

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

FORM 10-K

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

For the fiscal year ended December 31, 2009
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 000-51358

Kenexa Corporation

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania
(State or other jurisdiction of incorporation or organization)

23-3024013
(I.R.S. Employer Identification Number)

650 East Swedesford Road, Wayne, PA
(Address of Principal Executive Offices)

19087
(Zip Code)

Registrant's Telephone Number, Including Area Code: (610) 971-9171

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

Common Stock, par value \$0.01 per share
(Title Class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Act). Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant on June 30, 2009 was approximately \$181,145,474. Such aggregate market value was computed by reference to the closing price of the common stock as reported on the Nasdaq National Market on June 30, 2009. For purposes of determining this amount only, the Registrant has defined affiliates of the Registrant to include the executive officers and directors of Registrant and holders of more than 10% of the Registrant's common stock on June 30, 2009.

The number of shares outstanding of the Registrant's Common Stock, as of March 3, 2010 was 22,583,034.

DOCUMENTS INCORPORATED BY REFERENCE

DOCUMENT
Portions of Proxy Statement for
2010 Annual Meeting of Shareholders

FORM 10-K
REFERENCE
Part III

KENEXA CORPORATION
FORM 10-K
DECEMBER 31, 2009
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PART I

This Annual Report on Form 10-K and the documents incorporated herein contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Those statements are therefore entitled to the protection of the safe harbor provisions of these laws. These forward-looking statements, which are usually accompanied by words such as “may,” “might,” “will,” “should,” “could,” “intends,” “estimates,” “predicts,” “potential,” “continue,” “believes,” “anticipates,” “plans,” “expects” and similar expressions, involve risks and uncertainties, and relate to, without limitation, statements about our market opportunities, our strategy, our competition, our projected revenue and expense levels and the adequacy of our available cash resources. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from those expressed or forecasted in, or implied by, such forward-looking statements, particularly those factors discussed in “Item 1A - Risk Factors” in this Annual Report on Form 10-K.

Although we believe that the expectations reflected in these forward-looking statements are based upon reasonable assumptions, no assurance can be given that such expectations will be attained or that any deviations will not be material. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Annual Report on Form 10-K may not occur and our actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. We disclaim any obligation or undertaking to disseminate any update or revision to any forward-looking statement contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

ITEM 1. Business

Company Overview

We provide software, proprietary content and services that enable organizations to more effectively recruit and retain employees. Our solutions are built around a suite of easily configurable software applications that automate talent acquisition and employee performance management best practices. We offer the software applications that form the core of our on-demand solutions, which materially reduces the costs and risks associated with deploying traditional enterprise applications. We complement our software applications with tailored combinations of outsourcing services, proprietary content and consulting services based on our 22 years of experience assisting customers in addressing their Human Resource (HR) requirements. Together, our software applications and services form complete and highly effective solutions available from a single vendor. We believe that these solutions enable our customers to improve the effectiveness of their talent acquisition programs, increase employee productivity and retention, measure key HR metrics and make their talent acquisition and employee performance management programs more efficient.

We sell our solutions to large and medium-sized organizations through our direct sales force. As of December 31, 2009, we had a customer base of approximately 4,900 companies, including approximately 170 companies on the Fortune 500 list published in May 2009. Our customer base includes companies that we billed for services during the 12 months ended December 31, 2009 and does not necessarily indicate an ongoing relationship with each such customer. Our top 80 customers contributed approximately 54.9%, 56.3%, and 53.5% of our total revenue for the years ended December 31, 2009, 2008 and 2007, respectively. Our customers typically purchase multi-year subscriptions which provide us with a recurring revenue stream. Historically, our customers have renewed more than 90% of the aggregate value of multi-year subscriptions for our on-demand talent acquisition and performance management solution contracts subject to renewal. Recently however, the economic downturn has adversely impacted this trend, resulting in lower annual renewals. During each of the years ended December 31, 2009 and 2008, our customers renewed approximately 80% and 75%, respectively, of the aggregate value of multi-year subscriptions.

We derive revenue primarily from two sources, subscription fees for our solutions and fees for discrete professional services. During the years ended December 31, 2009, 2008 and 2007, subscription revenue comprised approximately 84.9%, 80.2% and 81.7%, respectively, of our total revenue.

Company History

We are a Pennsylvania corporation. We began our operations under predecessor companies, Insurance Services, Inc., or ISI, and International Holding Company, Inc., or IHC, in 1987. In December 1999, we reorganized our corporate structure by merging ISI and IHC with and into Raymond Karsan Associates, Inc., or RKA, a Pennsylvania corporation and a wholly owned subsidiary of Raymond Karsan Holdings, Inc., or RKH, a Pennsylvania corporation. Each of RKA and RKH were newly created to consolidate the businesses of ISI and IHC. In April 2000, we changed our name to TalentPoint, Inc. and we changed the name of RKA to TalentPoint Technologies, Inc. In November 2000, we changed our name to Kenexa Corporation, or Kenexa, and we changed the name of TalentPoint Technologies, Inc. to Kenexa Technology, Inc., or Kenexa Technology. Currently, Kenexa transacts business primarily through Kenexa Technology and its wholly owned subsidiaries.

Our principal executive offices are located at 650 East Swedesford Road, Second Floor, Wayne, PA 19087.

Our telephone number is (610) 971-9171. We maintain an Internet website at <http://www.kenexa.com>. We are not incorporating by reference into this Annual Report on Form 10-K any material from our website. The reference to our website is an inactive textual reference to the uniform resource locator (URL) and is for your reference only.

Recent Events

During the fourth quarter 2008, in response to the challenging macroeconomic environment, the strengthening U.S. dollar relative to other currencies of countries in which we do business, and the slowing or delaying of a number of projects by our customers, we announced a restructuring program involving reductions of approximately 200 employees and recorded severance and outplacement benefit costs totaling \$2.0 million. During the first quarter of 2009, as a result of the continued deterioration in the economic environment, we executed an additional reduction of approximately 159 employees and recorded severance and outplacement benefit costs totaling \$1.2 million.

During the three months ended March 31, 2009, due to a 32.5% decline in our stock price and market capitalization from the previous quarter, lower projected net income, cash flow estimates and slower projected growth rates in our industry, we reevaluated our goodwill impairment analysis. Our analysis was performed to determine the implied fair value of our goodwill with neither the write up or write down of any assets or liabilities, nor recording of any additional unrecognized identifiable intangible assets. Based upon our analysis we recorded a goodwill impairment charge of \$33.3 million during the quarter ended March 31, 2009. This goodwill impairment charge had no effect on our cash balances.

On January 20, 2009, we entered into an ownership interest transfer agreement (“the agreement”) with Shanghai Runjie Management Consulting Company, (“R and J”) in Shanghai, China for \$1.3 million. The initial investment provided us with a 46% ownership in the new entity Shanghai Kenexa Human Resources Consulting Co., Ltd., (the “variable interest entity”) and a presence in China’s human capital management market. The agreement also provided for a 1% annual ownership increase based upon adjusted EBITDA, as defined, for each of the years ended 2008, 2009 and 2010. In the third and fourth quarter of 2009, based upon the 2008 operating results for R and J, we paid an additional \$0.2 million in total for an additional 1% ownership interest in the variable interest entity. The variable interest entity was financed with \$0.3 million in initial equity contributions from us and R and J, and has no borrowings for which its assets would be used as collateral. On September 30, 2009, we provided \$0.2 million of financing for the variable interest entity. The creditors of the variable interest entity do not have recourse to our other assets.

On May 21, 2009, we elected not to renew our secured credit agreement with PNC Bank. We believe that our cash, short-term investments, UBS Settlement Agreement (as described in Footnote 3 of the Notes to the Consolidated Financial Statements) for our auction rate securities and projected cash from operations will be sufficient to meet our liquidity needs for at least the next twelve months.

On June 11, 2009 and July 16, 2009, two putative class actions were filed against Kenexa Corporation and our Chief Executive Officer and Chief Financial Officer in the United States District Court for the Eastern District of Pennsylvania, purportedly on behalf of a class of our investors who purchased our publicly traded securities between May 8, 2007 and November 7, 2007. The complaint filed on July 16, 2009 has since been voluntarily dismissed. In the pending action, Building Trades United Pension Trust Fund, individually and on behalf of all others similarly situated alleges violations of Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”), Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act in connection with various public statements made by Kenexa. This action seeks unspecified damages, attorneys’ fees and expenses.

Industry Overview

Talent acquisition is the sourcing, recruiting, screening and assessment of employees. Employee performance management is the systematic process by which an organization tracks, monitors and optimizes employee behavior and productivity, and evaluates performance through employee reviews, appraisals and business metrics.

Drivers of Demand for Talent Acquisition and Employee Performance Management Applications

According to the Bureau of Economic Analysis, an agency of the U.S. Department of Commerce, the amount spent on U.S. labor in 2009 was approximately \$6.3 trillion, or approximately 49.5% of the total U.S. gross domestic product. We believe that the drivers for human capital are affected by intense competition for qualified employees as a result of an aging workforce, declining tenure of employees, increased globalization, the increasing service component of the U.S. economy and pressure on human resource departments to reduce costs.

Over the past two decades, many organizations have implemented software systems that systematize best practices and drive efficiency in most departments, including enterprise resource planning systems (“ERP”), customer relationship management systems and supply chain management systems. These software applications provide a wide array of benefits that both assist revenue growth and eliminate expenses. Based on our experience, however, we believe that the HR departments of many of these organizations have only implemented HR information systems, which track basic employee information for payroll and benefits purposes, or rudimentary applicant tracking systems. Although these systems provide some level of automation, they do little to increase the effectiveness of talent acquisition and employee performance management programs. We believe that few organizations have systemized best practices for talent acquisition and employee performance management or have implemented software applications to support these processes and provide HR professionals with critical analytics and metrics.

Our experience indicates that, presently, many organizations' talent acquisition functions consist of manual, paper-based processes, ad hoc outsourcing and third-party or custom software applications with limited functionality. As a result, we believe that they suffer from the following shortcomings:

- *Inefficiency.* Many organizations rely on manual, paper-based processes and they cannot effectively manage the massive number of candidates presented by today's many recruiting resources, including unsolicited inquiries, internal referrals, career fairs, campus recruiting, Internet job boards and third-party referrals, among many others. As a result, they fail to identify high potential candidates or fail to process those candidates in a timely manner.
- *Redundancy.* Many organizations do not maintain easily searchable databases of processed candidates and they often conduct redundant searches. A candidate who did not meet the criteria for a certain position may meet the criteria for alternative or future positions. Without an easily searchable database, a candidate may be overlooked.
- *Ineffectiveness.* Organizations generally do not employ sophisticated screening and assessment mechanisms. As a result, most hiring decisions are at best loosely based on objective indicators of future success and fail to match high-potential candidates with roles or positions that leverage their unique abilities and experience. This lowers the probability that a new hire will succeed, and negatively impacts employee productivity and satisfaction.
- *Inconsistency.* Many organizations screen applications and resumes based on rudimentary criteria, and do not conduct sophisticated and objective assessments and base hiring decisions primarily on subjective, ad hoc interviews. This process lacks consistency and objectivity. This inconsistency not only negatively impacts the effectiveness of recruiting programs, but also may expose organizations to regulatory liability.
- *High cost and inflexibility.* As a result of their inflexibility and absence of a variable cost structure, organizations must either maintain larger HR departments or purchase a greater supply of third-party services in order to accomplish their recruiting goals, significantly increasing the costs of their talent acquisition programs.

Similarly, we believe that many organizations have neither automated nor applied best practices to employee performance management. In our experience, most organizations' employee performance management processes consist of annual performance reviews and informal mentoring programs. We believe that effective employee performance management requires a consistent, systematized process that identifies employee strengths, weaknesses and issues in a timely manner, continually aligns employee goals with the evolving goals of the organization, monitors opportunities for internal advancement and enables management to analyze employee data over time. We believe that the absence of effective employee performance management systems and processes has the following negative implications:

- *Failure to retain top performers.* The absence of systems and processes to ensure the fulfillment, motivation and internal mobility of key employees negatively impacts an organization's ability to retain its top performing employees. Management may not have the opportunity to rectify problems with valued employees before they depart from the organization without a system to highlight these issues. Reducing employee turnover can have a material impact on an organization's expenses.
- *Failure to optimize productivity.* Maximum productivity is obtained when employees believe their roles match their evolving skill sets, find their jobs challenging and have confidence in their upward mobility. The absence of strong employee performance management systems contributes to the failure to accomplish these goals, and even if organizations succeed in retaining employees, they may not be able to maintain maximum productivity from their employees.
- *Failure to remove poor performers.* An employee who does not fulfill his or her role effectively may have a recurring negative impact on an organization. To the extent that a poor performer has managerial responsibility, this negative impact on the organization expands materially. Without systems that identify poor performers, organizations may not be able to address weaknesses within their human capital in a timely manner.

We believe that the failure to employ sophisticated systems in their talent acquisition and employee performance management processes inhibits organizations from leveraging valuable data generated through these functions. This can negatively impact organizations in several ways, including the failure both to identify overall trends that could improve the efficiency and effectiveness of its processes and to quickly identify problems that could lead to employee turnover.

Emergence of On-Demand Applications

Based on our experience, we believe that organizations have become increasingly dissatisfied with traditional enterprise software applications, resulting in the growing adoption of the on-demand model for enterprise software. Historically, organizations have purchased perpetual software licenses and deployed enterprise software applications on-site within their IT environment. This traditional method of purchasing and deploying enterprise software applications has left many organizations questioning whether the benefits of these technologies outweigh the following burdens:

- *Expensive and time consuming implementation.* A traditional enterprise software application requires an organization to invest in ancillary IT such as hardware systems, application servers, databases, storage, and backup systems. In addition, the organization must employ consultants or additional IT staff to integrate the application into increasingly complicated IT environments and customize the application for specific needs. The ancillary costs of a complex deployment can be multiples of the perpetual license fee for the software application and can take several months or even years to complete.
- *Expensive maintenance.* Once the software application has been deployed, the organization must make further investments to maintain the application. In addition to the maintenance fee paid to the software vendor, which is typically approximately 20% of the perpetual license fee for all software used in running the application, the organization must retain both an IT staff capable of maintaining and upgrading the software as well as personnel to train new users to operate the applications. Such upgrades must be made to all applications required to run the software such as operating system, databases, security patches, etc. We believe that because of the expense that typical application upgrades significantly lag, denying end users the benefits of new technologies and solution functionalities.
- *Limited incentives to ensure customer success.* A typical perpetual software license requires the customer to pay up-front a material amount for the license, with a significantly smaller amount, typically approximately 20%, paid annually for basic support and upgrades. This model leaves little incentive for the software vendor to ensure a successful implementation and on-going customer satisfaction.

Developments in technology have enabled software developers to offer enterprise software applications on an on-demand basis. By leveraging the Internet, multi-tiered architectures, advances in security and open standards for application integration, software vendors can offer software applications to their customers as a service, hosting the software on servers operated by the software vendor. Customers, using an Internet browser, access the applications, which are designed to be easily configured and integrated with a customer's existing applications.

The on-demand model fundamentally changes both the purchasing and deployment of enterprise software from a customer perspective. Rather than making large, up-front investments in perpetual licenses, customers purchase limited term subscriptions for on-demand software applications. Further, because only an Internet browser is required to access on-demand software applications, which can be easily configured to meet the buyer's specific needs, organizations eliminate the expense of ancillary technology and third-party services required to implement, configure and maintain the enterprise application on-site. Finally, the finite duration of customer subscriptions provides a strong incentive to software vendors to ensure that the software provides the expected benefits to the customer, resulting in consistent customer service. The on-demand model also reduces research and development support costs for the software developer. Because only limited versions of the software exist at any one time, the on-demand model relieves the burden of maintaining and upgrading historical versions of the software so that customers benefit from a steady stream of the most recent features and technologies.

We believe that talent acquisition and employee performance management applications are particularly well-suited to the on-demand model. Talent acquisition and employee performance management applications are generally purchased by an organization's HR department. Because the HR departments of most organizations have little historical experience making capital expenditures for enterprise software applications, we believe that providing these departments the opportunity to license software applications on a subscription basis eliminates a major impediment to the adoption of talent acquisition and employee performance management applications.

Our Solution

We are a leading provider of integrated talent management solutions. Our solutions enable organizations to implement systematic talent acquisition practices that ensure the efficient, effective and consistent hiring of qualified and talented individuals. Our solutions also provide employee performance management systems that help to ensure that organizations retain and optimize the performance of qualified individuals, identify employees who fail to perform, and identify successors for critical positions. In addition, our solutions help organizations manage learning and assessment opportunities and events to develop employees for both current and desired future jobs. Finally, our solutions enable customers to determine its workforce's engagement level, and diagnose where changes in behavior (for individual employees, managers and senior leaders) or HR programs will improve organizational performance and business outcomes.

Our solutions are built around a suite of easily configurable software applications that automate and support talent management leading practices. We believe that by delivering our products via Software as a Service (SaaS), we materially reduce the costs and risks associated with traditional enterprise software application implementations. We also believe that implementing feature-rich and scalable, highly configurable on a real-time basis, talent acquisition and employee performance management solutions that meet organizations' specific needs requires a combination of software, services and domain-specific knowledge and expertise. Accordingly, we complement our software applications with consulting services, outsourcing services and proprietary content. Together, these components form solutions that enable our customers to improve the quality of their hiring programs, increase employee productivity and retention, enhance employee learning and development, increase employee engagement, and make their integrated talent management programs more cost-effective.

- *More effective and consistent talent acquisition programs.* Our talent acquisition solutions are comprised of two major components that enable our customers to increase the consistency and effectiveness of their recruiting programs. The first component is our applicant tracking system, which automates and streamlines the recruiting process. The second component is our testing and assessment solutions, which ensures that candidates have the desired knowledge, skills, behavior and experience necessary to be successful in the desired position. Our talent acquisition solutions enable our customers to:
 - expand the pool of qualified applicants;
 - accurately communicate a powerful employment brand that draws “best fit” candidates to the organization;
 - identify high-potential candidates more quickly;
 - accurately measure candidate skills, aptitude and experience;
 - create interviews focused on necessary skills and qualities indicative of success;
 - increase interview consistency and objectivity;
 - identify training needs immediately;
 - document compliance with regulatory requirements; and
 - ensure cultural fit between candidates and the organization.
- *Greater employee productivity and retention.* Our employee performance management solutions combine software, proprietary content and consulting services to automate and systematize employee performance management leading practices. Specifically, our solutions enable organizations to automate goal setting, performance appraisal, succession planning, career planning, and compensation management activities, manage learning and development events, design and administer effective and consistent employee surveys and implement productive mentoring programs. Our solutions include tools that facilitate the development of action plans to address weaknesses and cultivate strengths identified through these processes. We complement the software components of our solutions with consulting services that help to encourage and manage behavioral change within an organization. As a result, we understand that our customers experience greater employee productivity and improved employee retention after implementing our solutions, and thus directly impact business outcomes.
- *More cost-effective talent acquisition and employee performance management programs.* We believe that our solutions increase the cost-effectiveness of talent acquisition and employee performance management programs in three ways. First, our solutions automate these activities, enabling organizations to maintain smaller HR departments and eliminate some third-party services. Second, our solutions enable organizations to more effectively identify high-potential candidates and retain qualified employees. Third, our solutions provide management the opportunity to achieve economies of scale by outsourcing non-core functions while also ensuring the application of best HR practices and leading technology to these functions.

- *Application of analytics to talent acquisition and employee performance management programs.* Our solutions enable organizations to use the data generated by their talent acquisition and employee performance management programs in order to improve these programs. Specifically, our solutions enable management to identify overall trends that could improve the efficiency and effectiveness of their processes. For example, we enable our customers to identify their most productive recruiting channels, establish criteria indicative of success in various roles and identify problems that could lead to employee turnover.
- *Ease of integration, configuration and deployment.* We provide the software applications that form the core of our solutions on an on-demand basis, eliminating the material expenses and complexity of traditionally purchased and deployed software applications. We combine this deployment model with an intuitive user interface to facilitate rapid and widespread adoption within the HR department. Our solutions are designed for ease of use by non-technical staffing professionals, managers, candidates and employees. We believe that these aspects of our solutions enable organizations to quickly achieve the anticipated benefits.

Our Strategy

Our objective is to be the leading global provider of human capital management business solutions for global organizations with more than 5,000 employees. Key elements of our strategy include:

- *Focus on strategic talent management solutions.* Unlike some vendors that provide broad suites of HR administrative software, we have focused on the strategic HR functions that have the greatest potential to build and improve the workforces of our customers. We believe that this focus has enabled us to deliver solutions that meet the unique needs of our customers in these areas. We also believe that this focus has helped us to generate an increasingly recognized brand in these markets, which are expected to grow at a materially faster rate than the broader Human Capital Management (HCM) market over the next five years. We intend to continue to broaden our footprint in the integrated talent management space in order to leverage our increasingly recognized brand in these markets and these positive market dynamics.
- *Provide innovative and industry-specific solutions to our customers.* During the past three years, we have introduced several new solutions, each in response to the unique needs of our customers. We intend to continue to work closely with our customers to further develop innovative solutions that increase the effectiveness of their recruiting programs and contribute to greater employee retention and productivity. We have also introduced specific solutions for the following vertical industries: financial services and banking, manufacturing, life sciences, biotechnology and pharmaceuticals, retail, healthcare, hospitality, call centers, and education. We intend to develop specific solutions for additional vertical industries.
- *Cross-sell additional solutions to and further penetrate current customers.* During the year ended December 31, 2009, we renewed approximately 80% of the aggregate value of multi-year subscriptions for our on-demand talent acquisition and performance management solution contracts subject to renewal. This renewal rate provides us with a strong base of recurring revenue. We believe that our strong customer relationships provide us with a meaningful opportunity to cross-sell additional solutions to our existing customers and to achieve greater penetration within an organization. We expect to continue to create innovative programs designed to provide our employees with strong incentives to maximize the value we provide to each of our customers.
- *Continue to leverage our global sourcing strategy to provide quality solutions efficiently.* We established offices in Hyderabad, India in 2003. In January 2008 we completed construction and opened our facility in Vizag, India. We currently have approximately 312 employees working in our offices in Hyderabad and Vizag. We believe our sourcing strategy will continue to provide significant benefits to our customers including cost benefits and year round customer service, 24 hours a day, 7 days a week.
- *Expand our global presence and customer base.* For the year ended December 31, 2009 we have expanded our global presence to over 21 countries. Although our primary focus has been on the U.S. market, our solutions are also well suited to addressing problems faced by organizations outside the United States. In the future, we intend to expand our distribution efforts in Europe, the Middle East and the Asia/Pacific region. Although we have employed a direct sales force in the United States, we intend to expand our international distribution through direct sales and strategic partnerships. We believe that pursuing a channel strategy enables us to limit the costs associated with international expansion and acknowledges that different geographies present different cultural challenges best addressed by a local sales force.
- *Pursue complementary acquisitions.* We have completed 28 acquisitions of businesses since 1994. These acquisitions have helped us to adapt our business to the evolving needs of our customers. We believe that the HCM market is significantly fragmented. Many competing companies have strong technology or vertical market expertise but lack the scale to compete with the industry leaders in the long term. We continue to identify similarly situated companies that we believe could broaden the functionality and strength of our existing solutions.

Our Products and Services

We offer unified business solutions that support hiring and retention for the entire employee lifecycle.

Hiring Solutions:

Recruitment Process Outsourcing (“RPO”)

Our RPO offering delivers a higher quality of candidate—fast. With operations around the globe, we use technology and human ability to reach hard-to-find candidates and deliver them real-time to recruiters. We understand organizations need us to provide better recruiting for less, and use our global resources to drive cost savings and improve their workforces. Kenexa RPO provides global recruitment services for the largest companies in the world.

Recruitment Technology

We provide complete Recruitment Technology systems for the largest, most complex organizations in the world. Our web-based technology provides everything organizations need to locate and track talented candidates as they move through the hiring process. Built using cutting-edge technologies, our Recruitment Technology solutions deliver comprehensive support of recruiting processes, giving companies visibility and access to critical hiring and retention data.

Onboarding

Our Onboarding solution is built on the belief that every new employee needs to have the right information to be effective. Our solution offers forms management for legal documents, workflow and electronic signatures. We help companies extend a positive brand impression through ongoing communication and socialization that reinforces their culture and business practices. This helps organizations reduce the amount of time it takes employees to be fully competent in their jobs—increasing productivity and return on investment.

Employee Assessments

We offer Employee Assessments that help organizations select and retain top performers based on seven key areas that predict individual performance and potential—experience, skills, abilities, personality, motivation, situational judgment and culture fit. Our tools are delivered in the most usable formats—online, interviews and assessment centers. All of our solutions can be used as standalone systems or easily integrated with the quality and efficiency of recruiting and selection processes. They allow organizations to make better hiring and promotion decisions, and ensure that employees are a perfect fit in the organization’s culture.

Skills Tests

We offer skills tests that improve the screening process by helping organizations quickly identify and select the most talented candidates. Easy-to-use and administer, Kenexa Prove It!® System offers more than 1,000 validated assessments for specific job classifications, including software, office/professional, call center, financial, healthcare, industrial, legal and technical positions. Test results are received instantly—ideal for selecting candidates in a fast-paced, competitive environment.

Structured Interviews

We offer structured interviews that assess candidates with greater accuracy, objectivity and consistency, while improving the fit of new hires within each organization's culture. Kenexa Interview Builder® System provides a powerful online structured interview reference library of more than 3,000 questions that increase interviewer confidence, efficiency, accuracy and defensibility. With the ability to custom select behavioral, situational, attitudinal and job knowledge questions, Interview Builder encourages candidates to speak freely about their experiences and provides a broad spectrum of job analysis tools, job description templates, interview guides and competency profiles.

Employment Branding

Our Employment Branding offering applies the same consumer branding principles of attracting and retaining customers to attracting and retaining top employees. It’s a practice built on research that uncovers the strengths, weaknesses and hidden elements of an organization’s culture. Employment Branding integrates seamlessly with every Kenexa solution to create award-winning recruitment campaigns, provide candidates with an engaging career site experience, uncover the right media mix for sourcing, give insight into employee engagement and help retain top performers.

Retention Solutions:

Performance Management

We offer comprehensive Performance Management solutions that integrate performance management, compensation management, career development, goal alignment and succession planning. Our solutions enable companies to increase productivity, streamline processes, increase accountability and enhance employee engagement.

Employee Surveys

We deliver Employee Surveys that provide the measurements needed to further each organization and improve business outcomes. With the industry's best psychologists and top HR experts, we believe we are the proven leader in survey design, administration, reporting and behavior change. Our depth of experience, proven track record, high client retention rate, industry leading normative data and global footprint make us unique. Our tools and technology are intuitive and customized for each organization, making them easy for survey champions, employees and managers to use.

Learning Management

Our Learning Management solution enables organizations to deliver and track employee learning. Our system is ideal for all types of training, including skills and behavioral learning, new-hire orientation, leadership education and sales training. We help companies tailor the delivery of learning management processes by division, business unit and geography.

Leadership Solutions

We understand that leadership development efforts are not universal—they must be tailored to each organization's specific metrics and processes. Our Leadership Solutions are designed to address core business needs by increasing the quality of leadership in organizations. We offer Leadership Audit, Leadership Assessments and Leadership Development solutions that align with each company's business strategies to help drive greater organizational performance and success.

Technology, Development and Operations

Technology

We believe that the current market desires integrated talent management solutions that deliver a high degree of business value by linking human capital management solutions more directly to business outcomes. Available in a Software as a Service (SaaS) context, extending a customer's enterprise, this technology must be easy to use and inexpensive to configure and integrate with the customer enterprise. Kenexa solutions deliver this value by meeting the diverse needs of key stakeholders (Executives, HR, line managers, and employees), by supporting enterprise processes, and by integrating seamlessly with a wide variety of internal and third party applications and services.

Kenexa's technology strategy is a two-pronged approach: continued enhancement to our common services and existing applications, which provide standard features and functionally.

- *Common Services.* Kenexa utilizes a Service Oriented Architecture (SOA) to integrate its applications to other applications, vendors and customers. These common services also include application functionality that can be leveraged across multiple Kenexa applications, enables extension of best-of-breed capabilities, and drives rapid code deployment across applications. The benefit to Kenexa customers is that it enables us to bridge current applications with future needs, and better meet the diverse needs of our customer base.
- *Kenexa 2x™ Products.* This solution set is a Platform as a Service (PaaS) and represents the next generation of Kenexa development, via a fully integrated talent management application on a unified data model, security infrastructure, and user experience, with a universal talent record that enables organizations to aggregate all talent data across the enterprise and spanning entire employee life cycles. Kenexa 2x has been architected to use Common Services for various functions and to integrate with Kenexa Recruiter ® BrassRing category applications.

This architecture enables us to meet the needs of our current customer base while developing and deploying future capabilities with little to no customer impact, and thus delivers a high degree of customer care.

Our software is designed to support easy-to-use features such as dynamic workflows, job templates and user configuration that enable customers to adapt the application for their specific requirements. Dynamic workflows are designs that facilitate business processes whereby one step in the process cannot be completed until all prior steps have been completed.

Development

Innovation is an important part of our business. We believe that three primary factors drive our innovation: our employees, our domain experts and our customers. We have a formalized system to cultivate participation from all of our employees in research and development. We also leverage the experience of our research scholars and domain experts, who produce white papers, case studies and thought pieces which form the foundation for our innovation. Our research and development team maintains a repository of ideas, and selected ideas are presented to the market validation team. Market validated ideas progress to the prototype stage. The executive team reviews prototypes and selects those with the highest potential, which then enter the product development phase. In addition to our employees and domain experts, some of the key ideas are generated from customer feedback gathered during user group meetings, customer symposiums, and advisory councils.

We follow a development methodology that we believe allows us to develop projects quickly and then proceed on a predictable, low risk path for high-quality results. We conduct our product development through our global development teams. We are in the process of transitioning from being an ISO 9001:2000 certified organization to a Capability Maturity Model Integration (CMMI) certified organization. We intend to seek CMMI certification in the coming years.

Operations

Our data centers in Sterling, Virginia and Blanchardstown, Ireland serve as our hosting facilities for our on-demand solutions. We also have data centers in Massachusetts, Pennsylvania, Nebraska, England, and India. We seek to adhere to industry standards and best practices in our global operations. Our goal is to deliver world-class hosted solutions that are highly available, scalable and reliable across our suite of Talent Management solutions. We believe that we offer best-in-industry security to our customers and demonstrate this through a number of security related certifications including CyberTrust Enterprise, CyberTrust Application, TRUSTe, and SafeHarbor. We seek to deliver quality service with service level guarantees to customers.

Our Hosting Operations and Security teams include multiple Certified Information Systems Security Professionals, or CISSPs, with training in the latest security and availability threats. Our data centers are continuously and proactively monitored by a comprehensive set of tools, personnel, as well as partnering with a third party intrusion detection vendor, 24 hours a day, 7 days a week. Our hosted data center has built-in power redundancy from multiple power grids with uninterrupted power supplies backed up by N+1 diesel generators designed to provide uninterrupted service to our customers. The hosted infrastructure is designed with a focus on quality, reliability, scalability, privacy and security.

Customers

As of December 31, 2009, we had a customer base of approximately 4,900 companies over a number of industries, including financial services and banking, manufacturing, life sciences, biotechnology and pharmaceuticals, retail, healthcare, hospitality, call centers, and education, including approximately 170 companies on the Fortune 500 list published in May 2009. Our customer base includes companies that we billed for services during the year ended December 31, 2009 and does not necessarily indicate an ongoing relationship with each such customer. For the year ended December 31, 2009, we provided our talent acquisition and employee performance management solutions on a subscription basis to approximately 4,212 customers, with an average subscription term of two years. The remainder of our customers in 2009 engaged us to provide discrete professional services and may not engage us for future services once a project is completed. No single customer accounted for more than 10% of our revenue in the year ended December 31, 2009.

Customer Support

We believe that superior customer support is critical to our customers. Our customer support group assists our customers by answering questions and troubleshooting issues involving our solutions. Customer support is available 24 hours a day, 7 days a week by telephone and Internet from a member of our customer support team. Members of our customer support team receive comprehensive training and orientation to ensure that our customers receive high-quality support and service. Each of our customers is assigned a single point of contact. When an issue is reported to us, our customer support personnel follow a clearly defined escalation process to ensure that mission-critical issues are resolved to the satisfaction of the customer.

We utilize our talent acquisition and employee performance management solutions to recruit and manage our customer support personnel. We believe that applying these solutions to our customer service department has resulted in a customer support group with superior skills, competencies and aptitude for customer service. As of December 31, 2009, our customer support group consisted of 776 employees. The majority of our customer support groups reside in the following locations: Massachusetts, Nebraska, Pennsylvania, Texas, England, Germany, India and Poland.

Sales and Marketing

Our target customers are large and medium-sized organizations with complex talent acquisition and employee performance management needs. We sell our solutions to both new and existing customers primarily through our direct sales force, which is comprised of inside sales, telesales and field sales personnel. Our marketing strategy focuses on building Kenexa's value proposition in the marketplace, increasing the productivity of our sales engine and establishing relationships with industry influencers.

We believe that our customer relationships provide us with a meaningful opportunity to cross-sell additional solutions to our existing customers and to achieve greater penetration within the organizations. We have established a program intended to increase cross-selling into our largest customers, and we expect to continue to create innovative programs designed to incent our employees and maximize the value we provide to each of our customers.

Our marketing initiatives are generally targeted toward specific vertical industries or specific solutions. Our marketing programs primarily consist of:

- participation in and sponsorship of conferences, symposiums, regional user groups, networks, tradeshow and industry events;
- direct marketing campaigns;
- advertising in online media outlets, trade and mainstream publications;
- creation of white papers, case studies, sales materials and thought leadership papers;
- leveraging our website to provide product and company information, podcasts, social media forums, and resources to professionals; and
- Focusing public relations efforts on building and enhancing our brand in the marketplace.

Employees

As of December 31, 2009, we had 1,459 employees, consisting of 243 employees in sales and marketing, 291 employees in development, 776 employees in delivery of our solutions and 149 employees in general and administrative positions. As of December 31, 2008, we had 1,535 employees, consisting of 225 employees in sales and marketing, 411 employees in development, 757 employees in delivery of our solutions and 142 employees in general and administrative positions. None of our employees are represented by a union. We consider our relationship with our employees to be good and have not experienced any interruptions of our operations as a result of labor disagreements.

Intellectual Property

Our intellectual property rights are important to our business. We rely on a combination of patents, copyright, trade secret, trademark and other common laws in the United States and other jurisdictions, as well as confidentiality procedures, systems and contractual provisions to protect our proprietary technology, processes and other intellectual property.

Although we rely on patents, copyright, trade secret and trademark law, written agreements and common law, we believe that the following factors are more essential to establishing and maintaining a competitive advantage:

- the technological skills of our research and development personnel;
- the domain expertise of our consultants and outsourcing service professionals;
- frequent enhancements to our solutions;
- continued expansion of our proprietary content; and
- high levels of customer service.

Others may develop products that are similar to our technology. We generally enter into confidentiality and other written agreements with our employees and partners, and through these and other written agreements, we attempt to control access to and distribution of our software, documentation and other proprietary technology and other information. However, despite our efforts to protect our proprietary rights, third parties may, in an unauthorized manner, attempt to use, copy or otherwise obtain and market or distribute our intellectual property rights or technology or otherwise develop a product with the same functionality as our software. Policing unauthorized use of our software and intellectual property rights is difficult, and nearly impossible on a worldwide basis. Therefore, we cannot be certain that the steps we have taken or will take in the future will prevent misappropriation of our technology or intellectual property rights, particularly in foreign countries where we do business or where our software is sold or used, where the laws may not protect proprietary rights as fully as do the laws of the United States or where enforcement of such laws is not common or effective.

Substantial litigation regarding intellectual property rights exists in the software industry. From time to time, in the ordinary course of our business, we are subject to claims relating to our intellectual property rights or those of others, and we expect that third parties may commence legal proceedings or otherwise assert intellectual property claims against us in the future, particularly as we expand the complexity and scope of our business, the number of similar products increases and the functionality of these products further overlap. We cannot be certain that no third party intellectual property rights that exist could result in a claim against us in the future. These actual and potential claims and any resulting litigation could subject us to significant liability for damages. In addition, even if we prevail, litigation could be time consuming and expensive to defend and could affect our business materially and adversely. Any claims or litigation from third parties may also limit our ability to use various business processes, software and hardware, other systems, technologies or intellectual property subject to these claims or litigation, unless we enter into license agreements with the third parties. However, these agreements may be unavailable on commercially reasonable terms or not available at all.

Competition

We have experienced, and expect to continue to experience, intense competition from a number of companies. We compete with niche point solution vendors, some of whom are privately held, such as Peopleclick Authoria, iCIMS, Inc., Integrated Performance Systems, Inc., Kronos, Pilat HR Solutions, Inc., Previsor, Inc., SHL Group plc, SuccessFactors, Inc., and Taleo Corporation, which offer products that compete with one or more applications in our suite of solutions. In some aspects of our business, we also compete with established vendors of enterprise resource planning software with much greater resources, such as Oracle Corporation (PeopleSoft), SAP AG and Lawson, Inc. To a lesser extent, we compete with vendors of recruitment process outsourcing services and survey services, including Accolo, Inc., Alexander Mann Solutions, The Right Thing, and survey services such as The Gallup Organization. We believe the principal competitive factors in our industry include:

- solution breadth and functionality;
- ease of deployment, integration and configuration;
- domain expertise;
- industry-specific expertise;
- service support, including consulting services and outsourcing services;
- solution price;
- breadth of sales infrastructure; and
- breadth of customer support.

We believe that we generally compete favorably with respect to these factors.

We may face future competition in the talent acquisition and employee performance management market from large, established companies, such as Oracle and SAP, as well as from emerging companies. Barriers to entry into our industry are relatively low, new software products are frequently introduced and existing products are continually enhanced. In addition, we expect that there is likely to be consolidation in our industry, which could lead to increased price competition and other forms of competition. Established companies not only may develop their own competitive products, but may also acquire or establish cooperative relationships with current or future competitors, including cooperative relationships between both larger, established and smaller public and private companies.

In addition, our ability to sell our solutions will depend, in part, on the compatibility of our software with software provided by our competitors. Our competitors could alter their products so that they will no longer be compatible with our software or they could deny or delay access by us to advance software releases, which would limit our ability to adapt our software to these new releases. If our competitors were to bundle their products in this manner or make their products non-compatible with ours, our ability to sell our solutions might be harmed which could reduce our gross margins and operating income.

Securities and Exchange Commission Filings

We file annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and other information with the SEC. Members of the public may read and copy materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Members of the public may also obtain information on the Public Reference Room by calling the SEC at 1-800-732-0330. The SEC also maintains an Internet web site that contains reports, proxy and information statements and other information regarding issuers, including us, that file electronically with the SEC. The address of that site is www.sec.gov. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and other information filed by us with the SEC are available, without charge, on our Internet web site, www.kenexa.com as soon as reasonably practicable after they are filed electronically with the SEC.

ITEM 1A. Risk Factors

We operate in a market environment that involves significant risks, many of which are beyond our control. The following risk factors may adversely impact our results of operations, cash flows and the market price of our common stock. Although we believe that we have identified and discussed below the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant that may adversely affect our performance or financial condition.

Our business will suffer if our existing customers terminate or do not renew their software subscriptions.

We expect to continue to derive a significant portion of our revenue from renewals of subscriptions for our talent acquisition and employee performance management solutions. During the years ended December 31, 2009 and 2008, our customers renewed approximately 80% and 75%, respectively, of the aggregate value of multi-year subscriptions for our on-demand talent acquisition and performance management solution contracts subject to renewal, a rate which is lower than the approximately 90% rate at which our customers have historically renewed their subscriptions with us. If our customers terminate their agreements, fail to renew their agreements, renew their agreements upon less favorable terms to us, defer existing agreements or fail to purchase new solutions from us, our revenue may decline or our future revenue growth may be constrained.

Maintaining the renewal rate of our existing subscriptions is critical to our future success. Factors that may affect the renewal rate for our solutions include:

- the price, performance and functionality of our solutions;
- the availability, price, performance and functionality of competing products and services;
- the effectiveness of our support services;
- our ability to develop complementary products and services;
- the willingness of our customers to continue to invest their resources in our solutions in light of other demands on those resources;
- the macroeconomic environment.

Most of our existing customers have entered into subscription agreements with us that expire between one and three years from the initial contract date. Our customers have the right to terminate their contracts under certain circumstances and are not obligated to renew their subscriptions for our solutions after the expiration of the initial terms of their subscription agreements. In addition, our customers may negotiate terms which are less favorable to us upon renewal, or may request that we license our software to them on a perpetual basis, which may reduce recurring revenue from these customers. For example, some of our RPO customers restructured their RPO agreements with us during 2009 as a result of the economic downturn to decrease the amount of fixed fees and increase the amount of variable fees pursuant to the agreement. Our future success also depends in part on our ability to sell new solutions to our existing customers.

If the unemployment rate increases or fails to materially decrease, our business may be harmed.

Demand for our solutions depends in part on our customers' ability to hire and retain their employees. According to the U.S. Bureau of Labor Statistics, the U.S. unemployment rate in January 2010 was 9.7%. It is unknown whether unemployment will decrease, increase, or remain constant throughout 2010 and beyond as a result of the general downturn in macroeconomic conditions in the U.S. and globally. If the unemployment rate increases, or does not materially decrease, our existing and potential new customers may no longer consider improvement of their talent acquisition and employee performance management systems to be a necessity and may have less of a need to hire and retain employees, which could have a material adverse effect on our business, results of operations and financial condition.

If we fail to adequately protect our proprietary rights, our competitive advantage could be impaired, we may lose valuable assets, experience reduced revenue and incur costly litigation to protect our rights.

Our intellectual property rights are important to our business, and our success is dependent, in part, on protecting our proprietary software and technology and our brand, marks and domain names. We rely on a combination of patent, copyright, trademark, trade secret and other common laws in the United States and other jurisdictions as well as confidentiality procedures and contractual provisions to protect our proprietary technology, processes and other intellectual property. It may be possible for unauthorized third parties to copy our software and use information that we regard as proprietary to create products and services that compete with ours, which could harm our competitive position and cause our revenue to decline.

We have three issued patents, and additionally we have four pending patent applications. There is no guarantee that the U.S. Patent and Trademark Office will grant these patents, or do so in a manner that gives us the protection that we seek. We will not be able to protect our intellectual property if we are unable to enforce our rights or if we do not detect unauthorized use of our intellectual property. Existing intellectual property laws only afford limited protection.

To the extent that we expand our international activities, our exposure to unauthorized copying and use of our software and proprietary information may increase despite procedures and systems that control information access. Some license provisions protecting against unauthorized use, copying, transfer and disclosure of our licensed products may be unenforceable under the laws of certain jurisdictions and foreign countries in which we operate. Further, the laws of some countries, and in particular India, where we develop much of our intellectual property, do not protect proprietary rights to the same extent as the laws of the United States. For example, companies seeking to enforce proprietary rights in India can experience substantial delays in prosecuting trademarks and in opposition proceedings. In the event that we are unable to protect our intellectual property rights, especially those rights that we develop in India, our business would be materially and adversely affected.

Additional, litigation may be necessary in the future to enforce our intellectual property rights and to protect our trade secrets. Litigation, whether successful or unsuccessful, could result in substantial costs and diversion of management resources, either of which could seriously harm our business.

Reductions in information technology spending could limit our ability to grow our business.

Our operating results may vary based on changes in the information technology spending of our customers. The revenue growth and profitability of our business depend on the overall demand for enterprise application software and services. We sell our solutions primarily to large organizations whose businesses fluctuate with general economic and business conditions. As a result, decreased demand for enterprise application software and services, and in particular talent acquisition and employee performance management solutions, caused by a weakening global economy, or otherwise, may cause a decline in our revenue. Historically, corporate information technology spending has been one of the first costs that businesses cut, especially during economic downturns. In particular, software for talent acquisition and employee performance management software may be viewed by some of our existing and potential customers as a lower priority and may be among the first expenditures reduced, especially during unfavorable economic conditions. As a result, potential customers may decide to reduce their information technology budgets by deferring or reconsidering product purchases, which would negatively impact our operating results.

Because we recognize revenue from the sale of our solutions ratably over the term of the subscription period, a significant downturn in our business may not be immediately reflected in our operating results.

A decline in new or renewed subscriptions in any one quarter may not impact our financial performance in that quarter, but will negatively affect our revenue in future quarters. If a number of contracts expire and are not renewed in the same quarter, our revenue could decline significantly in that quarter and in subsequent quarters.

For the years ended December 31, 2009, 2008 and 2007, we derived approximately 84.9%, 80.2% and 81.7%, respectively, of our total revenue, from the sale of subscriptions for our solutions and expect that a significant portion of our revenue for the foreseeable future will be derived from those subscriptions. We recognize the associated revenue ratably over the term of the subscription agreement, which is typically between one and three years. As a result, a significant portion of the revenue that we report in each quarter reflects the recognition of deferred revenue from subscription agreements entered into during previous periods. Accordingly, the effect of significant declines in sales and market acceptance of our solutions may not be reflected in our short-term results of operations, making our results less indicative of our future prospects.

Historically, our customers have renewed more than 90% of the aggregate value of multi-year subscriptions for our on-demand talent acquisition and performance management solution contracts subject to renewal. However, our renewal rates during the years ended December 31, 2009 and 2008 were approximately 80% and 75%, respectively. We cannot assure you that our renewal rate will return to its historical levels, or that it will not decrease.

If our revenue does not meet our expectations, we may not be able to curtail our spending quickly enough and our cost of revenue, compensation and benefits and product development would increase as a percentage of revenue. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any one period, as revenue from new customers is recognized over the applicable subscription term.

Our revenue is highly susceptible to changes in general economic conditions, and a recession or other downturn in the U.S. economy, or in any geographic market in which we provide services, could substantially impact sales of our services and overall results of operations.

Our operating results may vary based on changes in the information technology spending of our customers. The revenue growth and profitability of our business depend on the overall demand for enterprise application software and services. We sell our solutions primarily to large organizations whose businesses fluctuate with general economic and business conditions. Our customers may reevaluate their expenditures on enterprise application software and services, and in particular talent acquisition and employee performance management solutions, especially given the recent financial crisis in today's economic environment, which could cause them to cancel all or any portion of our services or delay the payment of their bills for services previously performed by us. As a result, in the event of a prolonged recession or even a less severe downturn in general economic conditions, our results of operations could be negatively impacted as a result of decreased demand for enterprise application software and services, and in particular talent acquisition and employee performance management solutions, and the impact could be more pronounced for us than for those businesses that deliver products or services that customers deem to be a higher priority. In particular, software for talent acquisition and employee performance management software may be viewed by some of our existing and potential customers as a lower priority and may be among the first expenditures reduced as a result of unfavorable economic conditions. As a result, potential customers may decide to reduce their information technology budgets by deferring or reconsidering product purchases, which would negatively impact our operating results. In addition, volatility and disruption of financial markets could limit our customers' ability to obtain adequate financing or credit to purchase and pay for our services in a timely manner, or to maintain operations, and result in a decrease in demand for our services that could have a negative impact on our overall results of operations.

Our financial performance may be difficult to forecast as a result of our focus on large customers and the long sales cycle associated with our solutions.

Our sales cycles are generally up to nine months and in some cases even longer. This long sales cycle impedes our ability to accurately forecast the timing of sales in a given period which could adversely affect our ability to meet our forecasts for that period. We focus our sales efforts principally on large organizations with complex talent acquisition and employee performance management requirements. Accordingly, in any single quarter the majority of our revenue from sales to new customers may be composed of large sales made to a relatively small number of customers. Our failure to close a sale in any particular quarter may impede revenue growth until the sale closes, if at all. As a result, substantial time and cost may be spent attempting to close a sale that may not be successful. The period between an initial sales contact and a contract signing is relatively long due to several factors, including:

- the need to educate potential customers about the uses and benefits of our solutions and the on-demand delivery model;
- the discretionary nature of our customers' purchase and budget cycles;
- the competitive evaluation of our solutions;
- fluctuations in the talent acquisition and employee performance management requirements of our prospective customers;
- potential economic downturns and reductions in corporate IT spending;
- announcements or planned introductions of new products or services by us or our competitors; and
- the lengthy purchasing approval processes of our prospective customers.

If our efforts to attract new customers or to sell additional solutions to our existing customers are not successful, our revenue growth will be adversely affected.

To increase our revenue, we must continually add new customers and sell additional solutions to existing customers. If our existing and prospective customers do not perceive our solutions to be of sufficiently high value and quality, we may not be able to attract new customers or to increase sales to existing customers. Our ability to attract new customers and to sell new solutions to existing customers will depend in large part on the success of our sales and marketing efforts. However, our existing and prospective customers may not be familiar with some of our solutions, or may have traditionally used other products and services for some of their talent acquisition and employee performance management requirements. Our existing and prospective customers may develop their own solutions to address their talent acquisition and employee performance management requirements, purchase competitive product offerings or engage third-party providers of outsourced talent acquisition and employee performance management services. Additionally, some customers may require that we license our software to them on a perpetual basis or that we allow them the contractual right to convert from a term license to a perpetual license during the contract term, which may reduce recurring revenue from these customers.

Our quarterly operating results may fluctuate significantly, and these fluctuations may cause our stock price to fall.

As a result of fluctuations in our revenue and operating expenses, our quarterly operating results may vary significantly. We may not be able to curtail our spending quickly enough if our revenue falls short of our expectations. We expect that our operating expenses will increase substantially in the future as we expand our selling and marketing activities, increase our new product development efforts and hire additional personnel. Our operating results may fluctuate in the future as a result of the factors described below:

- our ability to renew and increase subscriptions sold to existing customers, attract new customers, cross-sell our solutions and satisfy our customers' requirements;
- changes in our pricing policies;
- the introduction of new features to our solutions;
- the rate of expansion and effectiveness of our sales force;
- the length of the sales cycle for our solutions;
- new product and service introductions by our competitors;
- concentration of marketing expenses for activities, such as trade shows and advertising campaigns;
- concentration of research and development costs; and
- concentration of expenses associated with commissions earned on sales of subscriptions for our solutions.

We believe that period-to-period comparisons of our results of operations are not necessarily meaningful as our future revenue and results of operations may vary substantially. It is also possible that in future quarters our results of operations will be below the expectations of securities market analysts and investors. In either case, the price of our common stock could decline, possibly materially.

Our business may not continue to grow if the markets for our products do not continue to grow.

Our growth is dependent upon the continued adoption of on-demand software as a key mechanism for delivering solutions in these markets. The rapidly evolving nature of this market reduces our ability to accurately evaluate our future prospects and forecast quarterly or annual performance. The adoption of on-demand talent acquisition and employee performance management solutions, particularly among organizations that have relied upon traditional software applications, requires the acceptance of a new way of conducting business and exchanging and compiling information. Because these markets are new and evolving, it is difficult to predict with any assurance the future growth rate and size of these markets which, in comparison with the overall market for enterprise software applications, is relatively small.

Interruptions or delays in service from our Web hosting facilities could impair the delivery of our service and harm our business.

We provide and manage our service through computer hardware and software that is currently located in a Qwest Web hosting facility in Sterling, VA USA and ServeCentric facility in Blanchardstown, Ireland. All Web hosting facilities are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. These facilities are also subject to break-ins, sabotage, intentional acts of terrorism, vandalism and similar misconduct. Despite precautions that we take at these facilities, the occurrence of a natural disaster, act of terrorism or other unanticipated problem at any of these facilities could result in lengthy interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our renewal rates. Our business will be harmed if our customers and potential customers believe our service is unreliable or if our Disaster Recovery Plan (DRP) fails to provide adequate disaster recovery capabilities.

If our security measures are breached and unauthorized access is obtained to customer data, we may incur liabilities and customers may curtail or stop their use of our solutions, which would harm our business, operating results and financial condition.

Our solutions involve the storage and transmission of confidential information of customers and their existing and potential employees, and security breaches could expose us to a risk of loss of, or unauthorized access to, this information, resulting in possible litigation and possible liability. Although we have never sustained such a breach, if our security measures were ever breached as a result of third-party action, employee error, malfeasance or otherwise, and, as a result, an unauthorized party obtained access to this confidential data, our reputation could be damaged, our business may suffer and we could incur significant liability. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not discovered until launched against a target. As a result, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of our security measures could be harmed and we could lose sales and customers.

If we fail to develop or acquire new products or enhance our existing solutions to meet the needs of our existing and future customers, our revenue may decline.

To remain competitive, we must continually improve and enhance the responsiveness, functionality and features of our existing solutions and develop new solutions that address the talent acquisition and employee performance management requirements of organizations. If we are unable to successfully develop or acquire new solutions or enhance our existing solutions, our revenue may decline and our business and operating results will be adversely affected. If we do not succeed in developing or introducing new or enhanced solutions in a timely manner, they may not achieve the market acceptance necessary to generate significant revenue.

In addition, it is possible that evolving technology may enable new deployment mechanisms that make our on-demand business model obsolete. To the extent that we are not successful in continuing to develop our solutions in correlation with evolving technology, we may not be successful in establishing or maintaining our customer relationships.

Releases of new solutions and enhancements to existing solutions may cause purchasing delays, which would harm our revenue.

Our practice and the practice in the industry in which we compete is to regularly develop and release new solutions and enhancements to existing solutions. As a result, our future success could be hindered by delays in our introduction of new solutions and/or enhancements of existing solutions, delays in market acceptance of new solutions and/or enhancements of existing solutions, and our, or our competitors', announcement of new solutions and/or solution enhancements or technologies that could replace or shorten the life cycle of our existing solutions. In addition, clients may delay their purchasing decisions in anticipation of our new or enhanced solutions or new or enhanced solutions of our competitors. Delays in client purchasing decisions could seriously harm our business and operating results. Moreover, significant delays in the general availability of new releases or client dissatisfaction with new releases could have a material adverse effect on our business, results of operations, cash flow and financial condition.

We may not receive significant revenue as a result of our current research and development efforts.

Developing and localizing software is expensive and the investment in product development often involves a long payback cycle. We have made and expect to continue to make significant investments in software research and development and related product opportunities. Accelerated product introductions and short product life cycles require high levels of expenditures for research and development that could adversely affect our operating results if not offset by corresponding revenue increases. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. However, it is difficult to estimate when, if ever, we will receive significant revenue as a result of these investments.

The use of open source software in our solutions may expose us to additional risks and harm our intellectual property.

Some of our solutions use or incorporate software components that are subject to one or more open source licenses. Open source software is typically freely accessible, usable and modifiable. Certain open source software licenses require a user who intends to distribute the open source software as a component of the user's software to disclose publicly part or all of the source code in the user's software. In addition, certain open source software licenses require the user of such software to make any derivative works of the open source code available to others on unfavorable terms or at no cost. This can subject previously proprietary software to open source license terms.

While we monitor the use of all open source software in our solutions, processes and technology and try to ensure that no open source software is used in such a way as to require us to disclose the source code to the related product or solution when we do not wish to do so, such use could inadvertently occur. Additionally, if a third-party software provider has incorporated certain types of open source software into software we license from such third party for our solutions, we could, under certain circumstances, be required to disclose the source code to our solutions. This could harm our intellectual property position and have a material adverse effect on our business, results of operations and financial condition.

Our ability to license our software is highly dependent on the quality of our services offerings, and our failure to offer high quality services could adversely affect our subscription revenue and results of operations.

Once our software has been implemented and deployed, our customers depend on us to provide them with ongoing support and resolution of issues relating to our software. Therefore, a high level of service is critical for the continued marketing and sale of our solutions. If we do not efficiently and effectively implement and deploy our software products, or succeed in helping our customers quickly resolve post-deployment issues, our ability to sell software products to these customers would be adversely affected and our reputation in the marketplace and with potential customers could suffer.

If we encounter barriers to the integration of our software or services with software provided by our competitors or with the software used by our customers, our revenue may decline and our research and development expenses may increase.

In some cases our software or services may need to be integrated with software provided by our competitors. These competitors could alter their products in ways that inhibit integration with our software, or they could deny or delay access by us to such software releases, which would restrict our ability to provide our services or adapt our software to facilitate integration with this software and could result in lost sales opportunities. In addition, our software is designed to be compatible with the most common third-party ERP systems. If the design of these ERP systems changes, integration of our software with new systems would require significant work and substantial allocation of our time and resources and increase our research and development expenses.

Material defects or errors in our software could affect our reputation, result in significant costs to us and impair our ability to sell our solutions, which would harm our business.

The software applications forming part of our solutions may contain material defects or errors, which could materially and adversely affect our reputation, result in significant costs to us and impair our ability to sell our solutions in the future. The costs incurred in correcting any material product defects or errors may be substantial and would adversely affect our operating results. After the release of our products, defects or errors may also be identified from time to time by our internal team and by our customers. Such defects or errors may occur in the future. Any defects that cause interruptions to the availability of our solutions could result in:

- lost or delayed market acceptance and sales of our solutions;
- loss of customers;
- product liability suits against us;
- diversion of development resources;
- injury to our reputation; and
- increased maintenance and warranty costs.

If we are unable to compete effectively with companies offering enterprise talent acquisition and employee performance management solutions, our revenue may decline.

We may not have the resources or expertise to compete successfully in the future. If we are unable to successfully compete, we could lose existing customers, fail to attract new customers and our revenue would decline. The talent acquisition and employee performance management solutions markets are rapidly evolving and highly competitive, and we expect competition in these markets to persist and intensify. Barriers to entry into our industry are low, new software products are frequently introduced and existing products are continually enhanced. We compete with niche point solution vendors such as PeopleClick Authoria, iCIMS, Inc., Integrated Performance Systems, Inc., Kronos Incorporated, Pilat HR Solutions, Inc., Previsor, Inc., SHL Group plc, SuccessFactors, Inc., and Taleo Corporation that offer products that compete with one or more applications contained in our solutions. In some aspects of our business, we also compete with established vendors of enterprise resource planning, or ERP, software with much greater resources, such as Oracle Corporation (PeopleSoft), SAP AG and Lawson, Inc. To a lesser extent, we compete with vendors of recruitment process outsourcing services, including Accolo, Inc., Alexander Mann Solutions, The Right Thing, and survey services such as The Gallup Organization. In addition, many organizations have developed or may develop internal solutions to address enterprise talent acquisition and employee performance management requirements that may be competitive with our solutions.

Some of our competitors and potential competitors, especially vendors of ERP software, have significantly greater financial, support, technical, development, marketing, sales, service and other resources, larger installed customer bases, longer operating histories, greater name recognition and more established relationships than we have. In addition, ERP software competitors could bundle their products with, or incorporate capabilities in addition to, talent acquisition and employee performance management functions, such as automated payroll and benefits, in products developed by themselves or others. Products with such additional functions may be appealing to some customers because they would reduce the number of different types of software or applications used to run their businesses. Our niche competitors' products may be more effective than our solutions at performing particular talent acquisition and employee performance management functions or may be more customized for particular customer needs in a given market. Further, our competitors may be able to respond more quickly than we can to changes in customer requirements or regulatory changes.

We may engage in future acquisitions or investments which present many risks, and we may not realize the anticipated financial and strategic goals for any of these transactions.

We have focused on developing solutions for the enterprise talent acquisition and employee performance management market. Our market is highly fragmented and in the future we may acquire or make investments in complementary companies, products, services or technologies. Acquisitions and investments involve a number of difficulties that present risks to our business, including the following:

- we may be unable to achieve the anticipated benefits from the acquisition or investment;
- we may have difficulty integrating the operations and personnel of the acquired business, and may have difficulty retaining the key personnel of the acquired business;
- we may have difficulty incorporating the acquired technologies or products with our existing solutions;
- our ongoing business and management's attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically and culturally diverse locations;
- we may lose customers of those companies that we acquire for reasons such as a particular customer desiring to have multiple service vendors;
- we may have difficulty maintaining uniform standards, controls, procedures and policies across locations; and
- we may experience significant problems or liabilities associated with product quality, technology and legal contingencies.

The factors noted above could have a material adverse effect on our business, results of operations and financial condition or cash flows, particularly in the case of a larger acquisition or multiple acquisitions in a short period of time. From time to time, we may enter into negotiations for acquisitions or investments that are not ultimately consummated. These negotiations could result in significant diversion of management time, as well as out-of-pocket costs.

The consideration paid for an investment or acquisition may also affect our financial results. If we were to proceed with one or more significant acquisitions in which the consideration included cash, we could be required to use a substantial portion of our available cash or obtain debt or equity financing. To the extent that we issue shares of our capital stock or other rights to purchase shares of our capital stock as consideration for an acquisition or in connection with the financing of an acquisition, including options or other rights, our existing shareholders may be diluted, and our earnings per share may decrease. In addition, acquisitions may result in the incurrence of debt, large one-time write-offs, including write-offs of acquired in-process research and development costs, and restructuring charges. Acquisitions in the future may require us to incur additional indebtedness to finance our working capital and may also result in goodwill and other intangible assets that are subject to impairment tests, which could result in future impairment charges.

Mergers or other strategic transactions involving our competitors could weaken our competitive position or reduce our revenue.

We believe that our industry is highly fragmented and that there is likely to be consolidation, which could lead to increased price competition and other forms of competition. Increased competition may cause pricing pressure and loss of market share, either of which could have a material adverse effect on our business, results of operations and financial condition. Our competitors may establish or strengthen cooperative relationships with business process outsourcing vendors, systems integrators, third-party consulting firms or other parties. Established companies may not only develop their own products but may also merge with or acquire our current competitors. In addition, we may face competition in the future from large established companies, as well as from emerging companies that have not previously entered the markets for talent acquisition and employee performance management solutions or that currently do not have products that directly compete with our solutions. It is also possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share or sell their products at significantly discounted prices causing pricing pressure. In addition, our competitors may announce new products, services or enhancements that better meet the price or performance needs of customers or changing industry standards. If any of these events occur, our revenues and profitability could significantly decline.

Because our products collect and analyze applicants' and employees' stored personal information, concerns that our products do not adequately protect the privacy of applicants and employees could inhibit sales of our products.

Some of the features of our talent acquisition and employee performance management applications depend on the ability to develop and maintain profiles of applicants and employees for use by our customers. These profiles contain personal information, including job experience, banking information, social security numbers, home address and home telephone number. Typically, our software applications capture this personal information when an applicant creates a profile to apply for a job, is being on-boarded, and an employee completes a performance review. Our software applications augment these profiles over time by capturing additional data and collecting usage data. Although our applications are designed to protect user privacy, privacy concerns nevertheless may cause employees and applicants to resist providing the personal data necessary to support our products. Any inability to adequately address privacy concerns could inhibit sales of our products and seriously harm our business, financial condition and operating results.

We may face risks associated with our international operations that could impair our ability to grow our revenue.

We generate a significant portion of our revenue outside the United States. For example, for the year ended December 31, 2009 and 2008, the percentage of revenue generated from customers outside the United States was 20.9% and 26.4% respectively. We intend to continue selling into our existing international markets and to expand into international markets where we currently do not conduct business, which will require significant management attention and financial resources. If we are unable to continue to sell our products effectively in the existing international markets and expand into additional international markets, our ability to grow our business would be adversely affected. Some of the key factors that may affect our ability to maintain and expand our operations and sales in foreign countries include:

- difficulties in staffing and managing foreign operations, including our ability to provide services to our customers;
- building and maintaining a competitive presence in existing and new markets;
- difficulty enforcing contracts and collecting accounts receivable in some countries, leading to longer collection periods;
- certification, qualification and compliance requirements and expenses relating to our products and business;
- regulatory requirements, including import and export regulations;
- changes in currency exchange rates;
- dependence on third parties to market our solutions through foreign sales channels;
- reduced protection for intellectual property rights in some countries;
- less stringent adherence to ethical and legal standards by prospective customers in some countries;
- potentially adverse tax treatment;
- the need to localize products for other languages and country-specific business requirements and regulations;
- difficulty competing with local vendors;
- language and cultural barriers; and
- political and economic instability.

Foreign currency exchange rate risks may adversely affect our results of operations.

Material portions of our revenue and expenses are generated by our operations in foreign countries, and we expect that our foreign operations will account for a material portion of our revenue and expenses in the future. Substantially all of our international expenses and revenue are denominated in foreign currencies, mostly the Indian rupees, British pounds, EURO's and Canadian dollars. For the year ended December 31, 2009, we generated approximately 20.9% of our total revenue and incurred approximately 20.2% of our total costs in foreign currencies. As a result, our financial results could be affected by factors, such as changes in foreign currency exchange rates or weak economic conditions in European markets and other foreign markets in which we have operations. Fluctuations in the value of those currencies in relation to the U.S. dollar have caused and will continue to cause dollar-translated amounts to vary from one period to another. We also incur currency transaction risk whenever one of our operating subsidiaries enters into either a purchase or a sales transaction using a currency other than the local currency in which it receives revenue and pays expenses. Given the volatility of exchange rates, we may not be able to manage effectively our currency translation or transaction risks, which may adversely affect our financial condition and results of operations.

Changes in the regulatory environment and general economic condition in India and elsewhere could have a material adverse effect on our business.

Adverse changes in the business or regulatory climate in India could have a material adverse effect on our business. In addition, wages in India are increasing at a faster rate than in the United States. In the event that wages continue to rise, the cost benefit of operating in India and elsewhere may diminish. India has also experienced significant inflation in the past and has been subject to civil unrest and terrorism. There can be no assurance that these and other factors will not have a material adverse effect on our business, results of operations and financial condition.

We may not be able to raise capital on terms that are favorable to us.

As of December 31, 2009, we had cash and cash equivalents of \$29.2 million and short term investments of 29.6 million. Changes in our operating plans, lower than anticipated revenue, increased expenses or other events, may cause us to seek additional debt or equity financing. Financing may not be available on acceptable terms, or at all, and our failure to raise capital when needed could negatively impact our growth plans and our financial condition and consolidated results of operations. Additional equity financing would be dilutive to the holders of our common stock, and debt financing, if available, may involve significant cash payment obligations and covenants or financial ratios that restrict our ability to operate our business.

Our results of operations may be adversely affected if we are subject to a protracted infringement claim or a claim that results in a significant damage award.

We expect that software product developers, such as ourselves, will increasingly be subjected to infringement claims as the number of products and competitors grows and the functionality of products in different industry segments overlaps. Our competitors or other third parties may challenge the validity or scope of our intellectual property rights. A claim may also be made relating to technology that we acquire or license from third parties. If we were subject to a claim of infringement, regardless of the merit of the claim or our defenses, the claim could:

- require costly litigation to defend and resolve, and the payment of substantial damages;
- require significant management time and attention;
- cause us to enter into unfavorable royalty or license agreements;
- require us to discontinue the sale of our solutions;
- create negative publicity that adversely affects the demand for our solutions;
- require us to indemnify our customers; and/or
- require us to expend additional development resources to redesign our software.

Litigation could be costly for us to defend, have a negative effect on our operating results and financial condition or require us to devote additional research and development resources to change our software.

We employ technology licensed from third parties for use in or with our solutions, and the loss or inability to maintain these licenses on similar terms or errors in the software we license could result in increased costs, or reduced service levels, which would adversely affect our business.

We include in the distribution of our solutions certain technology obtained under licenses from other companies. We anticipate that we will continue to license technology and development tools from third parties in the future. There may not always be commercially reasonable software alternatives to the third-party software that we currently license, or any such alternatives may be more difficult or costly to replace than the third-party software that we currently license. In addition, integration of our software with new third-party software may require significant work and substantial allocation of our time and resources. Also, to the extent we depend upon the successful operation of third-party products in conjunction with our software, any undetected errors in these third-party products could prevent the implementation or impair the functionality of our software, delay new solution introductions and injure our reputation. Our use of additional or alternative third-party software would require us to enter into license agreements with third parties, which could result in higher costs.

If we do not retain our executive officers, our ability to manage our business and continue our growth could be negatively impacted.

We have grown significantly in recent years, and our management remains concentrated in a small number of executive officers, most of whom have been employed with us for at least five years. Our future success will depend to a significant extent on the continued service of these executive officers, namely Nooruddin S. Karsan, Troy A. Kanter, Donald F. Volk, James P. Restivo, and Archie L. Jones, Jr. as well as our other key employees, software engineers and senior technical and sales personnel. We have not entered into employment agreements with any of our employees. The loss of the services of any of these individuals or group of individuals could have a material adverse effect on our business, financial condition and results of operations. Competition for qualified personnel in the software industry is intense, and we compete for these personnel with other software companies that have greater financial and other resources than we do. If we lose the services of one or more of our executive officers or other key personnel, or if one or more of them decide to join a competitor or otherwise compete directly or indirectly with us, our business could be harmed. Searching for replacements for key personnel could also divert management's time and attention and result in increased operating expenses.

We will not be able to maintain our revenue growth if we do not attract, train or retain qualified sales personnel.

If we fail to successfully maintain and expand our sales force, our future revenue and profitability will be adversely affected. We depend on our direct sales force for substantially all of our revenue and intend to make significant expenditures in upcoming years to expand our sales force. Our future success will depend in part upon the continued expansion and increased productivity of our sales force. To the extent that we experience attrition in our direct sales force, we will need to hire replacements. We face intense competition for sales personnel in the software industry, and we may not be successful in hiring, training or retaining our sales personnel in accordance with our plans. Even if we hire and train a sufficient number of sales personnel, we may not generate enough additional revenue to exceed the expense of hiring and training the new personnel.

Failure to implement the appropriate controls and procedures to manage our growth could harm our growth, business, operating results and financial condition.

We have and may continue to have periods of growth in our operations, which has placed, and may continue to place, a significant strain on our management, administrative, operational, technical and financial infrastructure. We increased our employee base from 522 employees in 2004 to 693 employees in 2005, to 1,220 employees in 2006, to 1,373 employees in 2007, and to 1,535 employees in 2008. In 2009 due to the challenging macroeconomic environment, the strengthening U.S. dollar relative to other currencies of countries in which we do business and the resulting slowing or delaying of a number of project implementations we announced, during the fourth quarter 2008, a restructuring program involving reductions of approximately 200 employees. As a result of the continued deterioration in the economic environment we executed an additional reduction of approximately 159 employees during the first quarter of 2009.

The increase in employees during 2006 was primarily due to the addition of 44 and 338 employees that we acquired as part of our acquisition of Webhire and BrassRing, respectively. The increase in employees during 2007 was primarily due to the addition of 134 and 25 employees that we acquired as part of our acquisition of Strategic Outsourcing Corporation and HRC Human Resources Consulting GmbH, respectively. The increase in employees during 2008 was primarily due to the addition of 135 employees that we acquired as a part of our acquisition of Quorum International Holdings Limited (“Quorum”). To manage our growth, we will need to continue to improve our operational, financial and management processes and controls and reporting systems and procedures. This effort may require us to make significant capital expenditures or to incur significant expenses, and may divert the attention of our personnel from our core business operations, any of which may adversely affect our financial performance. If we fail to successfully manage our growth, our business, operating results and financial condition may be adversely affected.

Evolving European Union regulations related to confidentiality of personal data may adversely affect our business.

In order to provide our solutions to our customers, we rely in part on our ability to access our customers’ employee data. The European Union and other jurisdictions have adopted various data protection regulations related to the confidentiality of personal data. To date, these regulations have not restricted our business as we have qualified for a safe harbor available for U.S. companies that collect personal data from areas under the jurisdiction of the European Union. To the extent that these regulations are modified in such a manner that our safe harbor no longer applies, our ability to conduct business in the European Union may be adversely affected.

Evolving regulation of the Internet may increase our expenditures related to compliance efforts, which may adversely affect our financial condition.

As Internet commerce continues to evolve, increasing regulation by federal, state and/or foreign agencies becomes more likely. We are particularly sensitive to these risks because the Internet is a critical component of our business model. For example, we believe that increased regulation is likely in the area of data privacy, and laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers’ ability to use and share data, potentially reducing demand for solutions accessed via the Internet and restricting our ability to store, process and share data with our customers via the Internet. In addition, taxation of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet may also be imposed. Any regulation imposing greater fees for Internet use or restricting information exchange over the Internet could result in a decline in the use of the Internet and the viability of Internet-based services, which could harm our business.

The failure of our solutions to comply with employment laws may require us to indemnify our customers, which may harm our business.

Some of our customer contracts contain indemnification provisions that require us to indemnify our customers against claims of non-compliance with employment laws related to hiring. To the extent these claims are successful and exceed our insurance coverages, these obligations would have a negative impact on our cash flow, results of operation and financial condition.

Our reported financial results may be adversely affected by changes in generally accepted accounting principles.

Generally accepted accounting principles in the United States are subject to interpretation by the Financial Accounting Standards Board, or FASB, the American Institute of Certified Public Accountants, the SEC, and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our historical or future financial results. For example, prior to January 1, 2006, we were not required to record share-based compensation charges if the employee's stock option exercise price was equal to or exceeded the deemed fair value of the underlying security at the date of grant. However, effective January 1, 2006 we are required to record the fair value of stock options as an expense in accordance with new accounting pronouncements.

Anti-takeover provisions of Pennsylvania law and our articles of incorporation and bylaws could delay and discourage takeover attempts that shareholders may consider to be favorable.

Certain provisions of our articles of incorporation and applicable provisions of the Pennsylvania Business Corporation Law may make it more difficult for a third party to, or prevent a third party from, acquiring control of us or effecting a change in our board of directors and management. These provisions include:

- the classification of our board of directors into three classes, with one class elected each year;
- prohibiting cumulative voting in the election of directors;
- the ability of our board of directors to issue preferred stock without shareholder approval;
- our shareholders may only take action at a meeting of our shareholders and not by written consent;
- prohibiting shareholders from calling a special meeting of our shareholders;
- our shareholders must comply with advance notice procedures in order to nominate candidates for election to our board of directors or to place shareholders proposals on the agenda for consideration at any meeting of our shareholders; and
- prohibiting us from engaging in some types of business combinations with holders of 20% or more of our voting securities without prior approval of our board of directors, unless a majority of our disinterested shareholders approve the transaction.

The Pennsylvania Business Corporation Law further provides that because our articles of incorporation provide for a classified board of directors, shareholders may remove directors only for cause. These and other provisions of the Pennsylvania Business Corporation Law and our articles of incorporation and bylaws could delay, defer or prevent us from experiencing a change of control or changes in our board of directors and management and may adversely affect our shareholders' voting and other rights. Any delay or prevention of a change of control transaction or changes in our board of directors and management could deter potential acquirers or prevent the completion of a transaction in which our shareholders could receive a substantial premium over the then current market price for their shares of our common stock.

From time to time, we have conducted share repurchase programs, which may restrict our funds available for other actions and negatively affect the market price of our securities.

Since November 2007, we have repurchased 3,125,651 shares of our common stock under share repurchase plans at an average price per share of \$17.80 and an aggregate cost of \$55.8 million. These shares were restored to original status and accordingly are presented as authorized but not issued. Share repurchases may not have the effects anticipated by our board of directors and may instead harm the market price of our securities. Share repurchase plans may use a significant portion of our cash reserves, and could limit our future flexibility to complete acquisition transactions or fund other growth opportunities. In addition, the share repurchases are subject to regulatory requirements. We may become subject to lawsuits regarding the use of our cash for share repurchases or for the failure to follow applicable regulatory requirements in connection with our share repurchase program. Our repurchase plans will also likely result in an increase in the share percentage ownership of our existing shareholders, and such increase may trigger disclosure or other regulatory requirements for our larger shareholders. As a result, certain shareholders may liquidate a portion of their holdings. In addition, our repurchase plans may decrease our public float as shares are repurchased by us on the open market pursuant to the plan and may have a negative effect on our trading volume. Such outcomes may have a negative impact on the liquidity of our common stock, the market price of our common stock and could make it easier for others to acquire a larger percentage of our voting securities.

The market price of our common stock has been, and may continue to be, particularly volatile, and our shareholders may be unable to resell their shares at a profit.

The market price of our common stock has been subject to significant fluctuations and may continue to fluctuate or decline. From September 2008 through December 31, 2009, our common stock has been particularly volatile as the price of our common stock has ranged from a high of \$24.01 to a low of \$3.66. In the past several years, technology stocks have experienced high levels of volatility and significant declines in value from their historic highs. Additionally, as a result of the current global credit crisis and the concurrent economic downturn in the U.S. and globally, there have been significant declines in the values of equity securities generally in the U.S. and abroad. Factors that could cause fluctuations in the trading price of our common stock include the following:

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of software companies in general, and HR software companies in particular;
- actual or anticipated changes in our earnings or fluctuations in our operating results;
- general economic conditions and trends;
- major catastrophic events;
- the timing and magnitude of stock repurchases pursuant to our stock repurchase plan;
- sales of large blocks of our stock; or
- departures of key personnel.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. If our stock price is volatile, we may become the target of securities litigation. For example, we are currently party to a securities class action lawsuit filed against us by a class of our investors who purchased our publicly traded securities between May 8, 2007 and November 7, 2007. Securities litigation, including the securities litigation we are currently subject to, could result in substantial costs and divert our management's attention and resources from our business.

Our investments in auction rate securities are subject to risks which may adversely affect our liquidity and cause losses.

At December 31, 2009, we held \$13.9 million of A, AA and AAA rated auction rate securities ("ARS"), the underlying assets of which are generally student loans which are substantially backed by the U.S. federal government. Auction rate securities are generally long-term instruments that are intended to provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined calendar intervals, allowing holders of these instruments to rollover their holdings and continue to own their respective securities or liquidate their holdings by selling the auction rate securities at par. Beginning in February 2008, auctions failed for our holdings because sell orders for these securities exceeded the amount of purchase orders. The funds associated with these failed auctions will not be accessible until the issuer calls the security, a successful auction occurs, a buyer is found outside the auction process, or the security matures. In November 2008, we entered into an agreement (the "UBS Settlement Agreement") with UBS AG which provides us (1) with a "no net cost" loan up to the par value of Eligible ARS until June 30, 2010, (2) the right to sell these auction rate securities back to UBS AG at par, at our sole discretion, anytime during the period from June 30, 2010 through July 2, 2012, and (3) UBS AG the right to purchase these auction rate securities or sell them on our behalf at par anytime through July 2, 2012. Based on the UBS Settlement Agreement, we transferred these investments from available-for-sale to trading securities and began recording the change in fair value of the ARS as gains or losses in current period earnings.

Our ability to enforce the terms of our auction rate settlement with UBS is subject to UBS's continued viability

UBS has experienced operational challenges including an executive management shakeup; the largest annual loss ever reported by a Swiss company; the elimination of 11,000 jobs; and the need for a Swiss government bailout. All of these factors could add to the worsening financial viability of the bank and cause it to cancel any settlement agreements involving the extension of credit to its customers. If UBS were to terminate its settlement agreement with its customers, our liquidity would adversely be affected.

Unexpected changes in tax rates and regulations could negatively impact our operating results.

We currently conduct significant activities internationally. Our foreign subsidiaries accounted for 20.9% of our total revenues during the year ended December 31, 2009, and 26.4% of our total revenues during the year ended December 31, 2008. Our financial results may be negatively impacted to the extent tax rates in foreign countries where we operate increase and/or exceed those in the United States and as a result of the imposition of withholding requirements on foreign earnings.

ITEM 3. Legal Proceedings

On August 27, 2007, a complaint was filed and served by Kenexa BrassRing, Inc. against Taleo Corporation in the United States District Court for the District of Delaware. Kenexa alleges that Taleo infringed Patent Nos. 5,999,939 and 6,996,561, and seeks monetary damages and an order enjoining Taleo from further infringement.

On May 9, 2008, Kenexa BrassRing, Inc. filed a similar lawsuit against Vurv Technology, Inc. in the United States District Court for the District of Delaware, alleging that Vurv has infringed Patent Nos. 5,999,939 and 6,996,561, and seeks monetary damages and an order enjoining further infringement. This lawsuit has been consolidated with the Kenexa BrassRing, Inc. versus Taleo Corporation lawsuit.

On June 25, 2008, Kenexa Technology, Inc. filed suit in the United States District Court of Delaware against Taleo Corporation for tortious interference with contract, unfair competition, unfair trade practices and unjust enrichment. On August 28, 2009, Taleo filed an amended answer and counterclaim against Kenexa BrassRing, Inc. asserting copyright infringement against Kenexa by the users accessing the Taleo system on behalf of Kenexa's recruitment process outsourcing customers. Kenexa seeks monetary damages and to enjoin the actions of Taleo. Taleo seeks monetary damages and to enjoin the actions of Kenexa.

On November 7, 2008, Vurv Technology LLC, sued Kenexa Corporation, Kenexa Technology, Inc., and two former employees of Vurv, who now work for Kenexa, in the United States District Court for the Northern District of Georgia. In this action, Vurv asserts claims for breach of contract, computer trespass and theft, misappropriation of trade secrets, interference with contract and civil conspiracy. Vurv seeks unspecified monetary damages and injunctive relief.

On June 11, 2009 and July 16, 2009, two putative class actions were filed against Kenexa Corporation and our Chief Executive Officer and Chief Financial Officer in the United States District Court for the Eastern District of Pennsylvania, purportedly on behalf of a class of our investors who purchased our publicly traded securities between May 8, 2007 and November 7, 2007. The complaint filed on July 16, 2009 has since been voluntarily dismissed. In the pending action, Building Trades United Pension Trust Fund, individually and on behalf of all others similarly situated alleges violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act in connection with various public statements made by Kenexa. This action seeks unspecified damages, attorneys' fees and expenses.

On July 17, 2009, Kenexa BrassRing, Inc. and Kenexa Recruiter, Inc. filed suit against Taleo Corporation, a current Taleo employee and a former Taleo employee in Massachusetts Superior Court. Kenexa amended the complaint on August 27, 2009 and added Vurv Technology LLC, two former employees of Taleo and two current employees of Taleo. Kenexa asserts claims for breach of contract and the implied covenant of good faith and fair dealing, unfair trade practices, computer theft, misappropriation of trade secrets, tortious interference, unfair competition, and unjust enrichment. Kenexa seeks monetary damages and injunctive relief.

We are involved in claims from time to time which arise in the ordinary course of business. In the opinion of management, we have made adequate provision for potential liabilities, if any, arising from any such matters. However, litigation is inherently unpredictable, and the costs and other effects of pending or future litigation, governmental investigations, legal and administrative cases and proceedings (whether civil or criminal), settlements, judgments and investigations, claims and changes in any such matters, could have a material adverse effect on our business, financial condition and operating results.

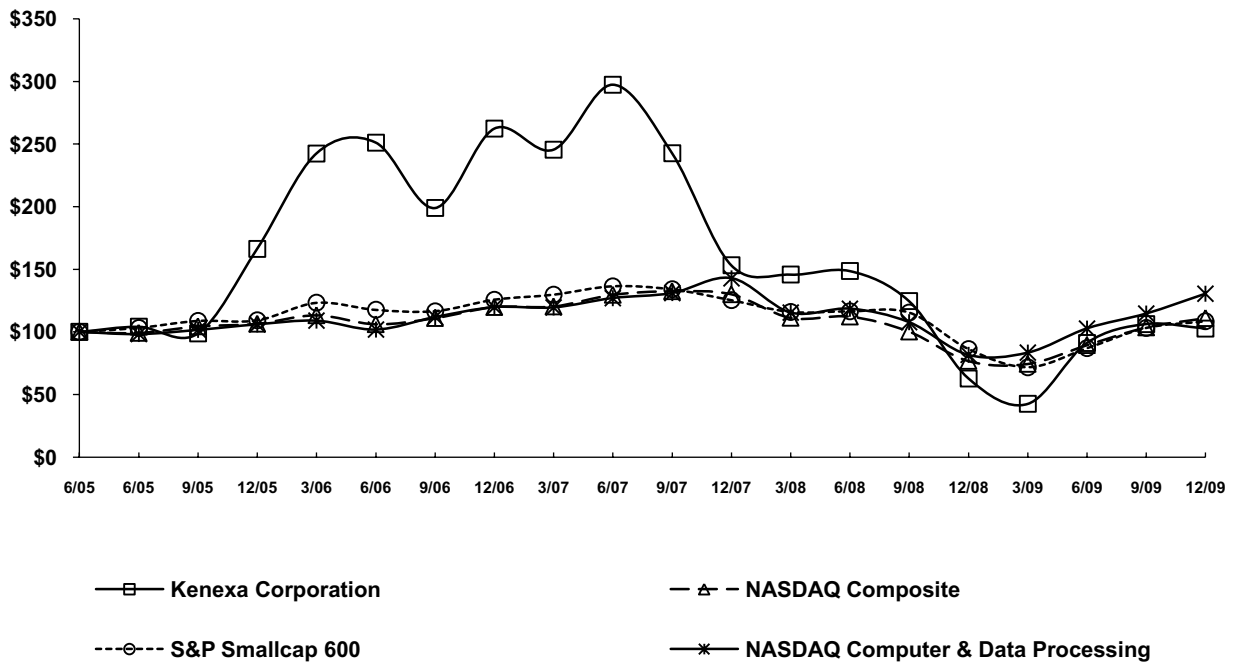
ITEM 4. Reserved

STOCK PERFORMANCE GRAPH AND CUMULATIVE TOTAL RETURN

The following graph shall not be deemed incorporated by reference into any of our filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference therein.

Prior to June 28, 2005, we were not publicly traded and there was no public market for our securities. The graph below compares the cumulative total return of our common stock with that of the Nasdaq Composite Index, the Nasdaq Computer & Data Processing Index and the S&P Smallcap 600 Index from June 28, 2005 (the date shares of our common stock began to trade publicly) through December 31, 2009. The graph assumes that you invested \$100 at the close of market on June 28, 2005 in shares of our common stock and invested \$100 on May 31, 2005 (the last day of the completed calendar month immediately preceding June 28, 2005) in each of these indexes, and in each case assumes the reinvestment of dividends. The comparisons in this graph are provided in accordance with Securities and Exchange Commission disclosure requirements and are not intended to forecast or be indicative of the future performance of shares of our common stock.

COMPARISON OF 54 MONTH CUMULATIVE TOTAL RETURN Among Kenexa Corporation



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

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the "Selected Consolidated Financial Data" section and our consolidated financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. In addition to historical information, this discussion and analysis contains forward-looking statements based on current expectations that involve risks, uncertainties and assumptions, such as our plans, objectives, expectations and intentions. Our actual results and the timing of events may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth in the "Item 1A-Risk Factors" section and elsewhere in this Annual Report on Form 10-K.

Overview

We provide business solutions for human resources which include a comprehensive suite of on-demand software applications and complementary services, including outsourcing services and consulting, to help global organizations recruit high performing individuals and to foster optimal work environments to increase employee productivity and retention. We employ a large force of organizational and industrial psychologists and statisticians who study the science of human behavior and its impact on business outcomes. This research is the foundation of our suite of software applications and supporting services that enable our customers to improve business results through human resources. Based on our 22 years of experience assisting customers in addressing their human resource requirements we believe our software applications and services form solutions that enable our customers to improve the effectiveness of their talent acquisition programs, increase employee productivity and retention, measure key HR metrics and make their talent acquisition and employee performance management program more efficient.

Since 1999, we have focused on providing talent acquisition and employee performance management solutions on a subscription basis and currently generate a significant portion of our revenue from these subscriptions. Our customers typically purchase multi-year subscriptions with an average length of approximately two years. For the years ended December 2009 and 2008 subscription revenue represented approximately 84.9% and 80.2% of our total revenue, respectively. We generate the remainder of our revenue from discrete professional services that are not provided as part of an integrated solution on a subscription basis. These subscription-based solutions provide us with a recurring revenue stream and we believe represent a more compelling opportunity in terms of growth and profitability than discrete professional services.

We sell our solutions to large and medium-sized organizations through our direct sales force. As of December 31, 2009, we had a customer base of approximately 4,900 companies, including approximately 170 companies on the Fortune 500 list published in May 2009. Our customer base includes companies that we billed for services during the year ended December 31, 2009 and does not necessarily indicate an ongoing relationship with each such customer. Our top 80 customers contributed approximately \$86.5 million, or 54.9%, of our total revenue for the year ended December 31, 2009.

In October 2009, unemployment in the United States peaked at 10.1% which will likely adversely affect our business in 2010 and may affect our business thereafter. However, the extent or degree to which we may be affected by these events is extremely difficult to predict. The uncertain economic prospects being experienced by our customers will likely translate into slower growth, or contraction, for us, since a substantial portion of our business is dependent upon our customers' hiring and human capital needs. However, we believe that, by optimizing our internal resources for the current business conditions, we can minimize these adverse effects and emerge from this economic crisis with a return to our historic operating margins.

Due to the economic downturn some of our customers, facing uncertainty and cost pressures in their own businesses, have indicated that they are waiting to purchase our products and are otherwise increasingly seeking purchasing terms and conditions that are less favorable to us. As a result, during the year ended December 31, 2009 and 2008, our customers renewed approximately 80% and 75%, respectively, of the aggregate value of multi-year subscriptions for our on-demand talent acquisition and performance management solution contracts subject to renewal during the period rather than our historical renewal rate of approximately 90%. As the business environment improves we expect renewal rates to improve to the 90% range from a long-term perspective.

Background

We commenced operations in 1987 as a provider of recruiting services to a wide variety of industries. In 1993, we offered our first automated talent acquisition system and by 1997 we had expanded our business to provide employee research, employee performance management technology and consulting services. In late 1997, responding to a growing demand from our customers, we began to provide comprehensive human capital management services integrated with on-demand software. Between 1994 and 1998, we acquired 15 businesses that collectively enabled us to offer comprehensive Human Capital Management (“HCM”) services integrated with on-demand technology.

Over the past eleven years, we have pursued a strategy designed to focus our business on talent acquisition and employee performance management solutions and reduce our strategic focus on discrete professional services that generated less predictable revenue streams and lower margins. To that end:

- in 1999, we exited our temporary staffing business;
- in 2000 and 2001, we acquired four businesses which enhanced our screening and behavioral assessment solutions and skills testing technologies;
- since 2002, we reduced our strategic focus on position-specific recruiting services;
- in 2003, we discontinued our Oracle implementation business and discontinued and sold our pharmaceutical training division;
- in 2005, we expanded our presence in North America and enhanced our customer base through our acquisition of Scottworks Solutions, Inc.;
- in 2006, we enhanced our talent acquisition solutions and customer base through our acquisitions of Webhire, Inc., Knowledge Workers Inc., Gantz-Wiley Research Consulting Group Inc., Psychometric Services Limited., and BrassRing Inc.;
- in 2007, we enhanced our talent acquisition solutions and customer base through our acquisitions of Strategic Outsourcing Corporation and HRC Human Resources Consulting GmbH,
- in 2008, we expanded our global footprint in the talent acquisition space through our acquisition of Quorum International Holdings Limited; and
- in 2009, we entered into an ownership interest transfer agreement with Shanghai Runjie Management Consulting Company to gain presence in China’s human capital management market.

As a result of our shift in strategic focus in 2000, we have focused on providing talent acquisition and employee performance management solutions on a subscription basis and currently generate a significant portion of our revenue from these subscriptions. We generate the remainder of our revenue from discrete professional services that are not provided as part of an integrated solution on a subscription basis. Subscription-based solutions provide us with a recurring revenue stream and we believe represent a more compelling opportunity in terms of growth and profitability than discrete professional services. In 2000, revenue derived from subscriptions for these solutions comprised approximately 54.4% of our total revenue. Since 2005, subscription revenue has represented approximately 80% of our total revenue. For the years ended December 2009 and 2008 subscription revenue represented approximately 84.9% and 80.2% of our total revenue, respectively. This shift to subscription based services has been driven by our customer’s adoption of the on-demand model for software delivery and need for solutions that improve employee recruiting and retention; we expect that trend to continue.

From our inception through 2001, our operations were funded primarily through internally generated cash flows and our line of credit, as well as private placements of our securities to institutional investors. On June 29, 2005, we completed our initial public offering and listed our common stock for trading on the Nasdaq Stock Market.

Recent Events

During the fourth quarter 2008, in response to the challenging macroeconomic environment, the strengthening U.S. dollar relative to other currencies of countries in which we do business, and the slowing or delaying of a number of projects by our customers, we announced a restructuring program involving reductions of approximately 200 employees, which included severance and outplacement benefits totaling approximately \$2.0 million. During the first quarter of 2009, as a result of the continued deterioration in the economic environment, we executed an additional reduction of approximately 159 employees and recorded severance and outplacement benefit costs totaling \$1.2 million.

During the three months ended March 31, 2009 and December 31, 2008, due to a 32.5% and 49.5%, respectively, decline in our stock price and market capitalization from the previous quarter, lower projected net income, cash flow estimates and slower projected growth rates in our industry, we reevaluated our goodwill impairment analysis. Our analysis was performed to determine the implied fair value of our goodwill with neither the write up nor write down of any assets or liabilities, nor recording of any additional unrecognized identifiable intangible assets. Based upon our analysis we recorded a goodwill impairment charge of \$33.3 million and \$167.0 million during the three months ended March 31, 2009 and December 31, 2008, respectively. This goodwill impairment charge had no effect on our cash balances.

On January 20, 2009, we entered into an ownership interest transfer agreement with Shanghai Runjie Management Consulting Company, ("R and J") in Shanghai, China for \$1.3 million. The initial investment provided us with a 46% ownership in the new entity Shanghai Kenexa Human Resources Consulting Co., Ltd., (the "variable interest entity") and a presence in China's human capital management market. The agreement with R and J also provided for a 1% annual ownership increase based upon adjusted EBITDA, as defined, for each of the years ended 2008, 2009 and 2010. In the third and fourth quarter of 2009, based upon the 2008 operating results for R and J, we paid an additional \$0.2 million for an additional 1% ownership interest in the variable interest entity. The variable interest entity was financed with \$0.3 million in initial equity contributions from us and R and J, and has no borrowings for which its assets would be used as collateral. On September 30, 2009 we provided \$0.2 million of financing for the variable interest entity. The creditors of the variable interest entity do not have recourse to our other assets.

On May 21, 2009, we elected not to renew our secured credit agreement with PNC Bank. We believe that our cash, short-term investments, UBS Settlement Agreement for our auction rate securities and projected cash from operations will be sufficient to meet our liquidity needs for at least the next twelve months.

On June 11, 2009 and July 16, 2009, two putative class actions were filed against Kenexa Corporation and our Chief Executive Officer and Chief Financial Officer in the United States District Court for the Eastern District of Pennsylvania, purportedly on behalf of a class of our investors who purchased our publicly traded securities between May 8, 2007 and November 7, 2007. The complaint filed on July 16, 2009 has since been voluntarily dismissed. In the pending action, Building Trades United Pension Trust Fund, individually and on behalf of all others similarly situated alleges violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act in connection with various public statements made by Kenexa. This action seeks unspecified damages, attorneys' fees and expenses.

Sources of Revenue

We derive revenue primarily from two sources: (1) subscription revenue for our solutions, which is comprised of subscription fees from customers accessing our on-demand software, consulting services, outsourcing services and proprietary content, and from customers purchasing additional support that is not included in the basic subscription fee; and (2) fees for discrete professional services.

Our customers primarily purchase renewable subscriptions for our solutions. The typical term is one to three years, with some terms extending up to five years. The majority of our subscription agreements are not cancelable for convenience although our customers have the right to terminate their contracts for cause if we fail to provide the agreed upon services or otherwise breach the agreement. A customer does not generally have a right to a refund of any advance payments if the contract is cancelled. Due to the current economic slowdown, a greater number of our customers are delaying or seeking to revise the terms and conditions of our service agreements. As a result, during the year ended December 31, 2009 our customers renewed approximately 80% of the aggregate value of multi-year subscriptions for our on-demand talent acquisition and performance management solution contracts subject to renewal during the period rather than our historical renewal rate of approximately 90%. As the business environment improves we expect renewal rates to improve to the 90% range from a long-term perspective.

Consistent with our historical practices, revenue derived from subscription fees is recognized ratably over the term of the subscription agreement. We generally invoice our customers in advance in quarterly installments and typical payment terms provide that our customers pay us within 30 days of invoice. Amounts that have been invoiced are recorded in accounts receivable prior to the receipt of payment and in deferred revenue to the extent revenue recognition criteria have not been met. As of December 31, 2009, deferred revenue increased by \$11.4 million or 29.5% to \$50.0 million from \$38.6 million at December 31, 2008. The increase in deferred revenue is a result of the increase in sales of our multiple elements or bundled arrangements. We generally price our solutions based on the number of software applications and services included and the number of customer employees. Accordingly, subscription fees are generally greater for larger organizations and for those that subscribe for a broader array of software applications and services.

We derive other revenue from the sale of discrete professional services, and translation services as well as from out-of-pocket expenses. The majority of our other revenue is derived from discrete professional services, which primarily consist of consulting and training services. This revenue is recognized differently depending on the type of service provided as described in greater detail below under "Critical Accounting Policies and Estimates."

For the year ended December 31, 2009, approximately 79.1% of our total revenue was derived from sales in the United States. Revenue that we generated from customers in the United Kingdom and Germany was approximately 7.1% and 2.6%, respectively, for the year ended December 31, 2009. Revenue for other countries amounted to an aggregate of 11.2%. Other than the countries listed, no other country represented more than 2.0% of our total revenue for the year ended December 31, 2009. The increase in our percentage revenue derived from sales in the United States is primarily due to decreased foreign sales.

Cost of Revenue

Our cost of revenue primarily consists of compensation, employee benefits and out-of-pocket travel-related expenses for our employees and independent contractors who provide consulting or other professional services to our customers. Additionally, our application hosting costs, amortization of third-party license royalty costs, technical support personnel costs, overhead allocated based on headcount and reimbursed expenses are also recorded as cost of revenue. Many factors affect our cost of revenue, including changes in the mix of products and services, pricing trends, changes in the amount of reimbursed expenses and fluctuations in our customer base. Because cost as a percentage of revenue is higher for professional services than for software products, an increase in the services component of our solutions or an increase in discrete professional services as a percentage of our total revenue would reduce gross profit as a percentage of total revenue. As our revenues begin to increase, we expect our cost of revenue to increase proportionately, subject to pricing pressure related to economic conditions and slightly influenced by the mix of services and software. To the extent new customers are added, we expect that the cost of services, as a percentage of revenue, will be greater than those services associated with existing customers.

Operating Expenses

We classify our operating expenses as follows:

Sales and Marketing. Sales and marketing expenses primarily consist of personnel and related costs for employees engaged in sales and marketing, including salaries, commissions, and other variable compensation, travel expenses and costs associated with trade shows, advertising and other marketing efforts and allocated overhead. We expense our sales commissions at the time the related revenue is recognized, and we recognize revenue from our subscription agreements ratably over the terms of the agreements. Over the past several years, our sales and marketing expense has increased in absolute terms and as a percentage of total revenue. Although we believe that our investment in sales and marketing commencing in 2003 resulted in significant revenue growth during 2004 through 2008, based on recent economic conditions we have reduced our sales and marketing expenditures to adjust for expected lower rates of growth projections. Consistent with our past practice, we intend to continue to invest in sales and marketing to pursue new customers and expand relationships with existing customers at levels we deem appropriate given our current economic conditions. We expect our sales and marketing expense to increase from current levels, mainly due to increased staff expense and continued emphasis on our rebranding effort.

General and Administrative. General and administrative expenses primarily consist of personnel and related costs for our executive, finance, human resources and administrative personnel, professional fees and other corporate expenses and allocated overhead. We expect general and administrative expenses to increase in the short term as we incur additional professional fees in connection with our patent infringement matter, however, in the longer term based upon the current state of the economy, we believe that general and administrative expenses will remain the same or slightly decrease in dollar amount and remain constant as a percentage of total revenue in 2010.

Professional fees related to our Chinese expansion. The company incurred professional fees in connection with its Chinese expansion in the amount of \$0.7 million during the first quarter of 2009. The Company believes that such exclusion facilitates comparisons to its historical operating results and to the results of other companies in the same industry, which have their own unique acquisition histories.

Severance expenses. We incurred charges in the amount of \$1.2 million in relation to additional severance expenses in the first quarter of 2009. These charges were excluded from its non-GAAP income to facilitate a more meaningful comparison to the prior year's results.

Expenses related to restructuring charges and related legal fees. We incurred charges in the amount of \$2.5 million in relation to the restructuring in the fourth quarter of 2008. Such charges consisted of severance and outplacement benefit costs of \$2.0 million and certain legal fees of \$0.5 million in relation to the termination of approximately 200 employees.

Research and development ("R&D") credits and the related consulting fees incurred to identify those credits. R&D credits in 2008 relate to R&D activities performed during the entire year of 2008, and reduce the Company's tax expense. These tax credits totaling \$0.5 million were claimed in the Company's fourth quarter tax filing and are reflected in the Company's December 31, 2008 financial statements. The R&D tax credit is excluded from the Company's non-GAAP financial measures in the current quarter to facilitate a more meaningful comparison to the prior year's results.

Goodwill impairment charge. We recorded a non-cash goodwill impairment charge in the first quarter of 2009 of \$33.3 million and \$167.0 million in the fourth quarter of 2008 of as a result of a substantial decrease in our stock price, reflecting the impact of the unprecedented turmoil in world economies and the resultant impact on our operations.

Noncontrolling Interest. Non Controlling interest of \$0.1 million includes income from operations due to our variable interest entity partner and is excluded from the calculation of non-GAAP net income from operations because it is unrelated to our ownership in the venture.

Net cash provided by operating activities. Net cash provided by operating activities is taken from our consolidated statement of cash flows and represents the amount of cash generated by our operations that is available for investing and financing activities. Generally, our net cash provided by operating activities has exceeded our operating income primarily due to the positive impact of deferred revenue, the add-back of non-cash goodwill impairment charges and more recently due to the collection of accounts receivables. It is possible that this trend may vary as business conditions change.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and consolidated results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to uncollectible accounts receivable and accrued expenses. We base these estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates.

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

Revenue Recognition

We derive our revenue from two sources: (1) subscription revenues for solutions, which are comprised of subscription fees from customers accessing our on-demand software, consulting services, outsourcing services and proprietary content, and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) other fees for professional services, translation services and reimbursed out-of-pocket expenses. Because we provide our solutions as a service, we follow the provisions of Financial Accounting Standards Board (“FASB”) ASC 605-10, “*Revenue Recognition*” and FASB ASC 605-25 “*Multiple Element Arrangements*”. We recognize revenue when all of the following conditions are met:

- there is persuasive evidence of an arrangement;
- the service has been provided to the customer;
- the collection of the fees is probable; and
- the amount of fees to be paid by the customer is fixed or determinable.

Subscription Fees and Support Revenues. Subscription fees and support revenues are recognized ratably over the lives of the contracts. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Other Revenue. Other revenue consists of discrete professional services, translation services and reimbursable out-of-pocket expenses. Discrete professional services, when sold with subscription and support offerings, are accounted for separately since these services have value to the customer on a stand-alone basis and there is objective and reliable evidence of fair value of the delivered elements. Our arrangements do not contain general rights of return. Additionally, when professional services are sold with other elements, the consideration from the revenue arrangement is allocated among the separate elements based upon the relative fair value. Revenues from professional services are recognized based upon proportional performance as value is delivered to the customer.

In determining whether revenues from professional services can be accounted for separately from subscription revenue, we consider the following factors for each agreement: availability of professional services from other vendors, whether objective and reliable evidence of the fair value exists of the undelivered elements, the nature and the timing of when the agreement was signed in comparison to the subscription agreement start date and the contractual dependence of the subscription service on the customer's satisfaction with the other services. If the professional service does not qualify for separate accounting, we recognize the revenue ratably over the remaining term of the subscription contract. In these situations we defer the direct and incremental costs of the professional service over the same period as the revenue is recognized.

In accordance with FASB ASC 605-45, “*Principal Agent Considerations*,” we record reimbursements received for out-of-pocket expenses as revenue and not netted with the applicable costs. These items primarily include travel, meals and certain telecommunication costs. Reimbursed expenses for the years ended December 31, 2009, 2008, and 2007, totaled \$2.2 million, \$4.7 million and \$3.5 million, respectively.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from customers' inability to pay us. The provision is based on our historical experience and for specific customers that, in our opinion, are likely to default on our receivables from them. In order to identify these customers, we perform ongoing reviews of all customers that have breached their payment terms, as well as those that have filed for bankruptcy or for whom information has become available indicating a significant risk of non-recoverability. We rely on historical trends of bad debt as a percentage of total revenue and apply these percentages to the accounts receivable associated with new customers and evaluate these customers over time. To the extent that our future collections differ from our assumptions based on historical experience, the amount of our bad debt and allowance recorded may be different.

Self-Insurance

We are self-insured for the majority of our health insurance costs, including claims filed and claims incurred but not reported subject to certain stop loss provisions. We estimate our liability based upon management's judgment and historical experience. We also rely on the advice of consulting administrators in determining an adequate liability for self-insurance claims. Self-insurance accruals totaled approximately \$0.6 million as of and for the periods ended December 31, 2009 and 2008. We continuously review the adequacy of our insurance coverage. Material differences may result in the amount and timing of insurance expense if actual experience differs significantly from management's estimates.

Capitalized Software Development Costs

In accordance with FASB ASC 985, "*Software*", and FASB ASC 350, "*Intangibles-Goodwill and Other*", costs incurred in the preliminary stages of a development project are expensed as incurred. Once an application has reached the development stage, internal and external costs, if direct and incremental, will be capitalized until the software is substantially complete and ready for its intended use. Capitalization ceases upon completion of all substantial testing. We also capitalize costs related to specific upgrades and enhancements when it is probable the expenditures will result in additional functionality. Maintenance and training cost are expensed as incurred. Internal use software is amortized on a straight-line basis over its estimated useful life, generally three years. Management evaluates the useful lives of these assets on an annual basis and tests for impairments whenever events or changes in circumstances occur that could impact the recoverability of these assets. There were no impairments to internal software in any of the periods covered in this report.

Goodwill and Other Identified Intangible Asset Impairment

Since 2002, we have recorded goodwill in accordance with the provisions of FASB ASC 350, “*Intangibles-Goodwill and Other*,” which requires us to annually review the carrying value of goodwill for impairment. If goodwill becomes impaired, some or all of the goodwill would be written off as a charge to operations. This comparison is performed annually or more frequently if circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount.

During the quarter ended December 31, 2008 we reevaluated our goodwill, due to adverse changes in the economic climate, a 49.5% decline in our market capitalization from October 1, 2008 (our annual testing date), and a downward revision in our earnings guidance for the quarter and year ended December 31, 2008. These factors signaled a triggering event, which required us to determine whether and to what extent our goodwill may have been impaired as of December 31, 2008. The first step of this analysis requires the estimation of our fair value, as an entity, and is calculated based on the observable market capitalization with a range of estimated control premiums as well as discounted future estimated cash flows. This step yielded an estimated fair value for us which was less than our carrying value including goodwill at December 31, 2008. The next step entails performing an analysis to determine whether the carrying amount of goodwill on our balance sheet exceeds our implied fair value. The implied fair value of our goodwill, for this step was determined in the same manner as goodwill recognized in a business combination. Our estimated fair value was allocated to our assets and liabilities, including any unrecognized identifiable intangible assets, as if we had been acquired in a business combination with our estimated fair value representing the price paid to acquire it. The allocation process performed on the test date was only for purposes of determining the implied fair value of goodwill with neither the write up or write down of any assets or liabilities, nor recording any additional unrecognized identifiable intangible assets as part of this process as of December 31, 2008. Based on the analysis, we determined that the implied fair value of goodwill was \$32.4 million, resulting in a goodwill impairment charge of \$167.0 million. The goodwill impairment charge had no effect on our cash balances.

During the quarter ended March 31, 2009 we reevaluated our goodwill due to continued adverse changes in the economic climate, a 32.5% decline in our market capitalization from December 31, 2008 through March 31, 2009 and a downward revision in internal projections. These factors signaled a triggering event, which required us to determine whether and to what extent our goodwill may have been impaired as of March 31, 2009. The allocation process performed on the test date was only for purposes of determining the implied fair value of goodwill with no assets or liabilities written up or down, nor any additional unrecognized identifiable intangible assets recorded as part of this process. Based on the analysis, a goodwill impairment charge of \$33.3 million was recorded to write off the remaining balance of our goodwill for the quarter ended March 31, 2009. The goodwill impairment charge had no effect on the Company’s cash balances

Classification and Fair Value Measurement of Auction Rate Securities

We hold investments in auction rate securities having contractual maturities of greater than one year and interest rate reset features of between 7 and 35 days. These auction rate securities were priced and initially traded as short-term investments because of the interest rate reset feature. During 2008, as a result of the deterioration in the credit markets, our auction rate securities failed to trade at auctions due to insufficient bids from buyers. The credit market crisis led to uncertainty surrounding the liquidity of our auction rate security investments and required us to reclassify our auction rate securities to long-term investments. In June 2009, due to our ability to liquidate these securities within the next twelve months, we reclassified our auction rate securities to short-term investments on our Consolidated Balance Sheet.

Our auction rate securities, which have a par value of \$15.3 million at December 31, 2009, were acquired through UBS AG. Due to the failure of the auction rate market in early 2008, UBS AG and other major banks entered into discussions with government agencies to provide liquidity to owners of auction rate securities. In November 2008, we entered into an agreement (the “UBS Settlement Agreement”) with UBS AG which provides us (1) with a “no net cost” loan up to the par value of Eligible ARS until June 30, 2010, (2) the right to sell these auction rate securities back to UBS AG at par, at our sole discretion, anytime during the period from June 30, 2010 through July 2, 2012, and (3) UBS AG the right to purchase these auction rate securities or sell them on our behalf at par anytime through July 2, 2012 (See Note 3 to the Consolidated Financial Statements). Following the execution of the UBS Settlement Agreement, we determined that we no longer had the intent to hold the ARS until either maturity or recovery of the ARS market. Based on this unusual circumstance related to the signing of the UBS Settlement Agreement, we transferred these investments from available-for-sale to trading securities and began recording the change in fair value of the ARS as gains or losses in current period earnings.

Contemporaneous with the determination to transfer the ARS to trading securities, we elected to measure the value of our option to put the securities (“put option”) to UBS AG under the fair value option of FASB ASC 825, “*Financial Instruments*”. As a result, at December 31, 2008, we recorded a non-operating gain representing the estimated fair value of the put option and a corresponding long-term asset of approximately \$2.2 million. At December 31, 2009, the put option’s estimated fair value decreased to \$1.4 million resulting in a non-operating loss of \$0.8 million for the twelve months ended December 31, 2009. The estimated fair value of the put option as of December 31, 2009 was based in part on an expected life of six months and a discount rate of 0.85%. In June 2009, due to our ability to exercise our put option within the next twelve months, we reclassified our put option to other current assets on our consolidated balance sheet. As a result of the transfer of the ARS from available-for-sale to trading investment securities noted above, we also recorded a non-operating gain for the twelve months ended December 31, 2009 of approximately \$0.8 million. The recording of the loss relating to the decrease in the fair value of the put option and the recognition of the gain in the ARS resulted in an overall net loss of less than \$0.1 million for the year ended December 31, 2009.

We anticipate that any future changes in the fair value of our put option under the UBS Settlement Agreement will partially be offset by the changes in the fair value of the related auction rate securities. Our option to put the securities under the UBS Settlement Agreement will continue to be measured at fair value utilizing Level 3 inputs as defined by FASB ASC 820, “*Fair Value Measurement and Disclosure*”, until the earlier of its maturity or exercise.

The fair values of our auction rate securities are estimated utilizing a discounted cash flow analysis or other types of valuation models as of December 31, 2009 rather than at par. These analyses are highly judgmental and consider, among other items, the likelihood of redemption, credit quality, duration, insurance wraps and expected future cash flows. These securities are also compared, when possible, to other observable market data with similar characteristics to the securities held by us. Any changes in fair value for our auction rate securities, which we attribute to market liquidity issues rather than credit issues, are recorded in our statement of operations.

Accounting for Income Taxes

We are subject to income taxes in the U.S. and various foreign countries. We record an income tax provision for the anticipated tax consequences of operating results reportable to each taxing jurisdiction in compliance with enacted tax legislation. We account for income taxes in accordance with FASB ASC 740, “*Income Taxes*”, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax basis of recorded assets and liabilities. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The realization of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. We have used tax-planning strategies to realize or renew net deferred tax assets in order to avoid the potential loss of future tax benefits. In addition, we operate within multiple taxing jurisdictions and are subject to audit in each jurisdiction. These audits can involve complex issues that may require an extended period of time to resolve. In our opinion, adequate provisions for income taxes have been made for all periods.

Our determination of the level of valuation allowance at December 31, 2009 is based on an estimated forecast of future taxable income which includes many judgments and assumptions primarily related to revenue, margins, operating expenses, tax planning strategies and tax attributes in multiple taxing jurisdictions. Accordingly, it is at least reasonably possible that future changes in one or more of these assumptions may lead to a change in judgment regarding the level of valuation allowance required in future periods.

Accounting for Share-Based Compensation

Share-based compensation expense recognized during the period is based on the value of the number of awards that are expected to vest multiplied by the fair value. We use a Black-Scholes option-pricing model to calculate the fair value of our share-based awards. The calculation of the fair value of the awards using the Black-Scholes option-pricing model is affected by our stock price on the date of grant as well as assumptions regarding the following:

- Volatility is a measure of the amount by which the stock price is expected to fluctuate each year during the expected life of the award and is based on a weighted average of peer companies, comparable indices and our stock volatility. An increase in the volatility would result in an increase in our expense.
- The expected term represents the period of time that awards granted are expected to be outstanding and is currently based upon an average of the contractual life and the vesting period of the options. With the passage of time actual behavioral patterns surrounding the expected term will replace the current methodology. Changes in the future exercise behavior of employees or in the vesting period of the award could result in a change in the expected term. An increase in the expected term would result in an increase to our expense.
- The risk-free interest rate is based on the U.S. Treasury yield curve in effect at time of grant. An increase in the risk-free interest rate would result in an increase in our expense.
- The estimated forfeiture rate is the rate at which awards are expected to expire before they become fully vested and exercisable. An increase in the forfeiture rate would result in a decrease to our expense.

In certain instances where market based, performance share awards are granted, we use the Monte Carlo valuation model to calculate the fair value. This approach utilizes a two-stage process, which first simulates potential outcomes for our shares using the Monte Carlo simulation. The first stage of the Monte Carlo simulation requires a variety of assumptions about both the statistical properties of our shares as well as potential reactions to such share price movements by our management. Such assumptions include the natural logarithm of our stock price, a random log-difference using the Russell 2000 stock index and a random variable using the specific deviations of our returns relative to the returns dictated by the CAPM model. The second stage employs the Black-Scholes model to value the various outcomes predicted by the Monte Carlo simulation. The resulting fair value, on the date of the grant (measurement date), is being recognized over the vesting period using the straight-line method.

Comparison of Years Ended December 31, 2009 and 2008

Revenues

Total revenue decreased by \$46.0 million or 22.6% to \$157.7 million for the year ended December 31, 2009 from \$203.7 million for the year ended December 31, 2008. Our subscription revenue decreased by \$29.5 million to \$133.9 million for the year ended December 31, 2009 from \$163.4 million for the year ended December 31, 2008. Subscription revenue represented approximately 84.9% of our total revenue for the year ended December 31, 2009 compared to 80.2% of our total revenue for the year ended December 31, 2008. The decrease in revenue is attributable primarily to the effects arising from the global economic recession, increased pricing pressures, high unemployment, and reduced demand for our products and services and the effects of delayed revenue recognition associated with sales of our multiple element or bundled arrangements. Based upon the current market conditions, we expect our subscription-based and other revenues to increase in 2010 over the prior year due to stabilization in the unemployment rate, slightly improved business environment and continued acceptance of our talent management solutions on-demand model.

Cost of Revenues

Cost of revenue decreased by \$8.2 million or 13.3% to \$53.4 million for the year ended December 31, 2009 from \$61.6 million for the year ended December 31, 2008. As a percentage of revenue, cost of revenue increased 3.7% to 33.9% for the year ended December 31, 2009 compared to 30.2% for the year ended December 31, 2008 due to decreased revenues in 2009. The \$8.2 million decrease in the cost of revenue was primarily due to reduced staff expense, reimbursable expense and third party fees, including marketing and agency costs, of approximately \$5.0 million, \$2.5 million and \$0.7 million, respectively, compared to the same period in 2008. Many factors affect our cost of revenue, including changes in the mix of products and services, the number of initial implementations versus recurring engagements, pricing trends, changes in the amount of reimbursed expenses and fluctuations in our customer base. As our overall revenue increases, we expect our cost of revenue will increase proportionately, subject to pricing pressure related to economic conditions and slightly influenced by the mix of services and software. To the extent new customers are added, we expect that the cost of services, as a percentage of revenue, will be greater than those services associated with existing customers.

Sales and Marketing

Sales and marketing expense decreased by \$5.7 million or 13.7% to \$35.1 million for the year ended December 31, 2009 compared to \$40.8 million for the year ended December 31, 2008. The \$5.7 million decrease was primarily due to reduced staff related expense, commissions, travel expenses and reserve for bad debt of approximately \$0.7 million, \$1.4 million, \$1.1 million, and \$3.1 million, respectively, partially offset by an increase in other expenses of \$0.6 million, compared to the same period in 2008. As a percentage of total revenue, sales and marketing expense increased by 2.3% to 22.3% for the year ended December 31, 2009 from 20.0% for the year ended December 31, 2008 due to decreased revenue. Consistent with our past practice, we intend to continue to invest in sales and marketing to pursue new customers and expand relationships with existing customers at levels we deem appropriate given our current economic conditions. We expect our sales and marketing expense to increase from current levels, mainly due to increased staff expense and continued emphasis on our rebranding effort.

General and Administrative

General and administrative expense decreased by \$8.1 million or 16.5% to \$40.8 million for the year ended December 31, 2009 compared to \$48.9 million for the year ended December 31, 2008. The \$8.1 million decrease was primarily due to reduced staff related expense, bonus, share-based compensation and travel expenses of approximately \$2.8 million, \$1.7 million, \$0.6 million and \$1.4 million, respectively. In addition, phone, entertainment and infrastructure expenses such as supplies, insurance and other expenses contributed approximately \$0.5 million, \$0.4 million, and \$0.7 million, respectively, of the decrease in expense compared to the same period in 2008. As a percentage of total revenue, general and administrative expense increased by 1.9% to 25.9% for the year ended December 31, 2009 compared to 24.0% for the year ended December 31, 2008 due to decreased revenues in 2009. In the short term, we expect general and administrative expense to increase as we incur additional professional fees in connection with our patent infringement matter, however, in the longer term based upon the current state of the economy, we believe that general and administrative expenses will remain the same or slightly increase in dollar amount and remain constant as a percentage of total revenue in 2010.

Research and Development

Research and development expense decreased by \$5.8 million or 37.3% to \$9.8 million for the year ended December 31, 2009 compared to \$15.6 million for the year ended December 31, 2008. The \$5.8 million decrease in research and development expense was primarily due to reduced staff related expense and an increase in capitalized software development costs. Capitalized software development costs increased by \$1.5 million or 18.3% to \$9.7 million for the year ended December 31, 2009 from \$8.2 million for the year ended December 31, 2008. The increase in capitalized software development costs was directly attributable to an increase in the software development projects qualifying for capitalization, pursuant to ASC 350-40, “*Internal-Use Software*”, and a decrease of research and development expenses. The increase in capitalized software development costs was due in part to greater use of third party software developers. As a percentage of total revenue, research and development expense decreased 1.4% to 6.2% for the year ended December 31, 2009 compared to 7.6% the year ended December 31, 2008. A small portion of our research and development expense relates to the efforts of our Kenexa Research Institute scientists, which is more fixed in nature. This cost structure will result in future research and development expense being more constant. We expect research and development expenses to remain flat or increase slightly as we continue to execute on our strategies which include furthering the common services enterprise architecture, introducing Kenexa 2x modules, and continuing to develop feature enhancements.

Depreciation and Amortization

Depreciation and amortization expense increased \$2.3 million or 18.0% to \$14.3 million for the year ended December 31, 2009 compared to \$12.0 million for the year ended December 31, 2008. The \$2.3 million increase was due in part to increased amortization expense associated with our acquisitions and increased depreciation expense associated with our capitalized software and our capital purchases including our building in Vizag. In the future, we expect depreciation and amortization expense to increase as we place our software development into service and due to recent capital purchases.

Goodwill Impairment

During the quarter ended March 31, 2009 we reevaluated our goodwill due to continued adverse changes in the economic climate, a 32.5% decline in our market capitalization from December 31, 2008 through March 31, 2009 and a downward revision in internal projections. These factors signaled a triggering event, which required us to determine whether and to what extent our goodwill may have been impaired as of March 31, 2009. We reviewed our goodwill by comparing the carrying values to the estimated fair values of the enterprise. Fair value is based on our estimate of the future discounted cash flows to be generated by the enterprise and our market capitalization. Such cash flows consider factors such as future operating income, historical trends, as well as demand and competition. Comparable company multiples are based upon public companies in sectors relevant to our business based on our knowledge of the industry. Changes in the underlying business could affect these estimates, which in turn could affect our assessment of the recoverability of goodwill. Based on the analysis a goodwill impairment charge of \$33.3 million for was recorded to write off the remaining balance of our goodwill for the quarter ended March 31, 2009. The goodwill impairment charge had no effect on our cash balances. See Critical Accounting Policies and Estimates for additional details.

Interest Income

Net interest expense was less than \$0.1 million for the year ended December 31, 2009 compared to \$1.4 million net interest income for the year ended December 31, 2008. The \$1.4 million decrease is due primarily to significantly lower rates of interest in 2009 and 2008 and the write off of deferred financing fees as a result of the termination of our Credit Agreement with PNC Bank.

Income Tax Expense

An income tax expense of \$1.9 million was recorded on a loss from operations of \$29.0 for the year ended December 31, 2009 as compared with an income tax benefit of \$38.1 million for the year ended December 31, 2008. The current year income tax expense is primarily attributable to an increase in the valuation allowance of \$7.0 million on federal, state and foreign net operating losses and the recognition of a goodwill impairment loss of \$33.3 million that is only partially deductible for U.S. tax purposes.

Webhire and BrassRing were two domestic companies which we acquired in 2006. During the year ended December 31, 2007, Webhire and BrassRing each made retroactive elections under Section 338(g) of the Internal Revenue Code with the effect of increasing the tax basis of certain acquired intangible assets to equal the deemed purchase price of these assets. We are amortizing the increased tax basis of these acquired intangibles over a 15-year period for federal and state income tax purposes. The amortization of these intangibles gives rise to temporary differences between the book basis and tax basis of these assets.

The goodwill impairment loss claimed in 2009 included certain intangible assets recorded by Webhire and BrassRing during their respective acquisitions. These intangibles are characterized as component-1 goodwill as we expect to recognize tax deductions as we amortize the tax basis of these assets over their remaining useful lives. The portion of impaired goodwill that has no tax basis is considered to be component-2 goodwill. We have allocated the impairment charge of \$33.3 million between component-1 goodwill (\$20.3 million) and component-2 goodwill (\$13.0 million) and recorded a deferred tax asset computed on the difference between the book and tax bases of component-1 goodwill.

Changes to deferred income taxes are generally based on management's evaluation of our positive and negative evidence bearing upon the realizability of its deferred tax assets and the determination that it is more likely than not that we will realize a portion of the benefits of federal and state tax assets. In assessing the need for a valuation allowance, management considers all available information within each taxing jurisdiction, including past operating results, estimates of future taxable income and the feasibility of tax planning strategies. Any changes in management's assessment of the amount of deferred tax assets that may be realized will result in an adjustment to its valuation allowance with a corresponding increase or decrease to income tax expense in the period in which such determination is made.

Comparison of Years Ended December 31, 2008 and 2007

Revenues

Total revenue increased by \$21.8 million or 12.0% to \$203.7 million for the year ended December 31, 2008 from \$181.9 million for the year ended December 31, 2007. Our subscription revenue increased by \$14.7 million to \$163.4 million for the year ended December 31, 2008 from \$148.7 million for the year ended December 31, 2007. Subscription revenue represented approximately 80.2% of our total revenue for the year ended December 31, 2008 compared to 81.7% of our total revenue for the year ended December 31, 2007. The increase in revenue is attributable primarily to an increase in sales volumes of our talent management solutions and the continued acceptance of our on-demand model. Revenue generated by Quorum comprised approximately 7.9% of the increase in our total revenue for the year ended December 31, 2008 compared to the prior year. Our other revenue increased by \$7.1 million to \$40.3 million for the year ended December 31, 2008 from \$33.2 million for the year ended December 31, 2007. This increase was mostly due to an increase in demand for our consulting services which resulted from an increase in our subscription-based revenues.

Cost of Revenues

Cost of revenue increased by \$10.7 million or 21.0% to \$61.6 million for the year ended December 31, 2008 from \$50.9 million for the year ended December 31, 2007. As a percentage of revenue, cost of revenue increased 2.2% to 30.2% for the year ended December 31, 2008 compared to 28.0% for the year ended December 31, 2007. The \$10.7 million increase in the cost of revenue was primarily due to increased salaries, overhead, direct costs and other expense of \$7.1 million, \$1.2 million, \$1.1 million and \$1.3 million, respectively. Our increased salaries were due in part to the addition of 100 employees from the acquisition of Quorum in 2008.

Sales and Marketing

Sales and marketing expense increased by \$5.5 million or 15.6% to \$40.8 million for the year ended December 31, 2008 compared to \$35.3 million for the year ended December 31, 2007. The \$5.5 million increase was due in part to an increase of staff related expense of approximately \$5.6 million, partially offset by a decrease in performance bonuses, commissions and travel expenses of approximately \$3.7 million from the prior year. The net \$1.9 million increase in salaries was due partially to the addition of 24 employees from our Quorum acquisition and 39 employees hired for our existing business in 2008. In addition, reserve for bad debt and advertising and marketing expense contributed approximately \$2.4 million and \$1.2 million to the increase in sales and marketing expense for the year ended December 31, 2008 over the prior year. The increase in bad debt was mainly attributed to three customers. As a percentage of total revenue, S&M expense increased to 20.0% for the year ended December 31, 2008 from 19.4% for the year ended December 31, 2007 due to increased expense.

General and Administrative

General and administrative expense increased by \$9.5 million or 24.1% to \$48.9 million for the year ended December 31, 2008 compared to \$39.4 million for the year ended December 31, 2007. The \$9.5 million increase was due in part to an increase in professional fees, rent and utilities expense, and share-based compensation expense which contributed \$2.6 million, \$1.6 million, and \$1.8 million, respectively, to the increase in general and administrative expense for the year ended December 31, 2008 compared to the prior year. In addition increased travel, phone and license expense contributed approximately \$0.9 million, \$0.8 million and \$0.4 million in expense for the year ended December 31, 2008 compared to the prior year. The remainder of the increase of \$1.4 million was attributable to increases in infrastructure expenses such as supplies, insurance and other expenses of \$1.0 million and salary and bonus expenses of \$0.4 million. As a percentage of total revenue, general and administrative expense increased by 2.4% to 24.0% for the year ended December 31, 2008 compared to 21.6% for the year ended December 31, 2007.

Research and Development

Research and development expense decreased by \$2.1 million or 11.9% to \$15.6 million for the year ended December 31, 2008 from \$17.7 million for the year ended December 31, 2007. The \$2.1 million decrease in research and development expense was directly attributable to increased capitalized software development costs during 2008. Capitalized software development costs increased by \$5.5 million or 203.7% to \$8.2 million for the year ended December 31, 2008 from \$2.7 million for the year ended December 31, 2007. The increase in capitalized software development costs represents 52.6% and 15.3% of research and development expense for the years ended December 31, 2008 and 2007, respectively and was directly attributable to an increase in the software development projects qualifying for capitalization, pursuant to ASC 350-40, "*Internal-Use Software*". This increase was due in part to greater use of third party software developers. As a percentage of total revenue, research and development expense decreased from 9.7% to 7.6% for the year ended December 31, 2008 compared to the year ended December 31, 2007 due to increased capitalized software development costs.

Depreciation and Amortization

Depreciation and amortization expense increased \$4.4 million or 57.9% to \$12.0 million for the year ended December 31, 2008 compared to \$7.6 million for the year ended December 31, 2007. The \$4.4 million increase was due in part to increased amortization expense associated with our recent acquisitions and increased depreciation expense associated with our capitalized software and our capital purchases including our building in Vizag.

Restructuring expense

During the quarter ended December 31, 2008 in response to the weakness of our macroeconomic environment and widespread deterioration in our business climate we announced a restructuring program involving staff reductions of approximately 200 employees which included severance and outplacement benefit costs totaling approximately \$2.0 million.

Goodwill Impairment

During the quarter ended December 31, 2008, due to adverse changes in the economic climate, a 49.5% decline in the our market capitalization from October 1, 2008, and a downward revision in our earnings guidance for the quarter and year ended December 31, 2008, we reevaluated our goodwill impairment analysis. Pursuant to FASB ASC 350, "*Assets-Intangibles-Goodwill and Other*", these factors signaled a triggering event, which required us to determine whether and to what extent our goodwill was impaired as of December 31, 2008. The first step of this analysis required the estimation of our fair value, as an entity, and is calculated based on the observable market capitalization with a range of estimated control premiums as well as discounted future estimated cash flows. This step yielded an estimated fair value for us which was less than our carrying value including goodwill at December 31, 2008. The next step entailed performing an analysis to determine whether the carrying amount of goodwill on our balance sheet exceeded our implied fair value. The implied fair value of our goodwill, for this step was determined in the same manner as goodwill recognized in a business combination. Our estimated fair value was allocated to our assets and liabilities, including any unrecognized identifiable intangible assets, as if we had been acquired in a business combination with our estimated fair value representing the price paid to acquire it. The allocation process performed on the test date was only for purposes of determining the implied fair value of goodwill with neither the write up or write down of any assets or liabilities, nor recording of any additional unrecognized identifiable intangible assets as part of this process, but did cause us to be out of compliance with the covenants under our credit facility pursuant as of December 31, 2008. Based on the analysis, we determined that the implied fair value of the Kenexa's goodwill was \$32.4 million, resulting in a goodwill impairment charge of \$167.0 million. The goodwill impairment charge had no effect on our cash balances.

Interest Income

Interest income decreased \$1.7 million or 54.8% for the year ended December 31, 2008 to \$1.4 million for the year ended December 31, 2008 from \$3.1 million for the year ended December 31, 2007. The \$1.7 million decrease was due primarily to lower cash balances and lower rates of interest in 2008.

Income Tax Expense

An income tax benefit on continuing operations of \$38.1 million was recorded for the year ended December 31, 2008 as compared with an income tax expense of \$10.6 million for the year ended December 31, 2007. This income tax benefit was primarily attributable to the recognition of a deferred tax asset of \$42.3 million relating to a goodwill impairment loss that was deductible for U.S. tax purposes. Changes to deferred income taxes are generally based on management's evaluation of our positive and negative evidence bearing upon the realizability of its deferred tax assets and the determination that it is more likely than not that we will realize a portion of the benefits of federal and state tax assets.

Webhire, which we acquired in January 2006, had a net operating loss carryforward balance of approximately \$48.0 million for federal purposes as of September 30, 2005. BrassRing, which we acquired in November 2006, had a net operating loss carryforward balance of approximately \$78.0 million for federal purposes as of December 31, 2006. Based upon the uncertainty of our ability to utilize these acquired net operating losses, we recorded a valuation allowance of approximately \$12.0 million during the year ended December 31, 2006.

During the year ended December 31, 2007, Webhire and BrassRing made retroactive elections under Section 338(g) of the Internal Revenue Code with the effect of increasing the tax basis of acquired intangible assets to the deemed purchase price of these assets. We will amortize the increased tax basis of acquired intangibles over a 15-year period for federal and state income tax purposes. Separate gains equal to the respective increases in tax basis were included in the pre-acquisition taxable incomes of each acquired company. Webhire and BrassRing each had sufficient net operating loss carryforwards to fully offset the income recognized on the deemed sale of assets for regular federal income tax purposes. However, under the federal alternative minimum tax rules, net operating loss carryforwards may not offset more than 90% of income taxable under this measure. We have therefore paid alternative minimum tax on these gains of approximately \$0.5 million. Concurrent with the recognition of these gains, certain of the acquired net operating losses were deemed to expire. Accordingly, we reduced the deferred tax assets associated with these acquired net operating losses and the related valuation allowances by offsetting amounts of approximately \$12.0 million.

Liquidity and Capital Resources

Since we were formed in 1987, we have financed our operations primarily through internally generated cash flows, our revolving credit facilities and the issuance of equity. As of December 31, 2009, we had cash and cash equivalents of \$29.2 million and short term investments of \$29.6 million. In addition, we had no debt and approximately \$0.5 million in capital equipment leases.

Our cash provided from operations was \$35.5 million, \$32.5 million and \$38.6 million for the years ended December 31, 2009, 2008 and 2007, respectively. Cash used in investing activities was \$28.2 million, \$18.1 million and \$86.3 million for the years ended December 31, 2009, 2008 and 2007, respectively. Cash (used in) and provided by financing activities was \$(0.2) million, \$(29.7) million and \$42.3 million for the years ended December 31, 2009, 2008 and 2007, respectively. All of these effects in 2009 resulted in an increase in our cash and cash equivalents of \$7.5 million for the year ended December 31, 2009. While our investing and financing activities have been significant over the past three years, we expect positive cash flow from operations to continue in future periods.

As of December 31, 2009, we held auction rate securities with a fair value of \$13.9 million and par value of \$15.3 million. Our auction rate securities portfolio includes investments rated A, AA and AAA and are comprised of federally and privately insured student loans. The auction rate securities we hold have continued to fail to trade at recent auctions due to insufficient bids from buyers. This limits the short-term liquidity of these instruments and may limit our ability to liquidate and fully recover the carrying value of our auction rate securities if we needed to convert some or all to cash in the near term. Despite the current lack of liquidity in the auction rate security market, we believe our current cash and cash equivalent balances and cash from operations will be sufficient to fund our operations.

Our auction rate securities were acquired through UBS AG. Due to the failure of the auction rate market in early 2008, UBS and other major banks entered into agreements with governmental agencies to provide liquidity to owners of auction rate securities. In November 2008, we entered into an agreement with UBS which provides us (1) with a “no net cost” loan up to the par value of Eligible ARS until September 30, 2010, (2) the right to sell these auction rate securities back to UBS AG at par, at our sole discretion, anytime during the period from June 30, 2010 through July 2, 2012, and (3) provides UBS AG the right to purchase these auction rate securities or sell them on our behalf at par anytime through July 2, 2012. (See Note 3 to our Consolidated Financial Statements included in this Annual Report on Form 10-K for more information).

On May 31, 2009, we elected not to renew our secured credit agreement with our bank and as a result, no longer have a revolving credit facility or other debt financing arrangement. We believe that our cash and short-term investments, our UBS Settlement Agreement for our auction rate securities and our projected cash from operations will be sufficient to meet our liquidity needs for at least the next twelve months.

On April 2, 2008, we acquired Quorum International Holdings Limited (“Quorum”), a provider of recruitment process outsourcing services based in London, England, for a purchase price of approximately \$27.9 million, in cash, to broaden our presence in the global recruitment market. The total cost of the acquisition, including legal, accounting, and other professional fees of \$1.3 million, was approximately \$29.2 million. In addition, the acquisition agreement contains an earnout provision which provides for the payment of additional consideration by the Company based upon the gross profit of Quorum for the twelve month period ending June 30, 2009 and June 30, 2010. Formulaically, the earnout is 3.86 times Quorum’s gross profit less the amount of base consideration, as defined in the agreement. Based upon the results for the twelve month period through June 30, 2009, it was determined that an earnout payment was due to the former shareholders of Quorum and as such, we accrued additional consideration of \$1.2 million. The related liability has been accrued in the financial statements at December 31, 2009. The additional consideration was paid in cash during the first quarter of 2010. In addition, as of December 31, 2009, the June 30, 2010 earnout amount was substantially uncertain, and, as such, the estimated earn out range is not possible to disclose. The Company evaluates the earnout provisions contained in the acquisition agreement at each financial statement reporting date.

On February 20, 2008, our board of directors authorized a stock repurchase plan providing for the repurchase of up to 3,000,000 shares of our common stock. In connection with our November 8, 2007 and February 20, 2008 stock repurchase plans, we repurchased 1.7 million and shares of our common stock at an average price of \$18.01 per share and an aggregate cost of \$30.3 million for the year ended December 31, 2008. For the period ended December 31, 2009, there were no repurchases under the stock repurchase plans. As of December 31, 2009, there was 1,847,349 shares available for repurchase under the stock repurchase plan.

Financing Activities

Net cash used in financing activities was \$0.2 million and \$29.7 million for the years ended December 31, 2009 and 2008, respectively. Net cash provided by financing activities was \$42.3 million for the year ended December 31, 2007.

For the year ended December 31, 2009, net cash used in financing activity resulted primarily from our variable interest entity of \$0.2 million, repayments of capital lease obligations and notes payable of \$0.4 million, partially offset by net proceeds from stock option exercises of \$0.1 million, and share issuance from our employee stock purchase plan of \$0.3 million.

For the year ended December 31, 2008, net cash used in financing activity resulted primarily from repurchases of our common shares of \$30.3 million, repayments of capital lease obligations and notes payable of \$0.3 million, partially offset by net proceeds from stock option exercises of \$0.4 million, excess tax benefits from share-based payment arrangements of \$0.2 million, and share issuance from our employee stock purchase plan of \$0.3 million.

For the year ended December 31, 2007, net cash provided by financing activity resulted primarily from net proceeds from our public offering of \$130.4 million, net proceeds from stock option exercises of \$1.6 million, excess tax benefits from share-based payment arrangements of \$1.3 million, share issuance from our employee stock purchase plan of \$0.2 million, partially offset by deferred financing costs of \$0.1 million, repayments of borrowings under our line of credit of \$65.0 million, repurchases of our common shares of \$25.5 million, repayments of capital lease obligations of \$0.2 million, and net repayments of notes payable of \$0.4 million.

Comparison of Unaudited Quarterly Results

Revenues

Total revenue increased throughout the second quarter of 2008 due to purchases of our solutions by new customers, purchases of additional solutions by existing customers and contract renewals, however as the economic conditions deteriorated during the latter half of 2008, total revenues declined. Subscription-based and other revenues decreased in 2009 over the prior year due to a greater number of customers delaying or revising the terms and conditions of our service agreements, the strengthening US dollar, the loss of RPO customers, and a loss of consulting engagements.

Cost of Revenues

Cost of revenue for the quarters presented has fluctuated between 27.2% and 35.3% based on the mix of sales between subscription revenue and other revenue. Cost of revenue was highest as a percentage of total revenue for the three months ended March 31, 2009. As our overall revenue fluctuates, we expect our cost of revenue to change proportionately, subject to pricing pressure related to economic conditions and slightly influenced by the mix of services and software. To the extent new customers are added, the cost of services, as a percentage of revenue, will be greater than those services associated with existing customers.

Sales and Marketing

Following our acquisitions in 2008 and our rebranding initiatives in 2009 sales and marketing increased slightly from approximately 19.1% to 23.4% of our total revenues for those periods. During 2008, sales and marketing expenses increased in terms of absolute dollars as a result of increased marketing programs and variable compensation programs. During 2009, based on economic conditions we reduced our sales and marketing expenditures to adjust for expected lower rates of growth projections. In the future, we intend to continue to invest in sales and marketing to pursue new customers, expand relationships with existing customers and market and advertise our new brand to existing and potential customers at levels we deem appropriate given our current economic conditions.

General and Administrative

General and administrative expenses have increased as a percentage of revenues from approximately 22.8% during 2008 to 28.0% through March 31, 2009 due to our restructuring programs which resulted in severance and outplacement benefit costs. In absolute dollar terms over the eight quarters presented general and administrative expenses have fluctuated due to our restructuring programs and professional fees in connection with our patent infringement matter. During the last nine months of 2009 as our revenues and corporate activities remained relatively flat, our general and administrative expense as a percentage of revenues held steady at approximately 25.2%. In the longer term based upon the current state of the economy, we believe that general and administrative expenses will remain the same or slightly increase in dollar amount and remain constant or decrease as a percentage of total revenue in 2010.

Research and Development

Research and development expenses have decreased as a percentage of revenues from 9.4% in March 31, 2008 to 5.6% during December 31, 2009 due to an increase in capitalized software development costs during 2008 and 2009. The increase capitalized software development costs was due in part to greater use of third party software developers and improved precision of their time and activity reporting.

Restructuring expense

During the quarter ended December 31, 2008 in response to the challenging macroeconomic environment, the strengthening U.S. dollar relative to other currencies of countries in which we do business, and the resulting slowing or delaying of a number of project implementations we announced a restructuring program involving staff reductions of approximately 200 employees which included severance and outplacement benefit costs totaling approximately \$2.0 million. As a result of the continued deterioration in the economic environment during the first quarter of 2009, we executed an additional reduction in force resulting in the elimination of approximately 159 employees and incurring \$1.2 million in severance and outplacement benefit costs.

Adoption of new accounting pronouncements

Effective July 1, 2009, we adopted “*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*”. This standard establishes only two levels of GAAP, authoritative and non-authoritative. The FASB Accounting Standards Codification (the “Codification”) became the source of authoritative, non-governmental GAAP, except for rules and interpretive releases of the SEC, which are sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification became non-authoritative. We began using the new guidelines and numbering system prescribed by the Codification when referring to GAAP in the third quarter of fiscal 2009. As the Codification was not intended to change or alter existing GAAP, it did not have any impact on our consolidated financial statements.

In May 2009, the FASB adopted Codification Topic 855, “*Subsequent Events*,” which codifies the guidance regarding the disclosure of events subsequent to the balance sheet date. The statement established general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855 is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. The adoption ASC 855 did not have a material impact on the Company’s financial statements.

In April 2009, the FASB issued ASC 805 “*Business Combinations*,” which amends ASC 805 by establishing a model to account for certain pre-acquisition contingencies. Under ASC 805, an acquirer is required to recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined, then the acquirer should follow the recognition criteria in ASC 450, “*Contingencies*”. In the first quarter of 2009, we adopted ASC 805 and will apply its provisions when applicable.

In December 2007, the FASB issued ASC 810-10, “*Consolidation-Overall*” and ASC 805, “*Business Combinations*”. Changes for business combination transactions pursuant to ASC 805 include, among others, expensing of acquisition-related transaction costs as incurred, the recognition of contingent consideration arrangements at their acquisition date fair value and capitalization of in-process research and development assets acquired at their acquisition date fair value. Changes in accounting for noncontrolling (minority) interests pursuant to ASC 810-10 include, among others, the classification of noncontrolling interest as a component of consolidated shareholders’ equity and the elimination of “minority interest” accounting in results of operations. ASC 805 is required to be adopted and was effective for fiscal years beginning on or after December 15, 2008. The adoption of ASC 805 will impact the accounting for the Company’s future acquisitions. The adoption of ASC 810-10 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued ASC 825, “*Financial Instruments*,” which permits the Company to choose to measure many financial instruments and certain other items at fair value. The Company adopted ASC 825 as of January 1, 2008. The adoption did not impact the Company’s consolidated financial statements on the date of adoption. However, during the fourth quarter of 2008, the Company elected to measure at fair value the put option related to its UBS Settlement Agreement.

In September 2006, the FASB issued ASC 820, “*Fair Value Measurements and Disclosures*”, which defines fair value, establishes a framework for measuring fair value, and also expands disclosures about fair value measurements. FASB ASC 820 is effective for periods beginning after November 15, 2007. The Company adopted this standard with respect to its financial assets effective January 1, 2008. In February 2008, the FASB amended certain provisions of ASC 820 delaying its effective date for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). See Footnote 3 of the Notes to the Consolidated Financial Statements for further detail regarding the impact of our adoption of ASC 820 for financial assets.

New Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update (“ASU”) No. 2009-13, “*Revenue Recognition: Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*”, which eliminates the use of the residual method for allocating consideration, as well as the criteria that requires objective and reliable evidence of fair value of undelivered elements in order to separate the elements in a multiple-element arrangement. By removing the criterion requiring the use of objective and reliable evidence of fair value in separately accounting for deliverables, the recognition of revenue will more closely align with certain revenue arrangements. The standard also will replace the term “fair value” in the revenue allocation guidance with “selling price” to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. ASU No. 2009-13 is effective for revenue arrangements entered or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently assessing the potential impact of this standard to determine if its adoption will have a material impact on the financial condition or results of operations of the Company.

In June 2009, the FASB issued new accounting guidance for variable interest entities. This guidance was codified under ASU 2009-17 in December 2009 and includes: (1) the elimination of the exemption from consolidation for qualifying special purpose entities, (2) a new approach for determining the primary beneficiary of a variable interest entity (“VIE”), which requires that the primary beneficiary have both (i) the power to control the most significant activities of the VIE and (ii) either the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE, and (3) the requirement to continually reassess who should consolidate a VIE. The new guidance is effective for annual reporting periods that begin after November 15, 2009 and applies to all existing and new VIEs. The Company is currently evaluating the impact of adopting this new guidance. This guidance was codified in December 2009 under ASU 2009-17.

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

Foreign Currency Exchange Risk

In 2009, approximately 79.1% of our total revenue was comprised of sales to customers in the United States. A key component of our business strategy is to expand our international sales efforts, which will expose us to foreign currency exchange rate fluctuations. A 10% increase in the value of the U.S. dollar during 2009, relative to each of our non-U.S. generated sales would have resulted in reduced annual revenues of less than 2% for the year ended December 31, 2009.

The financial position and operating results of our foreign operations are consolidated using the local currency as the functional currency. Local currency assets and liabilities are translated at the rate of exchange to the U.S. dollar on the balance sheet date, and the local currency revenue and expenses are translated at average rates of exchange to the U.S. dollar during the period. The related translation adjustments to shareholders’ equity were a decrease of \$0.9 million and \$3.9 million during 2009 and 2008, respectively, and are included in other comprehensive income (loss). The foreign currency translation adjustment is not adjusted for income taxes as it relates to an indefinite investment in a non-U.S. subsidiary.

Interest Rate Risk

The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. To minimize this risk in the future, we intend to maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, money market funds, government and non-government debt securities and certificates of deposit. Our cash equivalents, which consist solely of money market funds, are not subject to market risk because the interest paid on these funds fluctuates with the prevailing interest rate. We believe that a 10% change in interest rates would not have had a significant effect on our interest income for the year ended December 31, 2009.

ITEM 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Kenexa Corporation

We have audited the accompanying consolidated balance sheets of Kenexa Corporation and Subsidiaries (collectively, Kenexa Corporation) (a Pennsylvania corporation) as of December 31, 2009 and 2008, and the related consolidated statements of operations, shareholders' equity comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Kenexa Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kenexa Corporation and Subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Kenexa Corporation's internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 9, 2010 expressed an unqualified opinion.

/s/ Grant Thornton LLP

Philadelphia, PA

March 9, 2010

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements

(All amounts in thousands, except share and per share data, unless noted otherwise)

1. Organization

Kenexa Corporation, and its subsidiaries (collectively the "Company" or "Kenexa"), commenced operations in 1987 as a provider of recruiting services to a wide variety of industries. In 1993, the Company offered its first automated talent management system. Between 1994 to 2009 the Company acquired 28 businesses that enabled it to offer comprehensive human capital management, or HCM, services integrated with web-based technology. The Company's business solutions include a comprehensive suite of on-demand software applications and complementary services, including outsourcing services and consulting, to help global organizations recruit high performing individuals and to foster optimal work environments to increase employee productivity and retention.

The Company began its operations in 1987 under its predecessor companies, Insurance Services, Inc., or ISI, and International Holding Company, Inc., or IHC. In December 1999, the Company reorganized its corporate structure by merging ISI and IHC with and into Raymond Karsan Associates, Inc., or RKA, a Pennsylvania corporation and a wholly owned subsidiary of Raymond Karsan Holdings, Inc., or RKH, a Pennsylvania corporation. Each of RKA and RKH were newly created to consolidate the businesses of ISI and IHC. In April 2000, the Company changed its name to TalentPoint, Inc. and changed the name of RKA to TalentPoint Technologies, Inc. In November 2000, the Company changed its name to Kenexa Corporation, and changed the name of TalentPoint Technologies, Inc. to Kenexa Technology, Inc., or Kenexa Technology. Currently, Kenexa transacts business primarily through Kenexa Technology. While the Company has several product lines, our chief decision makers determine resource allocation decisions and assess and evaluate periodic performance under one operating segment.

2. Summary of Significant Accounting Policies

In June 2009, the FASB issued ASU 2009-01, "*Amendments based on Statement of Financial Accounting Standards No. 168 - The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*", to codify in ASC 105, "*Generally Accepted Accounting Principles*", FASB Statement 168, "*The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*", which was issued to establish the Codification as the sole source of authoritative U.S. GAAP recognized by the FASB, excluding SEC guidance, to be applied by nongovernmental entities. The guidance in ASC 105 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has revised its references to pre-Codification GAAP and noted no impact on the financial condition or results of operations of the Company.

Principles of Consolidation

The consolidated financial statements of the Company include the accounts of Kenexa Corporation and its subsidiaries and Variable interest entity described in note number five. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and such differences may be material to the Company's consolidated financial statements.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

2. Summary of Significant Accounting Policies (continued)

Reclassifications

Certain reclassifications have been made to the prior period consolidated financial statements to conform to the current period presentation. Reclassifications to the December 31, 2008 consolidated balance sheet include a transfer of \$7,185 relating to software in development from property and equipment to software and a transfer of \$1,256 of tax liabilities from other accrued liabilities to other liabilities.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial assets and liabilities, including cash and cash equivalents, accounts receivable, short-term investments, put option and accounts payable at December 31, 2009 and 2008 approximate fair value of these instruments.

Concentration of Credit Risk

Financial instruments which potentially expose the Company to concentration of credit risk consist primarily of accounts receivable and the UBS Settlement Agreement. Credit risk arising from receivables is mitigated due to the large number of customers comprising the Company's customer base and their dispersion across various industries. The Company does not require collateral. The customers are concentrated primarily in the Company's U.S. market area. At December 31, 2009 and 2008, there were no customers that represented more than 10% of the net accounts receivable balance. In addition, there were no customers that individually exceeded 10% of the Company's revenues for the years ended December 31, 2009 and 2008.

As discussed in Note 3, the Company has the right to sell its auction rate securities back to UBS AG. The ability of the Company to sell those securities is dependent on the liquidity of UBS at the time of the sale.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with remaining maturities of three months or less at the time of purchase. Cash which is restricted for lease deposits is included in other assets. Cash balances are maintained at several banks. Accounts located in the United States are insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$100 (which has been temporarily increased to \$250 through December 31, 2013). Certain operating cash accounts may periodically exceed the FDIC limits.

Cash and cash equivalents in foreign denominated currencies which are held in foreign banks totaled \$7,994 and \$6,935 and represented 27.4% and 31.9% of our total cash and cash equivalents balance at December 31, 2009 and 2008, respectively.

Foreign Currency Translation

The financial position and operating results of the Company's foreign operations are consolidated using the local currency as the functional currency. Local currency assets and liabilities are translated at the rate of exchange to the U.S. dollar on the balance sheet date, and the local currency revenues and expenses are translated at average rates of exchange to the U.S. dollar during the period. The operations of the variable interest entity in China are translated from Chinese renminbis, which is fixed at approximately 6.8 renminbis to one U.S. dollar. The related translation adjustments are reported in the shareholders' equity section of the balance sheet and resulted in a net reduction in shareholders' equity of \$925 and \$3,861 for the years ended December 31, 2009 and 2008, respectively. The foreign currency translation adjustment is not adjusted for income taxes as it relates to an indefinite investment in a non-U.S. subsidiary.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost. Equipment under capital lease is stated at the lower of the fair market value at the date of acquisition or net present value of the minimum lease payments at inception of the lease. Depreciation and amortization expense are recognized on a straight-line basis over the assets' estimated useful lives or, if shorter, the lease terms for leasehold improvements. Estimated useful lives are generally 7 years for office furniture, and 3 to 5 years for computer equipment and software. Reviews are regularly performed if facts and circumstances exist that indicate that the carrying amount of assets may not be recoverable or that the useful life is shorter than originally estimated. Costs of maintenance and repairs are charged to expense as incurred. When property and equipment or leasehold improvements are sold or otherwise disposed of, the fixed asset account and related accumulated depreciation account are relieved and any gain or loss is included in results of operations. Costs of software not yet placed into service are accumulated as software in development. Upon placement into service, the costs of the assets are transferred to software. Construction costs not yet placed into service are accumulated as building construction in progress. Upon placement into service, the costs of the assets are transferred to building. In January 2008, the building was placed into service and, accordingly, all costs of the building have been transferred out of construction in progress. The building is being depreciated over 30 years.

Software Developed for Internal Use

In accordance with FASB ASC 605, "*Revenue Recognition-Multiple Element Arrangements*", the Company applies FASB ASC 350, "*Intangibles-Goodwill and Other, Internal-Use Software*". The costs incurred in the preliminary stages of development are expensed as incurred. Once an application has reached the development stage, internal and external costs, if direct and incremental, are capitalized until the software is substantially complete and ready for its intended use. Capitalization ceases upon completion of all substantial testing. The Company also capitalizes costs related to specific upgrades and enhancements when it is probable the expenditures will result in additional functionality. Maintenance and training costs are expensed as incurred. Internal use software is amortized on a straight-line basis over its estimated useful life, generally three years. Management evaluates the useful lives of these assets on an annual basis and tests for impairments whenever events or changes in circumstances occur that could impact the recoverability of these assets. There were no impairments to internal software in any of the periods covered in these consolidated financial statements.

The Company capitalized internal-use software costs for the years ended December 31, 2009, 2008 and 2007 of \$9,665, \$8,137 and \$3,321, respectively. Amortization of capitalized internal-use software costs for the years ended December 31, 2009, 2008 and 2007 was \$3,623, \$1,629 and \$1,163, respectively.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

2. Summary of Significant Accounting Policies (continued)

Goodwill

Since 2002, the Company has recorded goodwill in accordance with the provisions of FASB ASC, 350, “*Intangibles-Goodwill and Other*”, which discontinued the amortization of existing goodwill and instead requires the Company to annually review the carrying value of goodwill for impairment. Prior to 2007, the Company evaluated the carrying value of its goodwill under two reporting units within its single segment. During 2007, the Company combined those two reporting units into a single reporting unit to be in alignment with its organizational and management structure which was evaluated and restructured as part of the integration of our acquired businesses. As a result, in 2007 and 2008 goodwill was evaluated at the enterprise or Company level. Following its investment in the variable interest entity in China in 2009, the Company reverted back to evaluating the carrying value of goodwill under two reporting units within a single segment. The Company conducted its 2009 annual evaluation of goodwill for impairment and determined that there was no impairment at October 1, 2009 and December 31, 2009.

Due to a downward revision in internal projections, continued adverse changes in the economic climate, a decline in the Company’s market capitalization of 49.5% from October 1, 2008 (the Company’s annual testing date) through December 31, 2008 and an additional 32.5% from December 31, 2008 through March 31, 2009. These events signified triggering events and required the determination as to whether, and to what extent, the Company’s goodwill may have been impaired. As a result, the Company completed in consecutive quarters its goodwill impairment analyses during the year ended December 31, 2008 and the quarter ended March 31, 2009.

The first step of each analysis required the estimation of fair value of the Company and was calculated primarily based on the observable market capitalization with a range of estimated control premiums as well as discounted future estimated cash flows. This step yielded an estimated fair value of the Company which was less than the Company’s carrying value (including goodwill) at each test date, December 31, 2008 and March 31, 2009. The next step entailed performing an analysis to determine whether the carrying amount of goodwill on the Company’s balance sheet exceeded its implied fair value. The implied fair value of the Company’s goodwill for this step was determined in a similar manner as goodwill recognized in a business combination. That is, the estimated fair value of the Company was allocated to its assets and liabilities, including any unrecognized identifiable intangible assets, as if the Company had been acquired in a hypothetical business combination with the estimated fair value of the Company representing the price paid to acquire it. The allocation process performed on each test date was only for purposes of determining the implied fair value of goodwill with no assets or liabilities written up or down, nor any additional unrecognized identifiable intangible assets recorded as part of this process. Based on these analyses, management recorded goodwill impairment charges of \$167,011 for the quarter and year ended December 31, 2008 and \$33,329 for the quarter ended March 31, 2009. The goodwill impairment charges had no effect on the Company’s cash balances.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition

The Company derives its revenue from two sources: (1) subscription revenue for solutions, which is comprised of subscription fees from customers accessing the Company's on-demand software, consulting services, outsourcing services and proprietary content, and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) other fees for discrete professional services. Because the Company provides its solutions as a service, the Company follows the provisions of FASB ASC 605-10, "*Revenue Recognition*" and FASB ASC 605-25 "*Multiple Elements Arrangements*". We recognize revenue when all of the following conditions are met:

- There is persuasive evidence of an arrangement;
- The service has been provided to the customer;
- The collection of the fees is probable; and
- The amount of fees to be paid by the customer is fixed or determinable.

Subscription fees and support revenues are recognized on a monthly basis over the lives of the contracts. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Discrete professional services and other revenues, when sold with subscription and support offerings, are accounted for separately since these services have value to the customer on a stand-alone basis and there is objective and reliable evidence of fair value of the undelivered elements. The Company's arrangements do not contain general rights of return. Additionally, when professional services are sold with other elements, the consideration from the revenue arrangement is allocated among the separate elements based upon the relative fair value. Professional services and other revenues are recorded as follows: Consulting revenues are recognized based upon proportional performance as value is delivered to the customer.

In determining whether revenues from professional services can be accounted for separately from subscription revenue, the Company considers the following factors for each agreement: availability from other vendors, whether objective and reliable evidence of fair value exists of the undelivered elements, the nature and the timing of when the agreement was signed in comparison to the subscription agreement start date and the contractual dependence of the subscription service on the customer's satisfaction with the other services. If the professional service does not qualify for separate accounting, the Company recognizes the revenue ratably over the remaining term of the subscription contract. In these situations the Company defers the direct and incremental costs of the professional service over the same period as the revenue is recognized.

Deferred revenue represents payments received or accounts receivable from the Company's customers for amounts billed in advance of subscription services being provided.

The Company records expenses billed to customers in accordance with FASB ASC 605-45, "*Revenue Recognition-Principal Agent Considerations*," which requires that reimbursements received for out-of-pocket expenses be classified as revenues and not as cost reductions. These items primarily include travel, meals and certain telecommunication costs. For the years ended December 31, 2009, 2008 and 2007 reimbursed expenses totaled \$2,218, \$4,700 and \$3,469, respectively.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

2. Summary of Significant Accounting Policies (continued)

Adoption of New Accounting Pronouncements

Effective July 1, 2009, we adopted “*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*”. This standard establishes only two levels of GAAP, authoritative and non-authoritative. The FASB Accounting Standards Codification (the “Codification”) became the source of authoritative, non-governmental GAAP, except for rules and interpretive releases of the SEC, which are sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification became non-authoritative. We began using the new guidelines and numbering system prescribed by the Codification when referring to GAAP in the third quarter of fiscal 2009. As the Codification was not intended to change or alter existing GAAP, it did not have any impact on our consolidated financial statements.

In May 2009, the FASB adopted Codification Topic 855, “*Subsequent Events*,” which codifies the guidance regarding the disclosure of events subsequent to the balance sheet date. The statement established general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855 is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. The adoption ASC 855 did not have a material impact on the Company’s financial statements.

In April 2009, the FASB issued ASC 805 “*Business Combinations*,” which amends ASC 805 by establishing a model to account for certain pre-acquisition contingencies. Under ASC 805, an acquirer is required to recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined, then the acquirer should follow the recognition criteria in ASC 450, “*Contingencies*”. In the first quarter of 2009, we adopted ASC 805 and will apply its provisions when applicable.

In December 2007, the FASB issued ASC 810-10, “*Consolidation-Overall*” and ASC 805, “*Business Combinations*”. Changes for business combination transactions pursuant to ASC 805 include, among others, expensing of acquisition-related transaction costs as incurred, the recognition of contingent consideration arrangements at their acquisition date fair value and capitalization of in-process research and development assets acquired at their acquisition date fair value. Changes in accounting for noncontrolling (minority) interests pursuant to ASC 810-10 include, among others, the classification of noncontrolling interest as a component of consolidated shareholders’ equity and the elimination of “minority interest” accounting in results of operations. ASC 805 is required to be adopted and was effective for fiscal years beginning on or after December 15, 2008. The adoption of ASC 805 and ASC 810-10 impacted the Company’s accounting related to the consolidation of its variable interest entity in 2009 and will impact the accounting for the Company's future acquisitions.

In February 2007, the FASB issued ASC 825, “*Financial Instruments*,” which permits the Company to choose to measure many financial instruments and certain other items at fair value. The Company adopted ASC 825 as of January 1, 2008. The adoption did not impact the Company’s consolidated financial statements on the date of adoption. However, during the fourth quarter of 2008, the Company elected to measure at fair value the put option related to its UBS Settlement Agreement.

In September 2006, the FASB issued ASC 820, “*Fair Value Measurements and Disclosures*,” which defines fair value, establishes a framework for measuring fair value, and also expands disclosures about fair value measurements. FASB ASC 820 is effective for periods beginning after November 15, 2007. The Company adopted this standard with respect to its financial assets effective January 1, 2008. In February 2008, the FASB amended certain provisions of ASC 820 delaying its effective date for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). See Footnote 3 of the Notes to the Consolidated Financial Statements for further detail regarding the impact of our adoption of ASC 820 for financial assets.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

2. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update (“ASU”) No. 2009-13, “*Revenue Recognition: Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*,” which eliminates the use of the residual method for allocating consideration, as well as the criteria that requires objective and reliable evidence of fair value of undelivered elements in order to separate the elements in a multiple-element arrangement. By removing the criterion requiring the use of objective and reliable evidence of fair value in separately accounting for deliverables, the recognition of revenue will more closely align with certain revenue arrangements. The standard also will replace the term “fair value” in the revenue allocation guidance with “selling price” to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. ASU No. 2009-13 is effective for revenue arrangements entered or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently assessing the potential impact of this standard to determine if its adoption will have a material impact on the financial condition or results of operations of the Company.

In June 2009, the FASB issued new accounting guidance for variable interest entities. This guidance was codified under ASU 2009-17 in December 2009 and includes: (1) the elimination of the exemption from consolidation for qualifying special purpose entities, (2) a new approach for determining the primary beneficiary of a variable interest entity (“VIE”), which requires that the primary beneficiary have both (i) the power to control the most significant activities of the VIE and (ii) either the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE, and (3) the requirement to continually reassess who should consolidate a VIE. The new guidance is effective for annual reporting periods that begin after November 15, 2009 and applies to all existing and new VIEs. The Company is currently evaluating the impact of adopting this new guidance. This guidance was codified in December 2009 under ASU 2009-17.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

4. Acquisitions

Quorum International Holdings Limited

On April 2, 2008, the Company acquired all of the outstanding stock of Quorum International Holdings Limited (“Quorum”), a provider of recruitment process outsourcing services based in London, England, for a purchase price of approximately \$27,950, in cash, of which \$19,753 was paid in April 2008 and \$8,197 was paid in July 2008. The total cost of the acquisition, including legal, accounting, and other professional fees of \$1,237, was approximately \$29,187, including acquired intangibles of \$8,633, with estimated useful lives between 3 and 10 years. In addition, the acquisition agreement contains an earnout provision which provides for the payment of additional consideration by the Company based upon the gross profit of Quorum for the twelve month period ending June 30, 2009 and June 30, 2010. Formulaically, the earnout is 3.86 times Quorum’s gross profit less the amount of base consideration, as defined in the agreement. Pursuant to FASB ASC 805, “*Business Combinations*,” the Company accrues contingent purchase consideration when the outcome of the contingency is determinable beyond a reasonable doubt. Based upon the results for the twelve month period through June 30, 2009, it was determined that an earnout payment was due to the former shareholders of Quorum and as such, the additional consideration of \$1,167 was accrued for in the financial statements at December 31, 2009. The additional consideration was paid in cash during the first quarter of 2010. In addition, as of December 31, 2009, the June 30, 2010 earnout amount was substantially uncertain, and, as such, the estimated earnout range is not possible to disclose. The Company evaluates the earnout provisions contained in the acquisition agreement at each financial statement reporting date. In connection with the acquisition, €500 or approximately \$717, of the purchase price was deposited into an escrow account and recorded in other long-term assets, to cover any claims for indemnification made by the Company against Quorum under the acquisition agreement. The escrow agreement will remain in place for approximately two years from the acquisition date, and any funds remaining in the escrow account at the end of the two year period will be distributed to the former stockholders of Quorum. The Company expects that the acquisition of Quorum will broaden its presence in the global recruitment market. The purchase price has been allocated to the assets acquired and liabilities assumed based upon management’s best estimate of fair value with any excess over the net tangible and intangible assets acquired allocated to goodwill. Quorum’s results of operations were included in the Company’s consolidated financial statements beginning on April 2, 2008.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

5. Variable Interest Entity

On January 20, 2009, the Company entered into an ownership interest transfer agreement (“the agreement”) with Shanghai Runjie Management Consulting Company, (“R and J”) in Shanghai, China. In conjunction with the agreement, the Company paid \$1,337 to provide an initial equity contribution and to compensate the former owners of R and J, who transferred their existing business into a new entity, Shanghai Kenexa Human Resources Consulting Co., Ltd., (the “variable interest entity”). The initial payment provided the Company with a 46% ownership in the variable interest entity, and a presence in China’s human capital management market. The former owners of R and J are required to transfer 1% additional ownership interests (in 1% increments up to 49% over a two year period), with consideration to be paid by the Company based upon adjusted EBITDA, as defined. In the fourth quarter of 2009, based upon the 2008 operating results for R and J, the Company paid an additional \$206 for an additional 1% ownership interest in the variable interest entity. At December 31, 2009, the Company had a 47% ownership interest in the variable interest entity.

Consideration for the ownership interest transfer in the third quarter was determined as the greater of 1) the amount of registered capital attributable to a 1% ownership interest or 2) an amount denominated in Chinese Yuan Renminbi (“RMB¥”) equal to the result of 47% times four and one half times the Adjusted EBITDA of the variable interest entity for the calendar year ended December 31, 2008, plus 1% of the variable interest entity’s free cash flow as of March 31, 2008, minus the amount of the initial investment or RMB¥ 8,145 or \$1,224. The additional transfers of ownership interests for 2010 and 2011 will be determined formulaically the same as above and will be adjusted only for any increase in actual ownership percentage by the Company.

Under the terms of the variable interest entity agreement, the Company has the right to acquire R and J’s remaining interest in the variable interest entity at any time after the earlier of the termination of the general manager’s employment by the variable interest entity or during the first three months of any calendar year beginning on or after January 1, 2013 (call rights). The purchase price for the remaining ownership interest is based upon the outstanding ownership interest multiplied by the sum of the amount of free cash flow plus four and one half times the Adjusted EBITDA, as defined. R and J may also require the Company to purchase its interest in the variable interest entity at any time after the earlier of the Company’s acquisition of more than fifty percent of the variable interest entity or January 1, 2011 (put rights).

In accordance with ASC 810, “*Variable Interest Entities*”, the new entity qualified for consolidation as it was determined to be a variable interest entity and the Company as its primary beneficiary. The determination of the primary beneficiary was based, in part, upon a qualitative assessment which included the Company’s commitment to finance the variable interest entity’s ongoing operations, the level of involvement in the variable interest entity’s operations, the use of the Company’s brand by the variable interest entity, and the lack of equity “at risk” by R and J given its put rights. The variable interest entity is consolidated in the Company’s financial statements because of the Company’s implicit guarantee to provide financing and as well as its significant involvement in the day-to-day operations. The equity interests of R and J not owned by the Company are reported as a noncontrolling interest in the Company’s December 31, 2009 accompanying consolidated balance sheet. All inter-company transactions are eliminated (see Note 2 – Summary of Significant Accounting Policies.)

The variable interest entity was financed with \$307 in initial equity contributions from the Company and R and J, and has no borrowings for which its assets would be used as collateral. Following the formation of the variable interest entity, the Company completed a valuation of the concern, which resulted in the recording of net tangible assets, intangible assets and goodwill of \$314, \$1,100 and \$1,512, respectively in the consolidated balance sheet. On September 30, 2009, the Company provided \$160 of financing for the variable interest entity in the form of an intercompany loan. The creditors of the variable interest entity do not have recourse to other assets of the Company.

Pursuant to ASC 480 “*Distinguishing Liabilities from Equity*” (formerly Emerging Issues Task Force Abstracts Topic No. D-98, “Classification and Measurement of Redeemable Securities”), due to the put rights included in the agreement, the Company has presented the estimated fair value of R and J’s 53% ownership interest in the variable interest entity amounting to \$1,330 at December 31, 2009 in noncontrolling interest and classified the amount as mezzanine equity (temporary equity) on the consolidated balance sheet.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

10. Commitments and Contingencies (continued)

Litigation

On August 27, 2007, a complaint was filed and served by Kenexa BrassRing, Inc. against Taleo Corporation in the United States District Court for the District of Delaware. Kenexa alleges that Taleo infringed Patent Nos. 5,999,939 and 6,996,561, and seeks monetary damages and an order enjoining Taleo from further infringement.

On May 9, 2008, Kenexa BrassRing, Inc. filed a similar lawsuit against Vurv Technology, Inc. in the United States District Court for the District of Delaware, alleging that Vurv has infringed Patent Nos. 5,999,939 and 6,996,561, and seeks monetary damages and an order enjoining further infringement. This lawsuit has been consolidated with the Kenexa BrassRing, Inc. versus Taleo Corporation lawsuit.

On June 25, 2008, Kenexa Technology, Inc. filed suit in the United States District Court of Delaware against Taleo Corporation for tortious interference with contract, unfair competition, unfair trade practices and unjust enrichment. On August 28, 2009, Taleo filed an amended answer and counterclaim against Kenexa BrassRing, Inc. asserting copyright infringement against Kenexa by the users accessing the Taleo system on behalf of Kenexa's recruitment process outsourcing customers. Kenexa seeks monetary damages and to enjoin the actions of Taleo. Taleo seeks monetary damages and to enjoin the actions of Kenexa.

On November 7, 2008, Vurv Technology LLC, sued Kenexa Corporation, Kenexa Technology, Inc., and two former employees of Vurv, who now work for Kenexa, in the United States District Court for the Northern District of Georgia. In this action, Vurv asserts claims for breach of contract, computer trespass and theft, misappropriation of trade secrets, interference with contract and civil conspiracy. Vurv seeks unspecified monetary damages and injunctive relief.

On June 11, 2009 and July 16, 2009, two putative class actions were filed against Kenexa Corporation and our Chief Executive Officer and Chief Financial Officer in the United States District Court for the Eastern District of Pennsylvania, purportedly on behalf of a class of our investors who purchased our publicly traded securities between May 8, 2007 and November 7, 2007. The complaint filed on July 16, 2009 has since been voluntarily dismissed. In the pending action, Building Trades United Pension Trust Fund, individually and on behalf of all others similarly situated alleges violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act in connection with various public statements made by Kenexa. This action seeks unspecified damages, attorneys' fees and expenses.

On July 17, 2009, Kenexa BrassRing, Inc. and Kenexa Recruiter, Inc. filed suit against Taleo Corporation, a current Taleo employee and a former Taleo employee in Massachusetts Superior Court. Kenexa amended the complaint on August 27, 2009 and added Vurv Technology LLC, two former employees of Taleo and two current employees of Taleo. Kenexa asserts claims for breach of contract and the implied covenant of good faith and fair dealing, unfair trade practices, computer theft, misappropriation of trade secrets, tortious interference, unfair competition, and unjust enrichment. Kenexa seeks monetary damages and injunctive relief.

The Company is involved in claims, including those identified above, which arise in the ordinary course of business. In the opinion of management, the Company has made adequate provision for potential liabilities, if any, arising from any such matters. However, litigation is inherently unpredictable, and the costs and other effects of pending or future litigation, governmental investigations, legal and administrative cases and proceedings (whether civil or criminal), settlements, judgments and investigations, claims and changes in any such matters, could have a material adverse effect on the Company's business, financial condition and operating results.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

11. Equity (continued)

Stock and Voting Rights

Undesignated Preferred Stock

The Company has 10,000,000 shares of \$0.01 par value undesignated preferred stock authorized, with no shares issued or outstanding at December 31, 2009 or 2008. These shares have preferential rights in the event of liquidation and payment of dividends.

Common Stock

At December 31, 2009 and 2008, the Company had 100,000,000 authorized shares of common stock. At December 31, 2009 and 2008 22,561,883 and 22,504,924 shares of common stock respectively, were outstanding. Each share of common stock has one-for-one voting rights.

Authorized but not issued shares

On November 8, 2007, our board of directors authorized a stock repurchase plan providing for the repurchase of up to 2,000,000 shares of our common stock, of which 1,448,091 shares were repurchased at an aggregate cost of \$25,482 as of December 31, 2007. These shares were restored to original status prior to December 31, 2007 and accordingly are presented as authorized but not issued. The timing, price and volume of repurchases were based on market conditions, relevant securities laws and other factors. As of December 31, 2007 the amount of shares available for repurchase under the stock repurchase plan was 551,909. Through January 24, 2008, the remaining 551,909 shares available for repurchase under the stock repurchase plan were repurchased at an aggregate cost of \$9,848.

On February 20, 2008, our board of directors authorized a stock repurchase plan providing for the repurchase of up to 3,000,000 shares of the Company's common stock, of which 1,125,651 shares were repurchased at an aggregate cost of \$20,429 as of December 31, 2008. These shares were restored to original status prior to December 31, 2008 and accordingly are presented as authorized but not issued. The timing, price and volume of repurchases were based on market conditions, relevant securities laws and other factors. As of December 31, 2008 the amount of shares available for repurchase under the stock repurchase plan was 1,874,349. For the year ended, December 31, 2009 no repurchases were made under the stock repurchase plan.

Kenexa Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

(All amounts in thousands, except share and per share data, unless noted otherwise)

12. Stock Plans

Stock Option Plan

The Company's 2005 Equity Incentive Plan (the "2005 Option Plan"), which was adopted by the Company's Board of Directors (the "Board") in March 2005 and was approved by the Company's shareholders in June 2005, provides for the granting of stock options to employees and directors at the discretion of the Board or a committee of the Board. The 2005 Option Plan replaced the Company's 2000 Stock Option Plan (the "2000 Option Plan"). The purpose of stock options is to recognize past services rendered and to provide additional incentive in furthering the continued success of the Company. Stock options granted under both the 2005 Option Plan and the 2000 Stock Option Plan expires between the fifth and tenth anniversary of the date of grant and generally vest on the third anniversary of the date of grant. Unexercised stock options may expire up to 90 days after an employee's termination for options granted under the 2000 Option Plan.

As of December 31, 2009, there were options to purchase 3,173,907 shares of common stock outstanding under the 2005 Option Plan. The Company is authorized to issue up to an aggregate of 4,842,910 shares of its common stock pursuant to stock options granted under the 2005 Option Plan. As of December 31, 2009, there were a total of 1,031,506 shares of common stock not subject to outstanding options and available for issuance under the 2005 Option Plan.

FASB ASC 718, "*Compensation-Stock Compensation*", requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. In 2009 and 2008, the fair value of each grant was estimated using the Black-Scholes valuation model. Expected volatility was based upon a weighted average of peer companies and the Company's stock volatility. The expected life was determined based upon an average of the contractual life and vesting period of the options. The estimated forfeiture rate was based upon an analysis of historical data. The risk-free rate was based on U.S. Treasury zero coupon bond yields for periods commensurate with the expected term at the time of grant.

Compensation expense, for awards with a service condition that cliff vest, is recognized on a straight-line basis over the award's requisite service period. For those awards with a service condition that have a graded vest, compensation expense is calculated using the graded-vesting attribution method. This method entails recognizing expense on a straight-line basis over the requisite service period for each separately vesting portion as if the grant consisted of multiple awards, each with the same service inception date but different requisite service periods. This method accelerates the recognition of compensation expense.

The fair value of market based, performance vesting share awards granted is calculated using a Monte Carlo valuation model that simulates various potential outcomes of the option grant and values each outcome using the Black-Scholes valuation model which yields a fair market value of the Company's common stock on the date of the grant (measurement date). This amount is recognized over the vesting period, using the straight-line method. Since the award requires both the completion of 4 years of service and the share price reaching predetermined levels as defined in the option agreement, compensation cost will be recognized over the 4 year explicit service period. If the employee terminates prior to the four-year requisite service period, compensation cost will be reversed even if the market condition has been satisfied by that time. The total grant date fair value of the options granted during 2008 using the Monte Carlo valuation model was \$1,026.

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

Not Applicable

ITEM 9A. Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this report, or the Evaluation Date. Based upon the evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the Evaluation Date. Disclosure controls and procedures are controls and procedures designed to reasonably ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to reasonably ensure that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control over Financial Reporting

(a) Management's Annual Report on Internal Control over Financial Reporting

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

Management assessed our internal control over financial reporting as of December 31, 2009, the end of our fiscal year. Management based its assessment on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and our overall control environment.

Based on its assessment, management has concluded that our internal control over financial reporting was effective as of the end of the fiscal year to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles. The results of management's assessment were reviewed with the Audit Committee of the Board of Directors.

Grant Thornton, LLP independently assessed the effectiveness of our internal control over financial reporting and has issued its opinion, which is included below.

(b) Report of Independent Registered Public Accounting Firm

**Report of Independent Registered Public Accounting Firm
On Internal Control over Financial Reporting**

Board of Directors and Shareholders
Kenexa Corporation

We have audited Kenexa Corporation and Subsidiaries' (collectively, Kenexa Corporation) (a Pennsylvania corporation) internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Kenexa Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Kenexa Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. In our opinion, Kenexa Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Kenexa Corporation and Subsidiaries, as of December 31, 2009 and 2008 and the related consolidated statements of operations, shareholders' equity, comprehensive income (loss) and cash flows for each of the three years in the period ended December 31, 2009 and our report dated March 9, 2010 expressed an unqualified opinion.

/s/ Grant Thornton LLP

Philadelphia, Pennsylvania
March 9, 2010

(c) Change in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting identified in connection with management's evaluation that occurred during the last fiscal quarter ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. Other Information

Not Applicable

ITEM 13. Certain Relationships, Related Transactions and Director Independence

We incorporate by reference the information contained under the caption “Certain Relationships and Related Party Transactions” and “Structure and Practices of the Board of Directors” in our 2010 Proxy Statement.

ITEM 14. Principal Accountant Fees and Services

We incorporate by reference the information contained under the caption Proposal No. 2 “Ratification of Selection of Independent Registered Public Accounting Firm” in our 2010 Proxy Statement.

PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a) Documents filed as part of this report:

1. Financial Statements. The financial statements as set forth under Item 8 of this Annual Report on Form 10-K are incorporated herein.
2. Financial Statement Schedules. All financial statement schedules have been omitted because they are not applicable, not required, or the information is shown in the financial statements or related notes.
3. Exhibits. See (b) below.

(b) Exhibits:

<u>Exhibit Number</u>	<u>Description of Document</u>
2.1	Agreement and Plan of Merger, dated as of December 21, 2005, among Kenexa Corporation, Kenexa Technology, Inc., Kenexa Acquisition Corp., Webhire, Inc., and Gazaway L. Crittenden, solely as the representative of the Equityholders (incorporated by reference to Exhibit 2.1 filed with the Company's Current Report on Form 8-K dated December 22, 2005)
2.2	Equity Purchase Agreement and Agreement and Plan of Merger, dated as of October 5, 2006, among Kenexa Corporation, Kenexa Technology, Inc., Birmingham Acquisition Corp., BrassRing LLC, BrassRing Inc., Gannett Satellite Information Network, Inc., BRLLC Holdings Inc., Tribune National Marketing Company, Accel VI L.P., Accel Internet Fund II, L.P., Accel Keiretsu VI L.P., Accel Investors '98 L.P., Accel VI-S L.P., Accel Investors '98-S L.P., James W. Breyer, and Gerald M. Rosberg solely as the representative of the stockholders of BRINC and the selling members of BRLLC (incorporated by reference to Exhibit 2.1 filed with the Company's Current Report on Form 8-K dated October 6, 2006)
3.1	Amended and Restated Articles of Incorporation of Kenexa Corporation (incorporated by reference to Exhibit 3.1 filed with the Company's Quarterly Report on Form 10-Q dated November 9, 2007)
3.2	Amended and Restated Bylaws of Kenexa Corporation (incorporated by reference to Exhibit 3.2 filed with the Company's Quarterly Report on Form 10-Q dated November 9, 2007)
4.1	Form of Specimen Common Stock Certificate of Kenexa Corporation (incorporated by reference to Exhibit 4.1 filed with Amendment No. 4 to the Company's Registration Statement on Form S-1 dated June 20, 2005, Registration No. 333-124028)
10.1*	Kenexa Corporation 2000 Stock Option Plan (incorporated by reference to Exhibit 10.1 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.2*	Form of Non-Qualified Stock Option Agreement under the Kenexa Corporation 2000 Stock Option Plan (incorporated by reference to Exhibit 10.2 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.3*	Kenexa Corporation 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.3 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.4*	Form of Non-Qualified Stock Option Award Agreement under the 2005 Equity Incentive Plan (Director) (incorporated by reference to Exhibit 10.4 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.5*	Form of Non-Qualified Stock Option Award Agreement under the 2005 Equity Incentive Plan (Employee) (incorporated by reference to Exhibit 10.5 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.6*	Kenexa Corporation Amended and Restated 2006 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 filed with the Company's Current Report on Form 8-K dated October 20, 2006)
10.7	Agreement of Lease between Liberty Property Limited Partnership and Raymond Karsan Associates dated July 1, 1996 (incorporated by reference to Exhibit 10.10 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.8	First Amendment to Agreement of Lease dated August 14, 2002 between Liberty Property Limited Partnership and Kenexa Corporation (incorporated by reference to Exhibit 10.11 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.9	Second Amendment to Agreement of Lease dated November 8, 2002 between Liberty Property Limited Partnership and Kenexa Corporation (incorporated by reference to Exhibit 10.12 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.10*	Form of Indemnification Agreements between Kenexa Corporation and each of its directors and certain officers (incorporated by reference to Exhibit 10.23 filed with the Company's Registration Statement on Form S-1 dated April 12, 2005, Registration No. 333-124028)
10.11*	Form of Restricted Stock Award Agreement under the 2005 Equity Incentive Plan (Non-Employee Director) (incorporated by reference to Exhibit 10.1 filed with the Company's Current Report on Form 8-K dated August 14, 2007.)
21.1	Subsidiaries of Kenexa Corporation
23.1	Consent of Grant Thornton LLP
31.1	Certification by Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
31.2	Certification by Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)
32.1	Certification Furnished Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Management contracts and compensatory plans and arrangements required to be filed as exhibits pursuant to Item 15(a)(3) of this Annual Report on Form 10-K.

(c) None.

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, on March 9, 2010.

Kenexa Corporation

/s/ Nooruddin S. Karsan

Nooruddin S. Karsan
Chairman of the Board and Chief Executive Officer (Principal Executive Officer)

/s/ Donald F. Volk

Donald F. Volk
Chief Financial Officer (Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed by the following persons on March 9, 2010 in the capacities indicated:

Signature	Title
<i>/s/ Nooruddin S. Karsan</i> Nooruddin S. Karsan	Chairman of the Board and Chief Executive Officer and Director (Principal Executive Officer)
<i>/s/ Donald F. Volk</i> Donald F. Volk	Chief Financial Officer (Principal Financial and Accounting Officer) President, Chief Operating Officer and Director
<i>/s/ Troy A. Kanter</i> Troy A. Kanter	Director
<i>/s/ Barry M. Abelson</i> Barry M. Abelson	Director
<i>/s/ Renee B. Booth</i> Renee B. Booth	Director
<i>/s/ Joseph A. Konen</i> Joseph A. Konen	Director
<i>/s/ John A. Nies</i> John A. Nies	Director
<i>/s/ Richard J. Pinola</i> Richard J. Pinola	Director
<i>/s/ Rebecca Maddox</i> Rebecca Maddox	

EXHIBIT INDEX

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* Management contracts and compensatory plans and arrangements required to be filed as exhibits pursuant to Item 15(a)(3) of this Annual Report on Form 10-K.

WHOLLY OWNED SUBSIDIARIES OF KENEXA CORPORATION EXCEPT AS NOTED*Subsidiary of Kenexa Corporation*

1. Kenexa Technology, Inc. (a Pennsylvania corporation)

Subsidiaries of Kenexa Technology, Inc.

1. Kenexa Technologies Private Limited (an Indian private limited company)
2. Devon Royce, Inc. (a Pennsylvania corporation)
3. Nextworx, Inc. (a Pennsylvania corporation)
4. Kenexa Technology Canada Inc. (a British Columbia corporation)
5. Kenexa Recruiter, Inc. (a Delaware corporation)
6. Kenexa Government Solutions, Inc. (a Colorado corporation)
7. Kenexa Puerto Rico Inc. (a Puerto Rico corporation)
8. Kenexa Strategic Outsourcing Corporation (a Texas corporation)
9. Kenexa BrassRing, Inc. (a Delaware corporation)
10. Shanghai Runjie Kenexa HR Consulting Co. Ltd. (China) – variable interest entity, 47% ownership
11. Kenexa SA (Proprietary) Limited (South Africa) – Joint Venture, 51% ownership

Subsidiaries of Kenexa BrassRing, Inc.

1. Kenexa International Limited (an Irish private limited company)
2. Kenexa BrassRing Holding BV (a Dutch private limited liability company, limited by shares)

Subsidiaries of Kenexa BrassRing Holding BV

1. Kenexa Limited (an English private limited liability company)
2. BrassRing Canada Inc. (a Canadian corporation)
3. Kenexa BrassRing BV (a Dutch private limited liability company, limited by shares)
4. BrassRing GmbH Messeveranstalter und Medienagentur (a German limited liability company)
5. Kenexa Singapore Pte Ltd. (a Singaporean private limited company)
6. Kenexa France SARL (France)
7. Kenexa Argentina S.R.L.

Subsidiaries of Kenexa-Munich AV GmbH

1. Kenexa Germany GmbH (a German limited liability company)

Subsidiaries of Kenexa International Limited

1. Kenexa Global Services Limited (an Irish private limited company)
2. Kenexa-Munich AV GmbH (a German limited liability company)
3. Kenexa Middle East FZ LLC (a United Arab Emirates limited liability company)
4. Kenexa Quorum Holding Ltd. (England)

Subsidiaries of Kenexa Quorum Holdings Limited

1. Quorum International Search Limited (England)
2. Kenexa Quorum Ltd. & Co. KG (Germany)

Subsidiaries of Quorum International Search Limited

1. Kenexa IT Boards Limited (England)
2. Quorum International Search d.o.o. (Croatia)
3. Kenexa Quorum sp. Z.o.o. (Poland)

Subsidiaries of Kenexa Singapore Pte. Ltd.

1. Kenexa Pty. Ltd. (an Australian private limited company)
2. Kenexa BrassRing Asia Pacific Limited (a Hong Kong private company limited by shares)
3. Kenexa Japan K.K. (a Japanese limited company)

Subsidiaries of Kenexa Technologies Private Limited

1. Kenexa Technologies Sdn. Bhd. (a Malaysian private limited company, limited by shares)

Subsidiaries of Kenexa Limited

1. Kenexa Testing Limited (a United Kingdom private limited company)
2. BrassRing Limited (a United Kingdom private limited company)

Consent of Independent Registered Public Accounting Firm

Kenexa Corporation
Wayne, Pennsylvania

We have issued our reports dated March 9, 2010, with respect to the consolidated financial statements and internal control over financial reporting included in the Annual Report of Kenexa Corporation on Form 10-K for the year ended December 31, 2009. We hereby consent to the incorporation by reference of said reports in the Registration Statements of Kenexa Corporation on Forms S-8 (File No. 333-136486, effective August 10, 2006 and File No. 333-129475, effective November 4, 2005).

/s/ Grant Thornton LLP

Philadelphia, Pennsylvania
March 9, 2010

I, Nooruddin S. Karsan, certify that:

1. I have reviewed this Annual Report on Form 10-K of Kenexa Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2010

/s/ Nooruddin S. Karsan

Nooruddin S. Karsan
Chief Executive Officer

I, Donald F. Volk, certify that:

1. I have reviewed this Annual Report on Form 10-K of Kenexa Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2010

/s/ Donald F. Volk

Donald F. Volk
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the accompanying Annual Report of Kenexa Corporation (the “Company”) on Form 10-K for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned, Nooruddin S. Karsan, Chief Executive Officer of the Company and Donald F. Volk, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to their respective knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Nooruddin S. Karsan

*Nooruddin S. Karsan
Chief Executive Officer
March 9, 2010*

By: /s/ Donald F. Volk

*Donald F. Volk
Chief Financial Officer
March 9, 2010*

This certification is made solely for the purposes of 18 U.S.C. Section 1350, subject to the knowledge standard contained therein, and not for any other purpose. A signed original of this written statement required by Section 906 has been provided to Kenexa Corporation and will be retained by Kenexa Corporation and furnished to the Securities and Exchange Commission or its staff upon request.