FIREPOND INC
Form 10-Q
September 14, 2001
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the Quarter Ended July 31, 2001**

**or**

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

**Commission File Number 0-29251**

# FIREPOND, INC.

**(Exact Name of Registrant as Specified in its Charter)**

**Delaware**
**41-1462409 (State or Other Jurisdiction of**
**Incorporation or Organization) (I.R.S. Employer**
**Identification No.) 890 Winter Street, Waltham, Massachusetts 02451**
**(Address of principal executive offices) (Zip Code)**

**(781) 487-8400**

**(Registrant s telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

As of July 31, 2001 there were 38,806,902 shares of the Registrant s Common Stock outstanding.

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**FIREPOND, INC. AND SUBSIDIARIES**

**FORM 10-Q**

**QUARTER ENDED JULY 31, 2001**

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**FIREPOND, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands, except share and per share data)**
**(unaudited)**

| | October 31, 2000 | July 31, 2001 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $79,500 | $43,677 |
| Short-term investments | 36,733 | 6,066 |
| Accounts receivable, net | 15,418 | 9,131 |
| Unbilled revenue | 1,676 | 812 |
| Restricted cash | | 3,353 |
| Prepaid expenses and other current assets | 2,436 | 2,344 |
| Total current assets | 135,763 | 65,383 |
| Property and equipment, net | 6,887 | 8,399 |
| Goodwill and other intangible assets, net | 389 | 12,575 |
| Restricted cash | 550 | 550 |
| Other assets | 731 | 972 |
| | $144,320 | $87,879 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $4,851 | $2,879 |

| | | |
|---|---|---|
| Accrued liabilities | 13,798 | 13,404 |
| Deferred revenue | 15,207 | 10,834 |
| Total current liabilities | 33,856 | 27,117 |
| Restructuring accrual, less current portion | | 737 |
| Stockholders equity: | | |
| Common stock, $0.01 par value | | |
| Authorized 100,000,000 shares at October 31, 2000 and July 31, 2001; | | |
| Issued and outstanding 35,596,022 shares at October 31, 2000 and 38,806,902 shares at July 31, 2001. | 356 | 388 |
| Additional paid-in capital | 195,166 | 201,451 |
| Accumulated deficit | (78,135) | (134,739) |
| Officer loans receivable | | (4,282) |
| Deferred compensation | (6,077) | (2,149) |
| Other comprehensive loss | (846) | (644) |
| Total stockholders equity | 110,464 | 60,025 |
| | $144,320 | $87,879 |

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

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**FIREPOND, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share data)**
**(unaudited)**

| | Three Months Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| Revenue: | | | | |
| Product-related revenue: | | | | |
| License | $6,794 | $3,924 | $15,622 | $11,589 |
| Services and maintenance | 6,492 | 5,329 | 16,008 | 21,509 |
| Total product-related revenue | 13,286 | 9,253 | 31,630 | 33,098 |
| Custom development services | 4,029 | 861 | 11,249 | 3,878 |
| Total revenue | 17,315 | 10,114 | 42,879 | 36,976 |
| Cost of revenue: | | | | |
| License | | | | |

| | | | | |
|---|---|---|---|---|
| | 159 | 145 | 426 | 369 |
| Product-related services and maintenance(1) | 4,470 | 6,381 | 9,581 | 24,176 |
| Custom development services(1) | 1,366 | 217 | 4,372 | 1,039 |
| Total cost of revenue | 5,995 | 6,743 | 14,379 | 25,584 |
| Gross profit | 11,320 | 3,371 | 28,500 | 11,392 |
| Operating expenses: | | | | |
| Sales and marketing(1) | 7,918 | 6,574 | 21,007 | 21,985 |
| Research and development(1) | 3,485 | 4,540 | 10,832 | 15,816 |
| General and administrative(1) | 2,507 | 2,904 | 6,711 | 8,838 |
| Stock-based compensation | 1,731 | 1,472 | 4,665 | 2,840 |
| Amortization of goodwill and other intangible assets | | 1,331 | | 2,278 |
| Restructuring charge (credit) | | 8,129 | (500) | 11,150 |
| Settlement of claim | | | 1,211 | |
| Acquired in-process research and development | | | 6,200 | |
| Total operating expenses | 15,641 | 24,950 | 42,715 | 70,318 |

Loss from operations
(4,321) (21,579) (14,215) (58,926)
Interest income
1,805 605 2,203 3,385
Other income (expense), net
(170) (381) 359 (1,062)

Net loss before extraordinary item
(2,686) (21,355) (11,653) (56,603)
Loss on extinguishment of debt
(1,437)

Net loss
(2,686) (21,355) (13,090) (56,603)
Stock dividend paid to preferred stockholders
(65,542)

Loss applicable to common stockholders
$(2,686) $(21,355) $(78,632) $(56,603)

Net loss per share:

Basic and diluted net loss per share before extraordinary item
$(0.08) $(0.59) $(0.45) $(1.57)

| | | | | |
|---|---|---|---|---|
| Extraordinary item | | | (0.06) | |
| Stock dividend paid to preferred shareholders | | | (2.51) | |
| Basic and diluted net loss per share applicable to common stockholders | $(0.08) | $(0.59) | $(3.02) | $(1.57) |
| Basic and diluted weighted average common shares outstanding | 34,835 | 36,200 | 26,111 | 35,947 |
| Pro forma net loss per share: | | | | |
| Pro forma net loss per share | $(0.08) | $(0.59) | $(0.41) | $(1.57) |
| Pro forma basic and diluted weighted average common shares outstanding | 34,835 | 36,200 | 32,230 | 35,947 |

(1) The following summarizes the departmental allocation of the stock-based compensation charge:

| | Three Months Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| Cost of revenue | $27 | $50 | $79 | $70 |
| Operating expenses: | | | | |
| Sales and marketing | 1,017 | 124 | 2,983 | 171 |
| Research and development | 613 | 138 | 1,317 | 254 |
| General and administrative | 74 | 1,160 | 286 | 2,345 |
| Total stock-based compensation | $1,731 | $1,472 | $4,665 | $2,840 |

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



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**FIREPOND, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**
**(unaudited)**

| | Nine Months Ended July 31, 2000 | Nine Months Ended July 31, 2001 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $(13,090) | $(56,603) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Acquired in-process research and development | | 6,200 |
| Settlement of claim | | (389) |
| Non-cash restructuring charges | | 1,644 |
| Stock-based compensation expense | 4,665 | 2,840 |
| Depreciation and amortization | 2,299 | 5,793 |
| Non-cash interest expense | 467 | |
| Loss on early extinguishment of debt | 1,437 | |
| Changes in assets and liabilities, net of acquisition: | | |
| Accounts receivable | 3,022 | 6,809 |
| Unbilled revenue | (414) | 864 |
| Prepaid expenses and other current assets | (712) | (3,838) |
| Accounts payable | (1,644) | (4,434) |
| Accrued liabilities | 5,998 | (5,022) |
| Deferred revenue | 3,996 | (5,460) |
| Restructuring accrual | (392) | 2,623 |
| Net cash provided by (used in) operating activities | 5,632 | (48,973) |

Cash flows from investing activities:

| | | |
|---|---|---|
| Purchases of short-term investments | (22,059) | (8,256) |
| Proceeds from the sale and maturities of short-term investments | | 38,970 |
| Purchases of property and equipment | (2,339) | (3,616) |
| Increase in restricted cash | | (177) |
| Acquisition of Brightware, Inc., net of cash acquired | | (10,105) |
| Increase in other assets | (243) | (35) |
| Net cash (used in) provided by investing activities | (24,641) | 16,781 |

Cash flows from financing activities:

| | | |
|---|---|---|
| Net repayments on line of credit | (6,740) | |
| Payments on long-term debt | (602) | (332) |
| Payments on Brightware debt | | (4,860) |
| Proceeds from common stock issuance, net of offering costs | 113,800 | |
| Proceeds from stock options and warrants exercised | 8,359 | 1,550 |
| Decrease in subscription receivables | 13 | |
| Net cash provided by (used in) financing activities | 114,830 | (3,642) |

Effect of exchange rate changes on cash and cash equivalents
(42) 11

Net increase (decrease) in cash and cash equivalents
95,779 (35,823)
Cash and cash equivalents, beginning of period
2,120 79,500

Cash and cash equivalents, end of period
$97,899 $43,677

Supplemental cash flow information:

Interest paid
$639 $69

Non-cash investing and financing activities:

Warrants issued in conjunction with subordinated notes payable
$1,904 $

Conversion of preferred stock into common stock
$191 $

Purchase of Business, net of cash acquired:

Fair value of assets acquired
$ $3,954
Liabilities assumed
(11,034)

| | |
|---|---|
| Goodwill | 7,449 |
| In-process research and development | 6,200 |
| Developed technology and know-how | 4,900 |
| Assembled workforce | 2,200 |
| Cash paid | (5,228) |
| Acquisition costs incurred | (2,576) |
| Fair value of stock issued | $ $5,865 |

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



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**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Nature of Business and Basis of Presentation**

Firepond, Inc., together with its wholly owned subsidiaries (the Company ) is a leading provider of comprehensive selling and customer service solutions that help companies more profitably acquire and retain customers. The Company s product lines leverage proven intelligence engines and patented automation technology to drive new revenue streams, increase profitability, and manage customer interactions across all channels and throughout the sales and service cycle.

On February 15, 2001, the Company acquired 100% of the issued and outstanding shares of capital stock of Brightware, Inc. (Brightware). The acquisition was accounted for as a purchase in accordance with APB No. 16. Accordingly, the results of operations of Brightware have been included in the Company s results of operations since the date of acquisition.

The accompanying consolidated financial statements include the accounts of Firepond, Inc. and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in the accompanying financial statements.

The accompanying condensed consolidated financial statements for the three and nine months ended July 31, 2001 and 2000 are unaudited and have been prepared on a basis consistent with the October 31, 2000 audited financial statements and include normal recurring adjustments which are, in the opinion of management, necessary for the fair presentation of the results of these periods. These condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto for the fiscal year ended October 31, 2000 included in the Company s Form 10-K. The results of operations for the three and nine months ended July 31, 2001 are not necessarily indicative of results to be expected for the entire year or any other period.

**2. Significant Accounting Policies**

*(a) Revenue Recognition*

The Company recognizes revenue based on AICPA Statement of Position, or SOP, No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, and SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*.

The Company generates revenue from two primary sources: (1) product-related license and service revenue and (2) custom development service revenue.

*Product-Related Revenue*

Product-related license revenue is generated from licensing the rights to the use of the Company s packaged software products. Product-related service revenue is generated from sales of maintenance, consulting and training services performed for customers that license the Company s products.

The Company has concluded that generally, for the SalesPerformer product suite and its components, the implementation services are essential to the customer s use of the packaged software products in arrangements where the Company is responsible for implementation services. As such, the Company recognizes revenue for these arrangements following the percentage-of-completion method over the implementation period. Percentage of completion is measured by the percentage of implementation hours incurred to date compared to estimated total implementation hours. This method is used because management has determined that past experience has shown expended hours to be the best measure of progress on these engagements. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is recorded.



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**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

In situations where the Company is not responsible for implementation services for the SalesPerformer Suite of products, the Company recognizes revenue on delivery of the packaged software if there is persuasive evidence of an arrangement, collection is probable, the fee is fixed or determinable and vendor-specific objective evidence exists to allocate the total fees to all elements of the arrangement.

In situations where the Company is not responsible for implementation services for the SalesPerformer Suite of products, however, is obligated to provide unspecified additional software products in the future, the Company recognizes revenue as a subscription over the term of the commitment period.

For separate sales of the eServices product line, which was acquired in connection with the Brightware transaction, the Company recognizes revenue on delivery of the packaged software if there is persuasive evidence of an arrangement, collection is probable, the fee is fixed or determinable and vendor-specific objective evidence exists to allocate the total fees to all elements of the arrangement. The Company has determined that implementation services are not essential to the functionality of the eServices product.

In situations where the Company enters into an arrangement for both its SalesPerformer Suite and its eServices product and is responsible for implementation services; it will recognize revenue for the entire arrangement under SOP 81-1.

Vendor-specific objective evidence is based on the price charged when an element is sold separately or, in the case of an element not yet sold separately, the price established by authorized management, if it is probable that the price, once established, will not change before market introduction. Elements included in multiple-element arrangements could consist of software products, upgrades, enhancements, maintenance, consulting and training services.

Revenue from maintenance services is recognized ratably over the term of the contract, typically one year. Consulting revenue is primarily related to implementation services performed on a time-and-materials basis under separate service arrangements. Revenue from consulting and training services is recognized as services are performed.

The Company generally bills for services on a monthly basis. The Company generally bills for product license fees upon commencement of the contract, however, the Company may delay billing based on the terms of the contract. The Company has recorded deferred revenue on amounts billed or collected by the Company before satisfying the above revenue recognition criteria. Deferred revenue consists of the following:

| | October 31, 2000 | July 31, 2001 |
|---|---|---|
| | (in thousands) | |
| Product license | $8,740 | $5,700 |
| Product-related services | 1,344 | 1,841 |
| Product-related maintenance | 2,865 | 2,886 |
| Custom development services | 2,258 | 407 |
| | $15,207 | $10,834 |

Unbilled revenue of $1,676,000 at October 31, 2000 and $812,000 at July 31, 2001 represents amounts due to the Company under license, service and maintenance agreements for work performed that had not been billed but for which revenue was recognized as of the period end. Product license fees for which the Company has not billed based on contract terms nor has the Company recognized or deferred revenue totaled $5,923,000 at October 31, 2000 and $1,339,000 at July 31, 2001.



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**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

*Custom Development Services Revenue*

The Company historically had provided services to develop highly customized applications utilizing core software technology. The Company no longer accepts new custom development service projects but continues to provide ongoing services related to previously completed custom development projects including software and data maintenance. Revenue from these ongoing arrangements is recognized as the services are performed.

*(b) Cash and Cash Equivalents*

The Company accounts for cash equivalents based on the guidance in Statement of Financial Accounting Standards, or SFAS, No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Cash equivalents are short-term, highly liquid investments with original maturity dates of three months or less. Cash equivalents at October 31, 2000 and July 31, 2001 consisted of interest-bearing bank deposits, money market accounts, commercial paper and discount notes.

| | October 31, 2000 | July 31, 2001 |
|---|---|---|
| | (In thousands) | |
| Cash and cash equivalents: | | |
| Cash | $7,186 | $4,163 |
| Money market accounts | 4,095 | 7,871 |
| Commercial paper | 68,219 | 28,847 |
| Discount notes | | 2,796 |
| Total cash and cash equivalents | $79,500 | $43,677 |

*(c) Short-term Investments*

In accordance with SFAS No. 115 and based on the Company s intentions regarding these instruments, the Company has classified all short-term investments as available-for-sale. These investments consist primarily of corporate notes and bonds with an original maturity of less than a year. Other comprehensive loss in stockholders equity included an unrealized holding loss of $4,000 for October 31, 2000 and an unrealized holding gain of $30,000 for July 31, 2001.

| | October 31, 2000 | July 31, 2001 |
|---|---|---|
| | (In thousands) | |
| Short-term investments: | | |
| Commercial paper (average 64 days to maturity for October 31, 2000) | $15,329 | $ |
| Corporate notes and bonds (average 148 and 100 days to maturity for October 31, 2000 and July 31, 2001, respectively) | 21,404 | 6,066 |

| | | |
|---|---|---|
| Total short-term investments | $36,733 | $6,066 |



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**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

*(d) Comprehensive Income (Loss)*

The components of comprehensive loss for the three and nine months ended July 31, 2000 and 2001 are as follows:

| | Three Months Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| | (In thousands) | | (In thousands) | |
| Comprehensive loss: | | | | |
| Net loss | $(2,686) | $(21,355) | $(13,090) | $(56,603) |
| Other comprehensive loss | | | | |
| Unrealized (loss) gain on short-term and long-term investments | (10) | (15) | (51) | 34 |
| Foreign currency translation | 107 | (90) | (463) | 169 |
| Comprehensive loss | $(2,589) | $(21,460) | $(13,604) | $(56,400) |

*(e) Recent Accounting Pronouncements*

On June 30, 2001, the FASB issued SFAS No. 141, Accounting for Business Combinations and SFAS No. 142, Accounting for Goodwill and Other Intangible Assets. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for under the purchase method. In accordance with SFAS 142, goodwill will no longer be amortized, rather goodwill will be subject to an assessment of impairment by applying a fair-value based test at least annually. There is no impact as of July 31, 2001, however, as of October 31, 2001, goodwill will cease to be amortized. The Company has not yet assessed the impairment, if any, that would be recognized utilizing a fair-value based goodwill impairment test.

**3. Accrued Liabilities**

Accrued liabilities consists of:

| | October 31, 2000 | July 31, 2001 |
|---|---|---|
| | (In thousands) | |
| Payroll and related costs | $4,142 | $1,495 |
| Restructuring costs | | 3,530 |
| Other | 9,656 | 8,379 |
| Total accrued liabilities | $13,798 | $13,404 |

**4. Net Loss Per Share**

*(a) Net Loss Per Share*

Net loss per share is computed based on the guidance of SFAS No. 128, *Earnings per Share*. SFAS No. 128 requires companies to report both basic loss per share, which is computed by dividing the net loss applicable to common stockholders by the weighted average number of common shares outstanding, and diluted loss per share, which is computed by dividing the net loss applicable to common stockholders by the weighted average number of common shares outstanding plus the weighted average dilutive potential common shares outstanding using the treasury stock method. As a result of the losses incurred by the Company for both the three and nine months ended July 31, 2000 and 2001, all potential common shares were antidilutive and were excluded from the diluted net loss per share calculations. The calculation of weighted average shares

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**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

outstanding for the three and nine months ended July 31, 2001 excludes contingently issuable shares of 2,607,183 representing shares issued but held in escrow in connection with the acquisition of Signature Software and Brightware (see Note 5(b)).

As of July 31, 2000 and 2001 common stock options and warrants outstanding which were not included in the calculation of diluted net loss per share since their inclusion would be antidilutive were 9,793,000 and 9,774,000, respectively.

*(b) Pro Forma Net Loss Per Share*

Pro forma net loss per share has been computed as described above and also gives effect to the conversion of preferred stock that converted upon the completion of the Company s initial public offering, using the if-converted method, from the original date of issuance.

The following table reflects the reconciliation of the shares used in the computation of pro forma loss per share:

| | Three Months Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| | (In thousands) | | (In thousands) | |
| Pro forma basic and diluted: | | | | |
| Weighted average common shares outstanding used in computing basic and diluted net loss per share | 34,835 | 36,200 | 26,111 | 35,947 |
| Weighted average common shares issuable upon the conversion of preferred stock | | | 4,696 | |
| Weighted average common shares issuable upon settlement of the priority payments | | | 1,336 | |
| Weighted average common shares issuable upon Exercise of series F preferred stock warrants | | | 87 | |
| Weighted average common shares outstanding used in computing pro forma basic and diluted net loss per share | 34,835 | 36,200 | 32,230 | 35,947 |

**5. Stockholders Equity**

*(a) Stock Options and Warrants*

The Company granted stock options to employees and consultants that require the recognition of stock-based compensation expense. Additionally, the Company granted stock warrants to certain customers and to strategic business partners. Stock-based compensation related to grants to employees represents the amortization, over the vesting period of the option, of the difference between the exercise price of options granted to employees and the fair market value of its common stock for financial reporting purposes. Stock-based compensation related to grants to non-employees and warrants issued represents the fair market value as computed using an established option valuation formula. As of July 31, 2001, the deferred compensation balance was $2,149,000 and will be recognized as an expense over the vesting period of the underlying stock options for options granted to employees and as earned for non-employees and customers/strategic business partners in accordance with EITF 96-18.

On June 26, 2001, the Company commenced a stock option exchange program in which its directors and eligible employees were offered the opportunity to exchange existing stock options for new stock options with an exercise price equal to the current market value of the Company s common stock. Participants in the exchange program received new options to purchase seventy-five percent (75%) of the number of shares of the





**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

Company s common stock subject to the options that were exchanged and canceled. The new options were granted on July 31, 2001, with an exercise price of $.66 per share. The Company accepted 7,179,285 stock options for exchange and issued 5,384,384 stock options in exchange for such tendered options. As a result of the cancellation of the outstanding options, the unamortized deferred compensation of approximately $783,000 was amortized and recorded as stock based compensation during the three months ended July 31, 2001.

In the future, the Company may incur compensation expense as a result of the issuance of the new options. The new options will be subject to variable plan accounting in accordance with APB No. 25 whereby, the Company will be required to record, as compensation expense, increases in the fair value of these options between the grant date of the option and the date the option is exercised or the measurement date. The greater the increase in the market value of the Company s common stock following the date of grant, the greater the compensation expense.

The Company granted options to employees to purchase 7,168,553 and 10,685,634 shares of common stock at a weighted-average exercise price of $0.79 and $1.94 per share during the three and nine months ended July 31, 2001, respectively. At July 31, 2001, 8,879,316 options were outstanding.

*(b) Common Stock Outstanding*

Common stock outstanding at July 31, 2001 includes 207,199 shares issued but held in escrow in connection with the Company s acquisition of Signature Software, Inc. in September 2000. These shares will be released from escrow based on the retention of Signature Software employees over a two-year period. It also includes 2,399,984 shares issued but held in escrow in connection with the Company s acquisition of Brightware, Inc. in February 2001. The shares held in escrow related to Brightware are subject to release as follows; (i) 899,993 shares are subject to release pending the settlement of the general indemnification and warranty period and (ii) 1,499,991 shares are subject to release based on achievement of specified financial performance objectives. The Company has requested the release of all shares held in escrow based on Brightware s failure to meet specified financial performance objectives and to satisfy certain other claims.

*(c) Officer Loan Receivable*

On November 28, 2000, the Company s Board of Directors approved a loan facility to Klaus Besier, the Company s Chairman and Chief Executive Officer, allowing borrowings up to $3,000,000 bearing interest at the applicable federal rate in effect during the term of the note. On January 9, 2001, the Company s Board of Director s approved an increase in the loan facility to $4,000,000. Originally the outstanding principal together with unpaid interest was due and payable on the earlier of October 31, 2001, an event of default, or an event of maturity, as defined. On August 21, 2001, the Board of Directors amended the facility to extend the maturity to December 8, 2005. Due to the modification of the facility, all amounts outstanding have been reclassified as a component of stockholders equity. The promissory note is secured by a pledge of 500,000 shares of common stock of Firepond, Inc. Amounts totaling $4,000,000 plus accrued interest have been advanced to Mr. Besier under this facility as of July 31, 2001.

**6. Segment Reporting**

The Company has adopted SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, which establishes standards for reporting information related to operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are defined as components of an enterprise about which separate, discrete financial information is available for evaluation by the chief operating decision maker,





**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

or decision-making group, in making decisions how to allocate resources and assess performance. The Company s chief operating decision maker, as defined under SFAS No. 131, is its chief executive officer.

The Company views its operations and manages its business as two segments, product-related licenses and services and custom development services. The Company s reportable segments are strategic business units that provide distinct services to the end customer. They are managed separately because each business segment requires different marketing and management strategies. The Company s approach is based on the way that management organizes the segments within the Company for making operating decisions and assessing performance.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company does not allocate operating expenses between its two reportable segments. Therefore, the Company s measure of performance for each reportable segment is based on total net revenue and direct costs of services, which are reported separately in the accompanying condensed consolidated statements of operations and no additional disclosure is required. The Company does not identify assets and liabilities by segment and therefore, identifiable assets, capital expenditures and depreciation and amortization are not reported by segment.

The majority of the Company s revenue is derived from the United States with approximately 33% and 35% coming from foreign countries for the three and nine months ended July 31, 2001. Revenue from contracts entered into by our United Kingdom subsidiaries contributed approximately 17% and 12% of our revenue for the three and nine months ended July 31, 2001, respectively. Revenue from contracts entered into by our Netherlands subsidiaries contributed approximately 9% and 17% of our revenue for the three and nine months ended July 31, 2001, respectively.

**7. Brightware Acquisition**

On February 15, 2001, pursuant to an Agreement and Plan of Merger between the Company and Brightware, Inc. the Company acquired 100% of the issued and outstanding capital stock of Brightware, a supplier of eCustomer assistance software. The purchase price of the acquisition was $13,669,000, which was composed of $5,228,000 in cash, the issuance of stock in the amount of $5,865,000, and $2,576,000 in acquisition related fees and expenses. The value of approximately 1,500,000 shares of Firepond common stock and cash payments totaling $3,250,000 have been excluded from purchase price as this consideration was contingent on achieving financial performance objectives as measured on April 30, 2001. The Company has notified the former Brightware stockholders that their performance objectives were not achieved and the Company is entitled to receive 1.5 million shares of its stock and $3.2 million of cash returned from escrow. The cash has been reflected on the financial statements as restricted cash and the shares are included in the amount as outstanding as of July 31, 2001. See note 5(b). In addition, the Company notified the Brightware shareholders of a claim for damages and requested the release of approximately 900,000 shares of its stock and approximately $650,000 held in general escrow. The acquisition was accounted for using the purchase method in accordance with APB No. 16 and accordingly, the results of operations of Brightware from the date of acquisition have been included in the results of operations of the Company.





**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

The following table summarizes the transaction:

| | Amount (in thousands) |
|---|---|
| Acquisition of Brightware: | |
| Fair value of assets acquired | $3,954 |
| Liabilities assumed | (11,034) |
| In-process research and development | 6,200 |
| Developed technology and know-how | 4,900 |
| Assembled workforce | 2,200 |
| Goodwill | 7,449 |
| | $13,669 |

As part of the purchase price allocation, all intangible assets that are a part of the acquisition were identified and valued. It was determined that technology assets and assembled workforce had value. As a result of this identification and valuation process, the Company allocated approximately $6,200,000 million of the purchase price to in-process research and development projects. This allocation represented the estimated fair value based on risk-adjusted cash flows related to the incomplete research and development projects. At the date of acquisition, the development of these projects had not yet reached technological feasibility, and the research and development in progress had no alternative future uses. Accordingly, these costs were expensed as of the date of the acquisition.

In making its purchase price allocation, management considered the present value in calculating income, an analysis of project accomplishments and remaining outstanding items, an assessment of overall contributions, as well as project risks. The value assigned to purchased in-process research and development was determined by estimating the costs to develop the acquired technology into commercially viable products, estimating the resulting net cash flows from the projects, and discounting the net cash flows to their present value. The revenue projection used to value the in-process research and development was based on estimates of relevant market sizes and growth factors, expected trends in technology, and the nature and expected timing of new product introductions by the Company and its competitors. The resulting net cash flows from such projects are based on management s estimates of cost of sales, operating expenses, and income taxes from such projects.

As a result of the identification and valuation of intangibles acquired, the Company also allocated approximately $4,900,000 and $2,200,000 to developed technology and know-how and assembled workforce, respectively. Developed technology represents patented and unpatented technology and know-how related to Brightware s current eService product offering founded on a combination of artificial intelligence, knowledge manager-technology and internet enterprise applications. Developed technology is being amortized over a period of three years. Assembled workforce is the presence of a skilled workforce that is knowledgeable about company procedures and possesses expertise in certain fields that are important to continued profitability and growth of a company. Assembled workforce is being amortized over a period of three years.

The excess of the purchase price over the fair value of identified intangible net assets of approximately $7,449,000 was allocated to goodwill. During the quarter ended July 31, 2001, the Company reassessed the potential loss on certain operating lease commitments assumed in the acquisition and increased its liabilities assumed which resulted in additional goodwill of approximately $1,166,000. Goodwill is being amortized over a period of three years.

Accumulated amortization of developed technology, assembled workforce and goodwill was $748,611, $336,111 and $1,125,228 as of July 31, 2001, respectively.



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**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

Unaudited pro forma operating results for the Company, assuming the acquisition of Brightware occurred at the beginning of the following periods are as follows:

| | Three Months Ended July 31, | Nine Months Ended July 31, | |
|---|---|---|---|
| | 2000 | 2000 | 2001 |
| | (In thousands) | (In thousands) | |
| Net sales | $19,612 | $56,143 | $39,299 |
| Net loss before extraordinary item | (11,888) | (28,475) | (61,033) |
| Net loss | (11,888) | (29,912) | (61,033) |
| Net loss per share basic and diluted | $(0.33) | $(1.09) | $(1.67) |

**8. Settlement of Claim**

On March 2, 2001 the Company entered into an agreement, under which the Company paid a customer $1,600,000 to resolve outstanding contractual matters. The expense for the settlement was partially offset by $389,000 previously paid by the customer but not yet earned by the Company. The Company recorded this transaction as a net charge of $1,211,000 to operations in the quarter ended April 30, 2001.

**9. Restructuring Charge**

As a result of a global slowdown in information technology spending and the Company s acquisition of Brightware, the Company undertook a plan to restructure its operations during the quarter ending April 30, 2001. A reduction-in-force was completed to align the Company s cost structure with the market conditions and eliminate redundant operations.

The significant components of the restructuring charge in the quarter ended April 30, 2001 were as follows:

| | Amount (in thousands) |
|---|---|
| Employee severance costs | $2,286 |
| Facilities related costs | 270 |
| Property and equipment | 114 |
| Other costs | 351 |
| | $3,021 |

The employee severance cost component of the restructuring charge was related to reductions in headcount. Under the plan, the Company terminated two general and administrative employees, 18 sales and marketing employees, 45 services employees, 16 development employees as well as 89 contractors.

The facilities related cost component consisted of idle lease space and termination payments for three satellite offices which are no longer required as a result of the reduction-in-force.

The property and equipment consist of excess computer equipment resulting from the reduction-in-force and leasehold write-offs related to the aforementioned office closings. Also included were office design and layout fees incurred for abandoned plans for expansion of the Company s Minneapolis, MN office. Expansion is no longer required as a result of the reduction-in-force.

During the quarter ended July 31, 2001, as a result of a continued slowdown of global information technology spending, specifically in the Customer Relationship Management market, the Company took





**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

actions to extend the first restructuring to better align the Company s cost structure with economic realities and preserve cash.

The significant components of the restructuring charge in the quarter ended July 31, 2001 were as follows:

| | Amount (in thousands) |
|---|---|
| Employee severance costs | $3,296 |
| Facilities related costs | 1,884 |
| Property and equipment | 1,530 |
| Contract termination fee | 1,050 |
| Other | 369 |
| | $8,129 |

The employee severance cost component of the restructuring charge was related to reductions in headcount. Under the plan, the Company terminated 13 general and administrative employees, 60 sales and marketing employees, 56 services employees, 28 development employees as well as one contractor.

The facilities related cost component consisted of idle lease space as a result of the reduction-in-force and the closing of our Australia and Malaysia offices.

The property and equipment consist of excess computer equipment resulting from the reduction-in-force and leasehold write-offs associated with the aforementioned office closings.

On July 1, 2001, the Company entered into a settlement agreement with Epam Systems, LLC and Epam Systems, Inc. Among other items, the Company agreed to pay these companies $1,000,000 in cash and granted options to purchase 100,000 shares of the Company s common stock in return for restructuring the relationship and a release of claims including those claims previously filed against the Company by these companies. As part of this agreement, the relationship has been restructured to reduce our monthly commitment to 50 Epam consultants through February 2002 and 30 Epam consultants through May 2002 in furtherance of our cost reduction measures.

A summary of the short and long-term restructuring accrual is as follows:

| | Amount (In thousands) |
|---|---|
| Balance at April 30, 2001 | $1,963 |
| Additional provision | 8,129 |
| Severance payments | (2,855) |
| Facilities related payments | (302) |
| Contract termination fee | (1,000) |
| Other payments | (146) |
| Property and equipment write-offs | (1,522) |

Balance at July 31, 2001
$4,267

**10. Subsequent Event**

Since August 1, 2001, a number of securities class action complaints were filed against the Company, the underwriters of the Company s initial public offering, and certain of the Company s executives in the United States District Court for the Southern District of New York. The complaints allege that the underwriters of the Company s initial public offering, the Company and the other named defendants violated federal securities

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**FIREPOND, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(unaudited)**

laws by making material false and misleading statements in the prospectus incorporated in our registration statement on Form S-1 filed with the SEC in November, 1999. The complaints allege, among other things, that FleetBoston Robertson Stephens, an underwriter of the Company s initial public offering, solicited and received excessive and undisclosed commissions from several investors in exchange for which FleetBoston Robertson Stephens allocated to these investors material portions of the restricted number of shares of common stock issued in connection with the Company s initial public offering. The complaints further allege that FleetBoston Robertson Stephens entered into agreements with its customers in which FleetBoston Robertson Stephens agreed to allocate the common stock sold in the Company s initial public offering to certain customers in exchange for which such customers agreed to purchase additional shares of the Company s common stock in the after-market at pre-determined prices. While we believe the claims against us are without merit and intend to defend the actions vigorously, the litigation is in the preliminary stage, and we cannot predict the outcome with certainty. We may incur substantial legal fees and expenses, and the litigation may divert the attention of some of our key management. Our defense of this litigation, regardless of its outcome, may be costly and time-consuming. Should the outcome of the litigation be adverse to us, we could be required to pay significant monetary damages to the plaintiffs, which could harm our business.

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

Certain statements in the Management s Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements that involve risks and uncertainties. Words such as anticipates, expects, intends, plans, believes, seeks, estimates and similar expressions identify such forward-looking statements. The forward-looking statements contained herein are based on current expectations and entail various risks and uncertainties that could cause actual results to differ materially from these expressed in such forward-looking statements. Factors that might cause such a difference include, among other things, those set forth under Overview , Liquidity and Capital Resources and Risk Factors included in these sections and those appearing elsewhere in this Form 10-Q. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis only as of the date hereof. We assume no obligation to update these forward-looking statements to reflect actual results or changes in factors or assumptions affecting forward-looking statements.

**Recent Events**

On August 22, 2001, we received a letter from The Nasdaq Stock Market, Inc., notifying us of our failure to maintain a minimum bid price of $1.00 per share during the preceding 30 consecutive business days. The letter stated that we must demonstrate compliance with Nasdaq s minimum bid rule by November 20, 2001, and that if we are not in compliance by that date, Nasdaq will notify us that our common stock will be delisted from the Nasdaq National Market. If such event occurs, we may appeal the decision to a Nasdaq Listing Qualifications Panel. We cannot assure you that our bid price will comply with the requirements for continued listing of our common stock on The Nasdaq National Market, or that any appeal of a decision to delist our common stock will be successful.

**Overview**

We are a leading provider of comprehensive selling and customer service solutions that help companies more profitably acquire and retain customers. Our product lines leverage proven intelligence engines and patented automation technology to drive new revenue streams, increase profitability, and manage customer interactions across all channels and throughout the sales and service cycle. From our inception in 1983 through 1997, we generated revenue primarily through providing custom development services. These services consisted of the development of highly customized applications utilizing core software technology, and related software maintenance and data maintenance services. In early fiscal 1997, we undertook a plan to change our strategic focus from a custom development services company to a software product company providing more standardized solutions. Our first packaged software product was introduced in May 1997. We released the Firepond Application Suite in October 1999 and renamed and repackaged the FirePond Application Suite as the SalesPerformer Suite in December 2000. As a result of these efforts, product-related revenue as a percentage of total revenue increased from 1.5% in fiscal 1997 to 76.5% in fiscal 2000 and to 89.5% in the nine months ended July 31, 2001.

On February 15, 2001, we acquired 100% of the issued and outstanding shares of capital stock of Brightware, Inc., located in San Rafael, California. The acquisition was accounted for as a purchase in accordance with APB No. 16. Accordingly, the results of operations of Brightware have been included in the Company s results of operations since the date of acquisition. In addition, on September 27, 2000, the Company acquired 100% of the issued and outstanding shares of capital stock of Signature Software, Inc. (Signature). This acquisition was also accounted for using the purchase method in accordance with APB No. 16. Accordingly, the results of operations of Signature from the date of acquisition, was included in the results of operations of the Company.

As a result of a global slowdown in information technology spending and the Company s acquisition of Brightware, the Company undertook a plan to restructure its operations during the quarter ended April 30, 2001. A reduction-in-force of 81 employees and 89 contractors was necessary to align the Company s cost structure with the market conditions and eliminate redundant operations. In addition, in the quarter ended July 31, 2001 as a result of the continued slow down in information technology spending and the resulting





effects on our revenue, we took further action to reduce our costs by reducing our employee base by an additional 157 employees and one contractor to better align the Company s cost structure with economic realities and preserve cash. We will see the full impact of the restructuring in the fourth quarter of 2001, as we expect expenses to decrease.

On July 1, 2001, we entered into a settlement agreement with Epam Systems, LLC and Epam Systems, Inc. Among other items, we agreed to pay these companies $1,000,000 in cash and granted options to purchase 100,000 shares of our common stock in return for restructuring the relationship and a release of claims including those claims previously filed against us by these companies. As part of this agreement, our relationship with Epam has been restructured to reduce our monthly commitment to 50 Epam consultants through February 2002 and 30 Epam consultants through May 2002 in furtherance of our cost reduction measures.

We have incurred quarterly and annual losses intermittently since we were formed, and regularly since we began transitioning to a software product business in early fiscal 1997. We incurred net losses of $28.9 million for fiscal 1999, $16.3 million for fiscal 2000, and $56.6 million for the nine months ended July 31, 2001. We currently plan on achieving break-even by the second quarter of our fiscal 2002 and expect to continue to incur losses on a quarterly basis until that time.

We derive revenue from software product licenses; product-related consulting and training, support and maintenance services; and custom development services and related support and maintenance.

We recognize revenue under Statement of Position, or SOP, No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, and SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. We generally recognize revenue from product-related license agreements over the implementation period. We recognize this revenue following the percentage-of-completion method over the implementation period because we have concluded that the implementation services are essential to our customers use of our SalesPerformer Suite of products. Percentage of completion is measured by the percentage of implementation hours incurred to date to total estimated implementation hours. In situations where the Company is not responsible for implementation services, the Company recognizes revenue on delivery of the packaged software if there is persuasive evidence of an arrangement, collection is probable, the fee is fixed or determinable and vendor-specific objective evidence exists to allocate the total fees to all elements of the arrangement. In situations where the Company is not responsible for implementation services, however, is obligated to provide unspecified additional software products in the future, the Company recognizes revenue as a subscription over the term of the commitment period.

We recognize revenue from product-related support and maintenance services ratably over the term of the contract, typically one year. Product-related support and maintenance services include technical support and unspecified upgrade and maintenance rights. We recognize consulting and training revenue as the services are performed. Consulting and training revenue is primarily related to implementation services performed on a time-and-materials basis under separate service arrangements.

For our eServices product line, which was acquired in connection with the Brightware transaction, we recognize revenue when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable and collectability is probable. We have determined that implementation services are not essential to the functionality of the eServices product.

The Company historically had provided services to develop highly customized applications utilizing core software technology. The Company no longer accepts new custom development service projects but continues to provide ongoing services related to previously completed custom development projects including software and data maintenance. Revenue from these ongoing arrangements is recognized as the services are performed.

In situations where the Company enters into an arrangement for both its SalesPerformer Suite and its eServices product and is responsible for implementation services; it will recognize revenue for the entire arrangement under SOP 81-1.



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We are planning for product-related revenue from product licenses to grow over the long-term as result of increased market acceptance of our products, the recent introduction of the SalesPerformer Suite and the recently acquired eServices product line, and increases in the productivity of our sales force. Therefore, we expect that a higher percentage of total revenue will be attributable to product-related revenue in the future.

We anticipate custom development services revenue remaining at or below its current levels, as we have strategically de-emphasized that business and do not plan to accept new custom development contracts. Custom development services revenue will continue to represent a material portion of total revenue until existing custom development contracts and related maintenance agreements are completed. Custom development services revenue in the future will be primarily from ongoing software maintenance and data maintenance services that we provide under custom development services contracts. The rate of decline in custom development revenue depends in part on our ability to convert custom development services customers to our software products.

We have invested heavily in research and development. Research and development expenses have been increasing since early fiscal 1997 when we began the development of our software products. Since the introduction of our first software product, we have determined that technological feasibility of our software products occurs late in the development cycle and close to general release of the products, and that the development costs incurred between the time technological feasibility is established and general release of the product are not material. Therefore, beginning in June 1997, we expense these costs as incurred to research and development expense. To enhance our product offering and market position, we believe it is essential for us to continue to make significant investment in research and development.

We have granted stock options to employees and consultants that require us to record stock-based compensation expense. We have also granted stock warrants to certain customers and to strategic business partners. Stock-based compensation related to grants to employees represents the amortization, over the vesting period of the option, of the difference between the exercise price of options granted to employees and the fair market value of our common stock for financial reporting purposes. Stock-based compensation related to grants to non-employees represents the fair market value of the options and warrants granted as computed using an established option valuation formula. We recorded stock-based compensation expense of approximately $1.7 million and $1.5 million for the three months ended July 31, 2000 and July 31, 2001, respectively, and $4.7 million and $2.8 million for the nine months ended July 31, 2000 and July 31, 2001, respectively. As of July 31, 2001, the deferred compensation balance was approximately $2.2 million and will be amortized over the remaining vesting period of the options and warrants.

On June 26, 2001, we commenced a stock option exchange program in which our directors and eligible employees were offered the opportunity to exchange existing stock options for new stock options with an exercise price equal to the current market value of our common stock. Participants in the exchange program received new options to purchase seventy-five percent (75%) of the number of shares of our common stock subject to the options that were exchanged and canceled. The new options were granted on July 31, 2001, with an exercise price of $.66 per share. We accepted 7,179,285 stock options for exchange and issued 5,384,384 stock options in exchange for such tendered options. As a result of the cancellation of the outstanding options, the unamortized deferred compensation of approximately $783,000 was amortized and recorded as stock based compensation during the three months ended July 31, 2001.

We may incur compensation expense as a result of the issuance of the new options because the new options will be subject to variable plan accounting in accordance with APB No. 25, accordingly, we will be required to record as a compensation expense, chargeable against our reported earnings, all increases in the fair value of those options, including any appreciation in the market price of the underlying option shares, which occurs between the grant date of that option and the date the option is exercised for those shares or otherwise terminates unexercised. The greater the increase in the market value of our common stock following the date of grant, the greater the compensation expense.

Our series A, series C and series G preferred stock, as well as shares of our common stock outstanding on May 20, 1997 other than those shares held by General Atlantic Partners, had rights that allow holders to receive a priority payment upon the completion of our initial public offering. These priority payments totaled





$35.8 million for the series A, series C and series G preferred stockholders, and $10.0 million for the shares of our common stock outstanding on May 20, 1997 other than those shares held by General Atlantic Partners. These amounts were payable in cash, or, at our option, a number of shares of common stock determined by dividing the amount payable by $12.00. Our board of directors elected to make these payments in 3,812,532 shares of common stock upon consummation of our initial public offering. At the initial public offering price of $22.00 per share, the value of the stock dividend totaled $65.5 million for the series A, series C and series G preferred stockholders, and $18.3 million for the stock dividend on the shares of our common stock outstanding on May 20, 1997 other than those shares held by General Atlantic Partners. The stock dividend on the preferred stock increased the loss attributable to common stockholders by $65.5 million for fiscal 2000.

As of October 31, 2000, we had available a net operating loss carryforward of approximately $53.0 million to reduce future federal and state income taxes, if any. This carryforward expires beginning in 2012 and may be subject to review and possible adjustment by the Internal Revenue Service. The Tax Reform Act of 1986 contains provisions that may limit the amount of net operating loss carryforwards that we may utilize in any one year in the event of cumulative changes in ownership over a three-year period in excess of 50%. The Company s wholly owned foreign subsidiaries have net operating loss carryforwards of approximately $16 million as of October 31, 2000.

**Results of Operations**

The following table presents selected consolidated financial data as a percentage of total net revenue:

| | Three Months Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | **2000** | **2001** | **2000** | **2001** |
| Revenue: | | | | |
| Product-related revenue: | | | | |
| License | 39.2% | 38.8% | 36.4% | 31.3% |
| Services and maintenance | 37.5 | 52.7 | 37.4 | 58.2 |

| | | | | |
|---|---|---|---|---|
| Total product-related revenue | 76.7 | 91.5 | 73.8 | 89.5 |
| Custom development services | 23.3 | 8.5 | 26.2 | 10.5 |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of revenue: | | | | |
| License | 0.9 | 1.4 | 1.0 | 1.0 |
| Product-related services and maintenance | 25.8 | 63.2 | 22.3 | 65.4 |
| Custom development services | 7.9 | 2.1 | 10.2 | 2.8 |
| Total cost of revenue | 34.6 | 66.7 | 33.5 | 69.2 |

| | | | | |
|---|---|---|---|---|
| Gross profit | 65.4 | 33.3 | 66.5 | 30.8 |
| Operating expenses: | | | | |
| Sales and marketing | 45.7 | 65.0 | 49.0 | 59.5 |
| Research and development | 20.1 | 44.9 | 25.3 | 42.8 |
| General and administrative | 14.5 | 28.7 | 15.7 | 23.9 |
| Stock-based compensation | 10.0 | 14.6 | 10.9 | 7.7 |
| Amortization of goodwill and other intangible assets | | 13.2 | | 6.2 |
| Restructuring charge (credit) | | 80.3 | (1.2) | 30.2 |
| Settlement of claim | | | | 3.3 |
| Acquired in-process research and Development | | | | 16.8 |
| Total operating expenses | 90.3 | 246.7 | 99.7 | 190.4 |



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| | Three Months Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| Loss from operations | (24.9) | (213.4) | (33.2) | (159.6) |
| Interest income | 10.4 | 6.0 | 5.2 | 9.2 |
| Other income (expense), net | (1.0) | (3.8) | 0.8 | (2.9) |

| | | | | |
|---|---|---|---|---|
| Net loss before extraordinary item | (15.5) | (211.2) | (27.2) | (153.3) |
| Loss on extinguishment of debt | | | (3.4) | |
| Net loss | (15.5)% | (211.2)% | (30.6)% | (153.3)% |

*Comparison of Three Months Ended July 31, 2000 and 2001*

*Revenue.* Total revenue decreased $7.2 million, or 41.6%, to $10.1 million in the three months ended July 31, 2001 from $17.3 million in the three months ended July 31, 2000. This decrease is attributable to a 78.6% decrease in custom development revenue and a 30.4% decrease in product-related revenue.

*License.* License revenue decreased $2.9 million, or 42.2%, to $3.9 million in the three months ended July 31, 2001 from $6.8 million in the three months ended July 31, 2000. License revenue as a percentage of total revenue decreased to 38.8% in the three months ended July 31, 2001 from 39.2% in the three months ended July 31, 2000. We believe the decrease in absolute dollars and as a percentage of total revenue is attributable to a global slow down in information technology spending experienced by software companies in our market segment. Over the long-term we are planning for license revenue growth as a result of additional license sales resulting from increased market acceptance of our products, a growing customer base, the success of our marketing efforts, and improved productivity of our sales force.

*Product service and maintenance.* Product service and maintenance revenue decreased $1.2 million, or 17.9%, to $5.3 million in the three months ended July 31, 2001 from $6.5 million in the three months ended July 31, 2000. Product services and maintenance revenue as a percentage of total revenue increased to 52.7% in the three months ended July 31, 2001 from 37.5% in the three months ended July 31, 2000. The decrease in absolute dollars is attributable to fewer SalesPerformer engagements. The increase in the percentage of total revenue is due to lower license revenue and increased post implementation consulting services provided. Over the long-term we are planning for product service and maintenance revenue growth as a result of additional customer implementations related to additional license sales.

*Custom development services.* Custom development services revenue decreased $3.2 million, or 78.6%, to $861,000 in the three months ended July 31, 2001 from $4.0 million in the three months ended July 31, 2000. Custom development services revenue as a percentage of total revenue decreased to 8.5% in the three months ended July 31, 2001 from 23.3% in the three months ended July 31, 2000. The decrease in absolute dollars and as a percentage of total revenue is due to the change of our strategic focus. We expect custom development services revenue to remain at current levels or decline.

*Cost of revenue.* Total cost of revenue increased $748,000, or 12.5%, to $6.7 million in the three months ended July 31, 2001 from $6.0 million in the three months ended July 31, 2000. Total cost of revenue as a percentage of total revenue increased to 66.7% in the three months ended July 31, 2001 from 34.6% in the three months ended July 31, 2000.

*Cost of license revenue.* Cost of license revenue consists primarily of costs of royalties, media, product packaging, and other production costs. Cost of license revenue decreased $14,000, or 8.8% to $145,000 in the three months ended July 31, 2001 from $159,000 in the three months ended July 31, 2000. Cost of license revenue as a percentage of license revenue increased to 3.7% in the three months ended July 31, 2001 from 2.3% in the three months ended July 31, 2000. The increase in cost of license revenue as a percentage of license revenue is due primarily to increased third party license costs.



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*Cost of product-related services and maintenance revenue.* Cost of product-related services and maintenance revenue consists primarily of salaries and related costs for consulting, training and customer support personnel, including cost of services provided by third-party consultants engaged by us. Cost of product-related services and maintenance revenue increased $1.9 million, or 42.8%, to $6.4 million in the three months ended July 31, 2001 from $4.5 million in the three months ended July 31, 2000. Cost of product-related services and maintenance revenue as a percentage of product-related services and maintenance revenue increased to 119.7% in the three months ended July 31, 2001 from 68.9% in the three months ended July 31, 2000. The increase in absolute dollars was primarily due to increased staff and consulting resources. The increase as a percentage of revenue was due to the company maintaining consulting staff in excess of the current customer demand for services. We expect costs of product-related services to decline for the remainder of this fiscal year as a result of the actions we have taken to reduce our employee base and related costs.

*Cost of custom development services revenue.* Cost of custom development services revenue consists primarily of salaries and related costs for development, consulting, training and customer support personnel related to our custom development projects, including cost of services provided by third-party consultants engaged by us. Cost of custom development services revenue decreased $1.1 million, or 84.1%, to $217,000 in the three months ended July 31, 2001 from $1.4 million in the three months ended July 31, 2000. Cost of custom development services as a percentage of custom development services revenue decreased to 25.2% in the three months ended July 31, 2001 from 33.9% in the three months ended July 31, 2000. The decrease in absolute dollars is primarily due to decreased staff supporting fewer custom development services engagements. The decrease as a percentage of custom development services revenue is primarily due to higher utilization as a result of decreased staffing. We expect the cost of custom development services revenue to remain at current levels or decline.

*Sales and marketing expenses.* Sales and marketing expenses consist primarily of salaries, commissions and bonuses for sales and marketing personnel and promotional expenses. Sales and marketing expenses decreased $1.3 million, or 17.0%, to $6.6 million in the three months ended July 31, 2001 from $7.9 million in the three months ended July 31, 2000. Sales and marketing expenses as a percentage of total revenue increased to 65.0% in the three months ended July 31, 2001 from 45.7% in the three months ended July 31, 2000. These expenses decreased in absolute dollars as a result of the actions we have taken to reduce our workforce, partially offset by incremental sales and marketing expenses incurred by the addition of the eServices product line. The increase in the percentage of total revenue is a result of lower revenues. We expect sales and marketing expenses will decline for the remainder of this fiscal year due to reduced payroll and other expenses. We plan to continue to invest in marketing programs in order to achieve planned revenue levels.

*Research and development expenses.* Research and development expenses consist primarily of salaries and personnel-related costs and the costs of contractors associated with the development of new products, the enhancement of existing products, and the performance of quality assurance and documentation activities. Research and development expenses increased $1.1 million, or 30.3%, to $4.5 million in the three months ended July 31, 2001 from $3.5 million in the three months ended July 31, 2000. Research and development expenses as a percentage of total revenue increased to 44.9% in the three months ended July 31, 2001 from 20.1% in the three months ended July 31, 2000. These expenses increased in absolute dollars due to increased headcount associated with the acquisition of the eServices product line. These expenses increased as a percentage of total revenue due to lower revenues. We expect research and development expenses will decline for the remainder of this fiscal year as a result of the actions we have taken to reduce our workforce which will result in reduced payroll and other expenses. We plan to continue to make necessary investments to enhance our existing products and develop new products in order to achieve planned revenue levels.

*General and administrative expenses.* General and administrative expenses consist primarily of salaries, and other personnel-related costs for executive, financial, human resource, information services, and other administrative functions, as well as legal and accounting costs. General and administrative expenses increased $397,000, or 15.8%, to $2.9 million in the three months ended July 31, 2001 from $2.5 million in the three months ended July 31, 2000. General and administrative expenses as a percentage of total revenue increased to 28.7% in the three months ended July 31, 2001 from 14.5% in the three months ended July 31, 2000. These

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expenses increased in absolute dollars due to increased headcount from Brightware transitional staff that were handling integration issues. The increase as a percentage of total revenue is a result of lower revenues. We expect that general and administrative expenses will remain approximately flat or decline through the remainder of the fiscal year.

*Stock-based compensation expense.* Stock-based compensation expense decreased $259,000, or 15.0%, to $1.5 million in the three months ended July 31, 2001 from $1.7 million in the three months ended July 31, 2000. Stock-based compensation expense as a percentage of total revenue increased to 14.6% in the three months ended July 31, 2001 from 10.0% in the three months ended July 31, 2000. The decrease in absolute dollars is primarily due to lower charges associated with option grants subject to fair value accounting, whereby the fair market value of the stock price at the beginning of the period was higher than at the end of the period. If we had allocated our stock-based compensation to the departments for which the services were performed in the three months ended July 31, 2001, the allocation would have increased cost of revenue by $50,000, increased sales and marketing expenses by $124,000, increased research and development expenses by $138,000 and increased general and administrative expenses by $1.2 million. For the three months ended July 31, 2000, the allocation would have increased cost of revenue by $27,000, sales and marketing expenses by $1.0 million, research and development expenses by $613,000 and general and administrative expenses by $74,000. The primary components of stock based compensation expense in the third quarter of fiscal 2001 was a $682,000 charge for amortization of deferred stock compensation related to retention of Signature Software employees associated with the acquisition of Signature Software in September 2000 and a $783,000 charge in connection with the stock option exchange program resulting in the cancellation of outstanding options. Due to our stock option exchange program there are options to purchase approximately 5.4 million shares of our common stock that are subject to variable plan accounting, which may result in potentially large stock-based compensation expense in the future.

*Amortization of goodwill and other intangible assets.* In conjunction with our acquisition of Brightware, we allocated approximately $6.3 million to goodwill which was adjusted by approximately $1.2 million in the quarter ended July 31, 2001 to $7.5 million, $4.9 million to developed technology and know-how and $2.2 million to assembled workforce. Developed technology represents patented and unpatented technology and know-how related to Brightware s current eService product offering founded on a combination of artificial intelligence, knowledge-manager technology and internet enterprise applications. Assembled workforce is the presence of a skilled workforce that is knowledgeable about company procedures and possesses expertise in certain fields that are important to continued profitability and growth of a company. Intangible assets are being amortized over three years. For the three months ended July 31, 2001, we recognized $1.3 million in amortization. We will adopt SFAS 142, *Goodwill and Other Intangible Asset* on November 1, 2001, and going forward goodwill, as defined, will be adjusted periodically for impairments and no goodwill amortization expense will be recorded.

*Restructuring charge (credit).* During the quarter ended July 31, 2001, the Company announced a restructuring of its operations due to a continued global slowdown in technology spending. In connection with this plan, we incurred $8.1 million of restructuring charges in the three months ended July 31, 2001, which includes $3.3 million of employee severance costs, $1.9 million of facilities related costs, $1.5 million of excess property and equipment costs, $1.0 million of contract termination fees and $369,000 of other costs.

*Interest income.* Interest income (expense), net, decreased $1.2 million, or 66.5%, to $605,000 of income in the three months ended July 31, 2001 from $1.8 million of income in the three months ended July 31, 2000. The decrease is primarily due to our decreased cash and cash equivalents and short-term investments.

*Other income (expense), net.* Other income (expense), net primarily consists of foreign currency transaction gains and losses. Other income (expense), net increased $211,000 to $381,000 in expense in the three months ended July 31, 2001 from $170,000 in expense in the three months ended July 31, 2000. The increase is primarily due to foreign currency transaction losses in the three months ended July 31, 2001.



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*Comparison of Nine Months Ended July 31, 2000 and 2001*

*Revenue.* Total revenue decreased $5.9 million, or 13.8%, to $37.0 million in the nine months ended July 31, 2001 from $42.9 million in the nine months ended July 31, 2000. This decrease is attributable to a 25.8% decrease in license revenue and a 65.5% decrease in custom development revenue offset by a 34.4% increase in service and maintenance revenue.

*License.* License revenue decreased $4.0 million, or 25.8%, to $11.6 million in the nine months ended July 31, 2001 from $15.6 million in the nine months ended July 31, 2000. License revenue as a percentage of total revenue decreased to 31.3% in the nine months ended July 31, 2001 from 36.4% in the nine months ended July 31, 2000. The decrease in license revenue in absolute dollars and as a percentage of total revenue is primarily attributable to the decrease in average transaction size as a result of a global slowdown in information technology spending experienced by software companies in our market segment. In addition, in our pursuit of customer satisfaction, we have experienced slower revenue recognition from our current customer implementations than anticipated due to performing professional services outside of the original scope of the engagement for no incremental revenue.

*Product service and maintenance.* Product service and maintenance revenue increased $5.5 million, or 34.4%, to $21.5 million in the nine months ended July 31, 2001 from $16.0 million in the nine months ended July 31, 2000. Product services and maintenance revenue as a percentage of total revenue increased to 58.2% in the nine months ended July 31, 2001 from 37.4% in the nine months ended July 31, 2000. The increase in absolute dollars and as a percentage of total revenue is attributable to an increase in the number of maintenance agreements and amount of services provided in connection with the license implementations in this period as compared to the prior year period.

*Custom development services.* Custom development services revenue decreased $7.4 million, or 65.5%, to $3.9 million in the nine months ended July 31, 2001 from $11.2 million in the nine months ended July 31, 2000. Custom development services revenue as a percentage of total revenue decreased to 10.5% in the nine months ended July 31, 2001 from 26.2% in the nine months ended July 31, 2000. The decrease in absolute dollars and as a percentage of total revenue is due to the change of our strategic focus.

*Cost of revenue.* Total cost of revenue increased $11.2 million, or 77.9%, to $25.6 million in the nine months ended July 31, 2001 from $14.4 million in the nine months ended July 31, 2000. Total cost of revenue as a percentage of total revenue increased to 69.2% in the nine months ended July 31, 2001 from 33.5% in the nine months ended July 31, 2000.

*Cost of license revenue.* Cost of license revenue decreased $57,000, or 13.4% to $369,000 in the nine months ended July 31, 2001 from $426,000 in the nine months ended July 31, 2000. Cost of license revenue as a percentage of license revenue increased to 3.2% in the nine months ended July 31, 2001 from 2.7% in the nine months ended July 31, 2000. The decrease in absolute dollars is due primarily to a decrease in royalty charges.

*Cost of product-related services and maintenance revenue.* Cost of product-related services and maintenance revenue increased $14.6 million, or 152.3%, to $24.2 million in the nine months ended July 31, 2001 from $9.6 million in the nine months ended July 31, 2000. Cost of product-related services and maintenance revenue as a percentage of product-related services and maintenance revenue increased to 112.4% in the nine months ended July 31, 2001 from 59.9% in the nine months ended July 31, 2000. The increase in absolute dollars was primarily due to increased staff and consulting resources to support product-related engagements in this period. The increase as a percentage of revenue was primarily due to lower billing rates realized on certain large engagements in this period as well as lower realized average revenue per hour on certain fixed price services contracts in this period caused by the Company improving customer satisfaction and performing services outside of the scope of the original engagement for no incremental revenue. In addition, we experienced a lower utilization of our consulting staff in this period.

*Cost of custom development services revenue.* Cost of custom development services revenue decreased $3.3 million, or 76.2%, to $1.0 million in the nine months ended July 31, 2001 from





$4.4 million in the nine months ended July 31, 2000. Cost of custom development services as a percentage of custom development services revenue decreased to 26.8% in the nine months ended July 31, 2001 from 38.9% in the nine months ended July 31, 2000. The decrease in absolute dollars and as a percentage of custom development services revenue is primarily due to decreased staff supporting fewer custom development services engagements.

*Sales and marketing expenses.* Sales and marketing expenses increased $978,000, or 4.7%, to $22.0 million in the nine months ended July 31, 2001 from $21.0 million in the nine months ended July 31, 2000. Sales and marketing expenses as a percentage of total revenue increased to 59.5% in the nine months ended July 31, 2001 from 49.0% in the nine months ended July 31, 2000. These expenses increased in absolute dollars and as a percentage of total revenue due to incremental sales and marketing expenses incurred by the addition of the eServices product line, offset by reductions in headcount due to the restructuring that have reduced sales and marketing expenses.

*Research and development expenses.* Research and development expenses increased $5.0 million, or 46.0%, to $15.8 million in the nine months ended July 31, 2001 from $10.8 million in the nine months ended July 31, 2000. Research and development expenses as a percentage of total revenue increased to 42.8% in the nine months ended July 31, 2001 from 25.3% in the nine months ended July 31, 2000. These expenses increased in absolute dollars and as a percentage of total revenue primarily as a result of increased staffing caused in part by the addition of the eServices product line.

*General and administrative expenses.* General and administrative expenses increased $2.1 million, or 31.7%, to $8.8 million in the nine months ended July 31, 2001 from $6.7 million in the nine months ended July 31, 2000. General and administrative expenses as a percentage of total revenue increased to 23.9% in the nine months ended July 31, 2001 from 15.7% in the nine months ended July 31, 2000. These expenses increased in absolute dollars and as a percentage of total revenue primarily as a result of increased headcount and cost of infrastructure.

*Stock-based compensation expense.* Stock-based compensation expense decreased $1.8 million, or 39.1%, to $2.8 million in the nine months ended July 31, 2001 from $4.7 million in the nine months ended July 31, 2000. Stock-based compensation expense as a percentage of total revenue decreased to 7.7% in the nine months ended July 31, 2001 from 10.9% in the nine months ended July 31, 2000. The decrease is primarily due to lower charges associated with option grants subject to variable accounting, whereby the fair market value of the stock price at the beginning of the period was higher than at the end of the period. If we had allocated our stock-based compensation to the departments for which the services were performed in the nine months ended July 31, 2001, the allocation would have increased cost of revenue by $70,000, sales and marketing expenses by $171,000, research and development expenses by $254,000 and general and administrative expenses by $2.3 million. For the nine months ended July 31, 2000, the allocation would have increased cost of revenue by $79,000, sales and marketing expenses by $3.0 million, research and development expenses by $1.3 million and general and administrative expenses by $286,000. The primary components of stock-based compensation expense in the first nine months of fiscal 2001 was $1.7 million of amortization of deferred stock compensation related to retention of Signature Software employees associated with the acquisition of Signature Software in September 2000 and a $783,000 charge in connection with the stock option exchange program resulting in the cancellation of outstanding options.

*Amortization of goodwill and other intangible assets.* In conjunction with our acquisition of Brightware, we allocated approximately $6.3 million to goodwill which was adjusted by approximately $1.2 million in the quarter ended July 31, 2001 to $7.5 million, $4.9 million to developed technology and know-how and $2.2 million to assembled workforce. Developed technology represents patented and unpatented technology and know-how related to Brightware s current eService product offering founded on a combination of artificial intelligence, knowledge-manager technology and internet enterprise applications. Assembled workforce is the presence of a skilled workforce that is knowledgeable about company procedures and possesses expertise in certain fields that are important to continued profitability and growth of a company. Intangible assets are being amortized over three years. For the nine months ended July 31, 2001, we recognized $2.3 million in amortization.





*Restructuring charge (credit).* During the quarter ended April 30, 2001 the Company announced a restructuring of its operations due to a global slowdown in technology spending and the Brightware acquisition resulting in some redundant operations. During the quarter ended July 31, 2001 the Company announced an extension of the first restructuring as a result of a continued slowdown in technology spending. In connection with this plan, we incurred $11.2 million of restructuring charges in the nine months ended July 31, 2001, which includes $5.6 million of employee severance costs, $2.2 million of facilities related costs, $1.6 million of excess fixed asset costs, $1.0 million of contract termination fees and $720,000 of other costs.

*Settlement of claim.* On March 2, 2001 we entered into an agreement with a customer under which we paid to the customer $1.6 million to resolve outstanding contractual matters. The expense for the settlement was partially offset by $389,000 previously paid by the customer but not yet earned by the Company. The Company recorded this transaction as a net charge of $1,211,000 to operations in the quarter ended April 30, 2001.

*Acquired in-process research and development.* As part of the purchase price allocation for Brightware, all intangible assets that are a part of the acquisition were identified and valued. It was determined that technology assets and assembled workforce had value. As a result of this identification and valuation process, we allocated approximately $6.2 million of the purchase price to in-process research and development projects. This allocation represented the estimated fair value based on risk-adjusted cash flows related to the incomplete research and development projects. At the date of acquisition, the development of these projects had not yet reached technological feasibility, and the research and development in progress had no alternative future uses. Accordingly, these costs were expensed as of the date of the acquisition.

*Interest income.* Interest income (expense), net, increased $1.2 million, or 53.7%, to $3.4 million of income in the nine months ended July 31, 2001 from $2.2 million of income in the nine months ended July 31, 2000. The increase is primarily due to higher average balances of cash and cash equivalents and short-term investments resulting in higher interest income earned.

*Other income (expense), net.* Other income (expense), net decreased $1.4 million to $1.1 million in expense in the nine months ended July 31, 2001 from $359,000 in income in the nine months ended July 31, 2000. The decline is primarily due to foreign currency transaction losses in the nine months ended July 31, 2001 as compared to foreign currency transaction gains in the fiscal 2000 period.

**Liquidity and Capital Resources**

As of July 31, 2001, cash and cash equivalents were $43.7 million and short-term investments were $6.1 million as compared with cash and cash equivalents of $79.5 million and short-term investments of $36.7 million as of October 31, 2000. The Company also has $3.2 million in restricted cash held in escrow in conjunction with the Brightware acquisition. Our working capital at July 31, 2001 was $37.5 million, compared to working capital of $101.6 million at October 31, 2000.

Net cash used in operating activities was $49.0 million in the nine months ended July 31, 2001, compared with net cash provided by operating activities of $5.6 million in the nine months ended July 31, 2000. Cash used in operating activities in the nine months ended July 31, 2001 was primarily attributable to our net loss and to a lesser extent, an increase in prepaid expenses and other current assets and accrued liabilities and a decrease in accounts payable and deferred revenue offset by a decrease in accounts receivable, non-cash expenses, stock-based compensation expense, depreciation and amortization and acquired in-process research and development.

Net cash provided by investing activities was $16.8 million in the nine months ended July 31, 2001, compared with net cash used in investing activities of $24.6 million in the nine months ended July 31, 2000. Net cash provided by investing activities in the nine months ended July 31, 2001 was primarily attributable to the sale or maturity of short-term investments offset by the acquisition of Brightware, net of cash acquired, the purchase of short-term investments and the purchase of property and equipment.

Net cash used in financing activities was $3.6 million in the nine months ended July 31, 2001, compared with net cash provided by financing activities of $114.8 million in the nine months ended July 31, 2000. Net





cash used in financing activities for the nine months ended July 31, 2001 were primarily from payments on debt related to the acquisition of Brightware partially offset by the exercise of stock options.

We anticipate continued spending on capital expenditures consistent with anticipated requirements for operations, infrastructure and personnel. We believe that our existing cash balances will be sufficient to meet our anticipated cash need for working capital and capital expenditures for at least the next 12 months. However, we may need to raise additional funds in the next 12 months or in the future to support more rapid expansion of our sales force, develop new or enhanced products or services, respond to competitive pressures, acquire complementary businesses or technologies or respond to unanticipated requirements. If we seek to raise additional funds, we may not be able to obtain funds on terms which are favorable or acceptable to us. If we raise additional funds through the issuance of equity securities, the percentage ownership of our existing stockholders would be reduced. Furthermore, these securities may have rights, preferences or privileges senior to our common stock.

**Recent Accounting Pronouncements**

On June 30, 2001, the FASB issued SFAS No. 141, Accounting for Business Combinations and SFAS No. 142, Accounting for Goodwill and Other Intangible Assets. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for under the purchase method. In accordance with SFAS 142, goodwill will no longer be amortized, rather, goodwill will be subject to an assessment of impairment by applying a fair-value based test at least annually. There is no impact as of July 31, 2001, however, as of October 31, 2001, goodwill will cease to be amortized. The Company has not yet assessed the impairment, if any, that would be recognized utilizing a fair-value based goodwill impairment test.

**Risk Factors**

As defined under Safe Harbor provisions of The Private Securities Litigation Reform Act of 1995, except for the historical information contained herein, some of the matters discussed in this filing contain forward-looking statements regarding future events that are subject to risks and uncertainties. The following factors, among others, could cause actual results to differ materially from those described by such statements.

**We face possible Nasdaq delisting which would result in a limited public market for our common stock and make obtaining future equity financing more difficult for us**

We must satisfy a number of requirements to maintain our listing on the Nasdaq National Market, including maintaining a minimum bid price for our common stock of $1.00 per share and maintaining a market value for our publicly-held shares of at least $5 million. On August 22, 2001, we received a letter from The Nasdaq Stock Market, Inc., notifying us of our failure to maintain a minimum bid price of $1.00 per share during the preceding 30 consecutive business days. The letter stated that we must demonstrate compliance with Nasdaq s minimum bid rule by November 20, 2001, and that if we are not in compliance by that date, Nasdaq will notify us that our common stock will be delisted from the Nasdaq National Market. If such event occurs, we may appeal the decision to a Nasdaq Listing Qualifications Panel. We cannot assure you that our bid price will comply with the requirements for continued listing of our common stock on the Nasdaq National Market, or that any appeal of a decision to delist our common stock will be successful. If our common stock loses its Nasdaq National Market status, shares of our common stock would likely trade in the over-the-counter market. Consequently, selling our common stock would be more difficult because smaller quantities of shares would likely be bought and sold, transactions could be delayed, and security analysts and news media coverage of us may be reduced. In addition, in the event our common stock is delisted, broker-dealers have certain regulatory burdens imposed upon them, which may discourage broker-dealers from effecting transactions in our common stock, further limiting the liquidity thereof. These factors could result in lower prices and larger spreads in the bid and ask prices for shares of common stock.

Such delisting from the Nasdaq National Market or further declines in our stock price could also greatly impair our ability to raise additional necessary capital through equity or debt financing, and significantly increase the ownership dilution to stockholders caused by our issuing equity in financing or other transactions.



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Furthermore, our delisting from the Nasdaq National Market will likely damage our general business reputation and thus may harm our financial condition and operating results.

**We are the target of several securities class action complaints and are at risk of securities class action litigation, which could result in substantial costs and divert management attention and resources**

Since August 1, 2001, a number of securities class action complaints were filed against us, the underwriters of our initial public offering, and certain of our executives in the United States District Court for the Southern District of New York. The complaints allege that the underwriters of our initial public offering, Firepond and the other named defendants violated federal securities laws by making material false and misleading statements in the prospectus incorporated in our registration statement on Form S-1 filed with the SEC in November 1999. The complaints allege, among other things, that FleetBoston Robertson Stephens solicited and received excessive and undisclosed commissions from several investors in exchange for which FleetBoston Robertson Stephens allocated to these investors material portions of the restricted number of shares of common stock issued in connection with our initial public offering. The complaints further allege that FleetBoston Robertson Stephens entered into agreements with its customers in which FleetBoston Robertson Stephens agreed to allocate the common stock sold in our initial public offering to certain customers in exchange for which such customers agreed to purchase additional shares of our common stock in the after-market at pre-determined prices. Securities class action litigation could result in substantial costs and divert our management s attention and resources, which could seriously harm our business.

**We expect to continue to incur losses and may not be profitable in the future**

We have incurred quarterly and annual losses intermittently since we were formed in 1983, and regularly since fiscal 1997. We incurred net losses of $9.0 million for fiscal 1998, $28.9 million for fiscal 1999, $16.3 million for fiscal 2000 and $21.4 million and $56.6 million for the three and nine months ended July 31, 2001, respectively. Although we currently plan that we will stop incurring losses by the second quarter of our 2002 fiscal year, we may not achieve this goal and may continue to incur losses on a quarterly basis and not become profitable. Moreover, we expect to continue to incur significant sales and marketing and research and development expenses, and, as a result, we will need to generate significant revenue to achieve and maintain profitability. We may not grow or generate sufficient revenue to attain profitability.

**A continued slowdown in information technology spending could reduce the sale of our products**

Average license fees for our products typically range from approximately several hundred thousand dollars to several million dollars. Often this represents a significant IT capital expenditure for the companies to which we target our sales efforts. If the current global slowdown in IT spending should continue, whether resulting from a weakened economy or other factors, we may be unable to maintain or increase our sales volumes and achieve our targeted revenue growth.

**Disappointing quarterly revenue or operating results could cause the price of our common stock to fall**

We currently derive a significant portion of our license revenue in each quarter from a small number of relatively large orders, and we generally recognize revenue from our licenses over the related implementation period. If we are unable to recognize revenue from one or more substantial license sales planned for a particular fiscal quarter, our operating results for that quarter would be seriously harmed. In addition, the purchase of our products typically involves a substantial commitment of resources by our customers or their consultants over an extended period of time. The time required to complete an implementation may vary from customer to customer and may be protracted due to unforeseen circumstances. Because our revenue from implementation, maintenance and training services are largely correlated with our license revenue, a decline in license revenue would also cause a decline in our services revenue in the same quarter and in subsequent quarters. Because our sales cycle is long, we may have difficulty predicting when we will recognize revenue. If our quarterly revenue or operating results fall below the expectations of investors or securities analysts, the price of our common stock could fall substantially and we could become subject to securities class-action litigation. Litigation, if instituted, could result in substantial costs and a diversion of management s attention



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and resources, which would materially adversely affect our business, financial condition and results of operations.

**Our workforce reductions and financial performance may adversely affect the morale and performance of our personnel and our ability to hire new personnel**

In connection with our effort to streamline operations, reduce costs and bring our staffing and infrastructure in line with industry standards, we recently restructured our organization with reductions in our workforce. We reduced our workforce by 81 full-time positions and 89 consultant positions in April, 2001, and by 157 full-time positions and one consultant position in June, 2001. We have incurred costs of $5.6 million associated with the workforce reduction related to severance and other employee-related costs, and may incur further costs. Our restructuring may also yield unanticipated consequences, such as attrition beyond our planned reduction in workforce and loss of employee morale and decreased performance. As a result of these factors, our remaining personnel may seek employment with larger, more established companies. Continuity of personnel can be an important factor in the successful completion of our development projects, and ongoing turnover in our research and development personnel could materially and adversely impact our development and marketing efforts. We believe that hiring and retaining qualified individuals at all levels is essential to our success, and there can be no assurance that we will be successful in attracting and retaining the necessary personnel.

**Our results of operations will be harmed by charges associated with stock-based compensation and charges associated with other securities issuances by us**

On June 26, 2001, we announced an offer to allow our directors and certain eligible employees to exchange outstanding stock options for new stock options. The number of options granted was equal to three-fourths of the number of options that were tendered and accepted for exchange. On July 26, 2001, we accepted 7,179,285 options for exchange and, on July 31, 2001 issued 5,384,384 new stock options in exchange therefore. The new stock options have an exercise price equal to $.66 per share. The new option grants will be treated for financial reporting purposes as a variable award. Accordingly, we will be required to record as a compensation expense, chargeable against our reported earnings, all increases in the fair value of those options, including any appreciation in the market price of the underlying option shares, which occurs between the grant date of that option and the date the option is exercised for those shares or otherwise terminates unexercised. The greater the increase in the market value of our common stock following the date of grant, the greater the compensation expense and effect on our reported earnings.

**Difficulties and financial burdens associated with acquisitions could harm our business and financial results**

On February 15, 2001, we acquired all of the outstanding stock of Brightware, Inc. Our product range and customer base have increased in the recent past due in part to this acquisition. There can be no assurance that the integration of all of the acquired technologies will be successful or will not result in unforeseen difficulties that may absorb significant management attention.

In the future, we may acquire additional businesses or product lines. The recently completed acquisition, or any future acquisition, may not produce the revenue, earnings or business synergies that we anticipated, and an acquired product, service or technology might not perform as expected. Prior to completing an acquisition, however, it is difficult to determine if such benefits can actually be realized. The process of integrating acquired companies into our business may also result in unforeseen difficulties. Unforeseen operating difficulties may absorb significant management attention, which we might otherwise devote to our existing business. Also, the process may require significant financial resources that we might otherwise allocate to other activities, including the ongoing development or expansion of our existing operations.

If we pursue a future acquisition, our management could spend a significant amount of time and effort identifying and completing the acquisition. If we make a future acquisition, we could issue equity securities





which would dilute current stockholders percentage ownership, incur substantial debt, assume contingent liabilities, incur a one-time charge or be required to amortize goodwill.

**Because we have a limited operating history as a software company, our future success is uncertain**

Although Firepond was incorporated in 1983, we have only been focused on providing software products since 1997. Because we have only been focused on providing software products for a short time, we have a limited operating history pursuing this business model. The revenue and income potential of the market for e-business sales and services solutions is unproven. As a result, our historical financial statements are not an accurate indicator of our future operating results. In addition, we have limited insight into trends that may emerge and affect our business, and we cannot forecast operating expenses based on our historical results. In evaluating Firepond, you should consider the risks and uncertainties frequently encountered by early stage companies in new and rapidly evolving markets. If we are not able to successfully address these risks, our business could be harmed.

**A significant percentage of our product development is performed by a third party internationally, the loss of which would substantially harm our product development efforts**

A significant percentage of our product development work, and implementation services, are performed by a third-party development organization in Minsk, Belarus. In connection with these services the organization may from time to time control certain components of our proprietary technology. Unpredictable events in the political, economic and social conditions in Belarus, or our failure to maintain or renew our consulting agreement with this organization could eliminate or reduce the availability of these product development and implementation services and hinder our ability to retrieve or cause us to lose certain components of our proprietary technology. If access to these services were to be unexpectedly eliminated or significantly reduced, our ability to meet development objectives vital to our ongoing strategy would be hindered, certain components of our proprietary technology could be lost, and our business could be seriously harmed.

**The success of our business depends on the SalesPerformer Suite, which has been recently introduced and may not be widely adopted by our customers**

We expect to derive the majority of our product license revenue in the future from the Firepond Application Suite and its component products, which were released in October 1999, and renamed and repackaged as the SalesPerformer Suite in December 2000. Our business depends on the successful customer acceptance of this new suite of products. We expect that we will continue to depend on revenue from new and enhanced versions of the SalesPerformer Suite, and our business would be harmed if our target customers do not adopt and expand their use of the SalesPerformer Suite and its component products.

**We depend on key personnel and must attract and retain additional qualified personnel to be successful**

Our success depends upon the continued contributions of our senior sales, engineering and management personnel, who perform important functions, and would be difficult to replace. Specifically, we believe that our future success is highly dependent on Klaus P. Besier, our chairman and chief executive officer, and other senior management personnel. The loss of the services of any key personnel, particularly senior management and engineers, could seriously harm our business.

In addition, our success depends in large part upon our ability to attract, train, motivate and retain highly skilled employees, particularly sales personnel, software engineers and other senior personnel. Our failure to attract and retain the highly trained technical personnel that are integral to our product development, professional services and support teams may limit our ability to develop new products or product enhancements.

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**Failure to expand our relationships with systems integrators and consulting firms would impede acceptance of our products and delay the growth of our revenue**

At times we rely on systems integrators and consulting firms to recommend our products to their customers and to install and support our products for their customers. To increase our revenue and implementation capabilities, we must develop and expand our relationships with systems integrators and consulting firms. If these firms fail to implement our products successfully for their clients, we may not have the resources to implement our products on the schedule required by the client which would result in our inability to recognize revenue from the license of our products to these customers.

**Our stock price may continue to be volatile which may lead to losses by investors and result in securities litigation**

The trading price of our common stock has been and may continue to be highly volatile and could be subject to wide fluctuations in price in response to various factors, many of which are beyond our control, including quarterly variations in our results of operations; changes in recommendations by the investment community or in their estimates of our revenue or operating results; speculation in the press or investment community; strategic actions by our competitors, such as product announcements or acquisitions; and general market conditions.

In addition, the stock market in general and the Nasdaq National Market and securities of Internet and software companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to their operating performance. These broad market and industry factors may materially adversely affect the market price of our common stock, regardless of our actual operating performance. Litigation, if instituted, could result in substantial costs and a diversion of management s attention and resources, which would materially adversely affect our business, financial condition and results of operations.

**Failure to increase our international revenue could seriously harm our business**

International revenue currently accounts for a significant percentage of our total revenue. We expect international revenue to continue to account for a significant percentage of total revenue in the future and we believe that we must continue to expand our international sales activities to be successful. However, foreign markets for our products may develop more slowly than currently anticipated. International revenue as a percentage of total product-related revenue was 13% in fiscal 1999, 36% in fiscal 2000 and 36% and 39% for the three and nine months ended July 31, 2001. Our failure to expand our international sales could have a significant negative impact on our business.

**Due to our international operations we are subject to foreign exchange risk**

We serve our customers from offices throughout North America, Europe and Japan. Consequently, we are exposed to fluctuations of the dollar against the foreign currencies of those countries in which we have a substantial presence. For each of our foreign subsidiaries, the functional currency is the local currency. Accordingly, assets and liabilities are translated at period-end exchange rates, and operating statement items are translated at weighted-average rates prevailing during the periods presented. We have exchange rate exposure in the following principal currencies: the British Pound, the Euro and the Japanese Yen.

Fluctuations against the US dollar can produce significant differences in the reported value of sales and expenses. For sales in the US which are produced outside of the US, any weakening of the US dollar against a particular country s currency reduces the amount of net income reported in US dollars. Conversely, the same weakening of the US dollar generates an offsetting increase in the dollar value of profits arising from sales within that country. Any weakening of the US dollar that negatively impacts a foreign operation s trading profit will similarly reduce the dollar value of any overhead expense located in that country.

The translation of foreign denominated assets and liabilities at period-end exchange rates could materially adversely effect our reported earnings.

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**Failure to effectively manage our geographically dispersed organization could have a significant negative impact on our business operations**

If we fail to manage our geographically dispersed organization, we may fail to meet or exceed our objectives and our revenue may decline. We perform research and development activities in Minnesota, Massachusetts, California and Belarus, and our executive officers and other key employees are similarly dispersed throughout the United States, Europe and Japan. This geographic dispersion requires significant management resources that our locally based competitors do not need to devote to their operations. In addition, the expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources.

**Integration of a new management team and new personnel and growth may strain our operations**

All members of our senior management team have joined Firepond since May 1997, and we continue to experience turnover at the senior management level. This may place a significant burden on our management and our internal resources. If we are not able to install adequate systems, procedures and controls to support our future operations in an efficient and timely manner, or if we are unable to otherwise manage growth effectively, our business could be harmed.

**Intense competition from other technology companies could prevent us from increasing or sustaining revenue and prevent us from achieving or sustaining profitability**

The market for integrated e-business sales and services solutions is intensely competitive and we expect that this competition will increase. Many of our current and potential competitors have longer operating histories, greater name recognition and substantially greater resources than we do. Therefore, they may be able to respond more quickly than we can to new or changing opportunities, technologies, standards or customer requirements. If we are unable to compete effectively, our revenue could significantly decline.

**If e-business selling and customer service solutions are not widely adopted, we may not be successful**

Our products address a new and emerging market for e-business selling and customer service solutions. The failure of this market to develop, or a delay in the development of this market, would seriously harm our business. The success of e-business selling and customer service solutions depends substantially upon the widespread adoption of the Internet as a primary medium for commerce and business applications. The Internet infrastructure may not be able to support the demands placed on it by the continued growth upon which our success depends. Moreover, critical issues concerning the commercial use of the Internet, such as security, reliability, cost, accessibility and quality of service, remain unresolved and may negatively affect the growth of Internet use or the attractiveness of commerce and business communication over the Internet.

**If we are unable to introduce new and enhanced products on a timely basis that respond effectively to changing technology, our revenue may decline**

Our market is characterized by rapid technological change, changes in customer requirements, frequent new product and service introductions and enhancements, and evolving industry standards. Advances in Internet technology or in e-commerce software applications, or the development of entirely new technologies to replace existing software, could lead to new competitive products that have better performance or lower prices than our products and could render our products obsolete and unmarketable. In addition, if a new software language or operating system becomes standard or is widely adopted in our industry, we may need to rewrite portions of our products in another computer language or for another operating system to remain competitive. If we are unable to develop new and enhanced products on a timely basis that respond to changing technology, our business could be seriously harmed.



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**We depend on technology licensed to us by third parties, the loss of which could adversely affect our competitive position**

We license technology from a small number of software providers for use with our products. In addition, the effective implementation of our products depends upon the successful operation of third-party licensed technology in conjunction with our products. We anticipate that we will continue to license and rely on technology from third parties in the future. This technology may not continue to be available on commercially reasonable terms, if at all, and some of the technology we license would be difficult to replace. The loss of the use of this technology would result in delays in the license and implementation of our products until equivalent technology, if available, is identified, licensed and integrated. In turn, this could prevent the implementation or impair the functionality of our products, delay new product introductions, or injure our reputation.

**If we are unable to provide adequate professional service and customer support, our ability to sustain or grow our business will be harmed**

Our ability to continue to grow, to retain current and future customers and to recognize revenue from our licenses depends in part upon the quality of our professional service and customer support operations. Failure to offer adequate integration, consulting and other professional services in connection with the implementation of our products, and ongoing customer support, either directly or through third parties, could materially and adversely affect our operating results and reputation, and could cause demand for our products to decline.

**If our new and complex products fail to perform properly, our revenue would be adversely affected**

Software products as complex as ours may contain undetected errors, or bugs, which result in product failures, or may cause our products to fail to meet our customers expectations. Our products may be particularly susceptible to bugs or performance degradation because of the evolving nature of Internet technologies and the stress that full deployment of our products over the Internet to thousands of end-users may cause. Product performance problems could result in loss of or delay in revenue, loss of market share, failure to achieve market acceptance, diversion of development resources or injury to our reputation.

**Product liability claims related to our customers critical business operations could result in substantial costs**

Our products are critical to the business operations of our customers. If one of our products fails, a customer may assert a claim for substantial damages against us, regardless of our responsibility for the failure. Our product liability insurance may not cover claims brought against us. Product liability claims could require us to spend significant time and money in litigation or to pay significant damages. Any product liability claims, whether or not successful, could seriously damage our reputation and our business.

**Our limited ability to protect our intellectual property may harm our ability to compete**

Our success and ability to compete is dependent in part upon our proprietary technology. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of a competitive advantage and decreased revenue. Existing patent, copyright, trademark and trade secret laws afford only limited protection. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Therefore, we may not be able to protect our proprietary rights against unauthorized third party copying or use. Furthermore, policing the unauthorized use of our products is difficult. Some of our contractual arrangements provide third parties with access to our source code and other intellectual property upon the occurrence of specified events. This access could enable these third parties to use our intellectual property and source code to develop and manufacture competing products, which would adversely affect our performance and ability to compete. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. This litigation could result in substantial costs and diversion of resources and could materially adversely affect our future operating results.



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**Claims alleging infringement of a third party s intellectual property could result in significant expense to us and result in our loss of significant rights**

The software and other Internet-related industries are characterized by the existence of frequent litigation of intellectual property rights. From time to time, third parties may assert patent, copyright, trademark and other intellectual property rights to technologies that are important to our business. Any claims, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays, disrupt our relationships with our customers or require us to enter into royalty or licensing agreements, any of which could have a material adverse effect upon our operating results. Royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. If a claim against us is successful and we cannot obtain a license to the relevant technology on acceptable terms, license a substitute technology or redesign our products to avoid infringement, our business, financial condition and results of operations would be materially adversely affected.

**Claims may be brought against us if we hire former employees of our competitors, which may cause us to incur substantial costs**

Companies in the software industry, whose employees accept positions with competitors, frequently claim that those competitors have breached, or encouraged the breach of, noncompetition and nondisclosure agreements. These claims have been made against us in the past, and we may receive claims in the future as we hire additional qualified personnel. If a claim were to be made against us, it could result in material litigation. We could incur substantial costs in defending ourselves against any of these claims, regardless of the merits of these claims.

**Control by our executive officers, directors and associated entities may limit your ability to influence the outcome of director elections and other matters requiring stockholder approval**

As of July 31, 2001 our executive officers, directors and their affiliates own approximately 47% of the outstanding shares of our common stock. These stockholders have significant influence over matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions. This concentration of ownership could have the effect of delaying or preventing a change in our control or discouraging a potential acquirer from attempting to obtain control of us, which in turn could have a material adverse effect on the market price of the common stock or prevent our stockholders from realizing a premium over the market price for their shares of common stock.

**Future sales of our stock could cause our stock price to fall**

Sales of a substantial number of shares of our common stock in the public market could cause the market price of our common stock to decline. In addition, the sale of these shares could impair our ability to raise capital through the sale of additional equity securities.

**Provisions of Delaware law and of our charter and by-laws may make a takeover more difficult and lower the value of our common stock**

Provisions in our certificate of incorporation and by-laws and in Delaware corporate law may make it difficult and expensive for a third party to pursue a tender offer, change in control or takeover attempt that is opposed by our management. Public stockholders who might desire to participate in such a transaction may not have an opportunity to do so, and the ability of public stockholders to change our management could be substantially impeded by these anti-takeover provisions. For example, we have a staggered board of directors and the right under our charter documents to issue preferred stock without further stockholder approval, which could adversely affect the holders of our common stock.



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**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

We develop products in the United States and Belarus and sell them worldwide. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Since our sales are currently priced in U.S. dollars and are translated to local currency amounts, a strengthening of the dollar could make our products less competitive in foreign markets. Interest income and expense are sensitive to changes in the general level of U.S. interest rates, particularly since our investments are in short-term instruments. Based on the nature and current levels of our investments, however, we have concluded that there is no material market risk exposure.

## PART II. OTHER INFORMATION

**Item 1.** ***Legal Proceedings***

Beginning in August, 2001, a number of complaints were filed in the Southern District of New York seeking an unspecified amount of damages on behalf of an alleged class of persons who purchased shares of our common stock between the date of our initial public offering and December 6, 2000. The complaints name as defendants Firepond and certain of its directors and officers, and FleetBoston Robertson Stephens an underwriter of our initial public offering. Plaintiffs allege, among other things, that our prospectus, incorporated in the Registration Statement on Form S-1 filed with the Securities and Exchange Commission was materially false and misleading because it failed to disclose that the investment banks which underwrote Firepond s initial public offering of securities, and others received undisclosed and excessive brokerage commissions, and required investors to agree to buy shares of our securities after the initial public offering was completed at predetermined prices as a precondition to obtaining initial public offering allocations. The plaintiffs further allege that these actions artificially inflated the price of our common stock after the initial public offering. While we believe the claims against us are without merit and intend to defend the actions vigorously, the litigation is in the preliminary stage, and we cannot predict the outcome with certainty. We may incur substantial legal fees and expenses, and the litigation may divert the attention of some of our key management. Our defense of this litigation, regardless of its outcome, may be costly and time-consuming. Should the outcome of the litigation be adverse to us, we could be required to pay significant monetary damages to the plaintiffs, which could harm our business.

On July 1, 2001, we entered into a settlement agreement with Epam Systems, LLC and Epam Systems, Inc. Among other items, we agreed to pay these companies $1,000,000 in cash and granted options to purchase 100,000 shares of our common stock in return for restructuring the relationship and a release of claims including those claims previously filed against us by these companies with the American Arbitration Association and in the Massachusetts Superior Court. As part of this agreement, our relationship with Epam has been restructured to reduce our monthly commitment to 50 Epam consultants through February 2002 and 30 Epam consultants through May 2002 in furtherance of our cost reduction measures.

We are also subject to various other claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on our business, financial condition or results of operations.



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**Item 2.** ***Changes in Securities and Use of Proceeds***

Not applicable

**Item 3.** ***Defaults upon Senior Securities***

Not applicable

**Item 4.** ***Submission of Matters to a Vote of Security Holders***

Not applicable

**Item 5.** ***Other Information***

Not applicable

**Item 6.** ***Exhibits and Reports on Form 8-K***

**(a) Exhibits**

None

**(b) Reports on Form 8-K**

(1) On June 28, 2001 the Registrant filed a Current Report on Form 8-K relating to an exchange of the Registrant s outstanding stock options for new stock options (Item 5 of Form 8-K).

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**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.

FIREPOND, INC.

/s/ KLAUS P. BESIER

Klaus P. Besier
*Chairman, Chief Executive Officer*
*and Director (Principal Executive Officer)*

/s/ PAUL K. MCDERMOTT

Paul K. McDermott
*Chief Financial Officer and Vice President of Finance and Administration (Principal Financial Officer and Principal Accounting Officer)*

Dated: September 14, 2001

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