

# Letter to the Shareholders

In 2009, the economic environment and jobs market became even more difficult than 2008 and reached peak levels during the year. A government report issued in December 2009 noted that the under-employment rate, which includes part-time workers that would prefer full-time employment, rose to 17.3%. This is just below the highest levels on record dating back to over 15 years ago. In addition, U.S. employers cut 85,000 net jobs in December 2009.

We believe that our employees did a good job of navigating the company through such a difficult time period. We continued to focus on product innovation and customer success, while we delivered against our commitment to shareholders to generate meaningful profitability and cash flow irrespective of challenges presented by the difficult macro environment.

As we begin 2010, we are more optimistic about Kenexa®'s business and the fundamentals of the markets we serve. The primary factor that we believe will impact spending levels related to HR software and services is the unemployment rate, which is currently anticipated to stabilize by mid-2010. Moreover, the Employee Confidence Index, which is published by the Kenexa Research Institute, reported an increase in 11 of the 12 largest economies in the world during 2009 (with Japan being the exception). We have found the Employee Confidence Index to be highly correlated to multiple economic and business performance outcomes, including consumer confidence and GDP growth.

We believe that Kenexa is well positioned to benefit when the spending environment eventually improves. We have a unique business model and end-to-end value proposition that spans software, proprietary content, services and outsourcing. Talent management and HR is increasingly viewed as a strategic means to drive business performance by the largest global organizations, and we believe Kenexa's differentiation and investment in growth initiatives will drive a return to growth and market share gains over the long-term.

## Emerging Strong Out of the Economic Downturn

In spite of the difficult economic environment in 2009, there were many important achievements that evidence the resiliency of Kenexa's business and strength of the company's long-term competitive position.

- We had a record number of wins with large, global organizations as a result of Kenexa's domain expertise, comprehensive solution, strong technology and global presence. HR organizations are increasingly looking for a strategic business partner to help them drive improvements in their overall business, and Kenexa is uniquely positioned to help the largest global organizations in this regard.
- We added over 100 preferred partner customers during 2009 (customers that generate \$50,000+ in annual revenue), with the fourth quarter representing the highest level of the year.
- Our deferred revenue balance at the end of 2009 increased 29% compared to the end of 2008.
- The technology solutions portion of our overall business continued to grow during 2009, fueled in large part by our momentum and strong technology in the applicant tracking system segment of the market.
- We invested in and launched major releases and products during 2009, including our next generation Kenexa 2x™ platform and market-leading Kenexa Recruiter® BrassRing offering to name a few. Our technology continues to be recognized as market leading by leading independent industry analysts.
- Our renewal rates improved over the course of the year, exiting the year at over 80% and progressing toward our longer-term target of 90+% that we consistently delivered against in pre-recessionary time periods.
- Our RPO business, which is the area of our business that is most exposed to a sharp reduction in hiring trends, stabilized during the final three quarters of 2009 and is positioned for growth when the hiring environment improves.



*"While today's younger generations don't expect to make more money than their parents, they are more interested in the dignity of their jobs and their ability to make a difference in the world. As a result, organizations need to add those components as key areas of focus when interacting with their workforce. Regardless of the type of job, organizations need to demonstrate how they are making a difference and how they will enable individuals to reach their personal goals."*

Nooruddin (Rudy) Karsan  
CEO and Chairman of the Board

- We continued to grow our global footprint, exiting the year with operations in 21 countries. In addition, we now have operations in every continent, except Antarctica, after establishing our presence in South America most recently. Our focus now is further strengthening each of our geographic operations.
- We successfully rebranded Kenexa to put further focus on our unique, integrated end-to-end HR value proposition.
- Our continued profitability and the strong growth in billings/deferred revenue led to cash flows from operations that were near record levels.

### 2009 Financial Performance

Total revenue for 2009 came in at \$157.7 million, which was down from 2008 due to the difficult economic environment. Importantly, our quarterly revenue run rate stabilized throughout 2009, with our fourth quarter revenue representing an increase compared to our first quarter 2009 level. From a profitability perspective, Kenexa generated a non-GAAP operating margin of 10% during 2009, and cash flows from operations of \$35.5 million represented 23% of revenue.

Kenexa's financial profile at the end of 2009 remained strong. We had cash, cash equivalents, and short and long-term investments of \$58.8 million at December 31, 2009, which was an increase from \$42.8 million at the end of 2008.

During 2009, we remained committed to a key promise that we made to shareholders from the time we became a public company. We took action throughout the year to continue protecting the profitability of the company.

### Looking Ahead

At the start of 2009, we noted that we were cautious about the near-term outlook of our target markets. While the macro environment remains challenging, we are more optimistic about our business as we start 2010. We believe that Kenexa has weathered the worst of the economic storm, as evidenced by the stabilization in our total revenue run rate and RPO business during 2009, combined with the strong growth in our deferred revenue.

Interest levels relative to Kenexa's end-to-end solutions remained high throughout the economic downturn, and we believe a stabilization in the unemployment rate will lead to an increase in the number of deal opportunities that move forward. When combined with the build-up in Kenexa's deferred revenue, we believe Kenexa is well positioned to return to annual revenue growth during 2010.

A sign of our optimism that the spending environment will begin to improve during 2010 is the fact that we recently stated our intention to increase investments in sales and marketing. Customer demand is evolving toward the sweet spot of Kenexa's differentiated, end-to-end value proposition and we are making

the appropriate investments to position Kenexa for market share gains as organizations have access to increased budgets for strategic HR deployments.

Longer-term, we believe the demand drivers of this space remain intact—the aging of the workforce, the declining tenure of employees, increased globalization, fluidity of organizational structures and pressures on the HR department to minimize costs. We are as confident as ever that these long-term demand drivers will create and sustain an attractive market opportunity for Kenexa, and we are executing against our goal to reach the \$1 billion in annual revenue level during the current decade.

### Making a Difference to Humanity

There is growing optimism that the economy has stabilized and will begin to improve during 2010. Likewise, the unemployment rate is expected to stabilize by the mid-point of the year. What remains unclear at this time is how strong the recovery will be in the jobs market over the next 12-24 months as the global economy works its way out of the recession. What is more certain, right or wrong, is that individuals, on average, believe they will not be better off than their parents from a financial perspective. This marks a significant change from past generations, and it has implications on how HR organizations need to think and react.

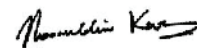
While today's younger generations don't expect to make more money than their parents, they are more interested in the dignity of their jobs and their ability to make a difference in the world. As a result, organizations need to add those components as key areas of focus when interacting with their workforce. Regardless of the type of job, organizations need to demonstrate how they are making a difference and how they will enable individuals to reach their personal goals.

At Kenexa, we are using our significant experience and domain expertise in HR to help our customers optimize their interactions, interviews and evaluations of employees to adapt to the expectations of today's younger generations of workers. We believe this will further improve our ability to connect the right individuals with the right companies and to the right careers and positions. This drive to make a difference is inherent in our employees, each of whom is extremely passionate about having a positive impact on our customers and society as a whole.

I would like to close by again thanking our shareholders for your continued support. We have gone through the most challenging economic environment during our lifetimes, and we believe that Kenexa has emerged a strong company that is well positioned for a return to growth and continued strong profitability and cash flow. We are short-term cautious and long-term optimistic.

I look forward to writing to you again next year.

Yours truly,



Rudy Karsan

