FIREPOND INC
Form 10-Q
September 15, 2003

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the Quarter Ended July 31, 2003

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 *(State or Other Jurisdiction of Incorporation or Organization)*	**41-1462409** *(I.R.S. Employer Identification No.)*
8009 S. 34th Avenue, Minneapolis, MN *(Address of principal executive offices)*	**55425** *(Zip Code)*

(952) 229-2300

(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 þ No o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of September 11, 2003 there were 3,671,983 shares of the Registrant s Common Stock outstanding.

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FIREPOND, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	July 31, 2003	October 31, 2002
	(Unaudited) (In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,504	$ 13,479
Short-term investments	6,143	15,690
Accounts receivable, net of allowance for doubtful accounts of $190 and $463	1,766	2,798
Unbilled revenue	153	268
Restricted cash		199
Prepaid expenses and other current assets	1,822	982
Total current assets	23,388	33,416
Property and equipment, net	998	2,105
Other intangible assets, net	60	137
Restricted cash	190	190
Other assets	489	511
	$ 25,125	$ 36,359
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 363	$ 1,546
Accrued liabilities	3,534	5,062
Accrued restructuring	657	2,266
Deferred revenue	4,343	5,952
Total current liabilities	8,897	14,826
Long-term accrued restructuring	116	160
Stockholders equity:		
Preferred stock, $0.10 par value Authorized 5,000,000 shares;		
Issued and outstanding none at July 31, 2003 and October 31, 2002		
Common stock, $0.10 par value		
Authorized 100,000,000		
Issued and outstanding 3,671,983 shares at July 31, 2003 and 3,684,983 shares at October 31, 2002	367	369
Additional paid-in capital	198,899	198,935
Accumulated deficit	(176,819)	(172,094)
Loans receivable	(4,015)	(4,287)
Deferred compensation	(5)	(10)
Accumulated other comprehensive loss	(2,315)	(1,540)
Total stockholders equity	16,112	21,373
	$ 25,125	$ 36,359

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2003	2002	2003	2002
	(Unaudited) (In thousands, except per share data)			
Revenue:				
License	$ 111	$ 638	$ 1,666	$ 4,851
Services and maintenance	2,156	3,680	7,727	12,367
Total revenue	2,267	4,318	9,393	17,218
Cost of revenue:				
License	57	4	97	101
Services and maintenance(1)	979	2,306	3,846	8,213
Total cost of revenue	1,036	2,310	3,943	8,314
Gross profit	1,231	2,008	5,450	8,904
Operating expenses:				
Sales and marketing(1)	1,052	2,036	3,396	6,247
Research and development(1)	1,077	2,290	3,252	7,801
General and administrative(1)	1,110	1,992	3,421	5,648
Stock-based compensation (credit)	4	(701)	240	734
Amortization of intangible assets	26	26	78	460
Restructuring charge	391	5,894	1,041	5,894
Impairment of developed technology and know-how				3,120
Total operating expenses	3,660	11,537	11,428	29,904
Loss from operations	(2,429)	(9,529)	(5,978)	(21,000)
Interest income	71	144	260	484
Other income (expense), net	273	308	993	240
Loss before cumulative effect of a change in accounting principle	(2,085)	(9,077)	(4,725)	(20,276)
Cumulative effect of a change in accounting principle				(3,973)
Net loss	$(2,085)	$ (9,077)	$ (4,725)	$(24,249)
Net loss per share:				
Basic and diluted loss per share before cumulative effect of a change in accounting principle	$ (0.57)	$ (2.46)	$ (1.28)	$ (5.54)
Cumulative effect of a change in accounting principle				(1.08)
Basic and diluted net loss per share applicable to common stockholders	$ (0.57)	$ (2.46)	$ (1.28)	$ (6.62)

Basic and diluted weighted average common shares outstanding	3,672	3,684	3,677	3,665

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2003	2002	2003	2002
Cost of revenue	$	$ (40)	$ 83	$ 72
Operating expenses:				
Sales and marketing		(30)		2
Research and development		(77)	3	110
General and administrative	4	(554)	154	550
Total stock-based compensation	$ 4	$ (701)	$ 240	$ 734

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

	Nine Months Ended July 31,	
	2003	**2002**
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net loss	$ (4,725)	$ (24,249)
Adjustments to reconcile net loss to net cash used in operating activities:		
Non-cash restructuring and other special charges		1,165
Stock-based compensation expense	240	734
Depreciation and amortization	1,375	2,413
Impairment of developed technology and know-how		3,120
Cumulative effect of a change in accounting principle		3,973
Changes in assets and liabilities:		
Accounts receivable	907	7,281
Unbilled revenue	111	(22)
Prepaid expenses and other assets	(1,173)	371
Accounts payable	(1,200)	(607)
Accrued liabilities	(1,828)	(1,425)
Accrued restructuring	(1,653)	(294)
Deferred revenue	(1,796)	(6,180)
Net cash used in operating activities	(9,742)	(13,720)
Cash flows from investing activities:		
Purchases of short-term investments	(997)	(24,127)
Proceeds from the sale and maturities of short-term investments	10,581	24,550
Purchases of property and equipment	(57)	(248)
Decrease (increase) in restricted cash	199	(138)
Return of cash from the Brightware acquisition escrow		617
Net cash provided by investing activities	9,726	654
Cash flows from financing activities:		
Borrowings on note payable		880
Payments on note payable		(591)
Proceeds from stock options and warrants exercised		79
Net cash provided by financing activities		368
Effect of exchange rate changes on cash and cash equivalents	41	102
Net increase (decrease) in cash and cash equivalents	25	(12,596)
Cash and cash equivalents, beginning of period	13,479	34,660
Cash and cash equivalents, end of period	$ 13,504	$ 22,064

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

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 (Firepond or the Company), considers itself to be a leading provider in sales configuration systems that help companies reduce the cost of selling complex products, regardless of the sales channel. Companies may achieve a measurable and meaningful return on investment in Firepond technology by converting more leads into accurate orders, whether they sell through a direct sales force, an indirect channel network, or via the web. Firepond also offers an online customer assistance solution. Marketed as Brightware eService Performer, this product line leverages advanced intelligence engines and natural language processing technology to manage a company s online customer interaction channels, with an emphasis on email response management.

The Company is subject to a number of risks similar to those of other companies of similar size in its industry, including recurring losses, rapid technological changes, competition, customer concentration, integration of acquisitions, management of international activities and dependence on key individuals.

The accompanying condensed 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, 2003 and 2002 are unaudited and have been prepared on a basis consistent with the October 31, 2002 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. The Company has combined its product-related revenue and custom development services reporting into one segment. Management determined that the custom development services segment was insufficient in size to warrant separately viewing and managing the engagements and resources. Prior year financials have been reclassified to include custom development services in product-related revenue. 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, 2002 included in the Company s Form 10-K. The results of operations for the three and nine months ended July 31, 2003 are not necessarily indicative of results to be expected for the entire year or any other period.

2. Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, *Consolidation of Variable Interest Entities*. This interpretation addresses the consolidation of certain variable interest entities for which a controlling financial interest exists. The interpretation applies immediately to variable interest entities created after January 31, 2003. It applies in the first interim period beginning after June 15, 2003 to pre-existing entities. The adoption of this interpretation did not affect the Company s financial statements.

In December 2002, the Financial Accounting Standards Board issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation expands the disclosures to be made by a guarantor in its annual and interim financial statements about its obligations under certain guarantees. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. As required by the interpretation, the Company adopted the disclosure and recognition requirements for the quarter ended January 31, 2003. In connection with the sale of its products in the ordinary course of business, the Company often makes representations affirming that its products do not infringe on the intellectual property rights of others and agrees to indemnify customers against third-party claims for such infringement. Also, the Company s amended and restated by-laws provide for indemnification by the Company of its directors, officers and certain non-officer employees under certain circumstances

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

against expenses, including attorneys fees, judgments, fines and amounts paid in settlement, reasonably incurred in connection with the defense or settlement of any threatened, pending or completed legal proceeding in which any such person is involved by reason of the fact that such person is or was a director, officer or employee of the Company if such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Company, and, with respect to criminal actions or proceedings, if such person had no reasonable cause to believe his or her conduct was unlawful. The Company has not been required to make any material payments under such provisions.

In December 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123* (SFAS No. 148) which provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the Company s method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition and annual disclosure requirements of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure requirements are effective for interim periods beginning after December 15, 2002. The Company adopted the disclosure requirements effective in the quarter ended April 30, 2003.

In June 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146) which nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. This accounting standard requires that liabilities associated with exit or disposal activities be recognized and measured at fair value when incurred, as opposed to at the date an entity commits to the exit or disposal plans. The Company has adopted this standard for its fiscal 2003 restructuring activities.

3. Accrued Liabilities

Accrued liabilities consist of the following:

	July 31, 2003	October 31, 2002
	(In thousands)	
Consulting and professional fees	$ 816	$1,054
Compensation and benefits	719	898
Sales, use and other taxes	1,592	1,338
Facilities and office expenses	27	908
Other	380	864
Total accrued liabilities	$3,534	$5,062

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Comprehensive Loss

The components of comprehensive loss for the three and nine months ended July 30, 2003 and 2002 are as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2003	2002	2003	2002
	(In thousands)		(In thousands)	
Comprehensive loss:				
Net loss	$(2,085)	$(9,077)	$(4,725)	$(24,249)
Other comprehensive loss				
Unrealized (loss) gain on investments	(8)	1	37	(11)
Foreign currency translation	(150)	(374)	(812)	(503)
Comprehensive loss	$(2,243)	$(9,450)	$(5,500)	$(24,763)

5. Stockholders Equity

(a) Stock Options and Warrants

The Company granted stock options to employees and directors in July 2001 in conjunction with a stock option exchange program that required the recognition of stock-based compensation expense. As of July 31, 2003, a total of approximately 306,424 options to purchase shares of the Company s common stock were subject to variable accounting as a result of the stock option exchange program. As of July 31, 2003, the Company recorded no deferred compensation associated with these options because the fair market value of the Company s common stock was below the option price.

The Company also granted stock options to non-employees and issued warrants to certain customers and strategic business partners that require the recognition of stock-based compensation expense. Stock-based compensation relating to these grants represents the fair market value as computed using the Black-Scholes option pricing model. As of July 31, 2003, the deferred compensation balance associated with these grants was approximately $5,000.

(b) Pro Forma Stock-Based Compensation

Under SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123*, the Company is required to disclose the pro forma effects on net income (loss) and net income (loss) per share as if the Company had elected to use the fair value approach to account for its entire employee stock-based compensation plans.

The Company has computed the pro forma disclosures required under SFAS No. 148 for options granted during the three and nine months ended July 31, 2003 and 2002 using the Black-Scholes option pricing model prescribed by SFAS No. 148. The weighted average assumptions used were as follows:

	2003	2002

Risk-free interest rate	2.8%	4.0%
Expected lives	5.0	5.0
Expected volatility	116%	117%

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Had compensation cost for the Company s plan been determined consistent with the fair value approach enumerated in SFAS No. 148, the Company s pro forma net loss and net loss per share would have been as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2003	2002	2003	2002
	(In thousands, except per share data)			
Net loss applicable to shareholders, as reported	$(2,085)	$ (9,077)	$(4,725)	$(24,249)
Add: Stock-based employee compensation expense included in reported net loss		(814)		(18)
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards	(1,257)	(2,675)	(4,600)	(9,448)
Net loss applicable to stockholders, pro forma	$(3,342)	$(12,566)	$(9,325)	$(33,715)
Basic and diluted net loss per share, as reported	$ (0.57)	$ (2.46)	$ (1.28)	$ (6.62)
Basic and diluted net loss per share, pro forma	(0.91)	(3.41)	(2.54)	(9.20)

(c) Loans Receivable

On November 28, 2000, the Company s Board of Directors approved a loan facility to Klaus P. Besier, the Company s Chairman, Chief Executive Officer and President, 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 Directors 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 December 11, 2001, the Company s Board of Directors amended the facility to extend the maturity to May 1, 2006. 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 50,000 shares of the Company s common stock, valued at $162,000 at July 31, 2003, and is generally not a recourse obligation of the borrower, with specified exceptions. As of July 31, 2003, the amount outstanding was approximately $4,000,000.

In addition in prior years, the Company issued notes to two former officers of the Company totaling $270,000 and to a former employee of the Company in the amount of $125,000. During the quarter ended January 31, 2003, management determined that the remaining loan to the former officer and the loan to the former employee were uncollectible, resulting in a $230,000 charge to stock-based compensation for the difference between the value of the shares securing each note and the $275,000 loan receivable balance. During the quarter ended January 31, 2002, in connection with the termination of one of the former officer s employment with the Company, the Company acquired the shares valued at approximately $7,000 securing the note from the officer in satisfaction of $120,000 due under the note. As a result, $113,000 was charged to stock-based compensation during the quarter ended January 31, 2002.

(d) 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 by the weighted average number of common shares outstanding, and diluted loss per share, which is computed by dividing the net loss 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 the three and nine months ended July 31, 2003 and 2002, all potential common

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shares were antidilutive and were excluded from the diluted net loss per share calculations. The calculation of weighted average shares outstanding for the three and nine months ended July 31, 2003 and 2002 excludes contingently issuable shares of 0 and 12,432, respectively, representing shares issued but held in escrow in connection with the acquisition of Signature Software.

As of July 31, 2003 and 2002, 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 822,085 and 652,400, respectively.

6. Segment Reporting

At the beginning of fiscal year 2003, the Company combined product-related services and custom development services into one reporting segment because management determined that the custom development services segment was insufficient in size to warrant separately viewing and managing the engagements and resources.

Revenue from the United States, Japan and the United Kingdom contributed approximately 73%, 6% and 10% of revenue, respectively, for the three months ended July 31, 2003 and revenue from the United States, Japan, and the United Kingdom contributed approximately 52%, 19%, and 11% of revenue, respectively for the three months ended July 31, 2002. Revenue from the United States, Japan and the United Kingdom contributed approximately 70%, 12%, and 8% of revenue, respectively, for the nine months ended July 31, 2003 and revenue from the United States, the United Kingdom and Japan contributed approximately 46%, 16%, and 11% of our revenue, respectively for the nine months ended July 31, 2002.

7. Brightware Acquisition

On February 15, 2001, pursuant to an Agreement and Plan of Merger between the Company and Brightware, Inc. (Brightware), the Company acquired 100% of the issued and outstanding capital stock of Brightware, a supplier of eCustomer assistance software. As a result of the identification and valuation of intangibles acquired, the Company allocated approximately $4,900,000 to developed technology and know-how. Developed technology was being amortized over a period of three years. During the quarter ended January 31, 2002, the Company lowered its estimates of the expected cash flows from the Brightware product line and determined that developed technology and know-how was significantly impaired. As such, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company recorded a $3,120,000 charge to write-off the impaired portion of developed technology and know-how leaving a balance of approximately $215,000 as of January 31, 2002, to be amortized over a two year period. The circumstances leading to the impairment related directly to the Company s strategic decision to focus on its core value proposition in the lead-to-order market with its SalesPerformer product because of the continued global slowdown in information technology spending and the Company s need to focus its resources to reach profitability. As a result of the change in strategic direction, the Company lowered the Brightware revenue forecasts, operating profits and cash flows, resulting in the impairment charge of the developed technology and know-how. As of July 31, 2003, accumulated amortization of developed technology and know-how was $155,000. The amortization expense for the nine months ended July 31, 2003 and 2002 was $78,000 and $460,000.

8. Goodwill and Other Intangible Assets Adoption of Statement No. 142

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, *Goodwill and Other Intangible Assets*, which establishes financial accounting and reporting for acquired goodwill and other intangible assets and supersedes Accounting Principles Board (APB) Opinion No. 17, *Intangible Assets*. The Company early adopted SFAS No. 142 on November 1, 2001, the beginning of its fiscal year 2002. SFAS No. 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but,

FIREPOND, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

instead, tested at least annually for impairment. Accordingly, the Company reclassified the net book value of assembled workforce to goodwill and ceased amortization of all goodwill on November 1, 2001. Intangible assets that have finite useful lives, consisting of developed technology and know-how, continue to be amortized over their useful lives.

The standard also requires that goodwill be tested for impairment annually. In the year of adoption, the standard required a transitional goodwill impairment evaluation, which was a two-step process. The first step was a screen for whether there was an indication that goodwill was impaired as of November 1, 2001. To do this, the Company identified its reporting units and determined the carrying value of each by assigning the Company s assets and liabilities, including existing goodwill, to them as of November 1, 2001. The Company then determined the fair value of each reporting unit by using a combination of present value and multiple of earnings valuation techniques and compared it to the reporting unit s carrying value. As of January 31, 2002, the Company completed this first step, which indicated that goodwill recorded during the Brightware acquisition was impaired as of November 1, 2001.

In the second step, the Company compared the implied fair value of the affected reporting unit s goodwill to its carrying value to measure the amount of impairment. The fair value of goodwill was determined by allocating the reporting unit s fair value to all of its assets and liabilities in a manner similar to a purchase price allocation in accordance with SFAS No. 141, *Business Combinations*. As of January 31, 2002, the Company completed this second step and measured and recognized a transitional impairment loss of $3,973,000 as a cumulative effect of a change in accounting principle in its statement of operations.

In accordance with SFAS No. 142, the fair value used to determine the impairment was based on a combination of earnings multiples and discounted cash flow valuation techniques. The circumstances leading to the goodwill impairment related to both a global slowdown in information technology spending as well as a significant decrease in comparable company market valuations. The negative economic trend lowered the Brightware operating profits and cash flows and is evidence that initial growth expectations when Brightware was acquired did not materialize. The decline in comparable company market valuations resulted in reduced earnings multiples.

9. Restructuring and Other Special Charges

(a) Fiscal 2003 Restructuring

During the quarter ended April 30, 2003, the Company undertook plans to restructure its operations as a result of lower than expected revenues due to a delayed recovery in global information technology spending. As such, the Company announced the consolidation of its corporate functions to its headquarters in Minneapolis, Minnesota and a reorganization of its European operations. These measures were taken to reduce global operating expenses to better position the Company to reach profitability in the future and to preserve cash. Overall, the Company terminated 7 general and administrative, 8 sales and marketing, 5 professional services and 1 development employees which resulted in a net charge of $650,000 in the quarter ended April 30, 2003. The restructuring activity was completed during the Company s quarter ended July 31, 2003. The Company recognized a net restructuring charge in the quarter ended July 31, 2003 of $391,000, principally for the closure of excess facilities. This restructuring charge included an $80,000 reduction of prior restructuring costs primarily due to lower than expected costs related to the closure of facilities. Subsequently, in September 2003, management approved and began to implement a restructuring plan aimed at further reducing operating expenses. This plan is intended to reduce the Company s headcount by approximately 25 employees by the first quarter of fiscal year 2004. As a result of this plan, the company expects to incur approximately $400,000 to $600,000 of additional restructuring charges, principally for severance, in the fourth quarter of fiscal year 2003 and the first quarter of fiscal year 2004.

FIREPOND, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The significant components of the restructuring and other special charges were as follows (in thousands):

	Quarter Ended July 31, 2003	Nine Months Ended July 31, 2003
Employee severance costs	$	$ 832
Facilities and other related costs	416	429
Excess contractual commitments and termination fees	55	101
Reduction of prior restructuring costs	(80)	(321)
	$391	$1,041

(b) Fiscal 2002 Restructuring

During the quarter ended July 31, 2002, the Company undertook plans to restructure its operations as a result of a prolonged slowdown of global information technology spending, specifically within the enterprise software marketplace. As such, the Company announced a strategic realignment to further enhance its focus on the lead-to-order market as well as measures to better align its cost structure with projected revenue and preserve cash. The Company reduced headcount and facilities as well as wrote off excess equipment and terminated and restructured certain contractual relationships. Overall, the Company terminated 19 general and administrative, 19 sales and marketing, 25 professional services and 30 development employees. The restructuring and other special charges for the quarter ended July 31, 2002 totaled $5.9 million.

The significant components of the restructuring and other special charges were as follows (in thousands):

	Quarter Ended July 31, 2002
Employee severance costs	$1,931
Facilities and other related costs	2,886
Impairment of property and equipment	824
Excess contractual commitments and termination fees	188
Other	65
	$5,894

The facilities related cost component consisted of idle lease space and lease termination fees associated with closing the Company s Netherlands, United Kingdom and San Rafael, California facilities. The Company s assumptions considered current market value of similar properties and ability, if any, to sublease the idle space or any other future use.

The impairment of property and equipment charges consisted of excess computer equipment and furniture and fixtures as well as leasehold write-offs resulting from reductions-in-force and office closures.

(c) Lease Termination of Idle Space

In November 2002, the Company reached a lease buy-out settlement for its leased space in California for which a portion of the estimated lease liability had been accrued in fiscal 2002 and 2001 restructuring accruals, as well as part of merger related costs associated with the Brightware acquisition. The net settlement for this idle facility was $1.6 million. To reflect the resolution of the idle lease space liability, in its fourth quarter of fiscal 2002, the Company recorded a $2.5 million reversal to its previously recorded restructuring charges for the difference between the amounts paid in November 2002 and the amounts previously accrued for estimated future payments.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(d) Accrued Restructuring

A summary of the activity of short and long-term accrued restructuring is as follows (in thousands):

	Balance at October 31, 2002	Provision	Payments	Reversal of Prior Restructuring	Balance at July 31, 2003
Employee severance costs	$ 357	$ 832	$ (954)	$ (26)	$ 209
Facilities and other related costs	1,932	429	(1,665)	(176)	520
Excess contractual commitments and termination fees	137	101	(75)	(119)	44
	$ 2,426	$ 1,362	$ (2,694)	$ (321)	$ 773

The remainder of the payments for the restructuring and other special charges will be paid out as follows: severance through December 2003, facilities related payments through December 2004, and contract termination fees and other payments through April 2004.

The restructuring and other special charges included a component for idle lease space. The Company s assumptions considered current market value of similar properties and the ability, if any, to sublease the idle space or any other future use. If actual market conditions are less favorable than those projected by the Company, additional charges may be required related to this idle lease space.

10. Commitments and Contingencies

On October 19, 2001, General Motors Corporation filed a complaint against us in the Superior Court of Massachusetts, Middlesex County. The complaint alleges, among other things, a breach of contract under agreements entered into in 1994, as amended; anticipatory repudiation of agreements entered into in 1994, as amended; unjust enrichment; establishment of a constructive trust; rescission and restitution based upon failure of consideration as well as extortion and coercion relating to agreements entered into in 1994, as amended; breach of the covenant of good faith and fair dealing; fraud; as well as violation of Chapter 93A of the General Laws of the Commonwealth of Massachusetts relating to unfair and deceptive trade practices. General Motors claims further relate to license agreements, services agreements and a general release entered into with us in May 2000. The claims generally allege, among other things, that we coerced, extorted or otherwise caused General Motors to enter into the May 2000 agreements under duress. On the Civil Cover Sheet for the Superior Court of Massachusetts, Middlesex County, General Motors claims damages in the amount of $9,000,000, exclusive of fees, costs and multiple damages. The complaint does not demand damages in specific dollar amounts. A Motion for Summary Judgment was filed on our behalf in December 2002. An opposition to the motion was filed on behalf of General Motors and a reply brief was filed on our behalf. The Motion for Summary Judgment was heard before the court on April 29, 2003. On July 1, 2003 the court denied Firepond s Motion for Summary Judgment. While we believe the claims against us are without merit and intend to defend the action 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 plaintiff, which could harm our business. Should the parties reach a settlement in this litigation, we could be required to pay significant settlement amounts which could materially adversely affect our financial condition and operating results.

Beginning in August 2001, a number of securities class action complaints were filed in the Southern District of New York seeking an unspecified amount of damages on behalf of a class of persons who allegedly 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, FleetBoston Robertson

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FIREPOND, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stephens, and other parties as underwriters of our initial public offering (the Firepond Defendants). The 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 our initial public offering of securities 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. The action against us is being coordinated with over three hundred other nearly identical actions filed against other companies. In July 2003, we decided to join in a settlement negotiated by representatives of a coalition of issuers named as defendants in this action and their insurers. Although we believe that the plaintiffs claims have no merit, we have decided to accept the settlement proposal to avoid the cost and distraction of continued litigation. Because the settlement will be funded entirely by Firepond s insurers, we do not believe that the settlement will have a material effect on our financial condition, results of operation or cash flows. The proposed settlement agreement is subject to final approval by the court. Should the court fail to approve the settlement agreement, we believe we have meritorious defenses to these claims and would defend the action vigorously.

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. ***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 those 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.

Overview

We are a leading provider of sales configuration systems that help companies reduce the total cost of selling complex products, regardless of the sales channel. Sold as a complete system, or as incremental modules that address specific business needs, our SalesPerformer sales configuration system simplifies the sale of complex products, enabling companies to convert more leads into accurate orders. We also offer an online customer assistance solution, called Brightware eServicePerformer, that leverages advanced intelligence engines and natural language processing technology to manage a company s online customer interaction channels, with an emphasis on email response management.

During the quarter ended April 30, 2003, we undertook plans to restructure our operations as a result of lower than expected revenues due to a delayed recovery in global information technology spending. As such, we announced the consolidation of our corporate functions to our headquarters in Minneapolis, Minnesota and a reorganization of our European operations. These measures were taken to reduce global operating expenses to better position us to reach profitability in the future and to preserve cash. Overall, we terminated 7 general and administrative, 8 sales and marketing, 5 professional services and 1 development employees. The restructuring charge for the quarter ended April 30, 2003 was $650,000, which included approximately $241,000 reduction of prior restructuring costs primarily due to the settlement of a lease at more favorable terms than originally estimated. We completed the restructuring activity during the quarter ended July 31, 2003. The restructuring charge for the quarter ended July 31, 2003 was $391,000, principally for the closure of excess facilities. This restructuring charge included an $80,000 reduction of prior restructuring costs primarily due to lower than expected costs related to the closure of facilities. Subsequently, in September 2003, management approved and began to implement a restructuring plan aimed at further reducing operating expenses. This plan is intended to reduce the Company s headcount by approximately 25 employees by the first quarter of fiscal year 2004. As a result of this plan, the Company expects to incur approximately $400,000 to $600,000 of additional restructuring charges, principally for severance, in the fourth quarter of fiscal year 2003 and the first quarter of fiscal year 2004.

During the quarter ended July 31, 2002, we announced a strategic realignment to further enhance our focus on the markets for sales configuration and email response management, as well as measures to better align our costs with economic conditions. In addition, as a result of a prolonged slowdown of global information technology spending, specifically within the enterprise software marketplace, we undertook a plan to restructure our operations. These actions sought to better align our cost structure with projected revenue in the future and preserve cash. We reduced headcount and facilities as well as wrote off excess equipment and terminated and restructured certain contractual relationships. Overall, we terminated 19 general and administrative, 19 sales and marketing, 25 professional services and 30 development employees. The restructuring and other special charges for fiscal 2002 totaled $3.4 million. These actions further contributed to the significant decrease in our expenses in the three and nine months ended July 31, 2003 compared to the same periods of the prior year.

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,	
	2003	2002	2003	2002
Revenue:				
License	4.9%	14.8%	17.7%	28.2%
Services and maintenance	95.1	85.2	82.3	71.8
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
License	2.5	0.1	1.0	0.6
Services and maintenance	43.2	53.4	41.0	47.7
Total cost of revenue	45.7	53.5	42.0	48.3
Gross profit	54.3	46.5	58.0	51.7
Operating expenses:				
Sales and marketing	46.4	47.2	36.2	36.3
Research and development	47.5	53.0	34.6	45.3
General and administrative	49.0	46.1	36.4	32.8
Stock-based compensation	0.2	(16.2)	2.6	4.3
Amortization of goodwill and other intangible assets	1.1	0.6	0.8	2.7
Restructuring charge	17.2	136.5	11.1	34.2
Impairment of developed technology and know-how				18.1
Total operating expenses	161.4	267.2	121.7	173.7
Loss from operations	(107.1)	(220.7)	(63.7)	(122.0)
Interest income	3.1	3.4	2.8	2.8
Other income (expense), net	12.0	7.1	10.6	1.4
Loss before cumulative effect of a change in accounting principle	(92.0)	(210.2)	(50.3)	(117.8)
Cumulative effect of a change in accounting principle				(23.0)
Net loss	(92.0)%	(210.2)%	(50.3)%	(140.8)%

Comparison of Three Months Ended July 31, 2003 and 2002

Revenue. Total revenue decreased $2.1 million, or 47.5%, to $2.3 million in the three months ended July 31, 2003 from $4.3 million in the three months ended July 31, 2002. This decrease is attributable to a 82.6% decrease in license revenue and a 41.4% decrease in services and maintenance revenue.

License. License revenue decreased $527,000, or 82.6%, to $111,000 in the three months ended July 31, 2003 from $638,000 in the three months ended July 31, 2002. License revenue as a percentage of total revenue decreased to 4.9% in the three months ended July 31, 2003 from 14.8% in the three months ended July 31, 2002. The decrease is primarily attributable to a decline in our software license sales which we believe is due in part to a continued slowdown in information technology spending by companies in our target markets. The decline in revenue is also due to a fewer number of implementation engagements contributing to license revenue as compared to the prior year period.

Services and maintenance. Services and maintenance revenue decreased $1.5 million, or 41.4%, to $2.2 million in the three months ended July 31, 2003 from $3.7 million in the three months ended July 31, 2002. Services and maintenance revenue as a percentage of total revenue increased to 95.1% in

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the three months ended July 31, 2003 from 85.2% in the three months ended July 31, 2002. The decrease in absolute dollars is attributable to the decrease in consulting engagements related to the decreased license revenue and a decrease in maintenance agreements in this period as compared to the prior year period.

Cost of revenue. Total cost of revenue decreased $1.3 million, or 55.2%, to $1.0 million in the three months ended July 31, 2003 from $2.3 million in the three months ended July 31, 2002. Total cost of revenue as a percentage of total revenue decreased to 45.7% in the three months ended July 31, 2003 from 53.5% in the three months ended July 31, 2002.

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 was $57,000 in the three months ended July 31, 2003 and $4,000 in the three months ended July 31, 2002. Cost of license revenue as a percentage of license revenue increased to 51.4% in the three months ended July 31, 2003 from 0.6% in the three months ended July 31, 2002. The increase in the cost of license revenue as a percentage of license revenue is primarily due to a change in the mix of license revenue toward more royalty-related products.

Cost of services and maintenance revenue. Cost of 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 services and maintenance revenue decreased $1.3 million, or 57.5%, to $1.0 million in the three months ended July 31, 2003 from $2.3 million in the three months ended July 31, 2002. Cost of services and maintenance revenue as a percentage of services and maintenance revenue decreased to 45.4% in the three months ended July 31, 2003 from 62.7% in the three months ended July 31, 2002. The decrease in absolute dollars and as a percentage of services and maintenance revenue is primarily due to decreased staff and consulting resources, and our efforts to reduce our operating costs.

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 $984,000, or 48.3%, to $1.1 million in the three months ended July 31, 2003 from $2.0 million in the three months ended July 31, 2002. Sales and marketing expenses as a percentage of total revenue decreased to 46.4% in the three months ended July 31, 2003 from 47.2% in the three months ended July 31, 2002. Sales and marketing expenses decreased in absolute dollars and as a percentage of total revenue primarily due to the decrease in headcount in our sales and marketing operations as a result of the actions we took to restructure our operations.

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 decreased $1.2 million, or 53.0%, to $1.1 million in the three months ended July 31, 2003 from $2.3 million in the three months ended July 31, 2002. Research and development expenses as a percentage of total revenue decreased to 47.5% in the three months ended July 31, 2003 from 53.0% in the three months ended July 31, 2002. These expenses decreased in absolute dollars and as a percentage of total revenue due to a decrease in headcount and decreased utilization of product development contractors as well as lower operating costs due to a consolidation of our research and development operations to Minnesota.

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 decreased $882,000, or 44.3%, to $1.1 million in the three months ended July 31, 2003 from $2.0 million in the three months ended July 31, 2002. General and administrative expenses as a percentage of total revenue increased to 49.0% in the three months ended July 31, 2003 from 46.1% in the three months ended July 31, 2002. These expenses decreased in absolute dollars primarily as a result of decreased headcount, which resulted in reduced

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payroll and other related expenses, and lower overall operating costs resulting from the consolidation of the company.

Stock-based compensation expense. Stock-based compensation expense increased to $4,000 in the three months ended July 31, 2003 from a $701,000 credit in the three months ended July 31, 2002. Stock-based compensation expense as a percentage of total revenue increased to 0.2% in the three months ended July 31, 2003 from (16.2)% in the three months ended July 31, 2002. Stock-based compensation expense at July 31, 2003 includes charges related to non-employee stock option grants and warrants.

Amortization of other intangible assets. Amortization of other intangible assets was $26,000 in the three months ended July 31, 2003 and the three months ended July 31, 2002. Amortization of other intangible assets as a percentage of total revenue increased to 1.1% in the three months ended July 31, 2003 from 0.6% in the three months ended July 31, 2002.

Restructuring charge. During the quarter ended April 30, 2003, the Company announced a restructuring of its operations due to a delayed recovery in global technology spending. In connection with this plan, we terminated 21 employees and incurred an $891,000 restructuring charge in the three months ended April 30, 2003, which included $832,000 of employee severance costs, and $59,000 of other costs. This restructuring charge was offset by a reduction of approximately $241,000 of prior restructuring costs principally due to a lease settlement at more favorable terms than originally estimated. The restructuring activity was completed during the Company s quarter ended July 31, 2003. The Company incurred an additional restructuring charge of $391,000 in the quarter ended July 31, 2003, of which $416,000 was for excess facilities and $55,000 for contractual commitments. This restructuring charge included an $80,000 reduction of prior restructuring costs primarily due to lower than expected costs related to the closure of facilities.

Subsequently, in September 2003, management approved and began to implement a restructuring plan aimed at further reducing operating expenses. This plan is intended to reduce the Company s headcount by approximately 25 employees by the first quarter of fiscal year 2004. As a result of this plan, the Company expects to incur approximately $400,000 to $600,000 of additional restructuring charges, principally for severance, in the fourth quarter of fiscal year 2003 and the first quarter of fiscal year 2004.

During the quarter ended July 31, 2002, the Company announced a restructuring of its operations to further enhance our focus on the lead-to-order market and to better align costs with current economic conditions. In connection with this plan the Company incurred $5.9 million of restructuring and other special charges in the three months ended July 31, 2002, which included $1.9 million of employee severance costs, $2.9 million of facilities related costs, $824,000 of excess fixed asset costs, $188,000 of excess contractual commitments and termination fees and $65,000 of other costs.

Interest income. Interest income decreased $73,000, or 50.7%, to $71,000 in the three months ended July 31, 2003 from $144,000 in the three months ended July 31, 2002. The decrease is primarily due to our decreased cash and cash equivalents and short-term investments as well as a decline in interest rates.

Other income (expense), net. Other income (expense), net primarily consists of bank fees and foreign currency transaction gains and losses. Other income (expense), net decreased $35,000, or 11.4%, to $273,000 in income in the three months ended July 31, 2003 from $308,000 in income in the three months ended July 31, 2002.

Comparison of Nine Months Ended July 31, 2003 and 2002

Revenue. Total revenue decreased $7.8 million, or 45.4%, to $9.4 million in the nine months ended July 31, 2003 from $17.2 million in the nine months ended July 31, 2002. This decrease is attributable to a 65.7% decrease in license revenue and 37.5% decrease in service and maintenance revenue.

License. License revenue decreased $3.2 million, or 65.7%, to $1.7 million in the nine months ended July 31, 2003 from $4.9 million in the nine months ended July 30, 2002. License revenue as a percentage of total revenue decreased to 17.7% in the nine months ended July 31, 2003 from 28.2% in the nine months ended July 31, 2002. We believe the overall decline is attributable to a global slowdown in

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information technology spending experienced by software companies in our industry. The decline in revenue is also due to a fewer number of implementation engagements contributing to license revenue as compared to the prior year period. Also, the results for the first quarter of fiscal 2002 included the completion of a large customer implementation resulting in a modification of the estimate to complete and the acceleration of license revenue of $1.2 million as well as the resolution of certain contingencies from two other customers resulting in an additional $1.2 million of license revenue.

Services and maintenance. Services and maintenance revenue decreased $4.6 million, or 37.5%, to $7.7 million in the nine months ended July 31, 2003 from $12.4 million in the nine months ended July 31, 2002. Services and maintenance revenue as a percentage of total revenue increased to 82.3% in the nine months ended July 31, 2003 from 71.8% in the nine months ended July 31, 2002. The decrease in absolute dollars is attributable to the decrease in consulting engagements related to the decreased license revenue and a decrease in maintenance agreements in this period as compared to the prior year period. The increase as a percentage of total revenue is due to maintenance revenue declining at a substantially lower rate than license and services revenue.

Cost of revenue. Total cost of revenue decreased $4.4 million, or 52.6%, to $3.9 million in the nine months ended July 31, 2003 from $8.3 million in the nine months ended July 30, 2002. Total cost of revenue as a percentage of total revenue decreased to 42.0% in the nine months ended July 31, 2003 from 48.3% in the nine months ended July 31, 2002.

Cost of license revenue. Cost of license revenue decreased $4,000, or 4.0%, to $97,000 in the nine months ended July 31, 2003 from $101,000 in the nine months ended July 31, 2002. Cost of license revenue as a percentage of license revenue increased to 5.8% in the nine months ended July 31, 2003 from 2.1% in the nine months ended July 31, 2002.. The increase in the cost of license revenue as a percentage of license revenue is due primarily to a change in the mix of license revenue toward more royalty related products.

Cost of services and maintenance revenue. Cost of services and maintenance revenue decreased $4.4 million, or 53.2%, to $3.8 million in the nine months ended July 31, 2003 from $8.2 million in the nine months ended July 31, 2002. Cost of services and maintenance revenue as a percentage of services and maintenance revenue decreased to 49.8% in the nine months ended July 31, 2003 from 66.4% in the nine months ended July 31, 2002. The decrease in absolute dollars of total services and maintenance revenue was primarily due to decreased staff and consulting resources which resulted in reduced payroll and other expenses and our continued efforts to reduce our operating costs.

Sales and marketing expenses. Sales and marketing expenses decreased $2.9 million, or 45.6%, to $3.4 million in the nine months ended July 31, 2003 from $6.2 million in the nine months ended July 31, 2002. Sales and marketing expenses as a percentage of total revenue decreased to 36.2% in the nine months ended July 31, 2003 from 36.3% in the nine months ended July 31, 2002. Sales and marketing expenses decreased in absolute dollars primarily due to the decrease in headcount in our sales and marketing operations as a result of the actions we took to restructure our operations and lower commissions on fewer license transactions.

Research and development expenses. Research and development expenses decreased $4.5 million, or 58.3%, to $3.3 million in the nine months ended July 31, 2003 from $7.8 million in the nine months ended July 30, 2002. Research and development expenses as a percentage of total revenue decreased to 34.6% in the nine months ended July 31, 2003 from 45.3% in the nine months ended July 31, 2002. These expenses decreased in absolute dollars and as a percentage of revenue primarily due to a decrease in headcount and decreased utilization of product development contractors as well as lower operating costs due to a consolidation of our research and development operations to Minnesota.

General and administrative expenses. General and administrative expenses decreased $2.2 million, or 39.4%, to $3.4 million in the nine months ended July 31, 2003 from $5.6 million in the nine months ended July 31, 2002. General and administrative expenses as a percentage of total revenue increased to 36.4% in the nine months ended July 31, 2003 from 32.8% in the nine months ended July 31 30, 2002. These expenses decreased in absolute dollars primarily as a result of decreased headcount, which resulted in reduced payroll

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and other related expenses. These expenses as a percentage of total revenue increased primarily due to the lower revenue in the fiscal 2003 period.

Stock-based compensation expense. Stock-based compensation expense decreased $494,000, or 67.3%, to $240,000 in the nine months ended July 31, 2003 from $734,000 in the nine months ended July 31, 2002. Stock-based compensation expense as a percentage of total revenue decreased to 2.6% in the nine months ended July 31, 2003 from 4.3% in the nine months ended July 31, 2002. Stock-based compensation expense for the fiscal 2003 period includes $10,000 for charges related to non-employee stock option grants and warrants and $230,000 for charges related to shares we acquired in satisfaction of two loan agreements.

Amortization of goodwill and other intangible assets. Amortization of goodwill and other intangible assets decreased $382,000, or 83.0%, to $78,000 in the nine months ended July 31, 2003 from $460,000 in the nine months ended July 30, 2002. Amortization of goodwill and other intangible assets as a percentage of total revenue decreased to 0.8% in the nine months ended July 31, 2003 from 2.7% in the nine months ended July 31, 2002.

Restructuring charge. During the quarter ended April 30, 2003, the Company announced a restructuring of its operations due to a delayed recovery in global technology spending. In connection with this plan, we terminated 21 employees and incurred an $891,000 restructuring charge in the three months ended April 30, 2003, which included $832,000 of employee severance costs and $59,000 of other costs. This restructuring charge was offset by a reduction of approximately $241,000 of prior restructuring costs principally due to a lease settlement at more favorable terms than originally estimated. The restructuring activity was completed during the Company s quarter ended July 31, 2003. The Company incurred an additional restructuring charge of $391,000 in the quarter ended July 31, 2003, of which $416,000 was for excess facilities and $55,000 for contractual commitments. This restructuring charge included approximately $80,000 reduction of prior restructuring costs primarily due to lower than expected costs related to the closure of facilities.

Subsequently, in September 2003, management approved and began to implement a restructuring plan aimed at further reducing operating expenses. This plan is intended to reduce the Company s headcount by approximately 25 employees by the first quarter of fiscal year 2004. As a result of this plan, the Company expects to incur approximately $400,000 to 600,000 of additional restructuring charges, principally for severance, as a result of this plan in the fourth quarter of fiscal year 2003 and the first quarter of fiscal year 2004.

During the quarter ended July 31, 2002, the Company announced a restructuring of its operations to further enhance our focus on the lead-to-order market and to better align costs with current economic conditions. In connection with this plan the Company incurred $5.9 million of restructuring and other special charges in the three months ended July 31, 2002, which included $1.9 million of employee severance costs, $2.9 million of facilities related costs, $824,000 of excess fixed asset costs, $188,000 of excess contractual commitments and termination fees and $65,000 of other costs.

Impairment of developed technology and know-how. During the nine months ended July 31, 2002, we recorded a $3.1 million impairment charge related to the impairment of the developed technology and know-how intangible assets related to the Brightware products eCustomer assistance software.

Interest income. Interest income decreased $224,000, or 46.3%, to $260,000 in the nine months ended July 31, 2003 from $484,000 in the nine months ended July 31, 2002. The decrease is primarily due to our decreased cash and cash equivalents and short-term investments as well as a decline in interest rates.

Other income (expense), net. Other income (expense), net increased $753,000, to $993,000 in income in the nine months ended July 31, 2003 from $240,000 in income in the nine months ended July 31, 2002. The increase is primarily due to the increase in foreign currency transaction gains in the nine months ended July 31, 2003.

Cumulative effect of a change in accounting principle. With the acquisition of Brightware in 2001, we allocated approximately $4.0 million to goodwill and $2.2 million to assembled workforce. As of October 31, 2001, accumulated amortization of goodwill and assembled workforce was $1.8 million and $519,000,

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respectively. Effective November 1, 2001, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets* and reclassified the net book value of assembled workforce to goodwill. As a result of the valuation under the new FASB standard of the remaining goodwill, we determined that the goodwill was fully impaired and, accordingly, recorded a cumulative change in accounting principle charge of $4.0 million in the quarter ended January 31, 2002.

Liquidity and Capital Resources

As of July 31, 2003, cash and cash equivalents were $13.5 million and short-term investments were $6.1 million as compared with cash and cash equivalents of $13.5 million and short-term investments of $15.7 million as of October 31, 2002. Our working capital at July 31, 2003 was $14.5 million compared to working capital of $18.6 million at October 31, 2002.

Net cash used in operating activities was $9.7 million in the nine months ended July 31, 2003 compared with net cash used in operating activities of $13.7 million in the nine months ended July 31, 2002. Cash used in operating activities in the nine months ended July 31, 2003 was primarily attributable to our net loss, and our reduction in our accrued liabilities, accrued restructuring charges and deferred revenue.

Net cash provided by investing activities was $9.7 million in the nine months ended July 31, 2003 compared with net cash provided by investing activities of $654,000 in the nine months ended July 31, 2002. Net cash provided by investing activities in the nine months ended July 31, 2003 was primarily attributable to proceeds from the sale and maturities of short-term investments and a decrease in restricted cash.

We lease facilities under non-cancelable operating leases which have various expiration dates ranging from 2003 through 2005. At July 31, 2003, future minimum annual lease payments amounted to $583,000 under these leases.

We anticipate continued spending on capital expenditures consistent with anticipated requirements for operations, infrastructure and personnel. We believe that our existing cash balances and short-term investments will be sufficient to meet our anticipated cash needs 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, pay damages under current or future litigation, 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

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, *Consolidation of Variable Interest Entities*. This interpretation addresses the consolidation of certain variable interest entities for which a controlling financial interest exists. The interpretation applies immediately to variable interest entities created after January 31, 2003. It applies in the first interim period beginning after June 15, 2003 to pre-existing entities. The adoption of this interpretation did not affect the Company s financial statements.

In December 2002, the Financial Accounting Standards Board issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation expands the disclosures to be made by a guarantor in its annual and interim financial statements about its obligations under certain guarantees. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. As required by the interpretation, we have adopted the disclosure and recognition requirements for the quarter ended January 31, 2003.

In December 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123* (SFAS No. 148) which provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about our method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition and annual disclosure requirements of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure requirements are effective for interim periods beginning after December 15, 2002. We adopted the disclosure requirements effective in the quarter ended April 30, 2003.

In June 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities (SFAS No. 146)* which nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. This accounting standard requires that liabilities associated with exit or disposal activities be recognized and measured at fair value when incurred, as opposed to at the date an entity commits to the exit or disposal plans. The Company has adopted this standard for its fiscal 2003 restructuring activities.

Risk Factors

As defined under the 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.

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

Average license fees for our SalesPerformer product typically range from approximately a few hundred thousand dollars to several million dollars. Often this represents a significant information technology capital expenditure for the companies to which we target our sales efforts. In addition, regardless of the cost of our products, many companies may elect not to pursue information technology projects which may incorporate either of our product suites, or our individual components, as a result of the continued slowdown in information technology spending. Consequently, if the continued slowdown in information technology spending should persist, due to a weakened economy or other factors, we may be unable to maintain or increase our sales volumes and achieve our targeted revenue growth. In addition, we depend on our customers to pay recurring maintenance fees to us for technical support and product upgrades. Often, this represents a significant and recurring information technology capital expenditure for our customers. As a result, if the continued slowdown in information technology spending should persist, due to a weakened economy or other factors, we may be unable to maintain our maintenance revenues at their current levels and achieve our targeted revenues.

If the markets for sales configuration and customer service solutions do not expand, we may not be successful

Our products address a new and emerging market for solutions that optimize the lead-to-order process and solutions which address guided customer service. The failure of these markets to expand, or a delay in the expansion of these markets, would seriously harm our business. Our business depends on the successful customer acceptance of our products and we expect that we will continue to depend on revenue from new and enhanced versions of our products. Our business would be harmed if our target customers do not adopt and expand their use of our products.

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

Our success depends upon the continued contributions of our senior management, sales, engineers, and professional services personnel, who perform important functions and would be difficult to replace. Also, we believe that our future success is highly dependent on Klaus P. Besier, our Chairman, Chief Executive Officer

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and President. The loss of the services of any key personnel, particularly senior management, sales, engineers, or professional services personnel could seriously harm our business.

We depend on our direct sales force for a significant portion of our current sales and our growth depends on the ability of our direct sales force to increase sales to a level that will allow us to reach and maintain profitability. Our ability to increase our sales will depend on our ability to train and retain top quality sales people who are able to target prospective customers senior management, and who can productively and efficiently generate and service large accounts. Competition for these individuals is intense, and we may not be able to attract, assimilate or retain highly qualified personnel in the future. Turnover among our sales staff has been significant and a number of our employees have left or been terminated. If we are unable to retain qualified sales personnel, or if newly hired personnel fail to develop the necessary skills or to reach productivity when anticipated, we may not be able to increase sales of our products and services.

In addition, in connection with our effort to streamline operations, reduce costs and bring our staffing and infrastructure in line with industry standards, we restructured our organization and reduced our workforce. In fiscal year 2002, we terminated 93 employees and incurred aggregate costs of $1.9 million associated with this workforce reduction related to severance and other employee-related costs. In the first two quarters of fiscal year 2003, we terminated 21 employees and incurred aggregate costs of $832,000 associated with this workforce reduction. We completed this restructuring activity during the quarter ended July 31, 2003 and recognized an additional net restructuring charge of $391,000, principally for the closure of excess facilities. Subsequently, in September 2003, management approved and began to implement a restructuring plan aimed at further reducing operating expenses. This plan is intended to reduce the Company s headcount by approximately 25 employees by the first quarter of fiscal year 2004. As a result of this plan, the company expects to incur approximately $400,000 to $600,000 of additional restructuring charges, principally for severance, in the fourth quarter of fiscal year 2003 and the first quarter of fiscal year 2004. Our restructuring may also yield unanticipated consequences, such as attrition beyond our planned reduction in workforce and loss of employee morale and decreased performance. Continuity of personnel is an important factor in the successful completion of our business plan and ongoing turnover in our personnel could materially and adversely impact our sales and marketing efforts, current customer implementations, and our development projects. 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.

Material litigation has caused, and may continue to cause, us to incur substantial costs as well as to divert management s attention and resources

On October 19, 2001, General Motors Corporation filed a complaint against us alleging certain statutory and common law claims including breach of contract, coercion, fraud, and unfair and deceptive trade practices. General Motors claims relate to our original 1994 agreement with General Motors, as amended, and license agreements, services agreements and a general release entered into with us in May 2000. 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, has been and may continue to 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. Should the parties reach a settlement in this litigation, we could be required to pay significant settlement amounts which could materially adversely affect our financial condition and operating results.

In addition, 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 Securities and Exchange Commission in November 1999. The complaints allege, among other things, that FleetBoston Robertson Stephens and the other underwriters solicited and received excessive and undisclosed commissions from several investors in exchange for which FleetBoston Robertson Stephens and the other underwriters allocated to these investors material portions of the restricted number of shares of common stock

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issued in connection with our initial public offering. The complaints further allege that FleetBoston Robertson Stephens and the other underwriters entered into agreements with their customers in which FleetBoston Robertson Stephens and the other underwriters 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. In July 2003, we decided to join in a settlement negotiated by representatives of a coalition of issuers named as defendants in this action and their insurers. Although we believe that the plaintiffs claims have no merit, we have decided to accept the settlement proposal to avoid the cost and distraction of continued litigation. Because the settlement will be funded entirely by Firepond s insurers, we do not believe that the settlement will have a material effect on our financial condition, results of operation or cash flow. The proposed settlement agreement is subject to final approval by the court. Should the court fail to approve the settlement agreement, we believe we have meritorious defenses to these claims and would defend the action vigorously. Securities class action litigation can result in substantial costs and divert our management s attention and resources, which could seriously harm our business.

Negative results from the discovery of fraudulent acts by our former acting vice president of sales could adversely affect our company

In fiscal 2002, as a result of senior management s discovery of three fraudulent transactions involving license amounts totaling approximately $5 million by our former acting vice president of sales, we lowered our previously reported results and reduced our forecasted revenues. The Securities and Exchange Commission s investigation into this matter as well as any further action brought by government agencies or any shareholder litigation has and may continue to result in substantial legal fees and expenses and divert management s attention and resources.

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

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 $4.7 million for the nine months ended July 31, 2003, $23.7 million in fiscal 2002, $70.3 million for fiscal 2001, and $16.3 million for fiscal 2000. We may continue to incur losses on a quarterly and annual basis and not become profitable. Additionally, we may not grow or generate sufficient revenue to attain profitability.

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We could 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

In the recent past, we have traded at levels that would have resulted in our failure to maintain the Nasdaq National Market minimum $5 million market value of publicly held share requirement. If the market value of our publicly held shares falls below $5 million for a period of thirty consecutive business days, Nasdaq has the right to delist the stock if within ninety days thereafter the market value of our publicly held shares is not $5 million for a minimum of ten consecutive business days. In the event the market value of our publicly held shares does not rise above $5 million for the required ten consecutive business days, we would have the right to request a hearing to appeal a Nasdaq determination that our stock should be delisted.

We cannot assure you that we 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. However, if our common stock loses its Nasdaq National Market status, we may apply for inclusion in the Nasdaq SmallCap Market. If our common stock loses its Nasdaq National Market status and we are unable to trade on the Nasdaq SmallCap Market, 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 securities 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 our 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. 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 may not achieve anticipated maintenance revenue if we do not successfully migrate our SalesPerformer customers to the latest version of our products and customers cancel their maintenance agreements

Our business depends on the success and customer acceptance of our products and the adoption of future enhancements to those products. Customers enter into maintenance agreements for the purpose of receiving both customer support and the right to future enhancements of the product. When implementing our SalesPerformer products customers may have requirements to create customized features or functionality outside of our base product offering. Customization of our products is usually performed by writing additional software code which will make it difficult for the customer to migrate to the next version of the product. Customers who extensively customized our products may be unwilling to or unable to commit additional resources to upgrade to the latest or next version of our product. If our customers do not adopt the latest version of our products, those customers may cancel their maintenance agreements and we may not achieve our anticipated maintenance revenue.

Failure to expand our relationships with third party channels may adversely impact our support and maintenance of existing customers, delay the implementation of our products and delay the growth of our revenue

Our strategy includes expanding and increasing third party channels which license and support our products, such as resellers, distributors, OEMs, system integrators and consulting firms. This often requires that these third parties recommend our products to their customers and install and support our products for their customers. To increase our revenue and implementation capabilities, we must develop and expand our relationships with these third parties. In addition, 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.

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Difficulties associated with the protection of our intellectual property and potential claims alleging infringement of third parties intellectual property could harm our ability to compete and result in significant expense to us and loss of significant rights

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.

Further, the software 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 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.

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

The market for sales configuration 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.

Our failure to successfully implement our products in a timely manner could result in negative publicity and reduced sales, both of which could significantly harm our business and operating results

In the future, our customers may experience difficulties or delays in completing the implementation of our products. We have found that implementing our SalesPerformer products may be more time consuming than we, or our customers, anticipate. The unique configuration or integration with our customers legacy systems, such as existing databases and enterprise resource planning software, may be underestimated and the deployment of our products can be delayed. Failing to meet customer expectations on deployment of our products could result in a loss of customers and negative publicity regarding us and our products, which could adversely affect our ability to attract new customers. In addition, time-consuming deployments may also increase the amount of professional services we allocate to each customer, thereby increasing our costs and adversely affecting our business and operating results.

We depend upon 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 and implementation services. 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.

Our results of operations may be harmed by charges associated with stock-based compensation

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 approximately 717,900 options for exchange and, on July 31, 2001 issued approximately 538,400 new stock options with an exercise price equal to $6.60 per share. For financial reporting purposes all option grants subject to the tender offer are treated as variable awards. Accordingly, we are required to record as compensation expense, chargeable against our reported earnings, all increases in the 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 or otherwise terminated 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 will be.

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 realize planned 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. However, foreign markets for our products may develop more slowly than currently anticipated. International revenue as a percentage of total revenue was 30% in the nine months ended July 31, 2003, 51% in fiscal 2002, 36% in fiscal 2001, and 28% in fiscal 2000. Our failure to realize our planned international sales levels 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 the United States, 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.

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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, Euro and Japanese Yen.

Fluctuations against the U.S. dollar can produce significant differences in the reported value of sales and expenses. For sales in the United States which are produced outside of the United States, any weakening of the U.S. dollar against a particular country s currency reduces the amount of net income reported in U.S. dollars. Conversely, the same weakening of the U.S. dollar generates an offsetting increase in the dollar value of profits arising from sales within that country. Any weakening of the U.S. dollar that negatively impacts a foreign operation s operating income 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 and adversely effect our reported financial position.

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.

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

Software products as sophisticated 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.

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

As of July 31, 2003, our executive officers, directors and entities associated with them own approximately 46.9% 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.

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.

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.

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

In the future, we may acquire additional businesses or product lines or be the target of a potential merger or acquisition. Any future merger or acquisition of or by us may not produce the revenue, earnings or business synergies anticipated, and an acquired product, service or technology might not perform as expected. Prior to completing a merger or acquisition, however, it is difficult to determine if such benefits can actually be realized. The process of integrating companies into our business or integrating our company into another 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 merger or acquisition, our management could spend a significant amount of time and effort identifying and completing the merger or 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 or incur a one-time charge.

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

We develop products in the United States 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.

Item 4. ***Controls and Procedures***

Our chief executive officer and our chief financial officer have concluded, based on their evaluation as of July 31, 2003, that the Company s disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

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PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

On October 19, 2001, General Motors Corporation filed a complaint against us in the Superior Court of Massachusetts, Middlesex County. The complaint alleges, among other things, a breach of contract under agreements entered into in 1994, as amended; anticipatory repudiation of agreements entered into in 1994, as amended; unjust enrichment; establishment of a constructive trust; rescission and restitution based upon failure of consideration as well as extortion and coercion relating to agreements entered into in 1994, as amended; breach of the covenant of good faith and fair dealing; fraud; as well as violation of Chapter 93A of the General Laws of the Commonwealth of Massachusetts relating to unfair and deceptive trade practices. General Motors claims further relate to license agreements, services agreements and a general release entered into with us in May 2000. The claims generally allege, among other things, that we coerced, extorted or otherwise caused General Motors to enter into the May 2000 agreements under duress. On the Civil Cover Sheet for the Superior Court of Massachusetts, Middlesex County, General Motors claims damages in the amount of $9,000,000, exclusive of fees, costs and multiple damages. The complaint does not demand damages in specific dollar amounts. A Motion for Summary Judgment was filed on our behalf in December 2002. An opposition to the motion was filed on behalf of General Motors and a reply brief was filed on our behalf. The Motion for Summary Judgment was heard before the court on April 29, 2003. On July 1, 2003 the court denied Firepond s Motion for Summary Judgment. While we believe the claims against us are without merit and intend to defend the action 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 plaintiff, which could harm our business. Should the parties reach a settlement in this litigation, we could be required to pay significant settlement amounts which could materially adversely affect our financial condition and operating results.

Beginning in August 2001, a number of securities class action complaints were filed in the Southern District of New York seeking an unspecified amount of damages on behalf of a class of persons who allegedly 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, FleetBoston Robertson Stephens, and other parties as underwriters of our initial public offering (the Firepond Defendants). The 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 our initial public offering of securities 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. The action against us is being coordinated with over three hundred other nearly identical actions filed against other companies. In July 2003, we decided to join in a settlement negotiated by representatives of a coalition of issuers named as defendants in this action and their insurers. Although we believe that the plaintiffs claims have no merit, we have decided to accept the settlement proposal to avoid the cost and distraction of continued litigation. Because the settlement will be funded entirely by Firepond s insurers, we do not believe that the settlement will have a material effect on our financial condition, results of operation or cash flows. The proposed settlement agreement is subject to final approval by the court. Should the court fail to approve the settlement agreement, we believe we have meritorious defenses to these claims and would defend the action vigorously.

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

(a) Exhibits

31.1	Principal Executive Officer	Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002
31.2	Principal Financial Officer	Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002
32.1	Principal Executive Officer	Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002
32.2	Principal Financial Officer	Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

None

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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.

By: /s/ KLAUS P. BESIER

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

By: /s/ KRISTI L. SMITH

Kristi L. Smith
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)

Dated: September 12, 2003