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EPICOR SOFTWARE CORP
Form 10-Q
May 15, 2001

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2001

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NO. 0-20740

EPICOR SOFTWARE CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

33-0277592
(IRS Employer
Identification No.)

195 TECHNOLOGY DRIVE
IRVINE, CALIFORNIA 92618-2402
(Address of principal executive offices, zip code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (949) 585-4000

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 No

As of May 4, 2001, there were 44,643,192 shares of common stock outstanding.

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PART I

FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS:

EPICOR SOFTWARE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	MARCH 31, 2001 ----- (Unaudited)	DECEMBER 2000 -----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 17,087	\$ 26,
Accounts receivable, net	43,620	60,
Prepaid expenses and other current assets	5,201	5,
	-----	-----

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Total current assets	65,908	93,
Property and equipment, net	10,559	12,
Software development costs, net	5,232	6,
Intangible assets, net	17,604	19,
Other assets	3,063	3,
	-----	-----
Total assets	\$ 102,366	\$ 134,
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 9,070	\$ 11,
Accrued expenses	28,643	33,
Current portion of long-term debt	3,759	4,
Accrued restructuring costs	438	
Deferred revenue	43,497	45,
	-----	-----
Total current liabilities	85,407	95,
	-----	-----
Long-term debt	4,515	5,
	-----	-----
Contingencies		
Stockholders' equity:		
Preferred stock	7,501	7,
Common stock	45	
Additional paid-in capital	245,634	240,
Less: deferred stock compensation expense	(4,036)	
Less: notes receivable from officers for issuance of restricted stock	(9,969)	(9,
Accumulated other comprehensive loss	(3,488)	(3,
Accumulated deficit	(223,243)	(201,
	-----	-----
Total stockholders' equity	12,444	34,
	-----	-----
Total liabilities and stockholders' equity	\$ 102,366	\$ 134,
	=====	=====

See accompanying notes to consolidated financial statements.

EPICOR SOFTWARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE OPERATIONS
(in thousands, except per share amounts)
(Unaudited)

THREE MONTHS ENDED
MARCH 31,

2001

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Revenues:		
Software license fees	\$ 12,326	\$ 2
Services	33,856	3
Other	760	
	-----	---
Total revenues	46,942	5
Cost of revenues	22,734	2
	-----	---
Gross profit	24,208	2
Operating expenses:		
Sales and marketing	16,929	2
Software development	8,031	
General and administrative	21,075	1
Amortization of deferred stock compensation expense	246	
	-----	---
Total operating expenses	46,281	4
	-----	---
Loss from operations	(22,073)	(1)
Other (expense) income, net	(22)	
	-----	---
Loss before income taxes	(22,095)	(1)
Provision for income taxes	--	
	-----	---
Net loss	\$ (22,095)	\$ (1)
	=====	====
Unrealized losses on foreign currency translation adjustments	(306)	
	-----	---
Total comprehensive loss	\$ (22,401)	\$ (1)
	=====	====
Net loss per share -- basic	\$ (0.53)	\$
Net loss per share -- diluted	\$ (0.53)	\$
Weighted average common shares outstanding -- basic	41,676	4
Weighted average common shares outstanding -- diluted	41,676	4

See accompanying notes to consolidated financial statements.

EPICOR SOFTWARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

THREE MONTHS ENDED
MARCH 31,

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	2001

OPERATING ACTIVITIES	
Net loss	\$ (22,095)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	4,130
Amortization of deferred stock compensation	246
Write down of capitalized software development costs	1,026
Provision for doubtful accounts	9,926
Changes in operating assets and liabilities:	
Accounts receivable	6,878
Prepaid expenses and other current assets	629
Other assets	693
Accounts payable	(2,107)
Accrued expenses	(4,910)
Accrued merger and restructuring costs	(101)
Deferred revenue	(1,877)

Net cash used in operating activities	(7,562)
INVESTING ACTIVITIES	
Purchases of property and equipment	(691)
Proceeds from sale of short-term investments	--
Software development costs capitalized	--
Proceeds from notes receivable from related party	--

Net cash (used in) provided by investing activities	(691)
FINANCING ACTIVITIES	
Exercise of common stock options	--
Common stock issued under the Employee Stock Purchase Plan	527
Common stock issued under Stock Option Exchange Program	3
Payments on bank debt	(1,719)
Payments on other long-term liabilities	(294)

Net cash (used in) provided by financing activities	(1,483)
Effect of exchange rate changes on cash	(2)

Net decrease in cash and cash equivalents	(9,738)
Cash and cash equivalents at beginning of period	26,825

Cash and cash equivalents at end of period	\$ 17,087
	=====

See accompanying notes to consolidated financial statements.

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The accompanying unaudited condensed consolidated financial statements included herein have been prepared by Epicor Software Corporation (the "Company") in accordance with generally accepted accounting principles and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial information for reporting on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments except for the write-down of capitalized software development costs as discussed below -- Write-Down of Capitalized Software Development Costs) necessary for a fair presentation of the Company's financial position, results of operations and cash flows.

Current and future financial statements may not be directly comparable to the Company's historical financial statements. The results of operations for the three months ended March 31, 2001, are not necessarily indicative of the results of operations that may be reported for any other interim period or for the entire year ending December 31, 2001. The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements, as permitted by SEC rules and regulations for interim reporting.

For the three months ended March 31, 2001 and 2000, the Company incurred net losses of \$22.1 million and \$14.2 million, and negative cash flows from operations of \$7.6 million and \$13.7 million, respectively. The Company had taken steps to reduce its operating expenses as part of its 1999 restructuring, including a reduction in workforce and facilities consolidation and closure. As a result of these actions and the Company's enhanced receivable collection activities, the Company generated positive cash flows from operating activities of \$3.8 million during the quarter ended September 30, 2000 and \$10.5 million in the quarter ended December 31, 2000. To further control costs, the Company announced a restructuring in the second quarter of 2001 in reaction to current economic and software market conditions. This restructuring again included a reduction in workforce and facilities consolidations. Based on the savings expected to be generated from this restructuring, the Company expects to again achieve positive cash flow from operations in the fourth quarter of 2001.

As of March 31, 2001, the Company's principal source of liquidity consisted of its cash and cash equivalents of \$17.1 million. In addition, at such date, the Company had borrowing capacity under its \$20 million revolving line of credit facility of \$9.0 million. The Company is dependent upon its ability to generate cash flows from software license fees, providing services to its customers and other operating revenues and through collection of its accounts receivable to maintain current liquidity levels. If the Company is not successful in achieving targeted 2001 revenues and expenses or positive cash flows from operations, the Company may be required to take further cost-cutting measures and reorganization actions.

Considering current cash reserves, and other existing sources of liquidity, including its revolving line of credit, management believes that the Company will have sufficient sources of financing to continue its operations throughout at least the next twelve months.

REVENUE RECOGNITION

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In October 1997, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") No. 97-2, Software Revenue Recognition. SOP 97-2, as amended by SOP 98-4 "Deferral of the Effective Date of a Provision of SOP 97-2", was adopted by the Company as of July 1, 1998. In December 1998, the AICPA issued SOP 98-9 "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions", which requires recognition of revenue using the "residual method" when (1) there is vendor-specific objective evidence of the fair values of all undelivered elements in a multiple-element arrangement that is not accounted for using long-term contract accounting, (2) vendor-specific objective evidence of fair value does not exist for one or more of the delivered elements in the arrangement, and (3) all revenue-recognition criteria in SOP 97-2 other than the requirement for vendor-specific objective evidence of the fair value of each delivered element of the arrangement are satisfied. SOP 98-9 was adopted by the Company on January 1, 2000.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101), which provides further guidance with regard to revenue recognition, presentation and disclosure. The Company adopted the provisions of SAB 101 during the fourth quarter of fiscal 2000. SAB 101 did not have a material impact on the Company's consolidated financial statements.

BASIC AND DILUTED NET LOSS PER SHARE

Net loss per share is calculated in accordance with SFAS No. 128, "Earnings per Share". Under the provisions of SFAS No. 128, basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period, excluding shares of non-vested restricted stock. Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of common and potential common shares outstanding during the period if their effect is dilutive.

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The following table presents the calculation of basic and diluted net loss per common share (in thousands, except per share amounts):

	Three Month March ----- 2001 -----
Net loss	\$ (22,095)
Weighted average shares outstanding	43,739
Weighted average common shares of non-vested restricted stock	(2,063)

Shares used in the computation of basic and diluted net loss per share	41,676
	=====
Net loss per share - basic and diluted	\$ (0.53)
	=====

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SEGMENT INFORMATION

In accordance with SFAS 131, "Disclosures about Segments of an Enterprise and Related Information", the Company has prepared operating segment information to report components that are evaluated regularly by the Company's chief operating decision maker, or decision making groups, in deciding how to allocate resources and in assessing performance.

The Company's reportable operating segments include software licenses, services, and other. Currently, the Company does not separately allocate operating expenses to these segments, nor does it allocate specific assets to these segments. Therefore, the segment information reported includes only revenues, cost of revenues and gross profit.

Operating segment data for the three months ended March 31, 2001 and 2000 is as follows (in thousands):

	Software Licenses -----	Services -----	Other -----
Three months ended March 31, 2001:			
Revenues	\$12,326	\$33,856	\$ 760
Cost of revenues	5,294	16,930	510
	-----	-----	-----
Gross Profit	\$ 7,032 =====	\$16,926 =====	\$ 250 =====
Three months ended March 31, 2000:			
Revenues	\$20,645	\$34,866	\$1,100
Cost of revenues	5,089	21,442	956
	-----	-----	-----
Gross Profit	\$15,556 =====	\$13,424 =====	\$ 144 =====

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The following schedule presents the Company's operations by geographic area for the three months ended March 31, 2001 and 2000 (in thousands):

	United States -----	Australasia -----	Europe -----	Canada -----
Three months ended March 31, 2001:				
Revenues	\$ 33,139	\$2,284	\$ 7,856	\$2,810
Operating income (loss)	(19,035)	87	(4,490)	1,399
Identifiable assets	73,126	7,953	17,001	4,117

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Three months ended March 31, 2000:

Revenues	\$ 42,692	\$2,645	\$ 7,946	\$2,597
Operating income (loss)	(12,548)	398	(3,291)	1,294
Identifiable assets	114,176	7,335	27,736	5,787

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes new accounting and reporting standards for derivative financial instruments and for hedging activities. SFAS No. 133 requires the Company to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability, depending on the Company's rights or obligations under the applicable derivative contract. In June 1999, the FASB issued SFAS No. 137, which deferred the effective date of the adoption of SFAS No. 133 for one year. The Company adopted SFAS No. 133 on January 1, 2001. The adoption of SFAS No. 133 did not have a material impact on the Company's consolidated financial statements.

In March 2000, the FASB issued FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees ("FIN 44"). FIN 44 clarifies the application of APB No. 25 for the following: the definition of employee for purposes of applying APB No. 25; the criteria for determining whether a plan qualifies as a non-compensatory plan; the accounting consequence for various modifications to the terms of a previously fixed stock option or award; and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 was effective July 1, 2000, but certain conclusions cover specific events occurring after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have a material impact on the Company's consolidated financial statements.

RESTRUCTURINGS

The following table summarizes the activity in the Company's reserves associated with its restructurings (in thousands):

	Balance at December 31, 2000 -----	Cash Payments -----
Facilities closing and downsizing -- 1999 restructuring	\$204	\$ (31)
Remaining restructuring accrual from prior periods -- 1998, 1997 and 1996	335 -----	(70) -----
Accrued restructuring costs	\$539 =====	\$(101) =====

At March 31, 2001, \$438,000 of the restructuring accruals remained and related primarily to lease commitments on which the Company will continue to make payments until the respective leases expire.

2001 Restructuring

In April 2001, the Company announced a restructuring of its operations in an effort to reduce its cost structure through a workforce reduction and the closure or reduction in size of certain of its facilities. The Company will record a charge for this restructuring ranging from approximately \$6.0 million to \$7.0 million during the second quarter of 2001.

CREDIT FACILITY

On July 26, 2000, the Company entered into a \$30.0 million senior credit facility with a financial institution comprised of a \$10.0 million term loan and a \$20.0 million revolving line of credit. On August 8, 2000, the Company received the \$10.0 million proceeds from the term loan. The term loan is due in 36 equal monthly installments, plus interest at the prime rate plus 3% (11.0% at March 31, 2001). The revolving line of credit expires in August 2003, bears interest at a variable rate equal to either the prime rate or at LIBOR, at the Company's option, plus a margin ranging from 0.25% to 1.25% on prime rate loans and 2.5% to 3.75% on LIBOR loans, depending on the Company's results of operations. Borrowings under the revolving line of credit are limited to 85% of eligible accounts receivable, as defined. To date, the Company has not borrowed any amounts against the revolving line of credit facility. As of March 31, 2001, the Company has borrowing capacity of \$9.0 million under its revolving line of credit.

Borrowings under the credit facility are secured by substantially all of the Company's assets and the Company is required to comply with certain financial covenants and conditions, including minimum levels of earnings before interest, taxes, depreciation and amortization (EBITDA) and tangible net worth. As of March 31, 2001, the Company had violated the EBITDA and the tangible net worth covenants included in the terms of the credit agreement. The Company received waivers from its lender for these violations on May 14, 2001. The Company is currently negotiating with its lender to revise the financial covenants to reduce the thresholds required by the EBITDA and the tangible net worth covenants.

WRITE-DOWN OF CAPITALIZED SOFTWARE DEVELOPMENT COSTS

During the quarter ended March 31, 2001, the Company determined that the carrying value of its capitalized software development costs related to localized products marketed in Europe as well as a component of one of its manufacturing products exceeded their net realizable value. Accordingly, a charge of approximately \$1.0 million is included in cost of revenues for the three months ended March 31, 2001 for the write-down of these capitalized costs to their estimated net realizable value.

STOCK OPTION EXCHANGE PROGRAM

In January 2001, the Company offered to current employees that held stock

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options the opportunity to exchange all of their outstanding stock options for restricted shares of the Company's common stock, at a price equal to the par value of such Common Stock. All employees who accepted the offer received one share of restricted stock for every two options exchanged. The restricted stock vests over a period of two to four years, depending upon whether the exchanged options were vested or unvested at the time of the exchange. Employees who elected to exchange their options are ineligible for stock option grants for a period of six months and one day following the exchange date of January 26, 2001. The Company will record a total compensation charge of up to \$4,283,000 over the vesting period of the restricted shares, which represents the fair market value of the restricted common stock issued on the exchange date based upon the quoted market price of the Company's common stock. Compensation expense to be charged to operations in 2001, 2002, 2003, 2004 and 2005 approximates \$1,352,000, \$1,475,000, \$734,000, \$666,000, and \$56,000 respectively, assuming all restricted stock grants vest. The charge to compensation expense for the three months ended March 31, 2001 was \$246,000. The breakdown of this charge by the Company's operating departments is as follows:

Cost of revenues	\$ 45,000
Sales and marketing	65,000
Software development	24,000
General and administrative	112,000

Total compensation expense	\$246,000
	=====

SALE OF PRODUCT LINE

In April 2001, the Company announced the sale of the net assets of its Impresa for MRO product line for approximately \$2.8 million in cash and other future contingent consideration. The sale will result in an after tax gain of approximately \$2.4 million which will be recorded in the Company's results of operations for the second quarter of 2001.

CONTINGENCIES

In August 1999, DataWorks filed for arbitration against AAR Corporation with the American Arbitration Association in Denver, Colorado. The arbitration arose out of the development, licensing and sale of software by DataWorks to AAR in 1997. AAR counterclaimed against DataWorks alleging breach of contract. In January 2001, the Company settled this matter by agreeing to pay AAR \$2,000,000. The Company paid this amount during the quarter ended March 31, 2001.

In December 1998, Alyn Corporation filed a lawsuit against DataWorks in San Diego, California Superior Court arising from the licensing and sale of software by DataWorks to Alyn in December 1996. In March 2000, the Company agreed to pay Alyn \$1,800,000 to settle the lawsuit. The Company paid this amount during the first half of 2000. The Company is continuing its discussions with its insurance carrier regarding the amount of coverage for this matter, but the amount of insurance coverage, if any, has not yet been determined.

In November 1998, a securities class action lawsuit was filed in the United States District Court for the Southern District of California against DataWorks, certain of its current and former officers and directors, and the Company. The consolidated complaint is purportedly brought on behalf of purchasers of DataWorks stock between October 30, 1997 and July 16, 1998. The complaint alleges that defendants made material misrepresentations and omissions concerning DataWorks' acquisition of Interactive Group, Inc. and demand for DataWorks' products. The Company is named as a defendant solely as DataWorks'

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successor, and is not alleged to have taken part in the alleged misconduct. No damage amount is specified in the complaint. The action is in the early stages of litigation, no trial date is set, and defendants' motion to dismiss the second amended consolidated complaint remains pending. The Company believes there is no merit to this lawsuit and intends to continue to defend against it vigorously.

The Company is subject to other legal proceedings and claims in the normal course of business. The Company is currently defending these proceedings and claims, and anticipates that it will be able to resolve these matters in a manner that will not have a material adverse impact on the Company's consolidated financial statements.

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ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS:

OVERVIEW

The Company designs, develops, markets and supports integrated enterprise business software solutions for use by mid-sized companies as well as divisions and subsidiaries of larger corporations worldwide. These integrated solutions address customers' requirements in the areas of customer relationship management, financials, distribution, manufacturing and e-business. The Company's business solutions are focused on the mid-market, which generally includes companies between \$10 million and \$500 million in annual revenues. Its product and services are sold worldwide by the Company's direct sales force, international subsidiaries and an authorized network of VARs, distributors and software consultants.

RESULTS OF OPERATIONS

The following table summarizes certain aspects of the Company's results of operations for the three months ended March 31, 2001 compared to the three months ended March 31, 2000 (in millions except percentages):

	Three Months Ended March 31,		
	2001	2000	Change
	-----	-----	-----
Revenues:			
Software license fees	\$ 12.3	\$ 20.6	\$ (8.3)
Services	33.9	34.9	(1.0)
Other	0.7	1.1	(0.4)
	-----	-----	-----
Total revenues	\$ 46.9	\$ 56.6	\$ (9.7)
As a percentage of total revenues:			
Software license fees	26.3%	36.5%	
Services	72.1%	61.6%	
Other	1.6%	1.9%	
	-----	-----	
Total revenues	100.0%	100.0%	
Gross profit	\$ 24.2	\$ 29.1	\$ (4.9)

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As a percentage of total revenues	51.6%	51.4%	
Sales and marketing expense	\$ 16.9	\$ 20.7	\$ (3.8)
As a percentage of total revenues	36.1%	36.5%	
Software development expense	\$ 8.0	\$ 5.7	\$ 2.3
As a percentage of total revenues	17.1%	10.1%	
General and administrative expense	\$ 21.1	\$ 17.3	\$ 3.8
As a percentage of total revenues	45.0%	30.6%	

Revenues

The Company experienced an overall decrease in software license fee revenues for the three month period ended March 31, 2001 as compared to the same period in 2000. This decrease was across all of the Company's product lines. This decline is due to delays in capital expenditures by customers and reduced IT budgets based on current market conditions and economic uncertainties. The Company expects that these conditions could continue to affect demand for eBusiness and enterprise applications for the remainder of 2001.

Services revenues consist of fees from software maintenance, consulting, and related services. The decrease in services revenues in absolute dollars for the three month period ended March 31, 2001 as compared with the same period in 2000 is attributable to a \$2.0 million, or 12.7%, decrease in consulting revenues due to fewer implementation projects as a result of decreased software license fee revenues as previously discussed. Although services revenues decreased in absolute dollars, as a percentage of total revenues, services revenues increased. This is the result of a \$1.1 million, or 5.9%, increase in maintenance services revenues due to growth of the Company's

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installed base of customers. The Company anticipates that consulting revenues will continue to be negatively impacted by a decrease in the related software license revenues for the remainder of 2001. However, as the Company's installed base continues to grow, some of this decrease in consulting revenues is expected to be offset by an increase in new project revenue with current customers, as well as an increase in maintenance revenues. Other revenues consist primarily of third-party hardware and forms sales. The decrease in other revenues in absolute dollars for the three months ended March 31, 2001 as compared with the same period in 2000 is due to a decrease in third-party hardware sales directly attributable to the aforementioned decrease in software license fees.

International revenues were \$13.8 million in the first quarter of 2001 and 2000, representing 29.4% and 24.4%, respectively, of total revenues. The increase in percentage of total revenues for the three months ended March 31, 2001 as compared to the same 2000 period is primarily attributable to the decrease in total revenues resulting from the aforementioned economic conditions being primarily a domestic occurrence which has not yet impacted international markets. With sales offices located in the Europe, Australia, Asia and South America, the Company expects international revenues to remain a significant portion of total revenues.

Gross Profit

Cost of revenues consist primarily of royalties paid for licensed software incorporated into the Company's products; costs associated with product packaging, documentation and software duplication; costs of consulting, custom

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programming, education and support; and the amortization and write-down of capitalized software development costs. A charge of approximately \$1.0 million is included in cost of revenues for the quarter ended March 31, 2001 to write-down capitalized software development costs related to localized products marketed in Europe and a component of one of the Company's manufacturing products to estimated realizable value.

The decline in gross profit in absolute dollars for the three month period ended March 31, 2001 as compared to the same period in 2000 was due to several factors, including the aforementioned decrease in software license fee revenues, and the previously discussed write-down of capitalized software development costs of \$1.0 million. The slight increase in gross profit percentage for the quarter ended March 31, 2001 as compared to the same quarter in 2000, was due to the above factors, offset by a decrease in the professional services cost base and an increase in the utilization rate of professional services personnel during the first quarter of 2001.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries, commissions, travel, advertising and promotional expenses. The decrease in absolute dollars for the three months ended March 31, 2001 compared to the same period of 2000 is primarily due to a decrease in the cost of salaries, benefits and other headcount related expenses as a result of a reduction in sales personnel, and lower commissions expense resulting from decreased software license fee revenue. Additionally, during the three month period ended March 31, 2001, the Company decreased its advertising and related costs as compared to the same period in 2000 as a result of its measures to decrease overall costs. As a result of the above factors, sales and marketing expense also decreased as a percentage of revenues. The Company expects sales and marketing expenses to decrease for the remainder of 2001 due largely to the second quarter 2001 restructuring, as discussed in the notes to the unaudited condensed consolidated financial statements, and other cost control measures.

Software Development

Software development expenses consist primarily of compensation of development personnel and related overhead incurred to develop the Company's products as well as fees paid to outside consultants. Software development costs are accounted for in accordance with Statement of Financial Accounting Standards No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," under which the Company is required to capitalize software development costs after technological feasibility is established. Costs that do not qualify for capitalization are charged to software development expense when incurred. During the three months ended March 31, 2000, the Company capitalized \$1.5 million of software development costs. No such costs were eligible for capitalization during the three months ended March 31, 2001. Capitalized software development costs include both internally generated development costs for development of the Company's future product releases and third party development costs related to the localization and translation of certain of the Company's products for foreign markets.

The increase in gross software development expenses for the three months ended March 31, 2001 as compared to the same period of 2000 is largely due to an increase in the cost of salaries, benefits and other headcount related expenses as a result of an increase in software development personnel. Additionally, the increase in software development expenses is attributable to the previously

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discussed absence of capitalized expenditures for the three months ended March 31, 2001. The increase in software development costs as a percentage of revenues for the three months ended March 31, 2001 as compared to the same period in the prior year is due to the aforementioned increase in personnel and absence of capitalized expenditures, as well as the decline in the Company's revenue base. The Company expects a decrease in software development expenses for the remainder of 2001, due to the second quarter 2001 restructuring, as discussed in the notes to the unaudited condensed consolidated financial statements, and other cost control measures.

General and Administrative

General and administrative expenses consist primarily of costs associated with the Company's executive, financial, human resources and information services functions. The increase in absolute dollars in general and administrative expenses for the three months ended March 31, 2001 as compared to the same period in 2000 is due to an increase in the Company's provision for doubtful accounts to better reflect the current economic environment and geographical market conditions.

As a percentage of revenue, general and administrative expenses increased for the three month period ended March 31, 2001 as compared to the same period in 2000. This increase is due to both the increases in the provision for doubtful accounts, as well as the decline in the Company's revenue base. The Company expects general and administrative expenses to decrease for the remainder of 2001, due largely to the second quarter 2001 restructuring, as discussed in the notes to the unaudited condensed consolidated financial statements, and other cost control measures.

Liquidity and Capital Resources

The following table summarizes the Company's cash and cash equivalents, working capital deficit and cash flows as of and for the three months ended March 31, 2001 (in millions):

	March 31, 2001 -----
Cash and cash equivalents	\$ 17.1
Working capital deficit	(19.5)
Net cash used in operating activities	(7.6)
Net cash used in investing activities	(0.7)
Net cash used in financing activities	(1.5)

As of March 31, 2001, the Company's principal sources of liquidity included cash and cash equivalents of \$17.1 million. The Company used \$7.6 million in cash for operating activities during the three month period ended March 31, 2001 primarily to fund its net loss. As part of the \$7.6 million in operating cash outlays in the three months ended March 31, 2001, the Company paid \$2.0 million in settlement of the previously discussed AAR lawsuit, \$0.1 million for lease payments related to the Company's restructurings and \$0.6 million for the settlement of a third party reseller agreement accrued for as part of the 1998 DataWorks merger. At March 31, 2001, the Company has \$0.4 million in cash obligations for lease terminations related to the Company's restructurings and \$1.9 million in cash obligations for lease terminations and other costs related to the 1998 DataWorks merger which is included in accrued expenses in the accompanying unaudited condensed consolidated financial statements. The Company believes these obligations will be funded from existing cash reserves, working

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capital, operations and new credit facility.

The Company's principal investing activities for the three month period ended March 31, 2001 included capital expenditures of \$0.7 million.

Financing activities for the three months ended March 31, 2001 included payments of \$1.7 million made against the Company's debt obligations. In addition, cash provided by financing activities included proceeds from the issuance of stock under the employee stock purchase program of \$0.5 million.

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On July 26, 2000, the Company entered into a \$30.0 million senior credit facility with a financial institution comprised of a \$10.0 million term loan and a \$20.0 million revolving line of credit. On August 8, 2000, the Company received the \$10.0 million proceeds from the term loan. The term loan is due in 36 equal monthly installments, plus interest at the prime rate plus 3% (11.0% at March 31, 2001). The revolving line of credit expires in August 2003, bears interest at a variable rate equal to either the prime rate or at LIBOR, at the Company's option, plus a margin ranging from 0.25% to 1.25% on prime rate loans and 2.5% to 3.75% on LIBOR loans, depending on the Company's results of operations. Borrowings under the revolving line of credit are limited to 85% of eligible accounts receivable, as defined. To date, the Company has not borrowed any amounts against the revolving line of credit facility. As of March 31, 2001, the Company has borrowing capacity of \$9.0 million under its revolving line of credit.

Borrowings under the credit facility are secured by substantially all of the Company's assets and the Company is required to comply with certain financial covenants and conditions, including minimum levels of earnings before interest, taxes, depreciation and amortization (EBITDA) and tangible net worth. As of March 31, 2001, the Company had violated the EBITDA and the tangible net worth covenants included in the terms of the credit agreement. The Company received waivers from its lender for these violations on May 14, 2001. The Company is currently negotiating with its lender to revise the financial covenants to reduce the thresholds required by the EBITDA and the tangible net worth covenants.

For the three months ended March 31, 2001 and 2000, the Company incurred net losses of \$22.1 million and \$14.2 million, and negative cash flows from operations of \$7.6 million and \$13.7 million, respectively. The Company had taken steps to reduce its operating expenses as part of its 1999 restructuring, including a reduction in workforce and facilities consolidation and closure. As a result of these actions and the Company's enhanced receivable collection activities, the Company generated positive cash flows from operating activities of \$3.8 million during the quarter ended September 30, 2000 and \$10.5 million in the quarter ended December 31, 2000. To further control costs, the Company announced a restructuring in the second quarter of 2001 in reaction to current economic and software market conditions. This restructuring again included a reduction in workforce and facilities consolidations. Based on the savings expected to be generated from this restructuring, the Company expects to again achieve positive cash flow from operations in the fourth quarter of 2001.

As of March 31, 2001, the Company's principal source of liquidity consisted of its cash and cash equivalents of \$17.1 million. In addition, at such date, the Company had borrowing capacity under its \$20 million revolving line of credit facility of \$9.0 million. The Company is dependent upon its ability to generate cash flows from software license fees, providing services to its customers and other operating revenues and through collection of its accounts receivable to

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maintain current liquidity levels. If the Company is not successful in achieving targeted 2001 revenues and expenses or positive cash flows from operations, the Company may be required to take further cost-cutting measures and reorganization actions.

Although management's goal is to reduce losses and, ultimately, return the Company to profitability, there can be no assurance that these actions will enable the Company to achieve profitability. Considering current cash reserves, and other existing sources of liquidity, including its revolving line of credit, management believes that the Company will have sufficient sources of financing to continue its operations throughout at least the next twelve months.

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes new accounting and reporting standards for derivative financial instruments and for hedging activities. SFAS No. 133 requires the Company to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability, depending on the Company's rights or obligations under the applicable derivative contract. In June 1999, the FASB issued SFAS No. 137, which deferred the effective date of the adoption of SFAS No. 133 for one year. The Company adopted SFAS No. 133 on January 1, 2001. The adoption of SFAS No. 133 did not have a material impact on the Company's consolidated financial statements.

In March 2000, the FASB issued FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees ("FIN 44"). FIN 44 clarifies the application of APB No. 25 for the following: the definition of employee for purposes of applying APB No. 25; the criteria for determining whether a plan qualifies as a non-compensatory plan; the accounting consequence for various modifications to the terms of a previously fixed stock option or award; and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 was effective July 1, 2000, but certain conclusions cover specific events occurring after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have a material impact on the Company's consolidated financial statements.

CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

FORWARD LOOKING STATEMENTS -- SAFE HARBOR.

Certain statements in this Quarterly Report on Form 10-Q are forward looking statements within the meaning of Section 27A of the Securities Act of 1993, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, that involve risks and uncertainties. Any statements contained herein (including without limitation statements to the effect that the Company or Management "estimates," "expects," "anticipates," "plans," "believes," "projects," "continues," "may," or "will" or statements concerning "potential" or "opportunity" or variations thereof or comparable terminology or the negative thereof) that are not statements of historical fact should be construed as forward looking statements. These statements include the Company's expectation that (i) the Company's software license revenue will continue to be impacted in 2001 by current software market conditions and economic uncertainties, (ii) consulting revenues will continue to be impacted by fluctuations in the related software license revenues in 2001, (iii) maintenance revenues will increase as

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the Company's installed base continues to grow, (iv) 2001 international revenues will continue to represent a significant portion of total revenues, (v) the Company will be able to successfully renegotiate the financial covenants of its credit facility, (vi) operating expenses will decrease in 2001 due to the second quarter 2001 restructuring and other cost control measures, and (vii) the Company will achieve positive cash flow from operations in the fourth quarter of 2001. Actual results could differ materially and adversely from those anticipated in such forward looking statements as a result of certain factors including the factors listed as pages 15 to 21. Because of these and other factors that may affect the Company's operating results, past performance should not be considered an indicator of future performance and investors should not use historical results to anticipate results or trends in future periods. The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements. Readers should carefully review the risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission including its quarterly reports on Form 10-Q to be filed by the Company during 2001, and its Annual Report on Form 10-K filed by the Company for the year ending December 31, 2000.

OUR CASH AND CASH EQUIVALENTS HAVE BEEN DECLINING AND THE PROPORTION OF OUR ACCOUNTS RECEIVABLE OVER 90 DAYS OLD HAVE BEEN INCREASING AND, AS A RESULT, OUR DOUBTFUL ACCOUNTS RESERVE MAY NOT BE SUFFICIENT, WE MAY NOT BE ABLE TO COLLECT THE AGED ACCOUNTS AND WE MAY NEED TO RAISE ADDITIONAL CASH.

The Company's cash and cash equivalents decreased from \$26.8 million at December 31, 2000 to \$17.1 million at March 31, 2001, principally due to the net loss incurred during the first quarter of 2001. See "Management's Discussion and Analysis of Financial Conditions and Results of Operations - Liquidity and Capital Resources." If the Company is not successful in achieving targeted revenues and expenses or maintaining a positive cash flow during 2001, the Company may be required to take further actions to align its operating expenses such as additional reductions in work force or other expense cutting measures. In addition, although the Company has obtained a bank line of credit, as of March 31, 2001, the Company had violated the EBITDA and the tangible net worth covenants included in the terms of the credit agreement. The Company received waivers from its lender for these violations on May 14, 2001. The Company is currently negotiating with its lender to revise the financial covenants to reduce the thresholds required by the EBITDA and the tangible net worth covenants. If the Company is unable to maintain a positive cash flow or comply with the financial covenants in its current credit agreement, there can be no assurance that the Company will be able to secure additional funding or, if secured, on favorable terms. The Company has also experienced since December 31, 1999, including as recently as first quarter 2001 an increase in the proportion of accounts receivable over 90 days old. If the Company is not successful in collecting a significant portion of its net accounts receivable, the Company may be required to seek alternative financing sources in addition to the bank credit facility. In addition, should the Company not reduce its aged receivables, its ability to borrow against the revolving portion of the credit facility may be severely restricted due to the fact that borrowings are limited to 85% of eligible receivables, which excludes receivables over ninety days old.

OUR QUARTERLY OPERATING RESULTS ARE SUBJECT TO FLUCTUATIONS AND IF WE FAIL TO MEET EXPECTATIONS OF SECURITIES ANALYSTS OR INVESTORS OUR SHARE PRICE MAY DECREASE.

The Company's quarterly operating results have fluctuated in the past. The Company's operating results may fluctuate in the future as a result of many factors that may include:

- The demand for the Company's products, including reduced demand related to changes in marketing focus for certain products, software market conditions or general economic conditions

- The size and timing of orders for the Company's products
- The number, timing and significance of new product announcements by the Company and its competitors
- The Company's ability to introduce and market new and enhanced versions of its products on a timely basis
- The level of product and price competition
- Changes in operating expenses of the Company
- Changes in average selling prices

Additionally, the Company noted a trend during the last several quarters of lengthening sales cycles for some of its products as existing and prospective customers transition to the purchase of the Company's integrated and comprehensive e-Business suite of products. The Company is unable to determine at this point in time whether this trend will continue or diminish in the future. In addition, the Company will most likely record a significant portion of its revenues in the final month of any quarter with a concentration of such revenues recorded in the final ten business days of that month.

Due to the above factors, among others, the Company's revenues will be difficult to forecast. The Company, however, will base its expense levels, in significant part, on its expectations of future revenue. As a result, the Company expects its expense levels to be relatively fixed in the short term. The Company's failure to meet revenue expectations could adversely affect operating results. Further, an unanticipated decline in revenue for a particular quarter may disproportionately affect the Company's operating results because a relatively small amount of the Company's expenses will vary with its revenues in the short run. As a result, the Company believes that period-to-period comparisons of the Company's results of operations are not and will not necessarily be meaningful, and you should not rely upon them as an indication of future performance. Due to the foregoing factors, it is likely that in some future quarter the Company's operating results will be below the expectations of public market analysts and investors. Such an event would likely have a material adverse effect upon the price of the Company's Common Stock.

IF WE FAIL TO RAPIDLY DEVELOP AND INTRODUCE NEW PRODUCTS AND SERVICES, WE WILL NOT BE ABLE TO COMPETE EFFECTIVELY AND OUR ABILITY TO GENERATE REVENUES WILL SUFFER.

The market for the Company's software products is subject to ongoing technological developments, evolving industry standards and rapid changes in customer requirements. The Company believes the Internet is transforming the way businesses operate and the software requirements of customers. Specifically, the Company believes that customers desire e-Business software applications, or applications that enable a customer to engage in commerce or service over the Internet. As companies introduce products that embody new technologies or as new industry standards emerge, such as web-based applications or applications that support e-Business, existing products may become obsolete and unmarketable. The Company's future business, operating results and financial condition will depend on its ability to:

- Continue to deliver and achieve successful market acceptance of

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e-Business application software to facilitate e-Business, including web enablement

- Enhance its existing products
- Continue to develop new and/or improved products that address the increasingly sophisticated needs of its customers, particularly in the areas of e-Business and e-Commerce
- Develop and continue to develop products for additional platforms
- Effectively train its sales force to sell an integrated suite of e-Business products

Further, if the Company fails to respond to technological advances, emerging industry standards and end-user requirements, or experiences any significant delays in product development or introduction, the Company's competitive position and revenues could be adversely affected. The Company's success will depend on its ability to continue to develop and successfully introduce new products and services, including those in the e-Business arena. The Company cannot assure you that it will successfully develop and market such new and/or improved products on a timely basis, if at all. In developing new products, the Company may encounter software errors or failures that force the delay in the commercial release of the new products. Any such delay or failure to develop could have a material adverse effect on the Company's business, results of operations and financial condition. From time to time, the Company or its competitors may announce new products, capabilities or technologies that have the potential to replace or shorten the life cycles of the Company's existing products. The Company cannot assure you that such announcements will not cause customers to delay or alter their purchasing decisions, which could have a material adverse effect on the Company's business, operating results and financial condition.

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OUR SOFTWARE PRODUCTS MAY CONTAIN ERRORS OR DEFECTS, WHICH COULD RESULT IN THE REJECTION OF OUR PRODUCTS AND DAMAGE OUR REPUTATION AS WELL AS CAUSE LOST REVENUE, DELAYS IN COLLECTING ACCOUNTS RECEIVABLE, DIVERTED DEVELOPMENT RESOURCES AND INCREASED SERVICE COSTS AND WARRANTY CLAIMS.

Software products as complex as the ERP products offered by the Company may contain undetected errors or failures when first introduced or as new versions are released. Despite testing by the Company, and by current and potential customers, any of the Company's products may contain errors after their commercial shipment. Such errors may cause loss of or delay in market acceptance of the Company's products, damage to the Company's reputation, and increased service and warranty costs. The Company from time to time is notified by some of its customers of errors in its various product lines, including its e by Epicor products. Although it has not occurred to date, the possibility of the Company being unable to correct such errors in a timely manner could have a material adverse effect on the Company's results of operations and its cash flows. In addition, technical problems with the current release of the database platforms on which the Company's products operate could impact sales of these products, which could have a material adverse effect on the Company's results of operations.

BUSINESS INTERRUPTIONS COULD ADVERSELY AFFECT OUR BUSINESS.

Our operations are vulnerable to interruption by fire, earthquake, power loss,

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telecommunications failure and other events beyond our control. A substantial portion of our facilities, including our corporate headquarters and other critical business operations, are located near major earthquake faults. We do not carry earthquake insurance and do not fund for earthquake-related losses. Although the facilities in which we host our computer systems are designed to be fault tolerant, the systems are susceptible to damage from fire, floods, earthquakes, power loss, telecommunications failures, and similar events. Our facilities in the State of California are currently subject to electrical blackouts as a consequence of a shortage of available electrical power which is expected to increase during the summer months. In the event these blackouts continue or increase in severity, they could disrupt the operations of our affected facilities. We do not carry financial reserves against business interruptions and although we do carry business interruption insurance limited to special causes of loss, if a business interruption occurs, our business could be seriously harmed.

WE INTEND TO PURSUE STRATEGIC ACQUISITIONS, INVESTMENTS, AND RELATIONSHIPS AND WE MAY NOT BE ABLE TO SUCCESSFULLY MANAGE OUR OPERATIONS IF WE FAIL TO SUCCESSFULLY INTEGRATE ACQUIRED BUSINESSES AND TECHNOLOGIES.

As part of its business strategy, the Company intends to continue to expand its product offerings to include application software products that are complementary to its existing client/server ERP applications, particularly in the areas of e-Business and e-Commerce. This strategy may involve acquisitions, investments in other businesses that offer complementary products, joint development agreements or technology licensing agreements. The risks commonly encountered in the acquisitions of businesses would accompany any future acquisitions or investments by the Company. Such risks may include the following:

- The difficulty of integrating previously distinct businesses into one business unit
- The substantial management time devoted to such activities
- The potential disruption of the Company's ongoing business
- Undisclosed liabilities
- Failure to realize anticipated benefits (such as synergies and cost savings)
- Issues related to product transition (such as development, distribution and customer support)

The Company expects that the consideration it would pay in such future acquisitions would consist of stock, rights to purchase stock, cash or some combination of the aforementioned. If the Company issues stock or rights to purchase stock in connection with these future acquisitions, earnings (loss) per share and then-existing holders of the Company's Common Stock may experience dilution.

The risks that the Company may encounter in licensing technology from third parties include the following:

- The difficulty in integrating the third party product with the Company's products
- Undiscovered software errors in the third party product
- Difficulties in selling the third party product

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- Difficulties in providing satisfactory support for the third party product

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- Potential infringement claims from the use of the third party product

WE RELY ON DISTRIBUTORS AND VARS TO SELL OUR PRODUCTS AND DISRUPTIONS TO THESE CHANNELS WOULD ADVERSELY AFFECT OUR ABILITY TO GENERATE REVENUES FROM THE SALE OF OUR PRODUCTS.

The Company distributes products through a direct sales force as well as through VARs and distributors. The Company's distribution channel includes distributors, VARs and authorized consultants, which consist primarily of professional firms. If the Company's VARs or authorized consultants cease distributing or recommending the Company's products or emphasize competing products, the Company's results of operations could be materially and adversely affected. In May 2000, the Company announced that effective September 1, 2000 in the United States it would only allow its e by Epicor product line to be resold by VARs who offer such product line exclusive of other competing product lines. The immediate result of this change was that as of September 1, 2000 the number of Company VAR's selling the e by Epicor product line domestically was approximately cut in half from 102 to 45. VAR sales for the period ended September 30, 2000 decreased from the quarter ended June 30, 2000. However, the Company was unable to determine how much of this drop in sales revenue, if any, was attributable to the change in the VAR program as opposed to other independent factors. While VAR sales for the quarter ended December 31, 2000 increased over the prior quarter, VAR sales for the quarter ended March 31, 2001 decreased from the previous quarter. The long term impact of this change in the VAR channel to the Company's performance is as of yet undetermined as is whether the Company's ability to generate license revenue from its e by Epicor products will be adversely or favorably impacted, which would effect the Company's consolidated results of operations and cash flows.

There can be no assurance that the direct sales force will not lead to conflicts with the Company's VAR channels.

WE DERIVE A SUBSTANTIAL PORTION OF OUR REVENUE FROM THE SALE OF ENTERPRISE APPLICATION SOFTWARE AND RELATED SUPPORT SERVICES AND IF THOSE SALES SUFFER, OUR BUSINESS WILL BE NEGATIVELY IMPACTED.

The Company derives its revenue from the sale of its various ERP application software packages and related services. Accordingly, any event that adversely affects fees derived from the sale of such systems would materially and adversely affect the Company's business, results of operations and performance. For example, the industry for ERP applications was negatively impacted in 1999 and the first half of 2000 by Year 2000 concerns. Similarly, in the first quarter of 2001, the industry for ERP applications was negatively impacted by the perceived domestic economic slowdown. Other such events may include:

- Competition from other products
- Significant flaws in the Company's products
- Incompatibility with third-party hardware or software products
- Negative publicity or evaluation of the Company or its products
- Obsolescence of the hardware platforms or software environments in which

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the Company's systems run

OUR PRODUCTS RELY ON THIRD PARTY SOFTWARE PRODUCTS AND OUR REPUTATION AND RESULTS OF OPERATIONS COULD BE ADVERSELY AFFECTED BY OUR INABILITY TO CONTROL THEIR OPERATIONS.

The Company's products incorporate and use software products developed by other entities. The Company cannot assure you that such third parties will:

- Remain in business
- Support the Company's product line
- Maintain viable product lines
- Make their product lines available to the Company on commercially acceptable terms

Any significant interruption in the supply of such third-party technology could have a material adverse effect on the Company's business, results of operation, cash flows and financial condition.

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THE MARKET FOR WEB-BASED DEVELOPMENT TOOLS, APPLICATION PRODUCTS AND CONSULTING AND EDUCATION SERVICES IS EMERGING AND IT COULD NEGATIVELY AFFECT OUR CLIENT/SERVER-BASED PRODUCTS.

The Company's development tools, application products and consulting and education services generally help organizations build, customize or deploy solutions that operate in a client/server computing environment. There can be no assurance that these markets will continue to grow or that the Company will be able to respond effectively to the evolving requirements of these markets. The Company believes that the environment for application software is continuing to change from client/server to a web-based environment to facilitate e-Business. If the Company fails to respond effectively to evolving requirements of this market, the Company's business, financial condition, results of operations and cash flows will be materially and adversely affected.

THE CONTINUING IMPACT ON THE COMPANY OF EMERGING AREAS SUCH AS THE INTERNET, ON-LINE SERVICES, E-BUSINESS APPLICATIONS AND ELECTRONIC COMMERCE IS UNCERTAIN AND COULD NEGATIVELY IMPACT OUR BUSINESS.

There can be no assurance that the Company will be able to continue to provide a product offering that will satisfy new customer demands in these areas. In addition, standards for web-enabled and e-Business applications, as well as other industry adopted and de facto standards for the Internet, are continuing to evolve rapidly. There can be no assurance that standards chosen by the Company will position its products to compete effectively for business opportunities as they arise on the Internet and other emerging areas. The success of the Company's product offerings depends, in part, on its ability to continue developing products that are compatible with the Internet. The increased commercial use of the Internet will require substantial modification and customization of the Company's products and the introduction of new products. The Company may not be able to effectively compete in the Internet-related products and services market.

Critical issues concerning the commercial use of the Internet, including security, demand, reliability, cost, ease of use, accessibility, quality of

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service and potential tax or other government regulation, remain partially and/or fully unresolved and may affect the use of the Internet as a medium to support the functionality of our products and distribution of our software. If these critical issues are not favorably resolved, the Company's business, operating results, cash flows and financial condition could be materially and adversely affected.

THE MARKET FOR OUR PRODUCTS IS HIGHLY COMPETITIVE AND IF WE ARE UNABLE TO COMPETE EFFECTIVELY WITH EXISTING OR NEW COMPETITORS OUR BUSINESS COULD BE NEGATIVELY IMPACTED.

The business information systems industry in general and the ERP computer software industry in particular are very competitive and subject to rapid technological change. Many of the Company's current and potential competitors have (1) longer operating histories, (2) significantly greater financial, technical and marketing resources, (3) greater name recognition, (4) larger technical staffs, and (5) a larger installed customer base than the Company has. A number of companies offer products that are similar to the Company's products and that target the same markets. In addition, any of these competitors may be able to respond quicker to new or emerging technologies and changes in customer requirements (such as e-Business and Web-based application software), and to devote greater resources to the development, promotion and sale of their products than the Company. Furthermore, because there are relatively low barriers to entry in the software industry, the Company expects additional competition from other established and emerging companies. Such competitors may develop products and services that compete with those offered by the Company or may acquire companies, businesses and product lines that compete with the Company. It also is possible that competitors may create alliances and rapidly acquire significant market share. Accordingly, there can be no assurance that the Company's current or potential competitors will not develop or acquire products or services comparable or superior to those that the Company develops, combine or merge to form significant competitors, or adapt quicker than will the Company to new technologies, evolving industry trends and changing customer requirements. Competition could cause price reductions, reduced margins or loss of market share for the Company's products and services, any of which could materially and adversely affect the Company's business, operating results and financial condition. There can be no assurance that the Company will be able to compete successfully against current and future competitors or that the competitive pressures that the Company may face will not materially adversely affect its business, operating results, cash flows and financial condition.

WE MAY NOT BE ABLE TO MAINTAIN AND EXPAND OUR BUSINESS IF WE ARE NOT ABLE TO RETAIN, HIRE AND INTEGRATE SUFFICIENTLY QUALIFIED PERSONNEL.

The Company's success depends on the continued service of key management personnel that are not subject to an employment agreement. In addition, the competition to attract, retain and motivate qualified technical, sales and

operations personnel is intense. The Company has at times experienced, and continues to experience, difficulty in recruiting qualified personnel, particularly in software development and customer support. There is no assurance that the Company can retain its key personnel or attract other qualified personnel in the future. The failure to attract or retain such persons could have a material adverse effect on the Company's business, operating results, cash flows and financial condition.

OUR FUTURE RESULTS COULD BE HARMED BY ECONOMIC, POLITICAL, REGULATORY AND OTHER

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RISKS ASSOCIATED WITH INTERNATIONAL SALES AND OPERATIONS.

The Company believes that any future growth of the Company will be dependent, in part, upon the Company's ability to maintain and increase revenues in international markets. There is no assurance that the Company will maintain or expand its international sales. If the revenues that the Company generates from foreign activities are inadequate to offset the expense of maintaining foreign offices and activities, the Company's business, financial condition and results of operations could be materially and adversely affected. International sales are subject to inherent risks, including:

- Unexpected changes in regulatory requirements
- Tariffs and other barriers
- Unfavorable intellectual property laws
- Fluctuating exchange rates
- Difficulties in staffing and managing foreign sales and support operations
- Longer accounts receivable payment cycles
- Difficulties in collecting payment
- Potentially adverse tax consequences, including repatriation of earnings
- Development of localized and translated products
- Lack of acceptance of localized products in foreign countries
- Burdens of complying with a wide variety of foreign laws
- Effects of high local wage scales and other expenses
- Shortage of skilled personnel required for the local operation

Any one of these factors could materially and adversely affect the Company's future international sales and, consequently, the Company's business, operating results, cash flows and financial condition. A portion of the Company's revenues from sales to foreign entities, including foreign governments, has been in the form of foreign currencies. The Company does not have any hedging or similar foreign currency contracts. Fluctuations in the value of foreign currencies could adversely impact the profitability of the Company's foreign operations.

IF THIRD PARTIES INFRINGE OUR INTELLECTUAL PROPERTY, WE MAY EXPEND SIGNIFICANT RESOURCES ENFORCING OUR RIGHTS OR SUFFER COMPETITIVE INJURY.

The Company relies on a combination of copyright, trademark and trade secret laws, employee and third-party nondisclosure agreements and other industry standard methods for protecting ownership of its proprietary software. However, the Company cannot assure you that in spite of these precautions, an unauthorized third party will not copy or reverse-engineer certain portions of the Company's products or obtain and use information that the Company regards as proprietary. There is no assurance that the mechanisms that the Company uses to protect its intellectual property will be adequate or that the Company's competitors will not independently develop products that are substantially equivalent or superior to the Company's products.

The Company may from time to time receive notices from third parties claiming that its products infringe upon third-party intellectual property rights. The

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Company expects that as the number of software products in the country increases and the functionality of these products further overlaps, the number of these types of claims will increase. Any such claim, with or without merit, could result in costly litigation and require the Company to enter into royalty or licensing arrangements. The terms of such royalty or license arrangements, if required, may not be favorable to the Company.

In addition, in certain cases, the Company provides the source code for some of its application software under licenses to its customers to enable them to customize the software to meet their particular requirements. Although the source code licenses contain confidentiality and nondisclosure provisions, the Company cannot be certain that

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such customers will take adequate precautions to protect the Company's source code or other confidential information.

SUBSTANTIAL SALES OF OUR STOCK COULD CAUSE OUR STOCK PRICE TO DECLINE.

As of May 4, 2001, the Company had 44,643,192 shares of common stock outstanding. There are presently 95,305 shares of Series C Preferred Stock outstanding. Each share of Series C Preferred Stock is convertible into ten shares of common stock, as adjusted for stock dividends, combinations or splits at the option of the holder and is entitled to vote with the holders of common stock on an as-converted basis on all matters presented for shareholder approval. The holders of the Series C Preferred Stock have the right to cause the Company to register the sale of the shares of common stock issuable upon conversion of the Series C Preferred Stock. Also, the Company has a substantial number of options or shares issuable to employees under employee option, stock grant, or restricted stock grant plans. As a result, a substantial number of shares of common stock will be eligible for sale in the public market at various times in the future. Sales of substantial amounts of such shares could adversely affect the market price of the Company's Common Stock.

THE MARKET FOR OUR STOCK IS VOLATILE AND FLUCTUATIONS IN OPERATING RESULTS, CHANGES IN EARNINGS ESTIMATES BY ANALYSTS AND OTHER FACTORS COULD NEGATIVELY AFFECT OUR STOCK'S PRICE.

The market prices for securities of technology companies, including the Company, have been quite volatile. Quarter to quarter variations in operating results, changes in earnings estimates by analysts, announcements of technological innovations or new products by the Company or its competitors, announcements of major contract awards and other events or factors may have a significant impact on the market price of the Company's Common Stock. In addition, the securities of many technology companies have experienced extreme price and volume fluctuations, which have often been unrelated to the companies' operating performance. These conditions may adversely affect the market price of the Company's Common Stock.

Because of these and other factors affecting the Company's operating results, past financial performance should not be considered an indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

ITEM 3 -- QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk. The Company's exposure to market risk for changes in

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interest rates relates primarily to the Company's investment portfolio. The Company does not use derivative financial instruments in its investment portfolio. The Company places its investments with high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company is averse to principal loss and ensures the safety and preservation of its invested funds by limiting default risk, market risk, and reinvestment risk. The Company mitigates default risk by investing in only the safest and highest credit quality securities and by constantly positioning its portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor.

Foreign Currency Risk. The Company transacts business in various foreign currencies, primarily in certain European countries, Canada and Australia. The Company does not have any hedging or similar foreign currency contracts. International revenues represented 29.4% of the Company's total revenues for the three months ended March 31, 2001 and 27.5% of revenues were denominated in foreign currencies. Significant currency fluctuations may adversely impact foreign revenues. However, the Company does not foresee or expect any significant changes in foreign currency exposure in the near future.

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PART II

OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

In August 1999, DataWorks filed for arbitration against AAR Corporation with the American Arbitration Association in Denver, Colorado. The arbitration arose out of the development, licensing and sale of software by DataWorks to AAR in 1997. AAR counterclaimed against DataWorks alleging breach of contract. In January 2001, the Company settled this matter by agreeing to pay AAR \$2,000,000. The Company paid this amount during the quarter ended March 31, 2001.

In December 1998, Alyn Corporation filed a lawsuit against DataWorks in San Diego, California Superior Court arising from the licensing and sale of software by DataWorks to Alyn in December 1996. In March 2000, the Company agreed to pay Alyn \$1,800,000 to settle the lawsuit. The Company paid this amount during the first half of 2000. The Company is continuing its discussions with its insurance carrier regarding the amount of coverage for this matter, but the amount of insurance coverage, if any, has not yet been determined.

In November 1998, a securities class action lawsuit was filed in the United States District Court for the Southern District of California against DataWorks, certain of its current and former officers and directors, and the Company. The consolidated complaint is purportedly brought on behalf of purchasers of DataWorks stock between October 30, 1997 and July 16, 1998. The complaint alleges that defendants made material misrepresentations and omissions concerning DataWorks' acquisition of Interactive Group, Inc. and demand for DataWorks' products. The Company is named as a defendant solely as DataWorks' successor, and is not alleged to have taken part in the alleged misconduct. No damage amount is specified in the complaint. The action is in the early stages of litigation, no trial date is set, and defendants' motion to dismiss the second amended consolidated complaint remains pending. The Company believes there is no merit to this lawsuit and intends to continue to defend against it vigorously.

The Company is subject to other legal proceedings and claims in the normal

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course of business. The Company is currently defending these proceedings and claims, and anticipates that it will be able to resolve these matters in a manner that will not have a material adverse impact on the Company's consolidated financial statements.

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) Reports on Form 8-K

None

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SIGNATURE

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.

EPICOR SOFTWARE CORPORATION

(Registrant)

Date: May 15, 2001

/s/ Lee Kim

Lee Kim
Vice President and Chief Financial Officer

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