FIREPOND INC
Form 10-Q/A
June 19, 2002

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

FORM 10-Q/A

Amendment No. 1

(Mark One)

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

For the Quarter Ended January 31, 2002

OR

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

Commission File Number 0-29251

FIREPOND, INC.

(Exact Name of Registrant as Specified in its Charter)

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

(781) 487-8400

(Registrant s telephone number, including area code)

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

Yes þ No o

As of January 31, 2002 there were 36,841,192 shares of the Registrant s Common Stock outstanding.

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FIREPOND, INC. AND SUBSIDIARIES
FORM 10-Q
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EXPLANATORY NOTE

This Form 10-Q/A amends the Registrant s quarterly report on Form 10-Q for the quarter ended January 31, 2002 as filed on March 18, 2002 and is being filed to reflect the restatement of the Registrant s consolidated financial statements for that period. The reasons for and effects of this restatement are presented in Note 1 to the consolidated financial statements. Except for Items 1 and 2 of Part I, no other information included in the original report on Form 10-Q is amended by this Form 10-Q/A. This report speaks as of the original filing date and, except as indicated, has not been updated to reflect events occurring subsequent to the original filing date. For the most recent information concerning the Registrant and updated Risk Factors, please see the Registrant s Quarterly Report on Form 10-Q for the quarter ended April 30, 2002.

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FIREPOND, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(unaudited)

	October 31, 2001	January 31, 2002
		Restated
ASSETS		
Current assets:		
Cash and cash equivalents	$ 34,660	$ 34,496
Short-term investments	9,593	7,274
Accounts receivable, net	10,310	4,606
Unbilled revenue	594	361
Prepaid expenses and other current assets	2,118	1,702
Total current assets	57,275	48,439
Property and equipment, net	5,356	4,702
Goodwill and other intangible assets, net	11,114	215
Restricted cash	550	400
Other assets	843	1,256
	$ 75,138	$ 55,012
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,790	$ 1,228
Accrued liabilities	8,874	8,349
Restructuring accrual	5,057	2,344
Deferred revenue	10,802	6,454
Total current liabilities	26,523	18,375
Restructuring accrual, less current portion	1,102	1,049
Stockholders equity:		
Common stock, $0.01 par value Authorized 100,000,000 shares at October 31, 2001 and January 31, 2002; Issued and outstanding 37,316,911 shares at October 31, 2001 and 36,841,192 shares at January 31, 2002	373	368
Additional paid-in capital	202,231	202,428
Accumulated deficit	(148,416)	(159,445)
Loans receivable	(4,407)	(4,294)
Deferred compensation	(1,285)	(2,514)
Other comprehensive loss	(983)	(955)
Total stockholders equity	47,513	35,588
	$ 75,138	$ 55,012

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

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FIREPOND, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(unaudited)

	Three Months Ended January 31,	
	2001	2002
		Restated
Revenue:		
Product-related revenue:		
License	$ 4,034	$ 3,236
Services and maintenance	8,273	3,840
Total product-related revenue	12,307	7,076
Custom development services	2,240	421
Total revenue	14,547	7,497
Cost of revenue:		
License	69	56
Product-related services and maintenance (1)	8,533	2,934
Custom development services	677	113
Total cost of revenue	9,279	3,103
Gross profit	5,268	4,394
Operating expenses:		
Sales and marketing (1)	6,852	2,066
Research and development (1)	4,678	2,863
General and administrative (1)	2,891	1,492
Stock-based compensation (1)	696	1,485
Amortization of other intangible assets		408
Impairment of developed technology and know-how (Note 7)		3,120
Total operating expenses	15,117	11,434
Loss from operations	(9,849)	(7,040)
Interest income	1,740	181
Other expense	(499)	(196)
Loss before cumulative effect of a change in accounting accounting principle	$ (8,608)	$ (7,055)
Cumulative effect of a change in accounting principle (Note 8)		(3,973)
Net loss	$ (8,608)	$ (11,028)
Net loss per share (Note 4):		
Basic and diluted loss per share before cumulative effect of a change in accounting principle	$ (0.24)	$ (0.19)
Cumulative effect of a change in accounting principle		(0.11)

Basic and diluted net loss per share	$ (0.24)	$ (0.30)
Basic and diluted weighted average common shares outstanding	35,548	36,393

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

	Three Months Ended January 31,	
	2001	**2002**
Cost of revenue	$ 10	$ 92
Operating expenses:		
Sales and marketing	72	35
Research and development	61	205
General and administrative	553	1,153
Total stock-based compensation	$696	$1,485

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

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FIREPOND, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Three Months Ended January 31,	
	2001	**2002**
		Restated
Cash flows from operating activities:		
Net loss	$ (8,608)	$ (11,028)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	696	1,485
Depreciation and amortization	949	1,085
Impairment of developed technology and know-how (Note 7)		3,120
Cumulative effect of a change in accounting principle (Note 8)		3,973
Changes in assets and liabilities:		
Accounts receivable	670	5,787
Unbilled services	(1,293)	233
Prepaid expenses and other current assets	(4,007)	379
Accounts payable	(1,330)	(556)
Accrued liabilities	(2,161)	(509)
Restructuring accrual		(2,766)
Deferred revenue	(40)	(4,348)
Net cash used in operating activities	(15,124)	(3,145)
Cash flows from investing activities:		
Purchases of short-term investments	(6,754)	(7,291)
Proceeds from the sale and maturities of short-term investments	17,490	9,600
Purchases of property and equipment	(1,875)	(72)
Return of cash from the Brightware acquisition escrow		520
Decrease in restricted cash		188
Increase (decrease) in other assets	(76)	10
Net cash provided by investing activities	8,785	2,955
Cash flows from financing activities:		
Payments on long-term debt	(118)	(4)
Proceeds from stock options and warrants exercised	1,544	39
Net cash provided by financing activities	1,426	35
Effect of exchange rate changes on cash and cash Equivalents	9	(9)
Net decrease in cash and cash equivalents	(4,904)	(164)
Cash and cash equivalents, beginning of period	79,500	34,660
Cash and cash equivalents, end of period	$ 74,596	$ 34,496
Supplemental cash flow information:		
Interest paid	$ 8	$ 37

Non-cash investing and financing activities:		
Return of shares issued to Brightware	$	$ 2,448
Increase in other assets for value of shares returned from Brightware	$	$ 430

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

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FIREPOND, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Nature of Business and Basis of Presentation

Firepond, Inc., together with its wholly owned subsidiaries (the Company) is a leading provider of solutions that optimize the lead-to-order process, helping companies more profitably acquire and retain customers. The Company s product lines leverage advanced intelligence engines and patented automation technology to drive new revenue streams, increase profitability, and manage customer interactions across all channels and throughout the lead-to-order process.

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

The 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 months ended January 31, 2002 and 2001 are unaudited and have been prepared on a basis consistent with the October 31, 2001 audited financial statements and include normal recurring adjustments which are, in the opinion of management, necessary for the fair presentation of the results of these periods. These condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto for the fiscal year ended October 31, 2001 included in the Company s Form 10-K. The results of operations for the three months ended January 31, 2002 are not necessarily indicative of results to be expected for the entire year or any other period.

Restatement

On May 31, 2002, the Company announced that its senior management had discovered that its acting vice president of sales was engaged in fraudulent behavior, including misrepresenting three customer transactions. The fraudulent transactions involved three contracts with license amounts totaling approximately $5 million, including a contract announced in the quarter ended January 31, 2002. The other two fraudulent transactions were announced in the Company s May 22, 2002 earnings release as new license contracts for the second quarter ended April 30, 2002.

FIREPOND, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Therefore, the accompanying January 31, 2002 condensed consolidated financial statements have been restated from the amounts previously reported to reflect the reversal of the first fraudulent transaction. The effects of this restatement on previously reported financial statements as of and for the three months ended January 31, 2002 include the following changes (in thousands, except per share amounts):

	As Previously Reported	As Restated
As of January 31, 2002:		
Accounts receivable, net	$ 5,930	$ 4,606
Unbilled revenue	418	361
Total current assets	49,820	48,439
Accrued liabilities	8,628	8,349
Deferred revenue	7,730	6,454
Total current liabilities	19,930	18,375
Other comprehensive loss	(978)	(955)
Total stockholders equity	35,414	35,588
For the three months ended January 31, 2002:		
Product services and maintenance revenue	3,897	3,840
Sales and marketing expense	2,275	2,066
Loss from operations	(7,192)	(7,040)
Net loss	(11,180)	(11,028)
Basic and diluted loss per share before cumulative effect of a change in accounting principle	(0.20)	(0.19)
Basic and diluted net loss per share	(0.31)	(0.30)

2. Significant Accounting Policies

(a) Use of Estimates

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

(b) Revenue Recognition

The Company recognizes revenue based on the provisions of the American Institute of Certified Public Accountants (AICPA) Statement of Position, No. 97-2*, Software Revenue Recognition (SOP 97-2)*, as amended, and Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts (SOP 81-1).*

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

Product-Related Revenue

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

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The Company has concluded that generally, for the SalesPerformer product suite and its components, the implementation services are essential to the customer s use of the packaged software products in arrangements where the Company is responsible for implementation services. As such, the Company recognizes revenue for these arrangements following the percentage-of-completion method over the implementation period. Percentage of completion is measured by the percentage of implementation hours incurred to date compared to estimated total implementation hours. This method is used because management has determined that past experience has shown expended hours to be the best measure of progress on these engagements. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is recorded. During the quarter ended January 31, 2002, the Company successfully completed a large customer implementation resulting in a modification of the estimate to complete and the recognition of license revenue of $1,172,000. Additional license revenue of $1,253,000 was recognized in the quarter ended January 31, 2002 resulting from the resolution of certain contingencies for two other customers.

In situations where the Company is not responsible for implementation services for the SalesPerformer Suite of products, the Company recognizes revenue on delivery of the packaged software if there is persuasive evidence of an arrangement, collection is probable and the fee is fixed or determinable.

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

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

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

For product sales that are recognized on delivery, the Company executes contracts that govern the terms and conditions of each software license, as well as maintenance arrangements and other services arrangements. These contracts may be elements in a multiple element arrangement. Revenue under multiple element arrangements, which may include several different software products and services sold together, is allocated to each element based on the residual method in accordance with the SOP 98-9, *Software Revenue Recognition with Respect to Certain Arrangements*.

The Company uses the residual method when vendor-specific objective evidence of fair value does not exist for one of the delivered elements in the arrangement. Under the residual method, the fair value of the undelivered elements is deferred and subsequently recognized. The Company has established sufficient vendor specific objective evidence for professional services, training and maintenance and support services based on the price charged when these elements are sold separately. Accordingly, software license revenue is recognized under the residual method in arrangements in which software is licensed with professional services, training, and maintenance and support services.

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

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(unaudited)

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

	October 31, 2001	January 31, 2002
		Restated
	(in thousands)	
Product license	$ 5,073	$ 1,595
Product-related services	1,957	1,486
Product-related maintenance	3,379	3,083
Custom development services	393	290
	$ 10,802	$ 6,454

Unbilled revenue of $594,000 at October 31, 2001 and $361,000 at January 31, 2002 represents amounts due to the Company under license, service and maintenance agreements for work performed that had not been billed but for which revenue was recognized as of the period end. Product license fees for which the Company has not billed based on contract terms nor has the Company recognized or deferred revenue totaled $343,000 at October 31, 2001 and $300,000 at January 31, 2002.

During the quarter ended January 31, 2002, the Company reversed $500,000 out of bad debt reserve due to the resolution of past-due receivables. This reversal was recorded as a reduction in operating expenses for the quarter ended January 31, 2002.

Custom Development Services Revenue

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

(c) Cash and Cash Equivalents

The Company accounts for cash equivalents based on the guidance in Statement of Financial Accounting Standards, or SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Cash equivalents are short-term, highly liquid investments with original maturity dates of three months or less. Cash equivalents are carried at cost, which approximates fair market value and consisted of the following:

	October 31, 2001	January 31, 2002
	(In thousands)	
Cash and cash equivalents:		
Interest bearing bank deposits	$ 2,776	$ 3,216
Money market accounts	10,765	14,882
Commercial paper	19,748	14,900
Discount notes	1,371	1,498
Total cash and cash equivalents	$ 34,660	$ 34,496

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FIREPOND, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

(d) Short-term Investments

In accordance with SFAS No. 115 and based on the Company s intentions regarding these instruments, the Company has classified all short-term investments as available-for-sale. These investments consist primarily of commercial paper, corporate notes and bonds and discount notes with an original maturity of less than a year. Other comprehensive loss in stockholders equity included an unrealized holding gain of $9,000 for October 31, 2001 and an unrealized holding loss of $1,000 for January 31, 2002.

	October 31, 2001	January 31, 2002
	(In thousands)	
Short-term investments:		
Commercial paper (average 57 and 76 days to maturity for October 31, 2001 and January 31, 2002, respectively)	$3,089	$ 5,678
Corporate notes and bonds (average 21 days to maturity for October 31, 2001)	4,512	
Discount notes (average 71 and 65 days to maturity for October 31, 2001 and January 31, 2002, respectively)	1,992	1,596
Total short-term investments	$9,593	$ 7,274

(e) Comprehensive Income (Loss)

The components of comprehensive loss for the three months ended January 31, 2001 and 2002 are as follows:

	Three Months Ended January 31,	
	2001	2002
		Restated
	(In thousands)	
Comprehensive loss:		
Netloss	$(8,608)	$(11,028)
Other comprehensive loss Unrealized gain (loss) on short-term investments	62	(10)
Foreign currency translation	263	38
Comprehensive loss	$(8,283)	$(11,000)

(f) Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No, 141, *Business Combinations*. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. This statement is effective for all business combinations initiated after June 30, 2001.

Effective November 1, 2001, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which establishes financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets*. SFAS No. 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but, instead, tested at least annually for impairment. See Note 8 of the Notes to Consolidated Financial Statements of this quarterly report for a further discussion of the impact of this statement on the Company s consolidated financial statements.

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(unaudited)

Effective November 1, 2001, the Company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement supercedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and the accounting and reporting provisions of Accounting Principles Board (APB) Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. Under this statement it is required that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and it broadens the presentation of discontinued operations to include more disposal transactions. See Note 7 of the Notes to Consolidated Financial Statements of this quarterly report for a further discussion of the impact of this statement on the Company s consolidated financial statements.

3. Accrued Liabilities

Accrued liabilities consists of:

	October 31, 2001	January 31, 2002
		Restated
	(In thousands)	
Accrued merger costs	1,122	1,039
Other	7,752	7,310
Total accrued liabilities	$8,874	$8,349

During the quarter ended January 31, 2002, the Company reversed $300,000 of loss contracts accrual due to the completion of certain implementations. This reversal was recorded as a reduction in cost of revenue during the quarter ended January 31, 2002.

4. 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 months ended January 31, 2001 and 2002, all potential common shares were antidilutive and were excluded from the diluted net loss per share calculations. The calculation of weighted average shares outstanding for the three months ended January 31, 2002 excludes contingently issuable shares of 397,079 representing shares issued but held in escrow in connection with the acquisition of Signature Software and Brightware (see Note 5(b)).

As of January 31, 2001 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 11,041,000 and 8,529,000, respectively.

5. Stockholders Equity

(a) Stock Options and Warrants

The Company granted stock options to employees that require the recognition of stock-based compensation expense. Until July 2001, stock-based compensation relating to employee grants represented the amortization, over the vesting period of the option, of the difference between the exercise price of options granted to employees and the fair market value on the date of grant of the Company s common stock for financial reporting purposes. In July 2001, the Company completed a stock option

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FIREPOND, INC. AND SUBSIDIARIES
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(unaudited)

exchange program in which its directors and eligible employees were offered the opportunity to exchange existing stock options for new stock options with an exercise price equal to the current market value of the Company s common stock. Participants in the exchange program received new options to purchase seventy-five percent (75%) of the number of shares of our common stock subject to the options that were exchanged and canceled. The new options were granted on July 31, 2001, with an exercise price of $.66 per share. We accepted 7,179,285 stock options for exchange and issued 5,384,384 stock options in exchange for such tendered options. All option grants issued in conjunction with the stock option exchange program are subject to variable plan accounting in accordance with APB No. 25, whereby the Company is required to record, as compensation expense, increases and decreases in the value of these options between the grant date of the option and the date the option is exercised. The greater the increase in the market value of the Company s common stock following the date of grant, the greater the compensation expense the Company will be required to record.

In the future, the Company may incur compensation expense as a result of the issuance of the new options. The new options may be subject to variable plan accounting in accordance with APB No. 25, as describe above. As of January 31, 2002, a total of 5,026,253 shares of common stock are subject to variable plan accounting as a result of the stock option exchange program. As of January 31, 2002, the Company has recorded $1,990,000 of deferred compensation associated with these options which reflects an increase during the quarter due to a rise in the fair market value of the Company s common stock.

The Company granted options to employees to purchase 1,250,588 shares of common stock at a weighted-average exercise price of $0.88 per share during the three months ended January 31, 2002. At January 31, 2002, 7,634,216 options were outstanding.

The Company also granted stock options to non-employees and issued warrants to certain customers and to strategic business partners that require the recognition of stock-based compensation expense. Stock-based compensation related to these grants represents the fair market value as computed using an established option valuation formula. As of January 31, 2002, the deferred compensation balance associated with these grants was $173,000 and will be recognized as an expense as earned in accordance with EITF 96-18.

(b) Common Stock Outstanding

Common stock outstanding at January 31, 2002 includes 49,728 shares issued but held in escrow in connection with the Company s acquisition of Signature Software, Inc. in September 2000. These shares will be released from escrow based on the retention of Signature Software employees over a two-year period. It also includes 347,351 shares issued but held in escrow in connection with the Company s acquisition of Brightware, Inc. in February 2001. The shares held in escrow related to Brightware are subject to release pending the settlement of the general indemnification and warranty period.

(c) Loans Receivable

On November 28, 2000, the Company s Board of Directors approved a loan facility to Klaus Besier, the Company s Chairman and Chief Executive Officer, allowing borrowings up to $3,000,000 bearing interest at the applicable federal rate in effect during the term of the note. On January 9, 2001, the Company s Board of Director s approved an increase in the loan facility to $4,000,000. Originally the outstanding principal together with unpaid interest was due and payable on the earlier of October 31, 2001, an event of default, or an event of maturity, as defined. On December 11, 2001, the 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 500,000 shares of common stock of Firepond, Inc. and is generally not a recourse obligation of the borrower, with specified exceptions. Amounts totaling $4,000,000 plus accrued interest have been advanced to Mr. Besier under this facility as of January 31, 2002.

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FIREPOND, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

In fiscal 2001, the Company issued notes to two former officers of the Company in the amount of $270,000 and to a former employee of the Company in the amount of $125,000. During the quarter ended January 31, 2002, in connection with the termination of one of the former officers employment with the Company, the Company acquired the shares securing the note, in the amount of $120,000, from the officer in satisfaction of the amounts due under the note. This amount was charged to operations during the period.

6. Segment Reporting

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

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

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

Revenue from the United States, the United Kingdom, Switzerland and Sweden contributed approximately 41%, 17% 17% and 11% of our revenue, respectively for the three months ended January 31, 2002. Revenue from the United States and Switzerland contributed approximately 64% and 17% of our revenue, respectively for the three months ended January 31, 2001.

7. Brightware Acquisition

On February 15, 2001, pursuant to an Agreement and Plan of Merger between the Company and Brightware, Inc. the Company acquired 100% of the issued and outstanding capital stock of Brightware, a supplier of eCustomer assistance software. The purchase price of the acquisition was $13,669,000, which was composed of $5,228,000 in cash, 1.3 million shares of Firepond common stock valued at $5,865,000, and $2,576,000 in acquisition related costs. The value of approximately 1.5 million shares of Firepond common stock and cash payments totaling $3,250,000 were excluded from the purchase price as this consideration was contingent on achieving financial performance objectives as measured on April 30, 2001 which subsequently were not achieved. In addition, the consideration was subject to a final accounting of Brightware s net assets as of February 15, 2001. The acquisition was accounted for using the purchase method in accordance with APB No. 16 and accordingly, the results of operations of Brightware from the date of acquisition have been included in the results of operations of the Company. The consideration payable was subject to a final accounting of Brightware s net assets as of February 15, 2001. In connection therewith, during the quarter ended January 31, 2002, the Company received $520,000 of cash and 553,000 shares of Firepond common stock previously escrowed in resolution of this provision of the transaction. This release from escrow had the effect of reducing the purchase price recorded by the Company by approximately $2,968,000 to $10,701,000.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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The following table summarizes the transaction:

	Amount (in thousands)
Acquisition of Brightware:	
Fair value of assets acquired	$ 3,954
Fair value of liabilities assumed	(11,034)
In-process research and development	6,200
Developed technology and know-how	4,900
Assembled workforce	2,200
Goodwill	4,051
Total purchase price	$ 10,271

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

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

As a result of the identification and valuation of intangibles acquired, the Company also allocated approximately $4,900,000 and $2,200,000 to developed technology and know-how and assembled workforce, respectively. Developed technology represents patented and unpatented technology and know-how related to Brightware s current eService product offering founded on a combination of artificial intelligence, knowledge manager-technology and internet enterprise applications. Assembled workforce is the presence of a skilled workforce that is knowledgeable about company procedures and possesses expertise in certain fields that are important to continued profitability and growth of a company. Both developed technology and assembled workforce were being amortized over a period of three years. The excess of the purchase price over the fair value of identified intangible assets of approximately $4,481,000 was allocated to goodwill.

During the quarter ended January 31, 2002, in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company lowered its estimates of the expected cash flows from the eServices product and determined that developed technology and know-how was significantly impaired. Accordingly, 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.

Through October 31, 2001, the Company amortized goodwill over a period of three years; however, on June 30 2001, the FASB issued SFAS No. 142 *Accounting for Goodwill and Other Intangible Assets*. SFAS 142 requires that goodwill, including amounts related to assembled workforce, no longer be amortized, instead, goodwill will be subject to an assessment of impairment by applying a fair-value based test at least annually. The Company has adopted SFAS 142 effective November 1, 2001. In accordance with SFAS 142, the net book value of assembled workforce was reclassified to goodwill and as a

FIREPOND, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
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result of an independent valuation, the Company determined that without regard to the lower expected cash flows from the eServices product determined during the quarter ended January 31, 2002, the goodwill was fully impaired upon adoption and, accordingly, recorded a cumulative effect of a change in accounting principle of $3,973,000 (see Note 8).

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

	Three Months Ended January 31, 2001
	(In thousands)
Net sales	$ 16,586
Net loss	(15,645)
Net loss per share basic and diluted	$ (0.42)

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

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

The circumstances leading to the goodwill impairment related directly to the global slow down in information technology spending. This negative economic trend has lowered the eServices operating profits and cash flows and is evidence that initial growth expectations when Brightware was acquired have not materialized. The fair value used to determine the impairment was based on a combination of earnings multiples and discounted cash flow valuation techniques.

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9. Restructuring Charge

The Company undertook three plans to restructure its operations during fiscal 2001. During the quarter ended April 30, 2001, as a result of the global information technology spending slowdown, specifically in the Customer Relationship Management market, and the Company s acquisition of Brightware on February 15, 2001, the Company undertook a plan to restructure its operations. During the quarters ended July 31, 2001 and October 31, 2001, as a result of a continued global slowdown in information technology spending, the Company took actions to extend the first restructuring. These actions sought to better align the Company s cost structure with its projected operations in the future, preserve cash, and in the case of the Brightware transaction, eliminate redundant operations.

The significant components of the restructuring charges were as follows:

	Quarter Ended			Year Ended
	April 30, 2001	July 31, 2001	October 31, 2001	October 31, 2001
	(In thousands)			
Employee severance costs	$2,286	$3,296	$2,931	$ 8,513
Facilities related costs	270	1,884	862	3,016
Impairment of property and equipment	114	1,530	2,247	3,891
Excess contractual commitments and termination fees		1,050	991	2,041
Other	351	369	62	782
	$3,021	$8,129	$7,093	$18,243

The employee severance cost was related to reductions in headcount. The Company terminated 31 general and administrative, 111 sales and marketing, 159 professional services, and 62 development employees, as well as 90 contractors.

The facilities related cost component consisted of idle lease space, lease termination fees, and the closing of our Australia and Malaysia facilities. 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.

The impairment of property and equipment charges consisted of excess computer equipment and furniture and fixtures resulting from the reductions-in-force and leasehold write-offs related to office closings or downsizings.

The excess contractual commitment and termination fees are primarily amounts resulting from the Company entering into a settlement agreement with EPAM Systems, an offshore organization which provides software development services to us, to resolve a contract dispute. Among other items, the Company agreed to pay EPAM Systems $1,000,000 in cash and granted options to purchase 100,000 shares of the Company s common stock in return for restructuring the relationship and a release of claims including those claims previously filed against the Company by EPAM Systems. As part of this agreement, the relationship has been restructured to reduce the Company s monthly commitment for the retention of EPAM Systems consultants in furtherance of the Company s cost reduction measures.

There were no other material contractual commitments terminated as a result of these restructurings.

FIREPOND, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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A summary of the short and long-term restructuring accrual is as follows:

	As of January 31, 2002
	(In thousands)
Restructuring reserve:	
Balance, beginning of period	$ 6,159
Severance payments	(1,839)
Facilities related payments	(622)
Contract termination fees	(218)
Other payments	(181)
Property and equipment write-offs	94
Balance, end of period	$ 3,393

10. Subsequent Event

In connection with the Company s acquisition of Brightware, Inc., a portion of the consideration payable was placed in escrow to be available to satisfy potential claims for damages as defined in the merger agreement. In connection therewith, on February 8, 2002, the Company received $97,499 of cash and 74,980 shares of Firepond common stock previously escrowed to satisfy claims for damages. This release from escrow has the effect of reducing the purchase price recorded by the Company by approximately $429,660 to $10,271,000. The Company accounted for this reduction in purchase price in the quarter ending January 31, 2002, by reducing goodwill and recording the value of cash and stock returned to other assets. The Company s total stockholders equity will be reduced by the value of the shares returned.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

We are a leading provider of solutions that optimize the lead-to-order process, helping companies more profitably acquire and retain customers. Our product lines leverage advanced intelligence engines and patented automation technology to drive new revenue streams, increase profitability, and manage customer interactions across all channels and throughout the lead-to-order process. From our inception in 1983 through 1997, we generated revenue primarily through providing custom development services. These services consisted of the development of highly customized applications utilizing core software technology, and related software maintenance and data maintenance services. In early fiscal 1997, we undertook a plan to change our strategic focus from a custom development services company to a software product company providing more standardized solutions. Our first packaged software product was introduced in May 1997. We released the Firepond Application Suite in October 1999 and renamed and repackaged the FirePond Application Suite as the SalesPerformer Suite in December 2000. As a result of these efforts, product-related revenue as a percentage of total revenue increased from 1.5% in fiscal 1997 to 90.2% in fiscal 2001 and to 94.4% in the three months ended January 31, 2002.

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

During fiscal 2001, as a result of a global slowdown in information technology spending, specifically in the Customer Relationship Management market, and our acquisition of Brightware, we undertook a plan to restructure its operations. These actions sought to better align our cost structure with projected operations in the future, preserve cash, and in the case of the Brightware transaction, eliminate redundant operations. We reduced headcount and facilities as well as wrote off excess equipment and terminated and restructured certain contractual relationships. Overall, we terminated 31 general and administrative, 111 sales and marketing, 159 professional services and 62 development employees, as well as 90 contractors. The restructuring charge for fiscal 2001 totaled $18.2 million. As a result of these actions, the expenses in the three months ended January 31, 2002 significantly decreased compared to the same period of the prior year.

On May 31, 2002, we announced that our senior management had discovered that our acting vice president of sales was engaged in fraudulent behavior, including misrepresenting three customer transactions. The fraudulent transactions involved three contracts with license amounts totaling approximately $5 million, including a contract announced in the quarter ended January 31, 2002. The other two fraudulent transactions were announced in our May 22, 2002 earnings release as new license contracts for the second quarter ended April 30, 2002. Therefore, our January 31, 2002 condensed consolidated financial statements have been restated from the amounts previously reported to reflect the reversal of the first fraudulent transaction. Refer to Note 1 of the accompanying consolidated financial statements of the Company for the effects of the restatement.

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We have incurred quarterly and annual losses intermittently since we were formed, and regularly since we began transitioning to a software product business in early fiscal 1997. We incurred net losses of $28.9 million for fiscal 1999, $16.3 million for fiscal 2000, $70.3 million for fiscal 2001, and $11.0 million in the three months ended January 31, 2002. We currently plan to incur an annual net loss for fiscal 2002. However, we plan to reach break even, excluding stock based compensation and amortization of intangible assets in the fourth quarter of fiscal 2002.

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

Revenue is recognized based on the provisions of Statement of Position, No. 97-2*, Software Revenue Recognition (SOP 97-2)*, and Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts (SOP 81-1).*

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

In situations where we are not responsible for implementation services for the SalesPerformer Suite of products, we recognize revenue on delivery of the packaged software if there is persuasive evidence of an arrangement, collection is probable and the fee is fixed or determinable.

In situations where we are not responsible for implementation services for the SalesPerformer Suite of products, but are obligated to provide unspecified additional software products in the future, we recognize revenue as a subscription over the term of the commitment period.

For separate sales of the eServicePerformer product line, which was acquired in connection with the Brightware transaction, we recognize revenue on delivery of the packaged software if there is persuasive evidence of an arrangement, collection is probable and the fee is fixed or determinable. We have determined that implementation services are not essential to the functionality of the eServicePerformer product.

In situations where we enter into a license agreement for both its SalesPerformer Suite and its eServicePerformer product and are responsible for implementation services, we recognize revenue for the entire arrangement under SOP 81-1.

We execute contracts that govern the terms and conditions of each software license, maintenance arrangement and other services arrangements. These contracts may be elements in a multiple element arrangement. Revenue under multiple element arrangements, which may include several different software products and services sold together, is allocated to each element based on the residual method in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position 98-9, Software Revenue Recognition with Respect to Certain Arrangements.

We use the residual method when vendor-specific objective evidence of fair value does not exist for one of the delivered elements in the arrangement. Under the residual method, the fair value of the undelivered elements is deferred and subsequently recognized. We have established sufficient vendor specific objective evidence for professional services, training and maintenance and support services based on the price charged when these elements are sold separately. Accordingly, software license revenue is recognized under the residual method in arrangements in which software is licensed with professional services, training, and maintenance and support services.

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

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We generally bill for services on a monthly basis. We generally bill for product license fees upon commencement of the contract, although we may delay billing based on the terms of the contract. We record deferred revenue on amounts billed or collected by us before satisfying the above revenue recognition criteria.

We historically have provided services to develop highly customized applications utilizing core software technology. We no longer accept new custom development service projects and anticipate custom development services revenue will continue to decline, as we have strategically de-emphasized that business and do not plan to accept new custom development contracts. We will continue to earn custom development services revenue until existing custom development contracts and related maintenance agreements are completed. Custom development services revenue in the future will be primarily from ongoing software maintenance and data maintenance services that we provide under custom development services contracts. Revenue from these ongoing arrangements is recognized as the services are performed.

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

We have granted stock options to employees that require the recognition of stock-based compensation expense. Until July 2001, stock-based compensation relating to employee grants represented the amortization, over the vesting period of the option, of the difference between the exercise price of options granted to employees and the fair market value on the date of grant of our common stock for financial reporting purposes. In July 2001, we completed a stock option exchange program in which our directors and eligible employees were offered the opportunity to exchange existing stock options for new stock options with an exercise price equal to the then current market value of our common stock. Participants in the exchange program received new options to purchase seventy-five percent (75%) of the number of shares of our common stock subject to the options that were exchanged and canceled. The new options were granted on July 31, 2001, with an exercise price of $.66 per share. We accepted 7,179,285 stock options for exchange and issued 5,384,384 stock options in exchange for such tendered options. All option grants issued in connection with the stock option exchange program are subject to variable plan accounting in accordance with APB No. 25, whereby we are required to record, as compensation expense, increases and decreases in the value of these options between the grant date of the option and the date the option is exercised. In addition, we have granted stock options to non-employees and issued warrants to certain customers and to strategic business partners. Stock-based compensation related to grants to non-employees represents the fair market value of the options and warrants granted as computed using an established option valuation formula

In connection with the Signature acquisition, we issued 276,266 shares of restricted common stock, valued at approximately $3.9 million, subject to vesting through September 27, 2002. Vesting of these shares is based on the retention of certain Signature employees measured on a quarterly basis, as defined. The value of these restricted shares is being recorded as stock-based compensation on a pro rata basis over the vesting period. Accordingly, we recognized approximately $162,000 of stock-based compensation for these shares in fiscal 2000, $2,404,000 in fiscal 2001 and $249,000 for the three months ended January 31, 2002. In fiscal 2001 we also recognized approximately $733,000 in stock-based compensation due to the acceleration of the vesting of certain shares of restricted common stock related to one employee termination.

In the aggregate, we recorded stock-based compensation expense of approximately $696,000 and $1.5 million for the three months ended January 31, 2001 and January 31, 2002, respectively. As of January 31, 2002, $510,000 of our deferred compensation balance of approximately $2.5 million will be amortized over the remaining vesting period of the options, warrants and restricted common stock. The remaining balance of $1.9 million relates to options subject to variable accounting and therefore, the amount of compensation recognized will fluctuate based on changes in the market value of our stock.

We have adopted SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets.* During the quarter ended January 31, 2002, in accordance with SFAS No. 144, we lowered our estimates of the expected cash flows from the eServices product and determined that developed technology and know-how was significantly impaired. Accordingly, we recorded a $3.1 million charge to write-off the impaired portion of developed technology and know-how.

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We have adopted SFAS 142 effective November 1, 2001. In accordance with SFAS 142, the net book value of assembled workforce was reclassified to goodwill and as a result of an independent valuation, we determined that without regard to the lower expected cash flows from the eServices product determined during the quarter ended January 31, 2002, the goodwill was fully impaired upon adoption and, accordingly, recorded a cumulative effect of a change in accounting principle of $4.0 million.

As of October 31, 2001, the Company has available net operating losses of approximately $93 million to reduce future federal and state income taxes, if any. This carryforward expires beginning in fiscal 2012 and may be subject to review and possible adjustment by the Internal Revenue Service. Utilization of these carryforwards may be subject to substantial limitations due to the ownership change limitations provided by the Internal Revenue Service Code of 1986. The Company s wholly-owned foreign subsidiaries have net operating loss carryforwards of approximately $31 million.

Critical Accounting Policies

In December 2001, the SEC requested that all registrants list their most critical accounting policies in MD&A. The SEC indicated that a critical accounting policy is one which is both important to the portrayal of the Company s financial condition and results and requires our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We believe that the following accounting policies fit this definition:

Revenue Recognition. We recognize a significant portion of our license revenue following the percentage of completion method over the implementation period. Percentage of completion is measured by the percentage of implementation hours incurred to date compared to estimated total implementation hours with revisions to estimates reflected in the period in which changes become known. We also derive a portion of our consulting services revenue from fixed-price contracts also following the percentage of completion method. If we do not accurately estimate the resources required or the scope of work to be performed, or do not manage our projects properly within the planned periods of time or satisfy our obligations under the contracts, then future consulting margins may be significantly and negatively affected or losses on existing contracts may need to be recognized. Any such resulting reductions in margins or contract losses could be material to our results of operations.

Valuation of Long-Lived Assets. We periodically review the carrying value of our long-lived assets for impairment . This review is based upon our projections of anticipated future cash flows. While we believe that our estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect our evaluations.

Lease Loss Estimates. Our restructuring charge taken in fiscal 2001 included a component for idle lease space. Our 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 us, additional charges may be required related to this idle lease space.

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Results of Operations

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

	Three Months Ended January 31,	
	2001	**2002**
Revenue:		
Product-related revenue:		
License	27.7%	43.2%
Services and maintenance	56.9	51.2
Total product-related revenue	84.6	94.4
Custom development services	15.4	5.6
Total revenue	100.0	100.0
Cost of revenue:		
License	0.5	0.8
Product-related services and maintenance	58.6	39.1
Custom development services	4.7	1.5
Total cost of revenue	63.8	41.4
Gross profit	36.2	58.6
Operating expenses:		
Sales and marketing	47.0	27.6
Research and development	32.2	38.2
General and administrative	19.9	19.9
Stock-based compensation	4.8	19.8
Amortization of intangible assets		5.4
Impairment of developed technology and know-how		41.6
Total operating expenses	103.9	152.5
Loss from operations	(67.7)	(93.9)
Interest income	11.9	2.4
Other expense	(3.4)	(2.6)
Net loss before cumulative effect of a change in accounting principle	(59.2)	(94.1)
Cumulative effect of a change in accounting principle		(53.0)
Net loss	(59.2)%	(147.1)%

Comparison of Three Months Ended January 31, 2001 and 2002

Revenue. Total revenue decreased $7.1 million, or 48.4%, to $7.5 million in the three months ended January 31, 2002 from $14.6 million in the three months ended January 31, 2001. This decrease is attributable to a 42.5% decrease in product related revenue and 81.2% decrease in custom development service revenue.

License. License revenue decreased $798,000, or 19.8%, to $3.2 million in the three months ended January 31, 2002 from $4.0 million in the three months ended January 31, 2001. License revenue as a percentage of total revenue increased to 43.2% in the three months ended January 31, 2002 from 27.7% in the three months ended January 31, 2001. The decrease in absolute dollars would have been greater if not for two events. We believe the overall decline is attributable to a global slow down in information technology spending experienced by software companies in our industry. The decrease in the license revenue was partially offset by the following transactions. In the first quarter of fiscal 2002, we successfully completed a large customer implementation resulting in a modification of the estimate to complete and the acceleration of license revenue recognition of $1.2 million. Additional license revenue of $1.2 million was recognized in the quarter resulting from the resolution of certain contingencies for two other customers. Over the long term we anticipate that license revenue will grow as a result of additional license sales resulting from increased market acceptance of our products, a growing customer base, increased marketing efforts, and improved productivity of our sales force.

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Product service and maintenance. Product service and maintenance revenue decreased $4.4 million, or 53.6%, to $3.8 million in the three months ended January 31, 2002 from $8.3 million in the three months ended January 31, 2001. Product services and maintenance revenue as a percentage of total revenue decreased to 51.2% in the three months ended January 31, 2002 from 56.9% in the three months ended January 31, 2001. The decrease in absolute dollars is attributable to the decrease in consulting engagements and maintenance agreements related to the decreased license revenue in this period as compared to the prior year period. Over the long term, we are planning for product service and maintenance revenue growth as a result of additional customer implementation related to additional license sales.

Custom development services. Custom development services revenue decreased $1.8 million, or 81.2%, to $421,000 in the three months ended January 31, 2002 from $2.2 million in the three months ended January 31, 2001. Custom development services revenue as a percentage of total revenue decreased to 5.6 % in the three months ended January 31, 2002 from 15.4% in the three months ended January 31, 2001. The decrease in absolute dollars and as a percentage of total revenue is due to the change of our strategic focus. We expect custom development services revenue to continue to decline.

Cost of revenue. Total cost of revenue decreased $6.2 million, or 66.6%, to $3.1 million in the three months ended January 31, 2002 from $9.3 million in the three months ended January 31, 2001. Total cost of revenue as a percentage of total revenue decreased to 41.4% in the three months ended January 31, 2002 from 63.8% in the three months ended January 31, 2001.

Cost of license revenue. Cost of license revenue consists primarily of costs of royalties, media, product packaging, and other production cost. Cost of license revenue decreased $13,000, or 18.8%, to $56,000 in the three months ended January 31, 2002 from $69,000 in the three months ended January 31, 2001. Cost of license revenue as a percentage of license revenue was 1.7% for the first quarter of both fiscal 2001 and fiscal 2002. The decrease in absolute dollars of cost of license revenue is due primarily to a decrease in royalty charges.

Cost of product-related services and maintenance revenue. Cost of product-related services and maintenance revenue consists primarily of salaries and related costs for consulting, training and customer support personnel, including cost of services provided by third-party consultants engaged by us. Cost of product-related services and maintenance revenue decreased $5.6 million, or 65.6%, to $2.9 million in the three months ended January 31, 2002 from $8.5 million in the three months ended January 31, 2001. Cost of product-related services and maintenance revenue as a percentage of product-related services and maintenance revenue decreased to 76.4% in the three months ended January 31, 2002 from 103.1% in the three months ended January 31, 2001. The decrease in absolute dollars and as a percentage of total product-related services and maintenance revenue was primarily due to decreased staff and consulting resources as a result of the action we took to reduce our workforce in fiscal 2001, which resulted in reduced payroll and other expenses, as well as a $300,000 reduction in expenses related to the reversal of loss contracts accrual due to the completion of certain implementations. We expect cost of product related services and maintenance revenue to remain flat or increase slightly for the remainder of fiscal 2002.

Cost of custom development services revenue. Cost of custom development services revenue consists primarily of salaries and related costs for development, consulting, training and customer support personnel related to our custom development projects, including cost of services provided by third-party consultants engaged by us. Cost of custom development services revenue decreased $564,000, or 83.3%, to $113,000 in the three months ended January 31, 2002 from $677,000 in the three months ended January 31, 2001. Cost of custom development services as a percentage of custom development services revenue decreased to 26.8% in the three months ended January 31, 2002 from 30.2% in the three months ended January 31, 2001. The decrease in absolute dollars is primarily due to decreased staff supporting fewer custom development services engagements.

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 $4.8 million, or 69.8%, to $2.1 million in the three months ended January 31, 2002 from $6.9 million in the three months ended January 31, 2001. Sales and marketing expenses as a percentage of total revenue decreased to 27.6% in the three months ended January 31, 2002 from 47.0% in the three months ended January 31, 2001. 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 action we took to restructure our operation in fiscal 2001, as well as a decrease in marketing program spending. We plan to continue to invest in marketing programs in order to achieve the planned revenue levels.

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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 $1.8 million, or 38.8%, to $2.9 million in the three months ended January 31, 2002 from $4.7 million in the three months ended January 31, 2001. Research and development expenses as a percentage of total revenue increased to 38.2% in the three months ended January 31, 2002 from 32.2% in the three months ended January 31, 2001. These expenses decreased in absolute dollars primarily due to a decrease in headcount in the R&D department and decreased utilization of engineering and product development contractors as a result of reduction of workforce in fiscal 2001. Research and development expenses increased as a percent of total revenue primarily due to our lower revenue in this period compared to the same period of prior year. We will continue to make necessary investments to enhance our existing products and develop new products in order to achieve planned revenue levels.

General and administrative expenses. General and administrative expenses consist primarily of salaries, and other personnel-related costs for executive, financial, human resource, information services, and other administrative functions, as well as legal and accounting costs. General and administrative expenses decreased $1.4 million, or 48.4%, to $1.5 million in the three months ended January 31, 2002 from $2.9 million in the three months ended January 31, 2001. General and administrative expenses as a percentage of total revenue was 19.9% in the three months ended January 31, 2002, and 19.9% in the three months ended January 31, 2001. These expenses decreased in absolute dollars primarily as a result of decreased headcount which resulted in reduced payroll and other expenses, as well as a $500,000 reduction in expenses from the reversal of bad debt reserves due to the resolution of certain past-due receivables. We expect that general and administrative expenses will moderately increase for the remainder of fiscal 2002 as compared to the first quarter results without regard to the $500,000 bad debt reversal.

Stock-based compensation expense. Stock-based compensation expense increased $789,000, or 113.4%, to $1.5 million in the three months ended January 31, 2002 from $696,000 in the three months ended January 31, 2001. Stock-based compensation expense as a percentage of total revenue increased to 19.8% in the three months ended January 31, 2002 from 4.8% in the three months ended January 31, 2001. If we had allocated our stock-based compensation to the departments for which the services were performed in the three months ended January 31, 2002, the allocation would have increased cost of revenue by $92,000, sales and marketing expenses by $35,000, research and development expenses by $205,000 and general and administrative expenses by $1.2 million. For the three months ended January 31, 2001, the allocation would have increased cost of revenue by $10,000, sales and marketing expenses by $72,000, research and development expenses by $61,000 and general and administrative expenses by $553,000. The increase in stock-based compensation expense is primarily the result of a $132,000 increase in charges for nonemployee stock options and warrants and a $893,000 increase in charges for modifications of stock option terms for employees, partially offset by a $239,000 decline in the charge from the Signature acquisition stock grants.

Amortization of intangible assets. In conjunction with our acquisition of Brightware, we allocated approximately $4.9 million to developed technology and know-how. Developed technology represents patented and unpatented technology and know-how related to Brightware s current eServices product offering founded on a combination of artificial intelligence, knowledge-manager technology and Internet enterprise applications. For the three months ended January 31, 2002, we recognized $408,000 in amortization.

Impairment of developed technology and know-how. During the quarter, we lowered our estimates of the expected revenue from the Brightware products and determined that the developed technology and know-how intangible asset was significantly impaired and, accordingly, recorded a $3.1 million impairment charge in the quarter.

Interest income. Interest income decreased $1.6 million, or 89.5%, to $181,000 in the three months ended January 31, 2002 from $1.7 million in the three months ended January 31, 2001. 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 expense. Other income (expense), net primarily consists of bank fees and foreign currency transaction gains and losses. Other income (expense), net improved $303,000, or 60.7%, to $196,000 in expense in the three months ended January 31, 2002 from $499,000 in expense in the three months ended January 31, 2001. The improvement is primarily due to the decrease in foreign currency transaction losses in the three months ended January 31, 2002.

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Cumulative effect of a change in accounting principle. With the acquisition of Brightware, Inc. in 2001, we allocated approximately $4.5 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, respectively. Effective November 1, 2001, we adopted SFAS 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.

Liquidity and Capital Resources

As of January 31, 2002, cash and cash equivalents were $34.5 million and short-term investments were $7.3 million as compared with cash and cash equivalents of $34.7 million and short-term investments of $9.6 million as of October 31, 2001. Our working capital at January 31, 2002 was $30.1 million, compared to working capital of $30.8 million at October 31, 2001.

Net cash used in operating activities was $3.1 million in the three months ended January 31, 2002, compared with net cash used in operating activities of $15.1 million in the three months ended January 31, 2001. Cash used in operating activities in the three months ended January 31, 2002 was attributable to our net loss and decreases in restructuring accrual and deferred revenue offset by stock-based compensation expense, depreciation and amortization impairment of developed technology and know-how, cumulative effect of a change in accounting principle and a decrease in accounts receivable.

Net cash provided by investing activities was $3.0 million in the three months ended January 31, 2002, compared with net cash provided by investing activities of $8.8 million in the three months ended January 31, 2001. Net cash provided by investing activities in the three months ended January 31, 2002 was primarily attributable to the sale or maturity of short-term investments and the return of cash from the Brightware acquisition escrow offset by the purchase of short-term investments.

Net cash provided by financing activities was $35,000 in the three months ended January 31, 2002, compared with net cash provided by financing activities of $1.4 million in the three months ended January 31, 2001. Net cash provided by financing activities for the three months ended January 31, 2002 was primarily from the exercise of stock options.

We lease facilities under non-cancelable operating leases which have various expiration dates ranging from 2002 through 2010. At October 31, 2001, future minimum annual lease payments amounted to $11.6 million 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 will be sufficient to meet our anticipated cash need for working capital and capital expenditures for at least the next 12 months. However, we may need to raise additional funds in the next 12 months or in the future to support more rapid expansion of our sales force, develop new or enhanced products or services, respond to competitive pressures, acquire complementary businesses or technologies or respond to unanticipated requirements. If we seek to raise additional funds, we may not be able to obtain funds on terms which are favorable or acceptable to us. If we raise additional funds through the issuance of equity securities, the percentage ownership of our existing stockholders would be reduced. Furthermore, these securities may have rights, preferences or privileges senior to our common stock.

Recent Accounting Pronouncements

In July 2001, the FASB issued SFAS No, 141, *Business Combinations*. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. This statement is effective for all business combinations initiated after June 30, 2001.

Effective November 1, 2001, we adopted SFAS No. 142, Goodwill and Other Intangible Assets, which establishes financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, Intangible Assets. SFAS No. 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but, instead, tested at least annually for impairment. See Note 9 of the Notes to Consolidated Financial Statements of this quarterly report for a further discussion of the impact of this statement on our consolidated financial statements.

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Effective November 1, 2001, the Company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement supercedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and the accounting and reporting provisions of Accounting Principles Board (APB) Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. Under this statement it is required that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and it broadens the presentation of discontinued operations to include more disposal transactions. See Note 7 of the Notes to Consolidated Financial Statements of this quarterly report for a further discussion of the impact of this statement on our consolidated financial statements.

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

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

Our products address a new and emerging market for e-business sales and services solutions. The failure of this market to develop, or a delay in the development of this market, would seriously harm our business. The success of our products depends substantially upon the widespread adoption of the Internet as a primary medium for commerce and business applications. The Internet infrastructure may not be able to support the demands placed on it by the continued growth upon which our success depends. Moreover, critical issues concerning the commercial use of the Internet, such as security, reliability, cost, accessibility and quality of service, remain unresolved and may negatively affect the growth of Internet use or the attractiveness of commerce and business communication over the Internet. In addition, we expect to derive the majority of our product license revenue in the future from the Firepond Application Suite and its component products, which were released in October 1999, and renamed and repackaged as the SalesPerformer Suite in December 2000. Our business depends on the successful customer acceptance of this new suite of products and we expect that we will continue to depend on revenue from new and enhanced versions of the SalesPerformer Suite. Our business would be harmed if our target customers do not adopt and expand their use of the SalesPerformer Suite and its component products.

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

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

All members of our senior management team have joined Firepond since May 1997, and we continue to experience turnover at the senior management level. This places a significant burden on our management and our internal resources. If we are not able to maintain adequate infrastructure to support and manage our operations effectively our business could be harmed.

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We depend on our direct sales force for nearly all 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, our success depends in large part upon our ability to attract, train, motivate and retain highly technical, skilled employees, particularly software engineers and professional services personnel. Our failure to attract and retain the highly trained technical personnel that are integral to our product development, professional services and support teams may limit our ability to develop new products or product enhancements, and implement our products successfully.

Recent material litigation could result in substantial costs and divert management 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, may be costly and time-consuming. Should the outcome of the litigation be adverse to us, we could be required to pay significant monetary damages to the plaintiffs, which could harm our business.

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 SEC 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 issued in connection with our initial public offering. The complaints further allege that FleetBoston Robertson Stephens and the other underwriters entered into agreements with its 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. Securities class action litigation can result in substantial costs and divert our management s attention and resources, which could seriously harm our business.

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 Suite 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 Suite 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.

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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 $28.9 million for fiscal 1999, $16.3 million for fiscal 2000, $70.3 million for fiscal 2001 and $11.0 million for the three months ended January 31, 2002. Although we currently plan that we will stop incurring a net loss, excluding stock based compensation and amortization of intangible assets, by the end of our 2002 fiscal year, we may not achieve this goal and may continue to incur losses on a quarterly basis and not become profitable. Additionally, we may not grow or generate sufficient revenue to attain profitability.

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

In connection with our effort to streamline operations, reduce costs and bring our staffing and infrastructure in line with industry standards, we restructured our organization and reduced our workforce. We terminated 81 employees and 89 consultants in April 2001, 157 employees and one consultant in June 2001, and 125 employees in October 2001. We have incurred costs aggregating of $8.5 million associated with these workforce reductions related to severance and other employee-related costs, and may incur further costs. Our restructuring may also yield unanticipated consequences, such as attrition beyond our planned reduction in workforce and loss of employee morale and decreased performance. 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.

Failure to expand our relationships with third party channels as well as systems integrators and consulting firms would impede acceptance 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.

We depend on third parties to assist in maintaining and developing certain components and also depend upon technology licensed to us by third parties, the loss of which could adversely affect out competitive position.

Although reduced from previous year s levels, a portion of our product development work in regard to key components as well as some implementation services continue to be performed by third party organizations, including off-shore organizations in India, Russia and Belarus. In connection with these services such organizations may from time to time control certain components of our proprietary technology. Unpredictable events in the political, economic and social conditions in India, Russia and Belarus, or our failure to effectively manage these organizations may hinder our ability to retrieve or cause us to lose certain components of our proprietary technology. If access to these services were to be unexpectedly eliminated or significantly reduced, our ability to meet development objectives vital to our ongoing strategy would be hindered, certain components of our proprietary technology could be lost or misappropriated, and our business could be seriously harmed.

In addition, 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.

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

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

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 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.

Our failure to successfully implement our products in a timely manner could result in negative publicity and reduced sales, both of which would 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.

Our results of operations will 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 7,179,285 options for exchange and, on July 31, 2001 issued 5,384,384 new stock options with an exercise price equal to $.66 per share. For financial reporting purposes all option grants subject to the tender offer will be treated as variable awards. Accordingly, we will be required to record as a 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 for those shares or otherwise terminates unexercised. The greater the increase in the market value of our common stock following the date of grant, the greater the compensation expense and effect on our reported earnings.

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

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

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

If we pursue a future acquisition, our management could spend a significant amount of time and effort identifying and completing the acquisition. If we make a future acquisition, we could issue equity securities which would dilute current stockholders percentage ownership, incur substantial debt, assume contingent liabilities or incur a one-time charge.

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

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

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

In the past, our stock price has closed below $1.00 for extended periods of time. If our common stock closing bid price falls below $1.00 per share for a period of thirty consecutive business days, Nasdaq has the right to delist the stock if within ninety days thereafter the bid price for the stock is not at least $1.00 per share for a minimum of ten consecutive business days. In the event our stock price does not rise above $1.00 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 our bid price will comply with the requirements for continued listing of our common stock on the Nasdaq National Market, or that any appeal of a decision to delist our common stock will be successful. If our common stock loses its Nasdaq National Market status, shares of our common stock would likely trade in the over-the-counter market. Consequently, selling our common stock would be more difficult because smaller quantities of shares would likely be bought and sold, transactions could be delayed, and security analysts and news media coverage of us may be reduced. In addition, in the event our common stock is delisted, broker-dealers have certain regulatory burdens imposed upon them, which may discourage broker-dealers from effecting transactions in our common stock, further limiting the liquidity thereof. These factors could result in lower prices and larger spreads in the bid and ask prices for shares of common stock.

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

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

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

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

Failure to increase our international revenue could seriously harm our business

International revenue currently accounts for a significant percentage of our total revenue. We expect international revenue to continue to account for a significant percentage of total revenue in the future and we believe that we must continue to expand our international sales activities to be successful. However, foreign markets for our products may develop more slowly than currently anticipated. International revenue as a percentage of total revenue was 11% in fiscal 1999, 28% in fiscal 2000, 36% for fiscal 2001 and 59% for the three months ended January 31, 2002. Our failure to expand our international sales could have a significant negative impact on our business.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As of January 31, 2002, our executive officers, directors and entities associated with them own approximately 48% 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.

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

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

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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.

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. 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 plaintiffs, which could harm our business.

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 an alleged class of persons who purchased shares of our common stock between the date of our initial public offering and December 6, 2000. The complaints name as defendants Firepond and certain of its directors and officers, and FleetBoston Robertson Stephens an underwriter of our initial public offering. 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 Firepond s 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. While we believe the claims against us are without merit and intend to defend the actions vigorously, the litigation is in the preliminary stage, and we cannot predict the outcome with certainty. We may incur substantial legal fees and expenses, and the litigation may divert the attention of some of our key management. Our defense of this litigation, regardless of its outcome, may be costly and time-consuming. Should the outcome of the litigation be adverse to us, we could be required to pay significant monetary damages to the plaintiffs, which could harm our business.

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

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ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit Number	Exhibit Description
10.20 *	Loan and Pledge agreement dated January 25, 2002 between the Registrant and Klaus P. Besier
10.21 *	Amended and Restated Promissory Note dated January 25, 2002 between the Registrant and Klaus P. Besier
10.22 *	Employment Letter dated July 13, 2001 between the Registrant and Cem Tanyel

* Previously filed as an exhibit to the Registrants Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on March 18, 2002.

(b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: June 19, 2002

FIREPOND, INC

/S/ KLAUS P. BESIER

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

/S/ SUSAN W. LEDOUX

Susan W. Ledoux
Chief Financial Officer (Principal
Financial
Officer and Principal Accounting
Officer)