FIREPOND INC
Form 10-Q
March 19, 2001

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED JANUARY 31, 2001

OR

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

COMMISSION FILE NUMBER 0-29251

FIREPOND, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	41-1462409
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)
890 WINTER STREET, WALTHAM, MASSACHUSETTS	02451
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

(781) 487-8400
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

Yes [X] No [ ]

As of January 31, 2001 there were 35,980,263 shares of the Registrant's Common Stock outstanding.

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FIREPOND, INC. AND SUBSIDIARIES

FORM 10-Q
QUARTER ENDED JANUARY 31, 2001

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FIREPOND, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(UNAUDITED)

	OCTOBER 31, 2000	JANUARY 31, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 79,500	$ 74,596
Short-term investments	36,733	26,059
Accounts receivable, net	15,418	14,870
Unbilled services	1,676	2,970
Prepaid expenses and other current assets	2,436	6,443

Total current assets	135,763	124,938
Property and equipment, net	6,887	7,869
Restricted cash	550	550
Other assets	1,120	1,139
	$144,320	$134,496
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 403	$ 285
Accounts payable	4,851	3,455
Accrued liabilities	13,395	11,168
Deferred revenue	15,207	15,167
Total current liabilities	33,856	30,075
Stockholders' equity:		
Common stock, $0.01 par value -- Authorized -- 100,000,000 shares at October 31, 2000 and January 31, 2001; Issued and outstanding -- 35,596,022 shares at October 31, 2000 and 35,980,263 shares at January 31, 2001	356	360
Additional paid-in capital	195,166	196,180
Accumulated deficit	(78,135)	(86,744)
Deferred compensation	(6,077)	(4,854)
Other comprehensive loss	(846)	(521)
Total stockholders' equity	110,464	104,421
	$144,320	$134,496

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

FIREPOND, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED JANUARY 31,	
	2000	2001
Revenues:		
Product-related revenues:		
License	$ 3,907	$ 4,034
Services and maintenance	4,458	8,273
Total product-related revenues	8,365	12,307
Custom development services	3,612	2,240
Total revenues	11,977	14,547

Cost of revenues:		
License	129	69
Product-related services and maintenance(1)	2,283	8,533
Custom development services	1,599	677
Total cost of revenues	4,011	9,279
Gross profit	7,966	5,268
Operating expenses:		
Sales and marketing(1)	6,418	6,852
Research and development(1)	3,697	4,678
General and administrative(1)	1,962	2,891
Stock-based compensation(1)	1,167	696
Total operating expenses	13,244	15,117
Loss from operations	(5,278)	(9,849)
Interest income (expense)	(807)	1,740
Other income (expense), net	262	(499)
Net loss	$(5,823)	$(8,608)
Net loss per share (Note 5(a)):		
Basic and diluted net loss per share	$ (0.58)	$ (0.24)
Basic and diluted weighted average common shares outstanding	10,101	35,548
Pro forma net loss per share (Note 5(b)):		
Pro forma net loss per share	$ (0.21)	$ (0.24)
Pro forma basic and diluted weighted average common shares outstanding	27,566	35,548

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

	THREE MONTHS ENDED JANUARY 31,	
	2000	2001
Cost of revenue	$ 44	$ 10
Operating expenses:		
Sales and marketing	640	72
Research and development	296	61
General and administrative	187	553
Total stock-based compensation	$1,167	$696

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

FIREPOND, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	THREE MONTHS ENDED JANUARY 31,	
	2000	2001
Cash flows from operating activities:		
Net loss	$(5,823)	$ (8,608)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	1,167	696
Depreciation and amortization	797	949
Non-cash interest expense	413	--
Changes in assets and liabilities:		
Accounts receivable	(1,654)	670
Unbilled services	184	(1,293)
Prepaid expenses and other current assets	(23)	(4,007)
Accounts payable	(2,332)	(1,330)
Accrued liabilities	1,643	(2,161)
Deferred revenue	1,721	(40)
Net cash used in operating activities	(3,907)	(15,124)
Cash flows from investing activities:		
Purchases of short term investments	--	(6,754)
Purchases of property and equipment	(688)	(1,875)
Proceeds from the sale and maturities of short-term investments	--	17,490
Increase in other assets	(318)	(76)
Net cash provided by (used in) investing activities	(1,006)	8,785
Cash flows from financing activities:		
Net borrowings on line of credit	205	--
Proceeds from subordinated notes payable	6,000	--
Payments on long-term debt	(431)	(118)
Proceeds from stock options and warrants exercised	437	1,544
Increase in subscription receivables	(30)	--
Net cash provided by financing activities	6,181	1,426
Effect of exchange rate changes on cash and cash equivalents	(17)	9
Net increase (decrease) in cash and cash equivalents	1,251	(4,904)
Cash and cash equivalents, beginning of period	2,120	79,500
Cash and cash equivalents, end of period	$ 3,371	$ 74,596
Supplemental cash flow information:		
Interest paid	$ 394	$ 8

Noncash investing and financing activities:

Warrants issued in conjunction with subordinated notes payable...	$ 1,904	$ --
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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 global provider of integrated e-business sales and marketing solutions that enable companies to optimize their customer relationships and maximize the effectiveness of their Internet-based and traditional sales channels. The Company provides software and services that allow its customers to merge their e-commerce selling, customer relationship management, and channel management strategies on a single, Internet-based platform.

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Revenue Recognition

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

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

Product-Related Revenue

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

The Company has concluded that 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.

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

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

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

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

The Company generally bills for services on a monthly basis. The Company generally bills for product license fees upon commencement of the contract. However, in some situations 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 consisted of the following:

	OCTOBER 31, 2000	JANUARY 31, 2001
	(IN THOUSANDS)	
Product license	$ 8,740	$ 8,565
Product-related services	1,344	2,170
Product-related maintenance	2,865	3,471
Custom development services	2,258	961
	$15,207	$15,167

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Unbilled product license fees for which the Company has not recognized or deferred revenue totaled $5,923,000 at October 31, 2000 and $3,630,000 at January 31, 2001.

Custom Development Services Revenue

The Company provides ongoing services related to custom development projects including software and data maintenance. Revenue from these arrangements is recognized as the services are performed. The Company also performs custom development services under fixed-price contracts, for which revenue is recognized using the percentage-of-completion method. These services consist of the development of highly customized applications utilizing core software technology. These contracts typically range in terms of one to five years. Percentage of completion is measured by the percentage of implementation hours incurred to date to estimated total implementation hours. This method is used because management considers 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.

Unbilled services represent amounts due to the Company under custom development service agreements for work performed that had not been billed as of the period end. The Company bills customers under custom development contracts upon achieving performance milestones or by billing dates, as specified in the contracts.

FIREPOND, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
(UNAUDITED)

(b) Cash and Cash Equivalents

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

	OCTOBER 31, 2000	JANUARY 31, 2001
	(IN THOUSANDS)	
Cash and cash equivalents:		
Cash	$ 7,186	$ 1,731
Money market accounts	4,095	14,384
Commercial paper	68,219	58,481
Total cash and cash equivalents	$79,500	$74,596

(c) Short-term Investments

In accordance with SFAS No. 115 and based on the Company's intentions regarding these instruments, the Company has classified all short-term investments as available-for-sale. These investments consist primarily of corporate notes and bonds with an original maturity of less than a year. Other comprehensive loss in stockholder's equity included an unrealized holding loss of $4,000 for October 31, 2000 and an unrealized holding gain of $58,000 for January 31, 2001.

	OCTOBER 31, 2000	JANUARY 31, 2001
	(IN THOUSANDS)	
Short-term investments:		
Certificates of deposit (average 70 days to maturity)	$ --	$ 2,004
Commercial paper	15,329	--
Corporate notes and bonds (average 105 days to maturity)	21,404	24,055
Total short-term investments	$36,733	$26,059

(d) Comprehensive Income (Loss)

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

	THREE MONTHS ENDED JANUARY 31, 2000	2001
	(IN THOUSANDS)	
Comprehensive loss:		
Net loss	$(5,823)	$(8,608)
Other comprehensive loss		
Unrealized gain on short-term investments	--	62
Foreign currency translation	(188)	263
Comprehensive loss	$(6,011)	$(8,283)

3. NOTE RECEIVABLE FROM OFFICER

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. The outstanding principal together with unpaid interest is due and payable on the earlier of October 31, 2001, an event of default, or an event of maturity, as defined. The promissory note is secured by a pledge of 500,000 shares of common stock of FirePond, Inc. and a covenant of cross default of other stock option agreements between Besier and the Company. Amounts totaling $3,575,489 have been advanced to Besier under this facility and is included in other current assets as of January 31, 2001.

4. ACCRUED LIABILITIES

Accrued liabilities consists of:

	OCTOBER 31, 2000	JANUARY 31, 2001
	(IN THOUSANDS)	
Payroll and related costs	$ 4,142	$ 2,416
Other	9,253	8,752
Total accrued liabilities	$13,395	$11,168

5. NET LOSS PER SHARE

(a) Net Loss Per Share

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

Under Securities and Exchange Commission Staff Accounting Bulletin No. 98, common stock and convertible preferred stock issued or granted for nominal consideration before the anticipated effective date of a company's initial public offering must be included in the calculation of basic and diluted net loss per share as if they had been outstanding for all periods presented. The Company has determined that there were no issuances of common stock and convertible preferred stock for nominal consideration.

The following table summarizes securities outstanding as of each period end

which were not included in the calculation of diluted net loss per share since their inclusion would be antidilutive:

	THREE MONTHS ENDED JANUARY 31,	
	2000	2001
	(IN THOUSANDS)	
Common stock options and warrants	11,163	11,041
Convertible preferred stock	19,098	--
Preferred stock warrants	864	--

(b) Pro Forma Net Loss Per Share

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

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

	THREE MONTHS ENDED JANUARY 31,	
	2000	2001
	(IN THOUSANDS)	
Pro forma basic and diluted:		
Weighted average common shares outstanding used in computing basic and diluted net loss per share	10,101	35,548
Weighted average common shares issuable upon the conversion of preferred stock	13,403	--
Weighted average common shares issuable upon settlement of the priority payments	3,813	--
Weighted average common shares issuable upon exercise of series F preferred stock warrants	249	--
Weighted average common shares outstanding used in computing pro forma basic and diluted net loss per share	27,566	35,548

6. STOCKHOLDERS' EQUITY (DEFICIT)

(a) Recapitalization

Upon the closing of the initial public offering in February 2000, the Company's certificate of incorporation was amended and restated to change its authorized capital stock to 100,000,000 shares of $0.01 par value common stock

and 5,000,000 shares of $0.01 par value preferred stock.

(b) Stock Options and Warrants

The Company granted stock options to employees and consultants that require the recognition of stock-based compensation expense. Additionally, the Company granted stock warrants to certain customers and to strategic business partners. Stock-based compensation related to grants to employees represents the amortization, over the vesting period of the option, of the difference between the exercise price of options granted to employees and the fair market value of its common stock for financial reporting purposes. Stock-based

compensation related to grants to non-employees represents the fair market value of the options and warrants granted as computed using an established option valuation formula. As of January 31, 2001, the deferred compensation balance was $4,854,000 and will be recognized as an expense over the vesting period of the underlying stock options for options granted to employees and as earned for non-employees in accordance with EITF 96-18.

The Company granted options to employees to purchase 1,013,206 shares of common stock at a weighted-average exercise price of $8.35 per share during the three months ended January 31, 2001.

7. 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.

The majority of the Company's revenues are derived from the United States with approximately 36% coming from foreign countries. Revenues from contracts entered into by our Netherlands' subsidiaries contributed approximately 22% of our revenues for the three months ended January 31, 2001. No single country contributed greater than 10% of our total revenues for the three months ended January 31, 2000, other than the United States.

8. SUBSEQUENT EVENTS

(a) Brightware Acquisition

On February 15, 2001, pursuant to an Agreement and Plan of Merger between the Company and Brightware, Inc. (Brightware), the Company acquired 100% of the issued and outstanding capital stock of Brightware, a supplier of eCustomer assistance software. The Company acquired the capital stock of Brightware in exchange for $8,500,000 in cash and the issuance of 2,825,305 shares of common stock for a total purchase price of approximately $23,000,000. A portion of the purchase price is conditional on Brightware achieving specific financial performance objectives. The acquisition will be accounted for using the purchase method in accordance with APB No. 16. Accordingly, the results of operations of Brightware, from the date of acquisition will be included in the results of operations of the Company.

FIREPOND, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
(UNAUDITED)

(b) Loss Contingency

On March 2, 2001 the Company entered into an agreement in principle with a customer which will require the Company to pay to a customer an estimated $1.6 million as a resolution of outstanding contractual matters. This issue arose subsequent to January 31, 2001. The Company will record this transaction as a charge to operations in the quarter ended April 30, 2001.

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 global provider of integrated e-business sales and marketing solutions that enable companies to optimize their customer relationships and maximize the effectiveness of their Internet-based and traditional sales channels. We provide software and services that allows our customers to merge their e-commerce selling, customer relationship management, and channel management strategies on a single, Internet-based platform. From our inception in 1983 through 1997, we generated revenue primarily through providing custom development services. These services consisted of the development of highly customized applications utilizing core software technology, and related software maintenance and data maintenance services. In early fiscal 1997, we undertook a plan to change our strategic focus from a custom development services company to a software product company providing more standardized solutions. Our first packaged software product was introduced in May 1997. We released the Firepond Application Suite in October 1999 and renamed and repackaged the FirePond Application Suite as the SalesPerformer Suite in December 2000. As a result of these efforts, product-related revenue as a percentage of total revenue increased from 1.5% in fiscal 1997 to 76.5% in fiscal 2000 and to 84.6% in the three months ended January 31, 2001.

We anticipate that product-related revenue from product licenses will grow as result of increased market acceptance of our products, the recent introduction of the SalesPerformer Suite, and increases in both the size and productivity of our sales force. Therefore, we expect that a higher percentage of total revenue will be attributable to product-related revenue in the future. Unlike our custom development services, our product-related services represent the implementation of our packaged software products.

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

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

We acquired 100% of the issued and outstanding shares of capital stock of Signature Software, Inc. (Signature) on September 27, 2000. The acquisition was accounted for as a purchase in accordance with APB No. 16. Accordingly, the results of operations of Signature have been included in the Company's results of operations since the date of acquisition. In addition, subsequent to January 31, 2001, the Company acquired 100% of the issued and outstanding shares of capital stock of Brightware, Inc. (Brightware). This acquisition will also be accounted for using the purchase method in accordance with APB No. 16. Accordingly, the results of operations of Brightware from the date of acquisition, February 15, 2001, will be included in the results of operations of the Company.

We recognize revenue under Statement of Position, or SOP, No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-9, and SOP No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. We generally recognize revenue from product-related license agreements over the implementation period. We recognize this revenue following the percentage-of-completion method over the implementation period because we

have concluded that the implementation services are essential to our customers' use of our packaged software products. Percentage of completion is measured by the percentage of implementation hours incurred to date to total estimated implementation hours.

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

Revenue from custom software development projects can be either fixed-price or on a time-and-materials basis. We recognize revenue as the services are performed when the project is based on time-and-materials. We recognize revenue on a percentage-of-completion method when the project is a fixed-price contract. Percentage-of-completion is determined based on the number of hours incurred to date on a project compared to the total estimated hours.

Since May 1998, we have been investing heavily in the infrastructure necessary to expand our global operations, including the formation and staffing of international subsidiaries. We expect to continue to invest in our international operations as we expand our international direct sales channel and enhance our marketing effort to increase our worldwide market share.

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

We have granted stock options to employees and consultants that require us to record stock-based compensation expense. We have also granted stock warrants to certain customers and to strategic business partners. Stock-based compensation related to grants to employees represents the amortization, over the vesting period of the option, of the difference between the exercise price of options granted to employees and the fair market value of our common stock for financial reporting purposes. Stock-based compensation related to grants to non-employees represents the fair market value of the options and warrants granted as computed using an established option valuation formula. We recorded stock-based compensation expense of approximately $1.2 million and $696,000 for the three months ended January 31, 2000 and January 2001, respectively. As of January 31, 2001, the deferred compensation balance was approximately $4.9 million and will be amortized over the remaining vesting period of the options and warrants.

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 $27.0 million for fiscal 1997, $9.0 million for fiscal 1998, $28.9 million for fiscal 1999, $16.3 million for fiscal 2000, and $8.6 million for the three months ended January 31, 2001. We expect to continue to incur losses on both a quarterly and annual basis in the future.

On March 2, 2001 we entered into an agreement in principle with a customer which will require us to pay to a customer an estimated $1.6 million as a resolution of outstanding contractual matters. This issue arose subsequent to January 31, 2001. We will record this transaction as a charge to operations in the quarter ended April 30, 2001.

As of October 31, 2000, we had available a net operating loss carryforward of approximately $46.0 million to reduce future federal and state income taxes, if any. This carryforward expires beginning in 2012 and may be subject to review and possible adjustment by the Internal Revenue Service. The Tax Reform Act of 1986 contains provisions that may limit the amount of net operating loss carryforwards that we may utilize in any one year in the event of cumulative changes in ownership over a three-year period in excess of 50%. The Company's wholly owned foreign subsidiaries have net operating loss carryforwards of approximately $16 million as of October 31, 2000.

RESULTS OF OPERATIONS

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

	THREE MONTHS ENDED JANUARY 31,	
	2000	2001
Revenue:		
Product-related revenue:		
License	32.6%	27.7%
Services and maintenance	37.2	56.9
Total product-related revenue	69.8	84.6
Custom development services	30.2	15.4
Total revenue	100.0	100.0
Cost of revenue:		
License	1.1	0.5
Product-related services and maintenance	19.1	58.6
Custom development services	13.3	4.7
Total cost of revenue	33.5	63.8
Gross profit	66.5	36.2
Operating expenses:		
Sales and marketing	53.6	47.0
Research and development	30.9	32.2
General and administrative	16.4	19.9
Stock-based compensation	9.7	4.8
Total operating expenses	110.6	103.9
Loss from operations	(44.1)	(67.7)
Interest income (expense)	(6.7)	11.9
Other income (expense), net	2.2	(3.4)

Net loss..	(48.6)%	(59.2)%
	=====	=====

Comparison of Three Months Ended January 31, 2000 and 2001

Revenue. Total revenue increased $2.5 million, or 21.5%, to $14.5 million in the three months ended January 31, 2001 from $12.0 million in the three months ended January 31, 2000. This increase is attributable to a 47.1% increase in product related revenue, offset by a 38.0% decrease in custom development service revenue.

License. License revenue increased $127,000, or 3.3%, to $4.0 million in the three months ended January 31, 2001 from $3.9 million in the three months ended January 31, 2000. License revenue as a percentage of total revenue decreased to 27.7% in the three months ended January 31, 2001 from 32.6% in the three months ended January 31, 2000. The increase in license revenues in absolute dollars is

primarily attributable to an increase in the number of licenses implemented during the first quarter of fiscal 2001. The decrease as a percentage of total revenue is the result of product services and maintenance revenue increasing at a greater rate than license revenue. License revenue for the quarter ended January 31, 2001 has declined by $3.5 million or 46.3% compared to the three months ended October 31, 2000. We believe this decline is attributable to a global slowdown in information technology spending experienced by software companies in our industry. In addition, in our pursuit of customer satisfaction, we have experienced slower revenue recognition from our current customer implementations than anticipated due to performing professional services outside of the original scope of the engagement for no incremental revenue. 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.

Product service and maintenance. Product service and maintenance revenue increased $3.8 million, or 85.6%, to $8.3 million in the three months ended January 31, 2001 from $4.5 million in the three months ended January 31, 2000. Product services and maintenance revenue as a percentage of total revenue increased to 56.9% in the three months ended January 31, 2001 from 37.2% in the three months ended January 31, 2000. Approximately $2.8 million of the increase is attributable to the increase in the number of consulting engagements and maintenance agreements related to the increased license revenue in this period as well as an increased amount of services provided for the license implementations in this period as compared to the prior year period. Additionally, approximately $1.0 million of the increase is attributable to a greater number of post-license implementation consulting engagements and maintenance contracts in this period.

Custom development services. Custom development services revenue decreased $1.4 million, or 38.0%, to $2.2 million in the three months ended January 31, 2001 from $3.6 million in the three months ended January 31, 2000. Custom development services revenue as a percentage of total revenue decreased to 15.4 % in the three months ended January 31, 2001 from 30.2% in the three months ended January 31, 2000. The decrease in absolute dollars and as a percentage of total revenue is due to the change of our strategic focus. We expect custom development services revenue to continue

to decline.

Cost of revenue. Total cost of revenue increased $5.3 million, or 131.3%, to $9.3 million in the three months ended January 31, 2001 from $4.0 million in the three months ended January 31, 2000. Total cost of revenue as a percentage of total revenue increased to 63.8% in the three months ended January 31, 2001 from 33.5% in the three months ended January 31, 2000.

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 $60,000, or 46.5% to $69,000 in the three months ended January 31, 2001 from $129,000 in the three months ended January 31, 2000. Cost of license revenue as a percentage of license revenue decreased to 1.7% in the three months ended January 31, 2001 from 3.3% in the three months ended January 31, 2000. The decrease in 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 increased $6.2 million, or 273.8%, to $8.5 million in the three months ended January 31, 2001 from $2.3 million in the three months ended January 31, 2000. Cost of product-related services and maintenance revenue as a percentage of product-related services and maintenance revenue increased to 103.1% in the three months ended January 31, 2001 from 51.2% in the three months ended January 31, 2000. The increase in absolute dollars was primarily due to increased staff and consulting resources to support a greater number of product-related engagements in this period. The increase as a percentage of revenue was primarily due to lower billing rates realized on certain large engagements in this period as well as lower realized average revenue per hour on certain fixed price services contracts in this period. These increases were caused by the Company pursuing customer

satisfaction and performing services outside of the scope of the original engagement for no incremental revenue.

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 $922,000, or 57.7%, to $677,000 in the three months ended January 31, 2001 from $1.6 million in the three months ended January 31, 2000. Cost of custom development services as a percentage of custom development services revenue decreased to 30.2% in the three months ended January 31, 2001 from 44.3% in the three months ended January 31, 2000. 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 increased $434,000, or 6.8%, to $6.9 million in the three months ended January 31, 2001 from $6.4 million in the three months ended January 31, 2000. Sales and marketing expenses as a percentage of total revenue decreased to 47.0% in the three months ended January 31, 2001 from 53.6% in the three months ended January 31, 2000. Sales

and marketing expenses increased in absolute dollars primarily due to the increase in headcount in the sales operations, particularly our international direct sales channel, as well as an approximate $250,000 increase in marketing program spending to promote our product. Sales and marketing expenses decreased as a percentage of total revenue primarily due to our revenue increasing at a greater rate than our sales and marketing expense. We believe sales and marketing expenses will continue to increase in absolute dollars as we expand our sales and marketing organization and initiate additional marketing programs.

Research and development expenses. Research and development expenses consist primarily of salaries and personnel-related costs and the costs of contractors associated with the development of new products, the enhancement of existing products, and the performance of quality assurance and documentation activities. Research and development expenses increased $981,000, or 26.5%, to $4.7 million in the three months ended January 31, 2001 from $3.7 million in the three months ended January 31, 2000. Research and development expenses as a percentage of total revenue increased to 32.2% in the three months ended January 31, 2001 from 30.9% in the three months ended January 31, 2000. These expenses increased in absolute dollars and as a percentage of total revenue primarily as a result of increased utilization of engineering and product development contractors associated with our investment in the SalesPerformer Suite. We expect research and development expenses will continue to increase as we enhance our existing products and develop new products.

General and administrative expenses. General and administrative expenses consist primarily of salaries, and other personnel-related costs for executive, financial, human resource, information services, and other administrative functions, as well as legal and accounting costs. General and administrative expenses increased $929,000, or 47.3%, to $2.9 million in the three months ended January 31, 2001 from $2.0 million in the three months ended January 31, 2000. General and administrative expenses as a percentage of total revenue increased to 19.9% in the three months ended January 31, 2001 from 16.4% in the three months ended January 31, 2000. These expenses increased in absolute dollars and as a percentage of total revenue primarily as a result of increased headcount and increased cost of infrastructure necessary to support our growth. We expect that general and administrative expenses will continue to increase to support our expanding operations.

Stock-based compensation expense. Stock-based compensation expense decreased $471,000, or 40.4%, to $696,000 in the three months ended January 31, 2001 from $1.2 million in the three months ended January 31, 2000. Stock-based compensation expense as a percentage of total revenue decreased to 4.8% in the three months ended January 31, 2001 from 9.7% in the three months ended January 31, 2000. If we had allocated our stock-based compensation to the departments for which the services were performed in 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. For the three months ended January 31, 2000, the allocation would have increased

cost of revenue by $44,000, sales and marketing expenses by $640,000, research and development expenses by $296,000 and general and administrative expenses by $187,000. The decrease in stock-based compensation expense in the first quarter of fiscal 2001 consists primarily of an approximate $660,000 decline in expense associated with unvested non-employee options and warrants due a decline in the Company's stock price and an approximate $300,000 decline in amortization of below fair market value employee stock option grants, offset by a $487,000 expense in this period associated with the acquisition of Signature Software in September 2000.

Interest income (expense), net. Interest income (expense), net, improved to $1.7 million of income in the three months ended January 31, 2001 from $807,000 of expense in the three months ended January 31, 2000. The improvement is primarily due to interest earned on increased cash and cash equivalents and short-term investments as a result of our initial public offering on February 4, 2000.

Other income (expense), net. Other income (expense), net primarily consists of bank fees and foreign currency transaction gains and losses. Other income (expense), net decreased $761,000 to $499,000 in expense in the three months ended January 31, 2001 from $262,000 in income in the three months ended January 31, 2000. The decline is primarily due to foreign currency transaction losses in the three months ended January 31, 2001.

LIQUIDITY AND CAPITAL RESOURCES

As of January 31, 2001, cash and cash equivalents were $74.6 million and short-term investments were $26.1 million as compared with cash and cash equivalents of $79.5 million and short-term investments of $36.7 million as of October 31, 2000. Our working capital at January 31, 2001 was $94.9 million, compared to working capital of $101.9 million at October 31, 2000.

Net cash used in operating activities was $15.1 million in the three months ended January 31, 2001, compared with net cash used in operating activities of $3.9 million in the three months ended January 31, 2000. Cash used in operating activities in the three months ended January 31, 2001 was primarily attributable to our net loss, an increase in unbilled services and prepaid expenses and other current assets and a decrease in accounts payable and accrued liabilities offset in part by non-cash expenses including stock-based compensation expense, depreciation and amortization.

Net cash provided by investing activities was $8.8 million in the three months ended January 31, 2001, compared with net cash used in investing activities of $1.0 million in the three months ended January 31, 2000. Net cash provided by investing activities in the three months ended January 31, 2001 was primarily attributable to the purchase and sale of short-term investments offset in part by the purchase of property and equipment to support our expanding operations.

Net cash provided by financing activities was $1.4 million in the three months ended January 31, 2001, compared with $6.2 million in the three months ended January 31, 2000. Net cash provided by financing activities for the three months ended January 31, 2001 were primarily from the exercise of stock options partially offset by payments on long-term debt.

Subsequent to January 31, 2001, the Company acquired 100% of the issued and outstanding capital stock of Brightware, Inc. In connection with this transaction, the Company expects to use approximately $18.0 to $20.0 million in cash for deal consideration, net liabilities assumed and costs incurred to combine the entities.

We anticipate continued spending on capital expenditures consistent with anticipated growth in 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.

RISK FACTORS

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

WE EXPECT TO CONTINUE TO INCUR LOSSES AND MAY NOT BE PROFITABLE IN THE FUTURE

We have incurred quarterly and annual losses intermittently since we were formed in 1983, and regularly since fiscal 1997. We incurred net losses of $9.0 million for fiscal 1998, $28.9 million for fiscal 1999, $16.3 million for fiscal 2000 and $8.6 million for the three months ended January 31, 2001. We expect to continue to incur losses on both a quarterly and annual basis and we are uncertain if or when we will become profitable. Moreover, we expect to continue to incur significant sales and marketing and research and development expenses, and, as a result, we will need to generate significant revenues to achieve and maintain profitability. We may not sustain our growth or generate sufficient revenues to attain profitability.

DISAPPOINTING QUARTERLY REVENUES OR OPERATING RESULTS COULD CAUSE THE PRICE OF OUR COMMON STOCK TO FALL

We currently derive a significant portion of our license revenues in each quarter from a small number of relatively large orders, and we generally recognize revenues from our licenses over the related implementation period. If we are unable to recognize revenues from one or more substantial license sales planned for a particular fiscal quarter, our operating results for that quarter would be seriously harmed. In addition, the purchase of our products typically involves a substantial commitment of resources by our customers or their consultants over an extended period of time. The time required to complete an implementation may vary from customer to customer and may be protracted due to unforeseen circumstances. Because our revenues from implementation, maintenance and training services are largely correlated with our license revenues, a decline in license revenues would also cause a decline in our services revenues in the same quarter and in subsequent quarters. Because our sales cycle is long, we may have difficulty predicting when we will recognize revenues. If our quarterly revenues 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.

A DECLINE IN INFORMATION TECHNOLOGY SPENDING COULD REDUCE THE SALE OF OUR PRODUCTS

Average license fees for our products typically range from approximately several hundred thousand dollars to several million dollars. Often this represents a significant IT capital expenditure for the companies to which we target our sales efforts. If a decline in IT spending should occur, 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.

DIFFICULTIES AND FINANCIAL BURDENS ASSOCIATED WITH ACQUISITIONS COULD HARM OUR BUSINESS AND FINANCIAL RESULTS

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

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

business. Also, the process may require significant financial resources that we might otherwise allocate to other activities, including the ongoing development or expansion of our existing operations.

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

BECAUSE WE HAVE A LIMITED OPERATING HISTORY AS A SOFTWARE COMPANY, OUR FUTURE SUCCESS IS UNCERTAIN

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

A SIGNIFICANT PERCENTAGE OF OUR PRODUCT DEVELOPMENT IS PERFORMED BY A THIRD PARTY INTERNATIONALLY, THE LOSS OF WHICH WOULD SUBSTANTIALLY HARM OUR PRODUCT DEVELOPMENT EFFORTS

A significant percentage of our product development work, and some of our implementation services, are performed by a third-party development organization in Minsk, Belarus. Unpredictable developments in the political, economic and social conditions in Belarus, or our failure to renew our consulting agreement with this organization on terms similar to our current agreement, could eliminate or reduce the availability of these product development and implementation services. 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, and our business could be seriously harmed.

THE SUCCESS OF OUR BUSINESS DEPENDS ON THE SALESPERFORMER SUITE, WHICH HAS BEEN RECENTLY INTRODUCED AND MAY NOT BE WIDELY ADOPTED BY OUR CUSTOMERS

We expect to derive substantially all of our product license revenues in the future from 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 release, introduction and customer acceptance of this new suite of products. We expect that we will continue to depend on revenues from new and enhanced versions of the SalesPerformer Suite, and our business would be harmed if our target customers do not adopt and expand their use of the SalesPerformer Suite and its component products.

WE DEPEND ON KEY PERSONNEL AND MUST ATTRACT AND RETAIN ADDITIONAL QUALIFIED PERSONNEL TO BE SUCCESSFUL

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

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

FAILURE TO EXPAND OUR RELATIONSHIPS WITH SYSTEMS INTEGRATORS AND CONSULTING FIRMS WOULD IMPEDE ACCEPTANCE OF OUR PRODUCTS AND DELAY THE GROWTH OF OUR REVENUES

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

OUR STOCK PRICE MAY CONTINUE TO BE VOLATILE WHICH MAY LEAD TO LOSSES BY INVESTORS AND RESULT IN SECURITIES LITIGATION

The trading price of our common stock has been and may continue to be highly volatile and could be subject to wide fluctuations in price in response to various factors, many of which are beyond our control, including quarterly variations in our results of operations; changes in recommendations by the investment community or in their estimates of our revenues 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 REVENUES COULD SERIOUSLY HARM OUR BUSINESS

International revenues currently account for a significant percentage of our total revenues. We expect international revenues to continue to account for a significant percentage of total revenues 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 revenues as a percentage of total product-related revenues were 13% in fiscal 1999, 36% in fiscal 2000 and 42% for the three months ended January 31, 2001. Our failure to expand our international sales could have a significant negative impact on our business.

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 revenues may decline. We perform research and development activities in Minnesota, New Jersey, Massachusetts and Belarus, and our executive officers and other key employees are similarly dispersed throughout the United States, Europe and Asia. This geographic dispersion requires significant management resources that our locally based competitors do not need to devote to their operations. In addition, the expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources.

INTEGRATION OF A NEW MANAGEMENT TEAM AND NEW PERSONNEL AND CONTINUED RAPID GROWTH MAY STRAIN OUR OPERATIONS

We have experienced a period of rapid growth and expansion requiring a significant increase in new personnel to support our growth and the market opportunity. All members of our senior management team have joined Firepond since May 1997, and we continue to experience turnover at the senior management level. This may place a significant burden on our management and our internal resources. If we are not able to install

adequate systems, procedures and controls to support our future operations in an efficient and timely manner, or if we are unable to otherwise manage growth effectively, our business could be harmed.

INTENSE COMPETITION FROM OTHER TECHNOLOGY COMPANIES COULD PREVENT US FROM INCREASING OR SUSTAINING REVENUES AND PREVENT US FROM ACHIEVING OR SUSTAINING PROFITABILITY

The market for integrated e-business sales and marketing 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 revenues could significantly decline.

IF E-BUSINESS SALES AND MARKETING SOLUTIONS ARE NOT WIDELY ADOPTED, WE MAY NOT BE SUCCESSFUL

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

IF WE ARE UNABLE TO INTRODUCE NEW AND ENHANCED PRODUCTS ON A TIMELY BASIS THAT RESPOND EFFECTIVELY TO CHANGING TECHNOLOGY, OUR REVENUES 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.

WE DEPEND ON TECHNOLOGY LICENSED TO US BY THIRD PARTIES, THE LOSS OF WHICH COULD ADVERSELY AFFECT OUR COMPETITIVE POSITION

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

CLAIMS MAY BE BROUGHT AGAINST US IF WE HIRE FORMER EMPLOYEES OF OUR COMPETITORS, WHICH MAY CAUSE US TO INCUR SUBSTANTIAL COSTS

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

litigation. We could incur substantial costs in defending ourselves against any of these claims, regardless of the merits of these claims.

IF WE ARE UNABLE TO PROVIDE ADEQUATE PROFESSIONAL SERVICE AND CUSTOMER SUPPORT, OUR ABILITY TO SUSTAIN OR GROW OUR BUSINESS WILL BE HARMED

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

IF OUR NEW AND COMPLEX PRODUCTS FAIL TO PERFORM PROPERLY, OUR REVENUES 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 revenues, loss of market share, failure to achieve market acceptance, diversion of development resources or injury to our reputation.

PRODUCT LIABILITY CLAIMS RELATED TO OUR CUSTOMERS' CRITICAL BUSINESS OPERATIONS COULD RESULT IN SUBSTANTIAL COSTS

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

OUR LIMITED ABILITY TO PROTECT OUR INTELLECTUAL PROPERTY MAY HARM OUR ABILITY TO COMPETE

Our success and ability to compete is dependent in part upon our proprietary technology. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of a competitive advantage and decreased revenues. 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.

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.

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, 2001 our executive officers, directors and their affiliates 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.

FUTURE SALES OF OUR STOCK COULD CAUSE OUR STOCK PRICE TO FALL

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

PROVISIONS OF DELAWARE LAW AND OF OUR CHARTER AND BY-LAWS MAY MAKE A TAKEOVER MORE DIFFICULT AND LOWER THE VALUE OF OUR COMMON STOCK

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are engaged in legal proceedings incidental to the normal course of business. Although the ultimate outcome of these matters cannot be determined, we believe that the final outcome of these proceedings will not seriously harm our business.

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 NO.	DESCRIPTION
3.1	Third Amended and Restated Certificate of Incorporation of Firepond, Inc. (incorporated by reference to Exhibit 3.3 to the Firepond, Inc. registration statement on Form S-1, as amended (File No. 333-90911) which was originally filed with the SEC on November 12, 1999.)
3.2	Amended and Restated By-laws of Firepond, Inc. (incorporated by reference to Exhibit 3.5 to the Firepond, Inc. registration statement on Form S-1, as amended (File No. 333-90911) which was originally filed with the SEC on November 12, 1999.)

(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.

FIREPOND, INC.

/s/ KLAUS P. BESIER

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

/s/ PAUL K. MCDERMOTT

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

Dated: March 19, 2001

EXHIBIT INDEX

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