenses related to the offering. None of the costs and expenses related to the offering were paid directly or indirectly to any director, officer, general partner of Selectica or their associates, persons owning 10 percent or more of any class of equity securities of Selectica or an affiliate of Selectica.

After deducting the underwriting discounts and commissions and the offering expenses the net proceeds to Selectica from the offering were approximately $122.2 million. The net offering proceeds have been used for general corporate purposes, to provide working capital to develop products and to expand the Company's operations. Funds that have not been used have been invested in certificate of deposits and other investment grade securities. We also may use a portion of the net proceeds to acquire or invest in businesses, technologies, products or services.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our capital stock. We currently anticipate that we will retain future earnings, if any, to fund the development and growth of our business. Therefore, we do not expect to pay any cash dividends in the foreseeable future.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

	YEARS ENDED MARCH 31,				PERIOD FROM JUNE 6, 1996 (INCEPTION) THROUGH MARCH 31,
	2001	2000	1999	1998	1997
	(IN THOUSANDS, EXCEPT PER SHARE DATA)				
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Revenues:					
License	$ 23,933	$ 9,181	$ 1,656	$ 170	$ 50
Services	30,012	6,907	1,788	--	5
Total revenues	53,945	16,088	3,444	170	55
Cost of revenues:					
License	1,457	4,520	184	9	3
Services	27,323	14,686	1,184	51	--
Total cost of revenues	28,780	19,206	1,368	60	3
Gross profit (loss)	25,165	(3,118)	2,076	110	52
Operating expenses:					
Research and development	21,849	7,347	3,893	1,950	169
Sales and marketing	50,686	17,026	4,430	1,055	62
General and administrative	14,876	4,554	1,389	293	77
Total operating expenses	87,411	28,927	9,712	3,298	308
Loss from operations	(62,246)	(32,045)	(7,636)	(3,188)	(256)
Interest and other income, net	12,654	1,241	99	87	5
Net loss before taxes	(49,592)	(30,804)	(7,537)	(3,101)	(251)
Provision for income taxes	275	50	--	--	--
Net loss	(49,867)	(30,854)	(7,537)	(3,101)	(251)
Deemed dividend on Series E convertible preferred stock	--	925	--	--	--
Net loss applicable to common stockholders	$(49,867)	$(31,779)	$(7,537)	$(3,101)	$ (251)
Basic and diluted net loss per share applicable to common stockholders	$ (1.44)	$ (4.54)	$ (1.58)	$ (0.91)	$(0.15)
Shares used in computing basic and diluted net loss per share applicable to common stockholders	34,580	6,999	4,782	3,425	1,634

	MARCH 31,				
	2001	2000	1999	1998	1997
	(IN THOUSANDS)				
CONSOLIDATED BALANCE SHEET DATA:					
Cash, cash equivalents and short-term investments	$137,154	$215,818	$ --	$ 504	$788
Working capital (deficit)	123,816	202,611	(639)	422	770

Total assets	219,819	242,452	3,193	1,357	983
Total stockholders' equity	182,538	214,078	736	856	957

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

The statements contained in this section that are not historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Act of 1934, including statements regarding the Company's expectations, beliefs, intentions or strategies regarding the future. All forward-looking statements included in this document are based on information available to the Company as of the date hereof, and the Company assumes no obligation to update any such forward-looking statements. It is important to note that the Company's actual results could differ materially from those in such forward-looking statements.

The following table sets forth the percentage of total revenues for certain items in the Company's Consolidated Statements of Operations data for the years ended March 31, 2001, 2000, and 1999.

	YEARS ENDED MARCH 31,		
	2001	2000	1999
AS A PERCENTAGE OF TOTAL REVENUES:			
Revenues:			
License	44%	57%	48%
Services	56	43	52
Total revenues	100	100	100
Cost of revenues:			
License	3	28	5
Services	51	91	35
Total cost of revenues	54	119	40
Gross profit (loss)	46	(19)	60
Operating expenses:			
Research and development	41	46	113
Sales and marketing	94	106	129
General and administrative	28	28	40
Total operating expenses	163	180	282
Loss from operations	(117)	(199)	(222)
Interest and other income (expense), net	23	8	3
Net loss before taxes	(94)	(191)	(219)
Provision for income taxes	1	1	--
Net loss	(93)	(192)	(219)
Deemed dividend related to Series E convertible preferred stock	--	6	--
Net loss applicable to common stockholders	(93)%	(198)%	(219)%

RESULTS OF OPERATIONS

OVERVIEW

Selectica is a leading provider of Interactive Selling System software and services that enable companies to efficiently sell complex products and services over intranets, extranets and the Internet. Our ACE suite of software products is a comprehensive Interactive Selling System solution that gives sellers the ability to manage the sales process in order to facilitate the conversion of prospective buyers into customers. Our Interactive selling system solution allows companies to use the Internet platform to deploy a selling application to many points of contact, including personal computers, in-store kiosks and mobile devices, while offering customers, partners and employees an interface customized to their specific needs.

Revenues

We enter into arrangements for the sale of (1) licenses of our software products and related maintenance contract; (2) bundled license, maintenance, and services; and (3) services on a time and material basis. In instances where maintenance is bundled with a license of our software products, such maintenance term is typically one year.

For each arrangement, we determine whether evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. If any of these criteria are not met, revenue recognition is deferred until such time as all of the criteria are met.

For those contracts that consist solely of license and maintenance we recognize license revenues based upon the residual method after all elements other than maintenance have been delivered and recognize maintenance revenues over the term of the maintenance contract as vendor specific objective evidence of fair value for maintenance does exist.

Services can consist of maintenance, training and/or consulting services. Consulting services include a range of services including installation of our off-the-shelf software, customization of our software for the customer's specific application, data conversion and building of interfaces to allow our software to operate in customized environments.

In all cases, we assess whether the service element of the arrangement is essential to the functionality of the other elements of the arrangement. In this determination we focus on whether the software is off-the-shelf software, whether the services include significant alterations to the features and functionality of the software, whether the services involve the building of complex interfaces, the timing of payments and the existence of milestones. Often the installation of our software requires the building of interfaces to the customer's existing applications or customization of the software for specific applications. As a result, judgement is required in the determination of whether such services constitute "complex" interfaces. In making this determination we consider the following: (1) the relative fair value of the services compared to the software, (2) the amount of time and effort subsequent to delivery of the software until the interfaces or other modifications are completed, (3) the degree of technical difficulty in building of the interface and uniqueness of the application, (4) the degree of involvement of customer personnel, and (5) any contractual cancellation, acceptance, or termination provisions for failure to complete the interfaces. We also consider refunds, forfeitures and concessions when determining the significance of such services.

In those instances where we determine that the service elements are essential to the other elements of the arrangement, we account for the entire arrangement using contract accounting.

For those arrangements accounted for using contract accounting that do not include contractual milestones or other acceptance criteria we utilize the percentage of completion method based upon input measures of hours. For those contracts that include contract milestones or acceptance criteria we recognize revenue as such milestones are achieved or as such acceptance occurs.

In some instances the acceptance criteria in the contract requires acceptance after all services are complete and all other elements have been delivered. In these instances we recognize revenue based upon the completed contract method after such acceptance has occurred.

For those arrangements for which we have concluded that the service element is not essential to the other elements of the arrangement we determine whether the services are available from other vendors, do not involve a significant degree of risk or unique acceptance criteria, and whether we have sufficient experience in providing the service to be able to separately account for the service. When the service qualifies for separate accounting we use vendor specific objective evidence for the fair value of the services and the maintenance to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element.

Vendor-specific objective evidence of fair value of services is based upon hourly rates. As noted above, we enter into contracts for services alone and such contracts are based upon time and material basis. Such hourly rates are used to assess the vendor specific objective evidence in multiple element arrangements.

In accordance with paragraph 10 of Statement of Position 97-2, Software Revenue Recognition, vendor specific objective evidence of fair value of maintenance is determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate). Each license agreement offers additional maintenance renewal periods at a stated price. Maintenance contracts are typically one year in duration. To date 14 maintenance contracts has been renewed and 29 new contracts were signed. We believe that given the nature of our products as selling solutions for the Internet, our customers view maintenance of those products as important to their business and will continue to need upgrades and support of licensed products. As a result, we believe renewals will occur in the future as more contracts come up for renewal.

To date we have not entered into arrangements solely for license of our products and, therefore, we have not demonstrated vendor specific objective evidence for the fair value of the license element.

In all cases we classify revenues for these arrangements as license revenues and services revenues based on the estimates of fair value for each element.

For the year ended March 31, 2001, we recognized 45% of license and services revenues under the percentage-of-completion method, 33% under the residual method, and 22% under the completed contract method. For the year ended March 31, 2000, we recognized 28% of license and services revenues under the percentage-of-completion method, 45% under the residual method, and 23% the completed contract method. For the year ended March 31, 1999, we recognized 63% of license and services revenues under the percentage of completion method, 36% under the completed contract method.

Because we rely on a limited number of customers, the timing of customer acceptance or milestone achievement, or the amount of services we provide to a single customer can significantly affect our operating results. For example, our services and license revenues declined significantly in the quarters ended March 31, 2001 and June 30, 1999 due to the delay of milestone achievement of services under a particular contract.

Customer billing occurs in accordance with contract terms. Customer advances and amounts billed to customers in excess of revenue recognized are recorded as deferred revenue. Amounts recognized as revenue in advance of billing (typically under percentage-of-completion accounting) are recorded as unbilled receivables.

Factors Affecting Operating Results

A relatively small number of customers account for a significant portion of our total revenues. For the year ended March 31, 2001, revenue from Samsung SDS, Dell, and Cisco accounted for 17%, 16%, and 14% of our total revenues, respectively. For the year ended March 31, 2000, revenue from Samsung SDS, LVMH Group, 3Com Corporation, and Fireman's Fund accounted for 12%, 12%, 10%, and 10% of our total revenue, respectively. For the year ended March 31, 1999, revenue from BMW of North American and Olicom accounted for 60% and 10% of our total revenue, respectively. We expect that revenues from a limited number of customers will continue to account for a large percentage of total revenues in future quarters.

To date, our revenues have been predominantly attributable to sales in the United States. We plan to expand our international operations significantly, because we believe international markets represent a significant growth opportunity. Consequently, we expect that international revenues will increase as a percentage of total revenues in the future. The expansion of our international operations will be subject to a variety of risks that could significantly harm our business and operating results. As our international sales and operations expand, we anticipate that our exposure to foreign currency fluctuations will increase because we have not adopted a hedging program to protect us from risks associated with foreign currency fluctuations.

We have a limited operating history upon which we may be evaluated. We have incurred significant losses since inception and, as of March 31, 2001, we had an accumulated deficit of approximately $93.0 million. We believe our success depends on the continued growth of our customer base and the development of the emerging Interactive Selling System market. However, due to the slowing of the U.S. economy, particularly in the area of technology infrastructure investment and in an effort to achieve profitability, we underwent restructuring activities in March and April 2001. During the restructuring activities in March 2001, we reduced our headcount, primarily in India, by 158 individuals or approximately 20% of our workforce. As a

result, we reduced our annual operating expenses by approximately $3.7 million, principally from reduced salaries and associated expenses. During the restructuring activities in April 2001, we further reduced our headcount, primarily in the US engineering department, by 50 individuals or approximately 7% of our workforce. As a result, we reduced our annual expenses by approximately $6.7 million principally from reduced salaries and associated expenses. Despite these reductions in expenses, we expect to incur substantial operating losses for the foreseeable future, as such reduced expenses are not sufficient to cover the increasing cost of the operations.

In view of the rapidly changing nature of our business and our limited operating history, we believe that period-to-period comparisons of revenues and operating results are not necessarily meaningful and should not be relied upon as indications of future performance. Our limited operating history makes it difficult to forecast future operating results. Additionally, despite our recent revenue growth, we do not believe that historical growth rates are necessarily sustainable or indicative of future growth and we cannot be certain that revenues will increase as was evidenced by the results of the fourth quarter of fiscal 2001. Even if we were to achieve profitability in any period, we may not be able to sustain or increase profitability on a quarterly or annual basis.

Business Combinations

Wakely Software, Inc. Acquisition

In August 2000, we acquired Wakely Software, Inc., a provider of rating software and actuarial services for the insurance industry for approximately $13.7 million. As a result, Wakely Software, Inc. is a wholly owned subsidiary of Selectica. We issued approximately 175,000 of our common stock valued at the closing market price of $53.125 on August 8, 2000, and paid cash in the amount of approximately $4.4 million in exchange for all of the outstanding shares of Wakely Software, Inc. The transaction expenses were approximately $400,000. The acquisition was accounted under the purchase method of accounting.

LoanMarket Resources, LLC Acquisition

In November 2000, we acquired certain assets and liabilities of LoanMarket Resources, LLC ("LoanMarket"), a provider of real-time, mortgage, home equity, and unsecured lending software solutions. We issued approximately 35,000 shares of our common stock valued at the closing market price of $27.0156 on November 9, 2000, paid cash in the amount of approximately $220,000, and assumed liabilities of approximately $155,000. The transaction expenses were approximately $183,000. The Company allocated approximately $1.2 million to goodwill and will amortize this amount over a period of three years, the expected future life of the assets.

REVENUES

Our revenues increased to approximately $53.9 million in 2001 from approximately $16.1 million in 2000 and from approximately $3.4 million in 1999, representing increases of 235% and 367%, respectively. We believe that the future percentage increase in revenues will be significantly less than what has been achieved in prior years.

License. License revenues increased approximately $14.7 million or 161% to approximately $23.9 million in 2001. License revenues increased approximately $7.5 million or 454% from approximately $1.7 million in 1999 to approximately $9.2 million in 2000. The net increase in license revenues from fiscal 2000 to fiscal 2001 and fiscal 2000 from fiscal 1999 was primarily due to the addition of new customers as a result of expanded marketing activities, growth in our sales force, and greater demand for and the acceptance of our ACE suite of products. In fiscal year 2001, the increase was also offset by approximately $2.1 million of amortization of the fair value of a warrant issued to a significant customer in connection with a license and service agreement. We have fully amortized the amount associated with the fair value of this warrant as of March 31, 2001. We intend to generate additional license revenues from our existing customers and anticipate that this number will increase in absolute dollars in future periods, although it will fluctuate as a percentage of total revenues as our customers and size of transactions change.

Services. Services revenues increased approximately 23.1 million or 35% to approximately $30 million in 2001. Services revenues increased approximately $5.1 million or 286% from approximately $1.8 in 1999 to approximately $6.9 million in 2000. Our services revenues are comprised of fees from consulting, maintenance and training services. Services revenues from Wakely Software were immaterial from the date of acquisition to March 31, 2001. The increases from fiscal 2000 to 2001 and fiscal 2000 from fiscal 1999 were due primarily to the increase in maintenance and maintenance renewals, consulting, and training services associated with our increased installed base. In fiscal 2001, the services revenues were also reduced by amortization of approximately $3.8 million, the fair value of the warrant issued to a significant customer in connection with a license and service agreement as noted above. We expect to amortize the remaining $375,000 associated with the fair value of this warrant through the end of fiscal 2002. We expect services revenues to continue to increase in terms of absolute dollars in future periods as the number of consulting projects and maintenance contracts increases with the addition of new customers.

COST OF REVENUES

Cost of License Revenues. Cost of license revenues consists of the costs of the product media, duplication, packaging and delivery of our software products to our customers, which may include documentation, shipping and other data transmission costs. Cost of license revenues was approximately $1.5 million in 2001, $4.5 million in 2000, and $184,000 in 1999, representing 6%, 49%, and 11%, of license revenues, respectively. The fluctuation in fiscal 2000 was primarily due to a non-recurring $4.1 million warrant charge associated with a license agreement entered into in November 1999. As we enter into more independent software vendor agreements, we expect cost of license revenues to increase in absolute dollars and to fluctuate as a percentage of license revenues.

Cost of Services Revenues, including Related Party. Cost of services revenue is comprised mainly of salaries and related expenses of our services organization. Cost of services revenues increased approximately $12.6 million from $14.7 million in 2000 to $27.3 million in 2001. Cost of services revenue increased approximately $13.5 million from approximately $1.2 million in 1999 to approximately $14.7 million in 2000. Cost of services revenues represented 91%, 213% and 66% of services revenues for the years ended March 31, 2001, 2000 and 1999, respectively. Cost of services revenue from Wakely Software was approximately $1.8 million from the date of acquisition to March 31, 2001. The increases in cost of services revenues in 2001, 2000, and 1999 were primarily due to increases in the number of consulting and technical support personnel necessary to support both the expansion of our installed base of customers and new implementations. In addition, in fiscal 2001, we amortized approximately $746,000 of goodwill related to the Wakely Software acquisition, approximately $783,000 for deferred compensation and recorded an expense of approximately $291,000 related to the repurchase of stock from certain executives. In fiscal 2000, we incurred an approximate $5.6 million non-recurring warrant charge associated with a license agreement entered into in November 1999 and approximately $359,000 for deferred compensation expense. We anticipate that cost of services revenues will increase in absolute dollars in future periods as our number of customers increases. We expect cost of services revenues to fluctuate as a percentage of service revenue.

GROSS PROFIT

We experienced overall gross margins of 47%, negative 19% and 60% for the fiscal year ended March 31, 2001, 2000, and 1999, respectively. The increase in services revenues has resulted in reduced overall gross margins, since services revenues typically have lower gross margins than license revenues.

Gross Margin -- Licenses. Gross margin for license revenues were approximately 94%, 51% and 89% for the fiscal years of 2001, 2000, and 1999. During the fiscal year of 2001, gross margin was reduced by approximately $2.2 million representing amortization of the fair value of the warrant issued to a significant customer in connection with a license and service agreement. We have fully amortized the amount associated with the fair value of this warrant in the current year. In fiscal 2000, gross margins were affected by an approximate non-recurring $4.1 million warrant charge associated with the same license agreement entered into in November 1999.

Gross Margin -- Services. Gross margin for services revenue were approximately 9%, negative 113%, and 34% for the fiscal years of 2001, 2000, and 1999. As of March 31, 2001, the gross margin included amortization of approximately $3.9 million, the fair value of the warrant issued to a significant customer in connection with a license and service agreement. The negative gross margin in the fiscal year of 2000 was due to an approximate $5.6 million warrant charge associated with a license agreement entered into in November 1999 and the timing of services revenues recognition. We expect that our overall gross margins will continue to fluctuate due to the timing of services revenue recognition and will continue to be adversely affected by the lower margins on our service contracts. The impact on our gross profit will depend on the mix of services we provide, whether the services are performed by our in-house staff or third party consultants, whether the services are being performed on a fixed fee basis and the overall utilization rates of our professional services organization. We believe that costs of services revenues will decrease in absolute dollars in future periods as we decrease spending due to the slow down of the economy. We anticipate that the cost of services revenues will continue to fluctuate as a percentage of service revenue.

OPERATING EXPENSES

Research and Development. Our research and development costs primarily consist of salaries and related costs of our engineering, quality assurance, and technical publications efforts. Research and development costs increased to approximately $21.7 million in 2001 from approximately $7.3 million in 2000 and from approximately $3.9 million in 1999, representing increases of 196% and 89% in 2001 and 2000. Research and development expense from Wakely Software was approximately $230,000 from the date of acquisition to March 31, 2001. In the fiscal years of 2001, 2000, and 1999, the increases were primarily due to an increase in the number of research and development personnel to support the development of ACE 4.0, ACE 4.5, quality assurance, and technical publications operations. In fiscal 2001, we amortized approximately $500,000 for deferred compensation, approximately $157,000 related to the repurchase of stock from certain executives, and approximately $2.1 million for the development agreement entered into with Intel. Research and development expenses also included approximately $1.9 million for the one-time charge for in process research and development in relation to the Wakely Software acquisition. In fiscal 2000, we amortized approximately $116,000 for deferred compensation and approximately $600,000 from the amortization of the development agreement entered into with Intel. We believe our investment in research and development will decrease in future periods as we decrease spending due to a decline in technology infrastructure spending.

Sales and Marketing. Our sales and marketing expenses primarily consist of salaries and related costs for our sales and marketing organization, sales commissions, expenses for trade shows, public relations, collateral sales materials, advertising and an allocation of facilities, overhead and depreciation costs. Sales and marketing expenses increased to approximately $33.9 million or 199% from approximately $17 million in 2000 to approximately $50.9 million in 2001. Sales and marketing expenses increased approximately $12.6 million or 286% from approximately $4.4 million in 1999 to approximately $17 million in 2000. Sales and marketing expenses from Wakely Software were approximately $860,000 from the date of acquisition to March 31, 2001. The increases in fiscal years 2001, 2000, and 1999 were primarily due to the hiring of additional sales and marketing personnel and expenses incurred in connection with trade shows and additional marketing programs. In fiscal 2001, we amortized approximately $2.5 million for deferred compensation and recorded an expense of approximately $291,000 related to the repurchase of stock from certain executives. In fiscal 2000, we amortized approximately $737,000 for deferred compensation. We expect that sales and marketing expenses will decrease in absolute dollars over the next year as we decrease spending on advertising and marketing programs due to a decline in technology infrastructure spending.

General and Administrative. Our general and administrative expenses consist primarily of personnel and related costs for general corporate functions, including finance, accounting, legal, and human resources. General and administrative expenses increased approximately $10.0 million or 217% from approximately $4.6 million in 2000 to approximately $14.6 million in 2001. General and administrative expenses increased approximately $3.2 million or 229% from approximately $1.4 million in 1999 to approximately $4.6 million in 2000. General and administrative expenses from Wakely Software were approximately $505,000 from the date of acquisition to March 31, 2001. The increases in fiscal years 2001, 2000, and 1999 were primarily due to a

higher number of personnel and additional legal and accounting costs incurred in connection with business activities. In fiscal 2001, we amortized approximately $579,000 for deferred compensation and recorded an expense of approximately $448,000 related to the repurchase of stock from certain executives as of March 31, 2001. In addition, we incurred approximately $1.0 million from the amortization of goodwill in connection with the Wakely Software acquisition and anticipate incurring approximately $383,000 in quarterly amortization for the next twenty seven quarters. In fiscal 2000, we incurred approximately $247,000 in amortization of deferred compensation. We expect that general and administrative expenses will decrease in absolute dollars over the next fiscal year as we decrease spending due to a decline in technology infrastructure spending.

INTEREST AND OTHER INCOME, NET

Interest and other income, net primarily consists of interest earned on cash balances and stockholders notes receivable, offset by interest expense related to convertible debt issued in the first quarter of fiscal 2000 and converted in the same quarter. Interest and other income, net increased to approximately $12.7 million in 2001 from approximately $1.2 million in 2000. Interest and other income, net increased from approximately $99,000 in 1999 to approximately $1.2 million in 2000. The significant increase in net interest income for the fiscal year of 2001 resulted primarily from interest income on our initial public offering and private placement net proceeds of approximately $193.1 million, which was completed on March 10, 2000 offset by the use of cash in operations of approximately $54.0 million in 2001.

PROVISION FOR INCOME TAXES

We have recorded a tax provision of $275,000 and $50,000 for the years ended March 31, 2001 and 2000. The provision for income taxes consists primarily of state income taxes and foreign taxes.

FASB Statement No. 109 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes our historical operating performance and the reported cumulative net losses in all prior years, we have provided a full valuation allowance against its net deferred tax assets. We intend to evaluate the realizability of the deferred tax assets on a quarterly basis.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes methods for derivative financial instruments and hedging activities related to those instruments, as well as other hedging activities. Because we do not currently hold any derivative instruments and do not engage in hedging activities, the adoption of SFAS No. 133 will not have a material impact on our financial position, results of operations or cash flows. We will implement SFAS No. 133 for the year ending March 31, 2002.

In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation -- an Interpretation of APB Opinion No. 25." FIN 44 clarifies the application of APB Opinion No. 25 and, among other issues, clarifies the following: the definition of an employee for purposes of applying APB Opinion No. 25; the criteria for determining whether a plan qualifies as a noncompensatory plan; the accounting consequence of various modifications to the terms of the previously fixed stock options or awards; and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 was effective July 1, 2000, but certain conclusions in FIN 44 cover specific events that occurred after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have a material impact on our financial position or results of operations.

On February 14, 2001, the FASB issued a limited revision of its September 7, 1999 Exposure Draft, "Business Combinations and Intangible Assets", that proposes to significantly change the accounting for goodwill acquired in a purchase business combination. Under the revised proposal, goodwill would not be amortized but would be reviewed for impairment, using a complex methodology different form the original proposal, when an event occurs indicating the potential for impairment. Goodwill impairment charges would be presented as a separate line item within the operating section of the statement of operations. The

nonamortization approach would apply to previously recorded goodwill as well as goodwill arising from acquisitions completed after the application of the new standard. Amortization of the remaining book value of goodwill would cease and the new impairment-only approach would apply. The FASB expects to release the final statement in June 2001. The provisions of the proposed statement are to be applied at the beginning of the first fiscal quarter following it issuance.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2001, cash, cash equivalents and short-term investments totaled approximately $137.2 million, compared to approximately $215.8 million cash at March 31, 2000. In the fiscal year of 2001, approximately $31.0 million was invested in long-term securities, approximately $1.5 million was set aside as escrow fund in connection with the acquisition of Wakely Software, and an additional approximate $482,000 was held in a financial institution as security deposits for the long-term operating leases signed in the year. We currently have no significant capital commitments other than obligations under operating leases.

We have funded our operations with proceeds from the sale of preferred stock, private placements, and a public offering. Cash used by operating activities for the years ended March 31, 2001, 2000 and 1999 were approximately $54.7 million, $1.5 million and $6.6 million, respectively. Cash used in operations for fiscal 2001 was primarily a result of our net loss, increase in accounts receivable and decreases in accounts payable, and deferred revenues offset by noncash items.

Cash used for investing activities for the years ended March 31, 2001, 2000 and 1999 was approximately $95.1 million, $6.2 million and $731,000, respectively. Investing activities consisted primarily of net purchases of short-term and long-term investments, capital expenditures, and the acquisitions of Wakely Software and LoanMarket Resources.

Cash provided by financing activities for the years ended March 31, 2001, 2000 and 1999 was approximately $7.3 million, $223.5 million and $7.1 million, respectively. Financing activities consisted primarily of proceeds from the issuance of stock, proceeds from a revenue contract, and to a lesser extent, proceeds from borrowings, offset by fees related to our private placement in March 2000 and the repurchase of common stock from certain executives.

Due to the decline in technology infrastructure spending, we intend to reduce our operating expenses in absolute dollars to achieve our goal of profitability in the future. As a result, we anticipate the reduction of budgets on operating expenses, sales and marketing expenses, general and administrative expenses, and capital expenditures in next year will reserve cash resources for the future growth and development of the business.

On April 27, 2001, we commenced an option exchange program in which our employees were offered the opportunity to exchange stock options with exercise prices of $8.50 and above for new stock options. Participants in the exchange program will receive new options to purchase one hundred and twenty percent (120%) of the number of shares of our common stock subject to the options that were exchanged and canceled. The new options will be granted more than six months and one day from May 28, 2001, the date the old options were cancelled. The exercise price of the new options will be the closing market price on the NASDAQ Stock Market on the grant date of the new options. The exchange offer was not available to executive officers and the members of our Board of Directors.

In addition, on May 30, 2001, we granted additional options to purchase an aggregate of approximately 4 million shares of our common stock to all our employees that did not participate in the option exchange offer. We will amortize approximately $350,000 in deferred compensation expense associated with these grants over the next four years.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We develop products in the United States and India 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. Since our sales are currently priced in U.S. dollars and are translated to local currency amounts, a strengthening of the dollar could make our products less competitive in foreign markets.

Interest income is sensitive to changes in the general level of U.S. interest rates, particularly since our investments are in short-term instruments calculated at variable rates.

We established policies and business practices regarding our investment portfolio to preserve principal while obtaining reasonable rates of return without significantly increasing risk. This is accomplished by investing in widely diversified short-term investments, consisting primarily of investment grade securities, substantially all of which mature within the next twelve months or have characteristics of short-term investments. A hypothetical 50 basis point increase in interest rates would result in an approximate $291,000 (0.19%) in the fair value of our available-for-sale securities. This potential change is based upon a sensitivity analysis performed on our financial positions as of March 31, 2001.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ANNUAL FINANCIAL STATEMENTS

Our financial statements required by this item are submitted as a separate section of the Form 10-K. See Item 14(a) for a listing of financial statements provided in the section titled "Financial Statements."

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth, for the periods presented, selected data from our consolidated statements of operations. The data has been derived from our unaudited consolidated financial statements, and, in the opinion of our management, include all adjustments, consisting only of normal recurring adjustments, that are necessary for a fair presentation of the results of operations for these periods. This unaudited information should be read in conjunction with the consolidated financial statements and notes included elsewhere in this prospectus. The operating results in any quarter are not necessarily indicative of the results that may be expected for any future period. We have incurred losses in each quarter since inception and expect to continue to incur losses for the foreseeable future.

	QUARTERS ENDED			
	JUNE 30, 2000	SEPT. 30, 2000	DEC. 31, 2000	MAR. 31, 2001
	(IN THOUSANDS)			
CONSOLIDATED STATEMENT OF OPERATIONS DATA:				

Revenues:				
License	$ 3,674	$ 6,281	$ 8,659	$ 5,319
Services	3,907	6,966	10,950	8,189
Total revenues	7,581	13,247	19,609	13,508
Cost of revenues:				
License	231	277	414	535
Services	5,227	5,792	7,836	8,468
Services -- related party	--	--	--	--
Total cost of revenues	5,458	6,069	8,250	9,003
Gross profit (loss)	2,123	7,178	11,359	4,505
Operating expenses:				
Research and development	4,382	6,954	5,131	5,382
Sales and marketing	12,723	12,844	13,004	12,115
General and administrative	1,953	3,554	4,432	4,937
Total operating expenses	19,058	23,352	22,567	22,434
Loss from operations	(16,935)	(16,174)	(11,208)	(17,929)
Interest and other income (expense), net	3,342	3,353	3,364	2,595
Net loss before taxes	(13,593)	(12,821)	(7,844)	(15,334)
Provision for income taxes	--	125	75	75
Net loss	$(13,593)	$(12,946)	$ (7,919)	$(15,409)
Basic and diluted, net loss per share	$ (.41)	$ (.38)	$ (.23)	$ (.44)
Weighted-average shares of common stock used in computing basic and diluted, net loss per share	33,340	34,135	35,101	35,232

	QUARTERS ENDED			
	JUNE 30, 1999	SEPT. 30, 1999	DEC. 31, 1999	MAR. 31, 2000
	(IN THOUSANDS)			
CONSOLIDATED STATEMENT OF OPERATIONS DATA:				
Revenues:				
License	$ 708	$ 2,125	$ 2,348	$ 4,000
Services	493	1,309	2,157	2,948
Total revenues	1,201	3,434	4,505	6,948
Cost of revenues:				
License	52	90	117	4,261
Services	1,069	2,082	1,954	9,446
Services -- related party	135	--	--	--
Total cost of revenues	1,256	2,172	2,071	13,707
Gross profit (loss)	(55)	1,262	2,434	(6,759)
Operating expenses:				
Research and development	1,479	761	1,892	3,215
Sales and marketing	1,885	2,978	4,408	7,755
General and administrative	498	1,229	1,197	1,630
Total operating expenses	3,862	4,968	7,497	12,600
Loss from operations	(3,917)	(3,706)	(5,063)	(19,359)
Interest and other income (expense), net	(47)	145	221	922
Net loss before taxes	(3,964)	(3,561)	(4,842)	(18,437)
Provision for income taxes	26	24	--	--
Net loss	(3,990)	(3,585)	(4,842)	(18,437)
Deemed dividend related to Series E convertible preferred stock	--	--	925	--

Net loss applicable to common stockholders	$(3,990)	$(3,585)	$(5,767)	$(18,437)
Basic and diluted, net loss per share	$ (.21)	$ (.15)	$ (.23)	$ (1.50)
Weighted-average shares of common stock used in computing basic and diluted, net loss per share	19,380	23,179	25,104	12,252

In the past, our quarterly operating results have varied significantly, and we expect these fluctuations to continue. Future operating results may vary depending on a number of factors, many of which are outside of our control.

In the short term, we expect our quarterly revenues to be significantly dependent on the sale of a small number of relatively large orders for our products and services. In addition, our products and services generally have a long sales cycle. As a result, our quarterly revenues may fluctuate significantly if we are unable to complete one or more substantial sales in any given quarter. In many cases, we recognize revenues from licenses and services on a percentage-of-completion basis. Deployment of our products requires a substantial commitment of resources by our customers or their consultants over an extended period of time. The time required to complete a deployment may vary from customer to customer and may be protracted due to unforeseen circumstances. Our ability to recognize these revenues thus may be delayed if we are unable to meet milestones on a timely basis. We intend to significantly increase our operating expenses for the foreseeable future. Because these expenses are relatively fixed in the near term, any shortfall in anticipated revenues could cause our quarterly operating results to fall below anticipated levels.

We may also experience seasonality in revenues. For example, our quarterly results may fluctuate based upon our customers' calendar year budgeting cycles. These seasonal variations may lead to fluctuations in our quarterly revenues and operating results.

Based upon the foregoing, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and that such comparisons should not be relied upon as indications of future performance. In some future quarter, our operating results may be below the expectations of public market analysts and investors, which could cause volatility or a decline in the price of our common stock.

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

Not applicable

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

DIRECTORS

Information with respect to directors may be found in the section caption "Election of Directors" appearing in the definitive proxy statement to be delivered to stockholders in connection with the 2001 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

EXECUTIVE OFFICERS

Information with respect to executive officers may be found in the section caption "Executive Officers" appearing in the definitive proxy statement to be delivered to stockholders in connection with the 2001 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information with respect to directors may be found in the section caption "Executive Compensation" appearing in the definitive proxy statement to be delivered to stockholders in connection with the 2001 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information with this item may be found in the section caption "Security Ownership of Certain Beneficial Owners and Management" appearing in the definitive proxy statement to be delivered to stockholders in connection with the 2001 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information with respect to this item may be found in the section caption "Certain Relationships and Related Transactions" appearing in the definitive proxy statement to be delivered to stockholders in connection with the 2001 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, CONSOLIDATED FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this report:

(1) FINANCIAL STATEMENTS

The following are included in item 8 and are filed as part of this Annual Report on Form 10-K

- Consolidated Balance Sheets as of March 31, 2001 and 2000

- Consolidated Statement of Operations for the years ended March 31, 2001, 2000, and 1999

- Consolidated Statement of Stockholders' Equity for the years ended March 31, 2001, 2000, and 1999

- Consolidated Statements of Cash Flows for the years ended March 31, 2001, 2000, and 1999

- Notes to Consolidated Financial Statements

- Report of Ernst & Young LLP, Independent Auditors

(2) FINANCIAL STATEMENT SCHEDULES

Financial Statement Schedules have been omitted because the information required to be set forth therein is not applicable or is included in the Financial Statements or notes thereto.

(3) EXHIBITS

EXHIBIT NO.	DESCRIPTION
3.2*	The Second Amended and Restated Certificate of Incorporation.
3.3*	The amended and Restated Bylaws.
4.1*	Reference is made to Exhibits 3.1, 3.2 and 3.3.
4.2*	Form of Registrant's Common Stock certificate.
4.3*	Amended and Restated Investor Rights Agreement dated June 16, 1999.

10.1* Form of Indemnification Agreement.

10.2* 1996 Stock Plan.

10.3* 1999 Employee Stock Purchase Plan.

10.4* 1999 Equity Incentive Plan.

10.5* Lease between Spieker Properties L.P. and the Registrant, dated December 8, 1997.

10.6* Lease between John Arrilliga Survivors Trust and the Richard T. Perry Separate Property Trust as Landlord and the Registrant as Tenant, dated October 1, 1999.

10.7* Major Account License Agreement between the Registrant and Fujitsu Network Communica-tions, Inc., dated November 4, 1998.

10.8* Agreement for Web Site Design and Development Service between the Registrant and BMW of North America, Inc., dated July 15, 1998.

10.9* Major Account License Agreement between the Registrant and the Fireman's Fund Insurance Company, dated June 24, 1999.

10.10* Major Account License Agreement between the Registrant and Loanmarket Resources, LLC., dated June 30, 1999.

10.11* Major Account License Agreement between the Registrant and Aspect Telecommunications, dated May 17, 1999.

10.12* A Consulting Engagement Proposal from the Registrant to 3Com, dated July 29, 1999.

10.13* A Consulting Engagement Proposal from the Registrant to 3Com, dated August 10, 1999.

10.14* Employment Agreement between the Registrant and Rajen Jaswa, dated as of July 1, 1997.

10.15* Employment Agreement between the Registrant and Dr. Sanjay Mittal, dated as of July 1, 1997.

10.16* Offer letter from the Registrant to Stephen Bennion dated as of September 16, 1999.

EXHIBIT NO.	DESCRIPTION
10.18*	Major Account License Agreement between the Registrant and Samsung SDS Co., Ltd., dated January 12, 2000; amendment #1 to Major Account License Agreement between the Registrant and Samsung SDS Co., Ltd., dated February 10, 2000.
10.19*	International Value Added Reseller Agreement between the Registrant and Samsung SDS Co., Ltd., dated January 12, 2000; Amendment #1 to International Value Added Reseller Agreement between the Registrant and Samsung SDS Co., Ltd., dated February 29, 2000.
10.20*	Stock Purchase Agreement between the Registrant and Samsung SDS Co., Ltd., dated January 31, 2000; Amendment #1 to the Stock Purchase Agreement between the Registrant and Samsung SDS Co., Ltd., dated February 8, 2000.

10.21* Lease between John Arrillaga Survivors Trust and Richard T. Perry Separate Property Trust as Landlord and the Registrant as Tenant, dated October 1, 1999.

10.22* Stock Purchase Agreement between the Registrant and Dell USA, L.P., dated February 14, 2000.

10.23** Offer to exchange outstanding options, dated April 27, 2001.

21.1 Subsidiaries.

23.1 Consent of Ernst & Young LLP, independent auditors.

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* Previously filed in the Company's Registration Statement (No. 333-92545) declared effective on March 9, 2000.

** Previously filed in Schedule TO filed by the Company on April 27, 2001.

(B) REPORTS ON FORM 8-K

No reports on Form 8-K have been filed with the Securities and Exchange Commission during the quarter ending March 31, 2001.

FINANCIAL STATEMENTS

As required under Item 8. Financial Statements and Supplementary Data, the consolidated financial statements of the Company are provided in this separate section. The consolidated financial statements included in this section are as follows

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

SELECTICA, INC.

CONSOLIDATED BALANCE SHEETS

	MARCH 31, 2001	MARCH 31, 2000
	(IN THOUSANDS, EXCEPT PAR VALUE)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 73,306	$215,818

Short-term investments	63,848	--
Accounts receivable, net of allowance for doubtful accounts of $1,051 and $415, respectively	18,965	5,749
Prepaid expenses and other current assets	4,009	9,418
Total current assets	160,128	230,985
Property and equipment, net	11,469	6,127
Goodwill, net of amortization of $1,815 and $116, respectively	12,637	30
Other assets	1,311	2,054
Long term investments	31,144	--
Investments, restricted	2,079	100
Development agreement, net of amortization of $3,117 and $1,011, respectively	1,051	3,156
Total assets	$219,819	$242,452
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,210	$ 4,258
Accrued payroll and related liabilities	5,003	1,879
Other accrued liabilities	5,717	3,755
Deferred revenues	22,382	18,482
Total current liabilities	36,312	28,374
Other long term liabilities	969	--
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.0001 par value: Authorized shares -- 25,000 at March 31, 2001 and 2000; none issued and outstanding	--	--
Common stock, $0.0001 par value: Authorized shares -- 75,000 at March 31, 2001 and 2000 Issued and outstanding -- 37,032 at March 31, 2001 and 35,740 at March 31, 2000	4	3
Additional paid-in capital	285,179	281,773
Deferred compensation	(7,970)	(11,860)
Stockholder notes receivable	(1,915)	(12,716)
Accumulated deficit	(92,989)	(43,122)
Accumulated other comprehensive income	229	--
Total stockholders' equity	182,538	214,078
Total liabilities and stockholders' equity	$219,819	$242,452

See accompanying notes.

SELECTICA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED MARCH 31,		
	2001	2000	1999
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)		
Revenues:			
License	$ 23,933	$ 9,181	$ 1,656
Services	30,012	6,907	1,788
Total revenues	53,945	16,088	3,444
Cost of revenues:			
License	1,457	4,520	184
Services	27,323	14,686	1,184
Total cost of revenues	28,780	19,206	1,368
Gross profit (loss)	25,165	(3,118)	2,076

Research and development	21,849	7,347	3,893
Sales and marketing	50,686	17,026	4,430
General and administrative	14,876	4,554	1,389
Total operating expenses	87,411	28,927	9,712
Loss from operations	(62,246)	(32,045)	(7,636)
Interest income	12,654	1,303	127
Interest expense and other income (expense), net	--	(62)	(28)
Loss before provision for income taxes	(49,592)	(30,804)	(7,537)
Provision for income taxes	275	50	--
Net loss	(49,867)	(30,854)	(7,537)
Deemed dividend on Series E convertible preferred stock	--	925	--
Net loss applicable to common stockholders	$(49,867)	$(31,779)	$(7,537)
Basic and diluted, net loss per share applicable to common stockholders	$ (1.44)	$ (4.54)	$ (1.58)
Weighted-average shares of common stock used in computing basic and diluted, net loss per share applicable to common stockholders	34,580	6,999	4,782

See accompanying notes.

SELECTICA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	CONVERTIBLE PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	DEFERRED COMPENSATION	STOCKHOLDER NOTES RECEIVABLE	ACCUMULATED DEFICIT
	SHARES	AMOUNT	SHARES	AMOUNT				
					(IN THOUSANDS)			
BALANCE AT MARCH 31, 1998	8,703	$ 1	5,521	$--	$ 4,211	$ (4)	--	$ (3,352)
Issuance of Series D convertible preferred stock (net of issuance costs of $58)	4,864	--	--	--	7,092	--	--	--
Exercise of stock options by employees and consultants, net of repurchases	--	--	671	--	38	--	--	--
Issuance of common stock to consultants in exchange for services	--	--	46	--	42	--	--	--
Warrants issued in conjunction with credit agreement	--	--	--	--	26	--	--	--
Deferred compensation related to options granted at less than fair value	--	--	--	--	299	(299)	--	--
Compensation expense related to acceleration of stock options	--	--	--	--	170	--	--	--
Amortization of deferred compensation	--	--	--	--	--	48	--	--
Net and comprehensive loss	--	--	--	--	--	--	--	(7,537)
BALANCE AT MARCH 31, 1999	13,567	1	6,238	--	11,878	(255)	--	(10,889)
Issuance of Series E convertible preferred stock (net of issuance costs of $931)	4,403	1	--	--	24,345	--	--	--
Issuance of Series E convertible preferred stock in exchange for convertible notes payable (net of issuance costs of $48)	230	--	--	--	944	--	--	--
Repurchase of common stock held by founder	--	--	(228)	--	(2)	--	--	(454)
Warrants issued in connection with Series E convertible preferred stock financing	--	--	--	--	616	--	--	--
Warrants issued in connection with convertible notes payable	--	--	--	--	50	--	--	--
Compensation expense related to acceleration of stock options	--	--	--	--	66	--	--	--
Exercise of warrants issued in connection with Series E preferred stock financing	72	--	--	--	315	--	--	--
Warrants issued in connection with development agreement	--	--	--	--	381	--	--	--
Warrants issued in connection with license and services agreement	--	--	--	--	16,400	--	--	--
Exercise of stock options by employees, net of repurchase	--	--	1,035	--	1,706	--	--	--
Exercise of stock by employees for notes	--	--	2,034	--	12,716	--	(12,716)	--
Issuance of common stock for services	--	--	33	--	107	--	--	--
Issuance of Series E convertible stock for less than fair value	1,506	--	--	--	4,976	--	--	(925)
Issuance of common stock in public offering, (net of issuance costs								

of $11,281)	--	--	4,450	1	122,219	--	--	--
Issuance of common stock in private placement	--	--	2,400	--	72,000	--	--	--
Conversion of convertible preferred stock in connection with initial public offering	(19,778)	(2)	19,778	2	--	--	--	--
Deferred compensation related to options granted at less than fair value	--	--	--	--	12,866	(12,866)	--	--
Amortization of deferred compensation	--	--	--	--	--	1,261	--	--
Compensation expense related to issuance of common stock options to consultant	--	--	--	--	190	--	--	--
Net and comprehensive loss	--	--	--	--	--	--	--	(30,854)
BALANCE AT MARCH 31, 2000	--	--	35,740	3	281,773	(11,860)	(12,716)	(43,122)
Exercise of warrants issued in connection with Series E preferred financing	--	--	180	--	--	--	--	--
Exercise of warrants in connection with license and service agreement	--	--	650	1	--	--	--	--
Acquisition of Wakely Software, Inc. and LoanMarket Resources, LLC	--	--	210	--	10,243		--	--
Exercise of stock options by employees, net of repurchase	--	--	796	--	(574)	--	1,301	--
Repurchase of common stock issued to certain executives	--	--	(650)	--	(9,500)	--	9,500	--
Shares issued in connection with ESPP	--	--	106	--	2,364	--	--	--
Net deferred compensation related to options granted at less than FMV	--	--	--	--	2,082	3,890	--	--
Cost of financing	--	--	--	--	(1,209)	--	--	--
Accumulated other comprehensive income	--	--	--	--	--	--	--	--
Net and comprehensive loss	--	--	--	--	--	--	--	(49,867)
BALANCE AT MARCH 31, 2001	--	--	37,032	4	285,179	(7,970)	(1,915)	(92,989)

	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL STOCKHOLDERS' EQUITY
	(IN THOUSANDS)	
BALANCE AT MARCH 31, 1998	--	$ 856
Issuance of Series D convertible preferred stock (net of issuance costs of $58)	--	7,092
Exercise of stock options by employees and consultants, net of repurchases	--	38
Issuance of common stock to consultants in exchange for services	--	42
Warrants issued in conjunction with credit agreement	--	26
Deferred compensation related to options granted at less than fair value	--	--
Compensation expense related to acceleration of stock options	--	170
Amortization of deferred compensation	--	48
Net and comprehensive loss	--	(7,537)
BALANCE AT MARCH 31, 1999	--	735
Issuance of Series E convertible preferred stock (net of issuance costs of $931)	--	24,346
Issuance of Series E convertible preferred stock in exchange for convertible notes payable (net of issuance costs of $48)	--	944
Repurchase of common stock held by founder	--	(456)
Warrants issued in connection with Series E convertible preferred stock financing	--	616
Warrants issued in connection with convertible notes payable	--	50
Compensation expense related to acceleration of stock options	--	66
Exercise of warrants issued in connection with Series E preferred stock financing	--	315
Warrants issued in connection with development agreement	--	381
Warrants issued in connection with license and services agreement	--	16,400
Exercise of stock options by employees, net of repurchase	--	1,706
Exercise of stock by employees for notes	--	--
Issuance of common stock for services	--	107
Issuance of Series E convertible stock for less than fair value	--	4,051
Issuance of common stock in public offering, (net of issuance costs of $11,281)	--	122,220
Issuance of common stock in private placement	--	72,000
Conversion of convertible preferred stock in connection with initial public offering	--	--

Deferred compensation related to options granted at less than fair value	--	--
Amortization of deferred compensation	--	1,261
Compensation expense related to issuance of common stock options to consultant	--	190
Net and comprehensive loss	--	(30,854)
BALANCE AT MARCH 31, 2000	--	214,078
Exercise of warrants issued in connection with Series E preferred financing	--	--
Exercise of warrants in connection with license and service agreement	--	1
Acquisition of Wakely Software, Inc. and LoanMarket Resources, LLC	--	10,243
Exercise of stock options by employees, net of repurchase	--	727
Repurchase of common stock issued to certain executives	--	--
Shares issued in connection with ESPP	--	2,364
Net deferred compensation related to options granted at less than FMV	--	5,972
Cost of financing	--	(1,209)
Accumulated other comprehensive income	229	229
Net and comprehensive loss	--	(49,867)
BALANCE AT MARCH 31, 2001	229	182,538

See accompanying notes.

SELECTICA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED MARCH 31,		
	2001	2000	1999
		(IN THOUSANDS)	
OPERATING ACTIVITIES:			
Cash flows from operations:			
Net loss	$ (49,867)	$(30,854)	$(7,537)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	2,999	864	209
Amortization of goodwill	1,699	24	34
Amortization of deferred compensation	3,281	1,261	48
Amortization of private placement discount	3,536	--	--
Amortization of warrants in connection with licenses and services agreement	5,567	--	--
Amortization of development agreement	2,105	1,011	--
Net realized gain on short term investments	(5,191)	--	--
Net realized gain on long term investments	(7,660)	--	--
Acquired in-process research and development	1,870	--	--
Increase of fair value of Series E shares	--	265	--
Issuance of common stock options to consultant	--	190	--
Issuance of stock in exchange for services	--	106	42
Value of warrants in excess of contract	--	9,657	26
Expense related to repurchase of shares over fair market value	1,193	--	--
Accelerated vesting of stock options to employees	971	66	170
Accrued interest on convertible notes converted to convertible preferred stock	--	7	--
Warrants issued in conjunction with debt financing	--	35	
Loss on disposal of property and equipment	--	74	--
Changes in assets and liabilities:			
Accounts receivable	(12,706)	(3,791)	(1,418)
Prepaid expenses and other current assets	500	(4,342)	(136)
Other assets	(1,197)	(2,000)	--
Accounts payable	(1,124)	3,672	484
Accrued payroll and related liabilities	2,690	1,622	258
Other accrued liabilities	1,801	3,426	329

Deferred revenue	(5,203)	17,196	902
Advances from officers	--	--	(16)
Net cash used in operating activities	(54,736)	(1,511)	(6,605)
INVESTING ACTIVITIES			
Purchase of capital assets	(8,219)	(6,132)	(929)
Proceeds from disposition of property and equipment	--	80	--
Purchase of short-term investments	(76,280)	--	(5,577)
Purchase of long-term investments	(24,347)	--	--
Proceeds from sales and maturities of short-term investments	17,715	--	5,775
Proceeds from sales and maturities of long-term investments	1,000	--	
Acquisition of Wakely Software, Inc	(4,755)	--	--
Acquisition of certain assets and liabilities of LoanMarket Resource	(217)	--	--
Acquisition of Selectica, India	--	(150)	--
Net cash used in investing activities	(95,103)	(6,202)	(731)
FINANCING ACTIVITIES			
Net proceeds from initial public offering	--	122,219	--
Net proceeds from private placement	--	72,000	--
Cost of financing	(1,209)	--	--
Proceeds from stockholder notes receivable	718	--	--
Exercise of warrants in exchange for preferred stock	--	316	--
Proceeds from issuance of convertible notes	--	1,000	--
Proceeds from issuance of convertible preferred stock	--	24,913	7,092
Proceeds from issuance of warrants	--	800	--
Proceeds from issuance of common stock	2,909	1,250	38
Proceeds from revenue contract	4,909	1,033	--
Net cash provided by financing activities	7,327	223,531	7,130
Net increase (decrease) in cash and cash equivalents	(142,512)	215,818	(206)
Cash and cash equivalents at beginning of the period	215,818	--	206
Cash and cash equivalents at end of the period	$ 73,306	$215,818	$ --

	YEARS ENDED MARCH 31,		
	2001	2000	1999
		(IN THOUSANDS)	
SUPPLEMENTAL CASH FLOW INFORMATION			
Cash paid for interest	$ --	$ 53	$ 3
Conversion of preferred stock in common stock	$ --	$ 2	$ --
Deferred compensation related to stock options	$ 1,111	$ 12,866	$ 299
Convertible notes payable and accrued interest to convertible preferred stock	$ --	$ 944	$ --
Warrants issued in conjunction with convertible notes payable	$ --	$ 50	$ --
Warrants issued in conjunction with convertible preferred stock financing	$ --	$ 616	$ --
Warrants issued in connection with development agreement	$ --	$ 381	$ --
Warrant issued in conjunction with revenue contract	$ --	$ 16,400	$ --
Issuance of stock in exchange for notes	$ --	$ 12,716	$ --
Deferred charge on development agreement	$ --	$ 4,711	$ --
Repurchase of stock in exchange for cancellation of notes	$ 9,500	$ --	$ --

See accompanying notes.

SELECTICA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Business

Selectica, Inc. (the Company or Selectica) was incorporated in the state of California on June 6, 1996 and subsequently reincorporated in the State of Delaware on January 19, 2000. The Company was organized to develop and market Interactive Selling System software for electronic commerce, sales force automation, and build-to-order applications.

Principles of Consolidation

The consolidated financial statements include all the accounts of the Company and those of its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Reclassification of Prior Year Balances

Certain reclassifications have been made to prior year's consolidated balance sheets, consolidated statements of operations, and consolidated statements of cash flows to conform to the current year presentation. Amounts that were reclassified were not material.

Foreign Currency Transactions

Foreign currency transactions at foreign operations are measured using the U.S. dollar as the functional currency. Accordingly, monetary accounts (principally cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities) are remeasured using the foreign exchange rate at the balance sheet date. Operations accounts and non-monetary balance sheet accounts are remeasured at the rate in effect at the date of transaction. The effects of foreign currency remeasurement are reported in current operations and were immaterial for all periods presented.

Use of Estimates

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

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents, short-term investments, long-term investments, restricted investments, and accounts receivable. The Company places its short-term, long-term and restricted investments in high-credit quality financial institutions. The Company is exposed to credit risk in the event of default by these institutions to the extent of the amount recorded on the balance sheet. As of March 31, 2001, the Company has invested in short-term and long-term investments including commercial paper, corporate notes/bonds, and government agency notes/bonds. Restricted investments include corporate bonds and term deposits. Accounts receivable are derived from revenue earned from customers primarily located in the United States. The Company performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral. The Company maintains reserves for potential credit losses, and historically, such losses have been immaterial. Therefore, the concentration of credit risk is not significant.

Customer Concentrations

A limited number of customers have historically accounted for a substantial portion of the Company's revenues.

Customers who accounted for at least 10% of total revenues were as follows:

	MARCH 31, 2001	2000	1999
Samsung SDS	17%	12%	*
Dell Computer	16%	*	*
Cisco	14%	*	*
LVMH Group	*	12%	*
3Com Corporation	*	10%	*
Fireman's Fund Insurance	*	10%	*
BMW of North America	*	*	60%
Olicom, Inc.	*	*	10%

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* Revenues were less than 10% of total revenues.

Cash Equivalents and Investments

Cash equivalents consist of short-term, highly liquid financial instruments, principally money market funds, commercial paper, corporate notes and government agency notes with insignificant interest rate risk that are readily convertible to cash and have maturities of three months or less from the date of purchase. The fair value, based on quoted market prices, of cash equivalents is substantially equal to their carrying value at March 31, 2001 and 2000. The Company considers all investment securities with original maturities of more than 3 months but less than one year to be short term investments. Investments with original maturities of more than one year are considered to be long term investments.

The Company classifies investments as available-for-sale at the time of purchase and periodically reevaluates such designation. Unrecognized gains or losses on available-for-sale securities are included, net of tax, in stockholders' equity until their disposition. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in interest income. The cost of securities sold is based on the specific-identification method.

Accounts Receivable

The following describes activity in the accounts receivable allowance for doubtful accounts for the years ended March 31, 2001, 2000, and 1999:

FISCAL YEAR	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	AMOUNTS WRITTEN OFF	BALANCE AT END OF PERIOD
	(IN THOUSANDS)			
2001	$415	$1,596	$960	$1,051
2000	$104	$ 325	$ 14	$ 415
1999	$ 30	$ 74	$ --	$ 104

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally three to five years. Amortization of leasehold improvements is computed using the straight line method over the shorter of the lease term or the estimated useful life.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price of acquired companies over estimated fair values of tangible and intangible net assets acquired. Goodwill is amortized on a straight-line basis over the estimated useful life, generally five years. The carrying values of long-term assets and intangibles are reviewed if facts and circumstances suggest that they may be impaired. If this review indicates that carrying values of long-term assets, other intangibles, and associated goodwill will not be recoverable based on projected undiscounted future cash flows, carrying values are reduced to estimated fair values by first reducing goodwill and second by reducing long-term assets and other intangibles.

Revenue Recognition

The Company enters into arrangements for the sale of 1) licenses of software products and related maintenance contracts; 2) bundled license, maintenance, and services; and 3) services on a time and material basis. In instances where maintenance is bundled with a license of software products, such maintenance term is typically one year.

For each arrangement, the Company determines whether evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. If any of these criteria are not met, revenue recognition is deferred until such time as all of the criteria are met.

ARRANGEMENTS CONSISTING OF LICENSE AND MAINTENANCE ONLY. For those contracts that consist solely of license and maintenance the Company recognizes license revenues based upon the residual method after all elements other than maintenance have been delivered as prescribed by Statement of Position 98-9 "Modification of SOP No. 97-2 with Respect to Certain Transactions." The Company recognizes maintenance revenues over the term of the maintenance contract as vendor specific objective evidence of fair value for maintenance exists.

ARRANGEMENTS CONSISTING OF LICENSE, MAINTENANCE AND OTHER SERVICES. Services can consist of maintenance, training and/or consulting services. Consulting services include a range of services including installation of off-the-shelf software, customization of the software for the customer's specific application, data conversion and building of interfaces to allow the software to operate in customized environments.

In all cases, the Company assesses whether the service element of the arrangement is essential to the functionality of the other elements of the arrangement. In this determination the Company focuses on whether the software is off-the-shelf software, whether the services include significant alterations to the features and functionality of the software, whether the services involve the building of complex interfaces, the timing of payments and the existence of milestones. Often the installation of the software requires the building of interfaces to the customer's existing applications or customization of the software for specific applications. As a result, judgment is required in the determination of whether such services constitute "complex" interfaces. In making this determination the Company considers the following: (1) the relative fair value of the services compared to the software, (2) the amount of time and effort subsequent to delivery of the software until the interfaces or other modifications are completed, (3) the degree of technical difficulty in building of the interface and uniqueness of the application, (4) the degree of involvement of customer personnel, and (5) any contractual cancellation, acceptance, or termination provisions for failure to complete the interfaces. The Company also considers the likelihood of refunds, forfeitures and concessions when determining the significance of such services.

In those instances where the Company determines that the service elements are essential to the other elements of the arrangement, the Company accounts for the entire arrangement using contract accounting.

For those arrangements accounted for using contract accounting that do not include contractual milestones or other acceptance criteria the Company utilizes the percentage of completion method based upon

input measures of hours. For those contracts that include contract milestones or acceptance criteria the Company recognizes revenue as such milestones are achieved or as such acceptance occurs.

In some instances the acceptance criteria in the contract require acceptance after all services are complete and all other elements have been delivered. In these instances the Company recognizes revenue based upon the completed contract method after such acceptance has occurred.

For those arrangements for which the Company has concluded that the service element is not essential to the other elements of the arrangement the Company determines whether the services are available from other vendors, do not involve a significant degree of risk or unique acceptance criteria, and whether the Company has sufficient experience in providing the service to be able to separately account for the service. When the service qualifies for separate accounting the Company uses vendor specific objective evidence of fair value for the services and the maintenance to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element.

Vendor-specific objective evidence of fair value of services is based upon hourly rates. As previously noted, the Company enters into contracts for services alone and such contracts are based upon time and material basis. Such hourly rates are used to assess the vendor specific objective evidence of fair value in multiple element arrangements.

In accordance with paragraph 10 of Statement of Position 97-2, "Software Revenue Recognition," vendor specific objective evidence of fair value of maintenance is determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate). Each license agreement offers additional maintenance renewal periods at a stated price. Maintenance contracts are typically one year in duration.

Customer billing occurs in accordance with contract terms. Customer advances and amounts billed to customers in excess of revenue recognized are recorded as deferred revenues. Amounts recognized as revenue in advance of billing (typically under percentage-of-completion accounting) are recorded as unbilled receivables.

Advertising Expense

The cost of advertising is expensed as incurred. Advertising expense of the years ended March 31, 2001 and 2000 was approximately $2.8 million and $891,000, respectively. Advertising expenses were immaterial for the year ended March 31, 1999.

Development Costs

Software development costs, which are required to be capitalized pursuant to Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed," have not been material to date.

Comprehensive Loss

The components of comprehensive loss are as follows:

	MARCH 31,		
	2001	2000	1999
	(IN THOUSANDS)		
Net loss applicable to common stockholders	$(49,867)	$(31,779)	$(7,537)
Other comprehensive income	229	--	--
Total comprehensive loss	$(49,638)	$(31,779)	$(7,537)

Other comprehensive loss represents net unrealized gain on securities for the year.

SELECTICA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Net Loss Per Share

Basic and diluted net loss per common share is presented in conformity with Statement of Financial Accounting Standards No. 128, "Earnings Per Share" (FAS 128), for all periods presented. In accordance with FAS 128, basic and diluted net loss per share have been computed using the weighted-average number of shares of common stock outstanding during the period, less shares subject to repurchase.

The following table presents the computation of basic and diluted and pro forma basic and diluted net loss per share:

	YEARS ENDED MARCH 31,		
	2001	2000	1999
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)		
Net loss applicable to common stockholders	$(49,867)	$(31,779)	$(7,537)
BASIC AND DILUTED:			
Weighted-average shares of common stock outstanding	36,474	8,630	5,987
Less weighted-average shares subject to repurchase	(1,894)	(1,631)	(1,205)
Weighted-average shares used in computing basic and diluted, net loss per share applicable to common stockholders	34,580	6,999	4,782
Basic and diluted, net loss per share applicable to common stockholders	$ (1.44)	$ (4.54)	$ (1.58)
PRO FORMA:			
Shares used above			4,782
Pro forma adjustment to reflect weighted-average effect of the assumed conversion of convertible preferred stock			12,500
Shares used in computing pro forma basic and diluted, net loss per share applicable to common stockholders			17,282
Pro forma basic and diluted, net loss per share applicable to common stockholders			$ (0.44)

The Company has excluded all outstanding stock options and shares subject to repurchase by the Company from the calculation of basic and diluted net loss per share because these securities are antidilutive for all periods presented. Options and warrants to purchase 3.8 million, 4.3 million, and 1.4 million shares of common stock for the years ended March 31, 2001, 2000, and 1999 were not included in the computation of diluted net loss per share applicable to common stockholders because the effect would be antidilutive. Such securities, had they been dilutive, would have been included in the computation of diluted net loss per share using the treasury stock method.

Stock-Based Compensation

The Company accounts for employee stock-based compensation under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB Opinion No. 25), and related interpretations. Pro forma net loss, as presented in Note 10, is a disclosure required by Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation" (FAS 123).

Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Company operates in one segment, Interactive Selling System software for electronic commerce. The Company primarily markets its products in the United States. For the fiscal year ended March 31, 2001, sales to international locations were less than 10% of total revenues. For the fiscal year ended March 31, 2000, foreign sales, principally Asia, were 15% of total revenues. Foreign sales were less than 10% of the total revenues for the year ended March 31, 1999. Export revenues are attributable to countries based on the location of the customers.

The Company holds long-lived assets in India with a net book value of approximately $1.6 million and approximately $370,000 for the year ended March 31, 2001 and 2000.

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133). FAS 133 establishes accounting methods for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. The Company is required to implement FAS 133 for the fiscal year ending March 31, 2002. Because the Company does not currently hold any derivative instruments and does not engage in hedging activities, the adoption of FAS 133 will not have a material impact on its financial position or results of operations.

In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation -- an Interpretation of APB Opinion No. 25". FIN 44 clarifies the application of APB Opinion No. 25 and, among other issues clarifies the following: the definition of an employee for purposes of applying APB Opinion No. 25; the criteria for determining whether a plan qualifies as a noncompensatory plan; the accounting consequence of various modifications to the terms of the previously fixed stock options or awards; and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 was effective July 1, 2000, but certain conclusions in FIN 44 cover specific events that occurred after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have a material impact on the Company's results of operations, financial position, or cash flows.

On February 14, 2001, the FASB issued a limited revision of its September 7, 1999 Exposure Draft, "Business Combinations and Intangible Assets", that proposes to significantly change the accounting for goodwill acquired in a purchase business combination. Under the revised proposal, goodwill would not be amortized but would be reviewed for impairment, using a complex methodology different form the original proposal, when an event occurs indicating the potential for impairment. Goodwill impairment charges would be presented as a separate line item within the operating section of the statement of operations. The nonamortization approach would apply to previously recorded goodwill as well as goodwill arising from acquisitions completed after the application of the new standard. Amortization of the remaining book value of goodwill would cease and the new impairment-only approach would apply. The FASB expects to release the final statement in June 2001. The provisions of the proposed statement are to be applied at the beginning of the first fiscal quarter following it issuance.

2. CASH EQUIVALENTS AND INVESTMENTS

Cash Equivalents:

All cash equivalents as of March 31, 2001 and 2000 are classified as available-for-sale securities and consist of the following:

	MARCH 31, 2001	MARCH 31, 2000
	(IN THOUSANDS)	
Cash equivalents:		
Money market fund	$31,366	$200,002
Commercial paper	15,741	9,963
Government agency notes	8,947	--
Corporate notes	6,066	--
Total	$62,120	$209,965

As of March 31, 2001, the Company has four operating leases that require security deposits to be maintained at financial institutions for the term of the leases. The total security deposits of the leases in the amount of approximately $582,000 is classified as a restricted long-term investment and is held in commercial paper. In addition, due to the acquisition of Wakely Software, Inc., an escrow fund of approximately $1.5 million is held in corporate bonds and classified as a restricted long-term investment. The escrow fund in amounts of $500,000 and $1.0 million will be paid in 18 months and 36 months from the date of acquisition, respectively. The interest earned on the investment can be used in operations.

Unrealized holding gains and losses on available-for-sale securities for the fiscal year of 2001 was approximately $229,000. Gross realized gains and losses on sales of available-for-sale securities during the fiscal years of 2000 and 1999 were not significant.

Investments:

The Company did not hold any investments as of March 31, 2000. Short-term and long-term investments as of March 31, 2001 were classified as available-for-sale securities. The following is a summary of the aggregate cost, gross unrealized gains, and estimated fair value of the Company's short-term and long-term investments:

	MARCH 31, 2001
	(IN THOUSANDS)
SHORT-TERM INVESTMENTS:	
Commercial Paper	$ 4,494
Corporate notes and bonds	18,369
Government agencies	40,893
Short-term investments at cost	63,756
Unrealized gain	92
Fair value	$63,848

	MARCH 31, 2001
	(IN THOUSANDS)
LONG-TERM INVESTMENTS:	
Corporate notes and bonds	$20,981
Government agencies	10,026
Available-for-sales securities at cost	31,007
Unrealized gains	137
Fair value	$31,144

3. PROPERTY AND EQUIPMENT

Property and equipment, at cost, consist of the following:

	MARCH 31, 2001	MARCH 31, 2000
	(IN THOUSANDS)	
Furniture and equipment	$ 3,121	$1,034
Computers and software	10,065	4,385
Leasehold improvements	2,238	1,664
	15,424	7,083
Less: accumulated depreciation	(3,955)	(956)
Total property and equipment, net	$11,469	$6,127

4. STOCKHOLDER NOTES RECEIVABLE

During the year ended March 31, 2000, in consideration for the issuance of the Company's common stock, various key employees executed promissory notes in the principal amount of approximately $12.7 million. The notes bear interest at rates from 6.02% to 6.56% per annum, and are due and payable in four years from the date of issuance. The notes are full recourse, and in addition, each of the employees has pledged the common stock, 2.0 million shares of common stock in aggregate as of March 31, 2000, as collateral to secure the obligations under the notes.

During the year ended March 31, 2001, approximately $1.3 million of the notes receivable were repaid due to the sale of the company's stock by the various key employees. In addition, stock worth an aggregate of approximately $9.5 million, originally issued in exchange for full recourse notes, were repurchased by the Company. (see Note 10, Stock Repurchase)

5. OPERATING LEASE COMMITMENTS

The Company leases office space under operating lease agreements that expire at various dates through 2010. The Company vacated the premises at 2890 Zanker Road in January 2000 and entered into a sublet agreement. Rental receipts under the sublet agreement are materially consistent with future payments.

Aggregate future minimum annual payments under these lease agreements, which have non-cancelable lease terms, as of March 31, 2001, are as follows:

	(IN THOUSANDS)
2002	$ 3,290
2003	2,780
2004	2,513
2005	2,627
2006	2,566
Thereafter	10,674
Total future minimum payments	24,450
Future receipts under sublet agreement	(566)
Total net future minimum payments	$23,884

Rent expenses were approximately $4.7 million, $1.8 million, and $490,000 for the years ended March 31, 2001, 2000, and 1999, respectively.

6. LITIGATION

The Company is a party to various litigation and claims in the ordinary course of business. Although the results of litigation and claims cannot be predicted with certainty, the Company believes that the final outcome of such matters will not have a material adverse effect on the Company's financial position, results of operations, or cash flows. (See Footnote 15.)

7. LINES OF CREDIT

The Company has three lines of credit with approximately $556,000 available in connection with the Company's lease agreements. No amounts were committed under these letters of credit at March 31, 2001.

8. CONVERTIBLE PROMISSORY NOTES

In May 1999, the Company issued convertible promissory notes in the principal amount of $1 million that earned interest at a rate of prime plus 1%. During June 1999, the convertible promissory notes and related accrued but unpaid interest of approximately $7,000 were converted into 228,000 shares of Series E convertible preferred stock.

9. ACQUISITIONS

Catalogics Acquisition

In July 1996, the Company acquired the assets of Catalogics Software Corporation (Catalogics), a development stage software company in the business of internet software development. In exchange for the assets of Catalogics, the Company paid $150,000 and issued 2,750,000 shares of the Company's common stock. Of the 2,750,000 shares of the Company's common stock, issued to Dr. Mittal, 1,250,000 shares were subject to a repurchase right by the Company. The repurchase right lapses over 48 months beginning July 1, 1996. (see Note 10). Through this acquisition, the Company received an assembled workforce consisting solely of the founder of Catalogics, and the rights to software in the development stage. The acquisition was accounted for as a purchase, and the total purchase price was allocated as described below. The assembled workforce intangible is being amortized over three years, and the related goodwill is being amortized over five years, their estimated useful lives.

	(IN THOUSANDS)
Workforce intangible	$ 30
In-process research and development	17

Goodwill	118
	$165

As of March 31, 2001, 2000 and 1999, accumulated amortization of intangible assets was approximately $159,000, $116,000 and $93,000, respectively.

Selectica India Acquisition

In July 1999, the Company converted $150,000 of advances to Selectica Configurators India Pvt. Ltd. (Selectica India) into 637,500 shares of common stock of Selectica India, representing 99.9% of total outstanding shares. Through this acquisition, the Company received various property and equipment and an assembled workforce and assumed various liabilities. The acquisition was accounted for as a purchase, and the total purchase price was allocated to net tangible assets.

Wakely Software, Inc. Acquisition

In August 2000, the Company acquired Wakely Software, Inc., a provider of rating software and actuarial services for the insurance industry for approximately $13.7 million resulting in Wakely Software, Inc. becoming a wholly owned subsidiary of Selectica. The Company issued approximately 175,000 shares of its common stock valued at the closing market price of $53.125 on August 8, 2000, and paid cash in the amount of approximately $4.4 million in exchange for all of the outstanding shares of Wakely Software, Inc. common stock. The transaction expenses were approximately $400,000. The acquisition was accounted under the purchase method of accounting.

The Company is primarily responsible for estimating the fair value of the acquired tangible and intangible assets in all business combinations accounted for under the purchase method. Significant assumptions related to the determination of fair value of these assets are described below.

Valuation Methodology

In accordance with the provision of APB Opinion 16, all identifiable assets, including identifiable intangible assets were assigned a portion of the cost of the acquired enterprise (purchase price) on the basis of their respective fair values.

Valuation of acquired intangible assets. Intangible assets were identified through (i) analysis of the acquisition agreement, (ii) consideration of the Company's intentions for future use of the acquired assets, and (iii) analysis of data available concerning Wakely Software, Inc.'s products, technologies, markets, historical financial performance, estimated of future performance and the assumptions underlying those estimates. The economic and competitive environment in which the Company and Wakely Software, Inc. operate was also considered in the valuation analysis.

Developed technologies consisted principally of project management and other software tools that would be used by the Company's operations and consisted of eRate, eAnalysis, and WinRRS for a combined value of approximately $1.8 million.

To determine the value of developed technologies, the cost method was used, as the Company does not intend on selling any of this technology but rather using it in-house. All estimates of time of develop were based upon discussion with management at Wakely Software, Inc. and were based upon the actual time incurred historically.

To determine the value of assembled workforces, the Company considered, among other factors, the costs to replace existing employee including search costs, interview costs and training costs.

Goodwill is determined based on the residual difference between the amounts paid and the valued assigned to identified tangible and intangible assets. If the value assigned to identified tangible and intangible assets exceed the amounts paid, including the effect of deferred taxes, the valued assigned to long-term assets were reduced proportionately.

The following is a summary of the purchase allocation:

	AMOUNT	ESTIMATED USEFUL LIFE (YEARS)
	{(IN THOUSANDS)}	
Workforce intangible	$ 240	3 years
Licenses	362	7 years
Developed technology	1,814	3 years
In-process research and development	1,870	(less than) 1 year
Goodwill	10,727	7 years
Total purchase price	$15,013	

LoanMarket Resources, LLC Acquisition

In November 2000, the Company acquired certain assets and liabilities of LoanMarket Resources, LLC ("LoanMarket"), a provider of real-time, mortgage, home equity, and unsecured lending software solutions. The Company issued approximately 35,000 shares of its common stock valued at the closing market price of $27.0156 on November 9, 2000, paid cash in the amount of approximately $220,000, and assumed liabilities of approximately $155,000. The transaction expenses were approximately $183,000. The Company allocated $1.2 million to goodwill and will amortize this amount over a period of three years, the expected future life of the assets.

As of March 31, 2001, the accumulated amortization of goodwill was approximately $161,000.

10. STOCKHOLDERS' EQUITY

Common Stock

In July 1996, the Company issued 2.5 million shares of common stock to the founders of the Company in exchange for $12,500, the then estimated fair value of common stock. Such shares vest ratably over 48 months. There were no shares subject to repurchase as of March 31, 2001. For the fiscal years of 2000 and 1999, 156,000, and 781,000 shares were subject to repurchase at $0.01 per share, respectively.

Common Stock Reserved for Future Issuance

At March 31, 2001, common stock reserved for future issuance was as follows:

	(IN THOUSANDS)
Stock option plans:	
Outstanding	4,534
Reserved for future grants	1,938
Employee Stock Purchase Plan	894
Total common stock reserved for future issuance	7,366

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Convertible Preferred Stock

Prior to the Company's initial public offering in March 2000, the Company had 19.8 million shares of convertible preferred stock authorized. In accordance with the convertible preferred stock rights, all preferred stock outstanding automatically converted into 19.8 million shares of common stock upon closing of the initial public offering. There was no convertible stock authorized, issued, or outstanding at March 31, 2001 and 2000.

Preferred Stock

The Company's Certificate of Incorporation was amended to authorize 25 million shares of preferred stock at a par value of $0.0001 per share upon reincorporation in Delaware in January 2000. There was no preferred stock issued and outstanding at March 31, 2001 and 2000.

The Board of Directors has the authority, without action by the stockholders, to designate and issue the preferred stock in one or more series and to fix the rights, preferences, privileges, and related restrictions, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series or the designation of the series. The accompanying consolidated financial statements have been retroactively restated to give effect to the reincorporation.

Warrants

The Company had previously issued convertible preferred stock warrants. Upon the effectiveness of the Company's initial public offering, all such warrants became exercisable as common stock.

In association with a credit agreement entered into with a financial institution, the Company issued a warrant that entitles the holder to purchase 20,408 shares of Series D convertible preferred stock at an exercise price of $1.47 per share. The warrant expires April 17, 2005. The fair value of the warrant, $25,714, was amortized over the life of the credit agreement, which expired on June 1999. The Company determined the fair value of the warrants using the Black-Scholes valuation model assuming a fair value of the Company's Series D convertible preferred stock of $1.47, a risk-free interest rate of 6.0%, a volatility factor of 147%, and a life of five years. The warrants were exercised in April 2000.

In connection with convertible promissory notes issued in May 1999, the Company issued warrants to purchase 15,000 shares of Series E convertible preferred stock at $4.382 per share. This transaction resulted in the valuation of warrants of $49,781 of which $35,107 was amortized as interest expense prior to the conversion of the convertible debt into Series E convertible preferred stock on June 16, 1999. The Company determined the fair value of the warrants using the Black-Scholes valuation model assuming a fair value of the

Company's Series E convertible preferred stock of $4.382, risk free interest rate of 5.9%, volatility factor of 96.1%, and a life of five years. The warrants were exercised in fiscal 2000.

In connection with the issuance of shares of the Company's Series E convertible preferred stock, the Company issued warrants to purchase 187,129 shares of the Company's Series E convertible preferred stock at $4.382 per share. The warrants were exercised on February 25, 2000. The Company determined the fair value of the warrants of $3.29 using the Black-Scholes valuation model assuming a fair value of the Company's Series E convertible preferred stock of $4.382, risk free interest rate of 5.78%, volatility factor of 96.1%, and a life of five years.

In September 1999, the Company entered into a development agreement with an investor whereby the investor and the Company will work to port the current suite of ACE products to additional platforms. In connection with the development agreement, the Company issued warrants to purchase 57,000 shares of Series E convertible preferred stock at $4.382 per share. The warrants were issued in December 1999 and were exercised on March 9, 2000. The Company determined the fair value of the warrants using the Black-Scholes valuation model assuming a fair value of the Company's Series E convertible preferred stock of $19.00, risk free interest rate of 5.5%, volatility factor of 80% and a life of 22 months. The fair value of approximately $381,000 is being amortized over the remaining life of the development agreement. As March 31, 2001, total accumulated amortization of this warrant was approximately $277,000.

In November 1999, the Company entered into a license agreement and one year maintenance contract in the amount of approximately $3.0 million with a customer and in connection with the agreement committed to the issuance of a warrant to purchase 800,000 shares of common stock. In January 2000 the warrant was issued with an exercise price of $13.00 and was net exercised on July 25, 2000. The value of the warrants was estimated to be approximately $16.4 million and was based upon a Black-Scholes valuation model with the following assumptions: risk free interest rate of 5.5%, dividend yield of 0%, volatility of 80%, expected life of 2 years, exercise price of $13.00 and fair value of $30.00. As the warrant value less the warrant purchase price of $800,000, exceeds the related license and maintenance revenue under the agreement and subsequent services agreements, the Company recorded an approximate $9.7 million loss on the contract in the year ended March 31, 2000, of which approximately $4.1 million was charged to costs of license revenues and approximately $5.6 million was charged to cost of services revenues. As of March 31, 2001, the Company amortized approximately $5.5 million related to the fair value of the warrants against the revenue in the year.

Stock Option Plan

The Company's 1996 Stock Plan (the Plan) was adopted by the Board of Directors on August 26, 1996. The Plan provides for granting of incentive stock options to employees and nonstatutory stock options to outside directors and consultants. Incentive stock options are granted at an exercise price of not less than the fair value per share of the common stock on the date of grant as determined by the Board of Directors. Nonstatutory stock options are granted at an exercise price of not less than 85% of the fair value per share on the date of grant as determined by the Board of Directors. Vesting and exercise provisions are determined by the Board of Directors at the time of grant. Options generally vest with respect to 25% of the shares one year after the options' vesting commencement date and the remainder ratably over the following three years. Options granted under the Plan have a maximum term of ten years. Options can be exercised at any time and stock issued under the Plan may be, as determined by the Board of Directors, subject to repurchase by the Company. This right to repurchase generally lapses over four years from the original date of issuance or grant.

The Plan was cancelled in March 2000. At the date of cancellation 134,000 shares were available for future issuance. Shares repurchased or cancelled subsequent to the date of cancellation cannot be re-issued in future issuances. In 2001, 721,000 shares were cancelled and 946,000 shares were repurchased under the Plan.

1999 Equity Incentive Plan

The Company adopted the 1999 Equity Incentive Plan (the Equity Incentive Plan) in fiscal 2000. A total of 2.2 million shares of common stock has been reserved under the Equity Incentive Plan. On each January 1, starting in 2001, the number of shares will be automatically increased by the lesser of 5% of then outstanding shares or 1.8 million. The Equity Incentive Plan includes Incentive Stock Options, Nonstatutory Stock Options, Stock Appreciation Rights, Shares of Restricted Stock, and Stock Units. All employees, nonemployee directors, and consultants are eligible to participate in the Equity Incentive Plan. Each eligible participant is limited to being granted 330,000 shares per year, except in the first year of employment where the limit is 660,000 shares. The Equity Incentive Plan has a term of 10 years.

Activity under all stock option plans is as follows:

	OUTSTANDING STOCK OPTIONS}			
	SHARES AVAILABLE	NUMBER OF SHARES	EXERCISE PRICE	WEIGHTED-AVERAGE EXERCISE PRICE
	(IN THOUSANDS)			
BALANCE AT MARCH 31, 1998	762	1,280	$ 0.030 - $0.100	$ 0.06
Increase in shares reserved	750	--	$--	-$-
Options granted	(1,315)	1,315	$ 0.100 - $1.250	$ 0.37
Options exercised	--	(702)	$ 0.030 - $0.500	$ 0.05
Options canceled	469	(469)	$ 0.030 - $0.500	$ 0.10
Shares repurchased	31	--	$0.010	$ 0.01
Stock grant for services	(46)	--	$ 0.020 - $0.300	$ 0.26
BALANCE AT MARCH 31, 1999	651	1,424	$ 0.030 - $2.500	$ 0.35
Increase in shares reserved	6,809	--	$--	-$-
Options granted	(5,305)	5,305	$ 1.500 - $30.00	$10.04
Options exercised	--	(3,086)	$ 0.030 - $30.00	$ 4.71
Options canceled	62	(196)	$ 0.100 - $25.50	$ 2.60
Shares repurchased	16	--	$ 0.100 - $0.500	$ .22
Stock grant for services	(33)	--	$ 1.500 - $4.380	$ 2.37
BALANCE AT MARCH 31, 2000	2,200	3,447	$ 0.100 - $30.00	$11.19
Increase in shares reserved	1,800	--	$--	-$-
Options granted	(2,362)	2,362	$12.059 - $74.688	$31.92
Options exercised	--	(254)	$ 0.100 - $25.50	$ 3.29
Options canceled	300	(1,021)	$ 0.100 - $74.688	$17.53
BALANCE AT MARCH 31, 2001	1,938	4,534	$ 0.030 - $74.688	$21.13

	OPTIONS OUTSTANDING			OPTIONS VESTED	
RANGE OF EXERCISE PRICES	NUMBER OF OUTSTANDING SHARES AS OF MARCH 31, 2001	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	OPTIONS VESTED AT MARCH 31, 2001	WEIGHTED-AVERAGE AGGREGATE PURCHASE PRICE
	(IN THOUSANDS)			(IN THOUSANDS)	
$ 0.1000 - $ 2.5000	606	8.07	$ 1.6479	216	$ 1.4355
$ 4.3800 - $10.0000	422	8.68	$ 7.7476	110	$ 7.8130
$11.0000 - $11.0000	859	8.86	$11.0000	270	$11.0000
$12.0594 - $16.4200	257	9.71	$14.4576	10	$14.6100
$17.1875 - $17.1875	746	9.68	$17.1875	59	$17.1875
$19.3125 - $30.0000	789	9.12	$27.9672	164	$29.4662
$31.2500 - $54.7500	721	9.34	$48.1434	28	$38.7150
$61.6825 - $74.6875	134	9.23	$65.3907	3	$61.6825
$0.1000 - $74.6875	4,534	9.05	$21.1291	860	$14.4459

All shares granted under the Plan are exercisable, however, shares exercised but not vested are subject to repurchase. At March 31, 2001, 762,000 shares were subject to repurchase under the Plan.

1999 Employee Stock Purchase Plan

On November 18, 1999, the Company's Board of Directors approved, subject to shareholder approval, the adoption of the 1999 Employee Stock Purchase Plan (the Purchase Plan). A total of 1.0 million shares of common stock has been reserved for issuance under the Purchase Plan. On each May 1, starting in 2001, the number of shares will be automatically increased by the lesser of 2% of then outstanding shares of common stock or 1.0 million shares. Each offering period will consist of four consecutive purchase periods of six months duration. The initial offering period is expected to begin on March 10, 2000 and ends on April 30, 2002.

The Purchase Plan permits eligible employees to purchase common stock through payroll deductions, which may not exceed 15% of an employee's compensation, at a price equal to the lower of 85% of the fair market value of the Company's common stock at the beginning of each offering period or at the end of each purchase period. Employees who work more than five months per year and more than twenty hours per week are eligible to participate in the Purchase Plan. Stockholders who own more than 5% of outstanding common stock are excluded from participating in the Purchase Plan. Each eligible employee is limited to purchase no more than 750 shares per purchase date (1,500 shares per year) and no more than $25,000 of stock per calendar year. If not terminated earlier, the Purchase Plan has a term of twenty years.

Stock Issued for Services

Under the terms of the Company's 1996 Stock Plan from time to time the Company issues shares of common stock in exchange for services. All services were complete at the date of grant and the value of the services was based upon the then fair value of the common stock. No stock was issued for services in the fiscal year of 2001. During fiscal 2000 and 1999, the Company issued 33,000 and 46,304 shares of common stock at a weighted average fair value of $3.218 and $0.919 respectively, in exchange for various services including legal, accounting, recruiting, and consulting.

Deferred Compensation

During the years ended March 31, 2001, 2000, and 1999, the Company recorded net deferred compensation of approximately $14.3 million representing the difference between the exercise of stock options granted and the then deemed fair value of the Company's common stock. The amortization of deferred

compensation of deferred compensation is charged to operations over the vesting period of the options using the straight-line method, which is typically four years. For the years ended March 31, 2001, 2000, and 1999, the Company amortized approximately $3.3 million, $1.3 million and $47,500, respectively.

Accelerated Options

During fiscal 2001, in association with employee termination agreements, the Company accelerated vesting on options to purchase 91,000 shares of common stock and recorded approximately $971,000 of related compensation expense. During fiscal 1999, in association with an employee termination agreement, the Company accelerated 137,000 shares of unvested common stock and recorded approximately $170,000 of related compensation expense.

Pro Forma Disclosure of the Effect of Stock-Based Compensation

The Company uses the intrinsic value method in accounting for its employee stock options because, as discussed below, the alternative fair value accounting method requires use of option valuation models that were not developed for use in valuing employee stock options. Under the intrinsic value method, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, there is no compensation expense recognized.

Pro forma information regarding net loss as if the Company had accounted for its employee stock options granted during the fiscal year ended March 31, 2001, 2000 and 1999 under the fair value method was estimated at the date of grant using the Black-Scholes option-pricing model for the year ended March 31, 2001 and 2000 and the minimum value method for the fiscal year ended March 31, 1999, with the following weighted average assumptions:

	MARCH 31, 2001	2000	1999
Risk-free interest rate	6.00%	5.96%	5.05%
Dividend yield	0.00%	0.00%	0.00%
Expected volatility	99.00%	0.00%	0.00%
Expected option life in years	7.00	7.00	7.00

The option valuation models were developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected life of the option. Because the Company's employee 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 estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The weighted-average fair value where exercise price is equal to the deemed fair value of common stock on date of grant for the fiscal years ended March 31, 2001, 2000 and 1999 was $33.61, $4.90, and $0.11 respectively. The weighted-average fair value where exercise price is less than the deemed fair value of common stock on the date of grant for the fiscal years ended March 31, 2001, 2000 and 1999 was $23.86, $6.75 and $0.56 respectively. The Company has accounted for the difference between the exercise price and the deemed fair value as deferred compensation.

If compensation cost for the Company's stock-based compensation plan had been determined based on the fair value at the grant dates for awards under this plan, then the Company's net loss would have been as indicated in the pro forma amount below:

	FOR THE FISCAL YEAR ENDED MARCH 31, 2001	2000	1999
		(IN THOUSANDS)	
Net loss as reported	$(49,867)	$(31,779)	$(7,537)
Pro forma net loss	$(75,308)	$(33,577)	$(7,552)
Net loss per share as reported, basic and diluted	$ (1.44)	$ (4.54)	$ (1.58)
Pro forma net loss per share, basic and diluted	$ (2.18)	$ (4.80)	$ (1.58)

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

Stock Repurchase

During the year ended March 31, 2001, the Company has repurchased 650,000 shares of common stock from certain key employees (the "Stock Repurchase"). These shares were originally issued in exchange for full recourse promissory notes with an aggregate value of $9.5 million. As compensation for services rendered by these employees and in order to provide an inducement for continued employment, the shares were repurchased at the prices greater than their fair market values at the time of the repurchase. As a result, the Company recorded a total compensation expense of approximately $1.2 million of which approximately $156,000 was expensed to research and development, approximately $291,000 was expensed in cost of goods sold, approximately $291,000 was expensed in sales marketing, and approximately $447,000 was expensed in general and administrative expense.

11. INCOME TAXES

Financial Accounting Standards Board Statement No. 109 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based on the weight of available evidence, which includes the Company's historical operation performance and the reported cumulative net losses in all prior years, the Company has provided a full valuation allowance against its net deferred tax assets.

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

	YEARS ENDED MARCH 31,	
	2001	2000
	(IN THOUSANDS)	
Computed US tax	$(17,366)	$(10,781)
Losses not benefited	16,216	10,340
Deferred compensation expense	1,150	441
Other	275	50
Provision for income tax	$ 275	$ 50

	YEARS ENDED MARCH 31,	
	2001	2000
	(IN THOUSANDS)	
US current tax expense	$ --	$ --
Deferred tax	--	--
Foreign tax expense	275	50
Provision for income tax	$ 275	$ 50

	MARCH 31,		
	2001	2000	1999
Deferred tax assets:			
Net operating loss carryforwards	$ 14,800	$ 4,416	$ 3,967
Tax credit carryforwards	1,490	619	296
Other	12,560	12,197	450
Total deferred tax assets	28,850	17,232	4,713
Valuation allowance	(28,850)	(17,232)	(4,713)
Net deferred tax assets	$ --	$ --	$ --

Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance increased by approximately $11.6 million, $12.5 million and $3.3 million during 2001, 2000, and 1999, respectively.

As of March 31, 2001, the Company had federal and state net operating loss carryforwards of approximately $40.0 million and approximately $22.0 million, respectively. As of March 31, 2001, the Company also had federal and state research and development tax credit carryforwards of approximately $900,000 and $800,000, respectively. The net operating loss and tax credit carryforwards will expire at various dates beginning in 2005 through 2021, if not utilized.

12. RELATED PARTY

During the years ended March 31, 2000 and 1999, certain services were performed by Selectica Configurators India Pvt. Ltd. (Selectica India), a related party. These efforts included quality and assurance testing and consulting services. Prior to June 30, 1999, Selectica India was owned by the parents of the chief executive officer and founder of the Company. Total expenses related to these efforts, which are included in the Company's statements of operations, by Selectica India, amounted to $135,000, and $302,511 for the years ended March 31, 2000 and 1999, respectively. The Company also advanced $155,000 to Selectica India during 1999 for future services efforts. Amounts included in accounts payable were immaterial for all periods presented. During July 1999, the Company acquired a majority ownership of Selectica, India. See Note 9 for further details.

In December 1999, the Company acquired approximately 2% of the equity in LoanMarket Resources, LLC in exchange for a license and consulting service agreement. As there is no readily determinable fair value for the equity position in LoanMarket Resources, LLC, because this is a privately held company, the Company has not ascribed any value to the investment. In November, 2000, the Company purchased the remaining shares of LoanMarket Resources, LLC at the price of approximately $1.5 million. As a result of the acquisition, approximately $323,000 in deferred revenues was applied to the purchase and reduced goodwill by the same amount.

13. BENEFIT PLAN

Effective February 1998, the Company adopted a tax-deferred savings plan, the Selectica 401(k) Plan (the 401(k) Plan), for the benefit of qualified employees. The 401(k) Plan is designed to provide employees with an accumulation of funds at retirement. Qualified employees may elect to make contributions to the 401(k) Plan on a monthly basis. The 401(k) Plan does not require the Company to make any contributions. No contributions were made by the Company for the years ended March 31, 2001, 2000, and 1999. Administrative expenses relating to the 401(k) Plan are insignificant.

14. RESTRUCTURING

In fiscal 2001, the Company recorded restructuring charges of approximately $667,000 which was the result of a restructuring plan established to align the Company's global workforce with existing and anticipated future market requirements and necessitated by the Company's improved operating efficiencies (the "fiscal 2001 restructuring plan"). The restructuring charges were primarily for the severance and benefits paid to the terminated employees. The company terminated 158 employees globally as of March 31, 2001 and estimated that the annual salary and fringe benefits savings of approximately $3.7 million will be recognized beginning in fiscal 2002 as a result of these activities. The restructuring activities are expected to be complete by the second quarter of fiscal 2002 and are summarized as follows:

Severance and Benefits

FY 2001 Restructuring Charges	$ 667,000
Cash Charges	(317,000)
Reserve balance, March 31, 2001	$ 350,000

15. SUBSEQUENT EVENTS

In April 2001, the Board approved a stock buyback program which allows the Company to repurchase up to $30 million worth of stock in the open market. To date, no shares have been repurchased.

In April 2001, the Company further reduced its headcount, primarily in the US, by 50 individuals or approximately 7% of its workforce. The Company reduced its annual expenses by approximately $6.7 million principally from reduced salaries and associated expenses.

On April 27, 2001, the Company commenced an option exchange program in which its employees were offered the opportunity to exchange stock options with exercise prices of $8.50 and above for new stock options. Participants in the exchange program will receive new options to purchase one hundred and twenty percent (120%) of the number of shares of our common stock subject to the options that were exchanged and canceled. The new options will be granted more than six months and one day from May 28, 2001, the date the old options were cancelled. The exercise price of the new options will be the closing market price on the NASDAQ Stock Market on the grant date of the new options. The exchange offer was not available to executive officers and the members of our Board of Directors.

In addition, on May 30, 2001, the Company granted additional options to purchase an aggregate of approximately 4 million shares of its common stock to all its employees that did not participate in the option exchange offer.

On June 5, 2001, a number of securities class action complaints were filed against the Company, the Company's underwriters of the Company's IPO, and certain executives in the United States District Court for the Southern District of New York. The complaints allege that our underwriters of the Company's IPO, Selectica, and the other named defendants violated federal securities laws for making material false and

misleading statements in our prospectus incorporated in its registration statement on Form S-1 filed with the SEC in March, 2000. The complaints allege, among other things, that the lead underwriters solicited and received excessive and undisclosed commissions from several investors in exchange for which the lead underwriters allocated to these investors material portions of the restricted number of shares of common stock issued in connection with the Company's initial public offering. The complaints further allege that the lead underwriters entered into agreements with its customers in which the lead underwriters agreed to allocate the Company's common stock in its initial public offering in exchange for which such customers agreed to purchase additional shares of its common stock in the after-market at pre-determined prices. The Company plans to vigorously defend against these claims.

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Selectica, Inc.

We have audited the accompanying consolidated balance sheets of Selectica Inc. as of March 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended March 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Selectica Inc. at March 31, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended March 31, 2001, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

San Jose, California April 24, 2001,
except for Note 15, as to which
the date is June 27, 2001

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Jose, State of California, on the 28th day of June, 2001.

SELECTICA, INC.
Registrant

/s/ STEPHEN BENNION

Stephen Bennion
Chief Financial Officer and
Executive Vice President of Finance

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BELOW BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT AND IN THE CAPACITIES AND ON THE DATES INDICATED.

SIGNATURE	TITLE	DATE
PRINCIPAL EXECUTIVE OFFICER AND DIRECTOR:		
/s/ RAJEN JASWA Rajen Jaswa	President and Chief Executive Officer and Chairman of the Board	June 28, 2001
PRINCIPAL FINANCIAL OFFICER AND PRINCIPAL ACCOUNTING OFFICER:		
/s/ STEPHEN BENNION	Executive Vice President of Finance and Chief Stephen Bennion Financial Officer and Secretary	June 28, 2001
ADDITIONAL DIRECTORS:		
/s/ DR. SANJAY MITTAL Dr. Sanjay Mittal	Executive Vice President of Engineering and Chief Technical Officer and Vice Chairman of the Board	June 28, 2001
/s/ JOHN FISHER John Fisher	Director	June 28, 2001

/s/ MICHAEL LYONS Michael Lyons	Director	June 28, 2001
/s/ THOMAS NEUSTAETTER Thomas Neustaetter	Director	June 28, 2001

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
3.2*	The Second Amended and Restated Certificate of Incorporation.
3.3*	The amended and Restated Bylaws.
4.1*	Reference is made to Exhibits 3.1, 3.2 and 3.3.
4.2*	Form of Registrant's Common Stock certificate.
4.3*	Amended and Restated Investor Rights Agreement dated June 16, 1999.
10.1*	Form of Indemnification Agreement.
10.2*	1996 Stock Plan.
10.3*	1999 Employee Stock Purchase Plan.
10.4*	1999 Equity Incentive Plan.
10.5*	Lease between Spieker Properties L.P. and the Registrant, dated December 8, 1997.
10.6*	Lease between John Arrilliga Survivors Trust and the Richard T. Perry Separate Property Trust as Landlord and the Registrant as Tenant, dated October 1, 1999.
10.7*	Major Account License Agreement between the Registrant and Fujitsu Network Communica-tions, Inc., dated November 4, 1998.
10.8*	Agreement for Web Site Design and Development Service between the Registrant and BMW of North America, Inc., dated July 15, 1998.
10.9*	Major Account License Agreement between the Registrant and the Fireman's Fund Insurance Company, dated June 24, 1999.
10.10*	Major Account License Agreement between the Registrant and Loanmarket Resources, LLC., dated June 30, 1999.
10.11*	Major Account License Agreement between the Registrant and Aspect Telecommunications, dated May 17, 1999.
10.12*	A Consulting Engagement Proposal from the Registrant to 3Com, dated July 29, 1999.
10.13*	A Consulting Engagement Proposal from the Registrant to 3Com, dated August 10, 1999.
10.14*	Employment Agreement between the Registrant and Rajen Jaswa, dated as of July 1, 1997.
10.15*	Employment Agreement between the Registrant and Dr. Sanjay Mittal, dated as of July 1, 1997.

10.16* Offer letter from the Registrant to Stephen Bennion dated as of September 16, 1999.

10.18* Major Account License Agreement between the Registrant and Samsung SDS Co., Ltd., dated January 12, 2000; amendment #1 to Major Account License Agreement between the Registrant and Samsung SDS Co., Ltd., dated February 10, 2000.

10.19* International Value Added Reseller Agreement between the Registrant and Samsung SDS Co., Ltd., dated January 12, 2000; Amendment #1 to International Value Added Reseller Agreement between the Registrant and Samsung SDS Co., Ltd., dated February 29, 2000.

10.20* Stock Purchase Agreement between the Registrant and Samsung SDS Co., Ltd., dated January 31, 2000; Amendment #1 to the Stock Purchase Agreement between the Registrant and Samsung SDS Co., Ltd., dated February 8, 2000.

10.21* Lease between John Arrillaga Survivors Trust and Richard T. Perry Separate Property Trust as Landlord and the Registrant as Tenant, dated October 1, 1999.

10.22* Stock Purchase Agreement between the Registrant and Dell USA, L.P., dated February 14, 2000.

10.23** Offer to exchange outstanding options, dated April 27, 2001.

21.1 Subsidiaries

23.1 Consent of Ernst & Young LLP, independent auditors.

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* Previously filed in the Company's Registration Statement (No. 333-92545) declared effective on March 9, 2000.

** Previously filed in Schedule TO be filed by the Company on April 27, 2001.

EXHIBIT 21.1

SUBSIDIARIES

COUNTRY OR REGION	OFFICIAL NAME
Australia	Selectica Australia Pty Ltd.
Canada	Selectica Canada, Inc.
France	Selectica France Sarl
Germany	Selectica GmbH
India	Selectica India Private Limited
Mexico	Selectica Mexico S. de R.L. de C.V.
Sweden	Selectica Scandinavia AB
United Kingdom	Selectica U.K. Limited
U.S. SUBSIDIARIES	
Delaware	LoanMarket Resources, Inc.
Delaware	Wakely Acquisition Corp.

EXHIBIT 23.1

CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 333-56576 and 333-32666) pertaining to the Selectica, Inc. 1996 Stock Plan, 1999 Equity Incentive Plan, 1999 Employee Stock Purchase Plan and shares acquired under written Compensation Agreements of Selectica Inc. of our report dated April 24, 2001, with respect to the consolidated financial statements of Selectica Inc. included in the Annual Report (Form 10-K) for the year ended March 31, 2001.

/S/ ERNST & YOUNG LLP

San Jose, California
June 27, 2001