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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended October 31, 2006**

**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 number 0-22823**

# QAD Inc.

(Exact name of Registrant as specified in its charter)

| **Delaware** | **77-0105228** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**6450 Via Real, Carpinteria, California 93013**
(Address of principal executive offices)

**(805) 684-6614**
(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 ☑ No ☐.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ☐ Accelerated filer ☑ Non-accelerated filer☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑.

The number of shares outstanding of the issuer's common stock as of November 30, 2006 was 32,324,104.

**QAD INC.**
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## PART I

## ITEM 1 – FINANCIAL STATEMENTS

**QAD INC.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(in thousands, except share data)**
**(unaudited)**

| | October 31, 2006 | January 31, 2006 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and equivalents | $ 50,368 | $ 59,971 |
| Restricted cash | 2,612 | — |
| Accounts receivable, net | 42,432 | 61,819 |
| Other current assets | 14,452 | 14,406 |
| Total current assets | 109,864 | 136,196 |
| Property and equipment, net | 43,884 | 40,825 |
| Capitalized software costs, net | 7,943 | 5,251 |
| Goodwill | 11,903 | 10,640 |
| Other assets, net | 15,093 | 14,146 |
| Total assets | $ 188,687 | $ 207,058 |
| **Liabilities and stockholders' equity** | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ 271 | $ 243 |
| Accounts payable | 8,469 | 9,136 |
| Deferred revenue | 56,938 | 75,314 |
| Other current liabilities | 31,435 | 30,809 |
| Total current liabilities | 97,113 | 115,502 |
| Long-term debt | 17,334 | 17,546 |
| Other liabilities | 1,641 | 820 |
| Minority interest | 663 | 665 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, $0.001 par value. Authorized 5,000,000 shares; none issued and outstanding | 35 | 35 |
| Common stock, $0.001 par value. Authorized 150,000,000 shares; issued 35,351,806 and 35,350,084 shares at October 31, 2006 and January 31, 2006, respectively | 127,186 | 123,376 |
| Additional paid-in capital | | |
| Treasury stock, at cost (3,086,112 and 2,813,739 shares at October 31, 2006 and January 31, 2006, respectively) | (22,989) | (20,752) |
| Accumulated deficit | (24,630) | (23,551) |
| Unearned compensation – restricted stock | (229) | (330) |
| Accumulated other comprehensive loss | (7,437) | (6,253) |
| Total stockholders' equity | 71,936 | 72,525 |
| Total liabilities and stockholders' equity | $ 188,687 | $ 207,058 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**QAD INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**
**(in thousands, except per share data)**
**(unaudited)**

| | Three Months Ended October 31, | | Nine Months Ended October 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| License fees | $ 10,974 | $ 10,066 | $ 34,736 | $ 40,233 |
| Maintenance and other | 30,949 | 29,297 | 91,847 | 87,400 |
| Services | 15,401 | 12,049 | 42,515 | 37,805 |
| Total revenue | 57,324 | 51,412 | 169,098 | 165,438 |
| Costs and expenses: | | | | |
| Cost of license fees | 1,852 | 1,604 | 5,367 | 5,852 |
| Cost of maintenance, service and other revenue | 21,311 | 19,425 | 62,346 | 60,093 |
| Sales and marketing | 15,566 | 13,818 | 47,114 | 45,636 |
| Research and development | 9,835 | 7,302 | 30,092 | 23,644 |
| General and administrative | 7,389 | 6,315 | 21,138 | 19,573 |
| Amortization of intangibles from acquisitions | 107 | 51 | 148 | 237 |
| Total costs and expenses | 56,060 | 48,515 | 166,205 | 155,035 |
| Operating income | 1,264 | 2,897 | 2,893 | 10,403 |
| Other (income) expense: | | | | |
| Interest income | (617) | (334) | (2,008) | (993) |
| Interest expense | 320 | 336 | 859 | 1,240 |
| Other (income) expense, net | 99 | (350) | (1,533) | (1,345) |
| Total other (income) expense | (198) | (348) | (2,682) | (1,098) |
| Income before income taxes | 1,462 | 3,245 | 5,575 | 11,501 |
| Income tax expense | 515 | 557 | 2,099 | 2,463 |
| Net income | $ 947 | $ 2,688 | $ 3,476 | $ 9,038 |
| Basic net income per share | $ 0.03 | $ 0.08 | $ 0.11 | $ 0.28 |
| Diluted net income per share | $ 0.03 | $ 0.08 | $ 0.10 | $ 0.27 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**QAD INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in thousands)**
**(unaudited)**

| | Nine Months Ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net income | $ 3,476 | $ 9,038 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,654 | 5,585 |
| Provision for doubtful accounts and sales adjustments | 67 | 39 |
| (Gain) loss on disposal of property and equipment | 10 | (12) |
| Tax benefit from reversal of tax allowances and reserves | — | (793) |
| Exit costs | 524 | 1,075 |
| Stock compensation expense | 3,887 | 83 |
| Other, net | (82) | (154) |
| Changes in assets and liabilities, net of effects from acquisitions: | | |
| Accounts receivable | 22,200 | 23,664 |
| Other assets | 721 | 2,267 |
| Accounts payable | (1,957) | (3,861) |
| Deferred revenue | (19,751) | (14,666) |
| Other liabilities | (3,806) | (3,179) |
| Net cash provided by operating activities | 10,943 | 19,086 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (3,714) | (5,912) |
| Capitalized software costs | (1,044) | (2,845) |
| Acquisition of businesses, net of cash acquired | (6,973) | — |
| Restricted cash | (2,612) | — |
| Proceeds from sale of intangible assets | 906 | — |
| Proceeds from sale of marketable securities | — | 13,000 |
| Proceeds from sale of property and equipment | 177 | 43 |
| Net cash (used in) provided by investing activities | (13,260) | 4,286 |
| Cash flows from financing activities: | | |
| Repayments of debt | (244) | (7,794) |
| Proceeds from issuance of common stock | 1,384 | 2,236 |
| Changes in cash overdraft | 950 | (1,057) |
| Dividends paid | (2,441) | (2,450) |
| Minority shareholder payment | (389) | — |
| Repurchase of common stock | (5,567) | (14,800) |
| Net cash used in financing activities | (6,307) | (23,865) |
| Effect of exchange rates on cash and equivalents | (979) | (1,999) |
| Net decrease in cash and equivalents | (9,603) | (2,492) |
| Cash and equivalents at beginning of period | 59,971 | 55,289 |
| Cash and equivalents at end of period | $ 50,368 | $ 52,797 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**QAD INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

## 1. BASIS OF PRESENTATION

In the opinion of management, the accompanying Condensed Consolidated Financial Statements contain all adjustments necessary to present fairly the financial information contained therein. These statements do not include all disclosures required by accounting principles generally accepted in the United States of America for annual financial statements and should be read in conjunction with the audited financial statements and related notes included in the Annual Report on Form 10-K for the year ended January 31, 2006 of QAD Inc. (QAD or the Company). The results of operations for the three and nine months ended October 31, 2006 are not necessarily indicative of the results to be expected for the year ending January 31, 2007.

## RECLASSIFICATIONS

Certain prior year balances have been reclassified to conform to current year presentation.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

*Taxes Collected From Customers*

In June 2006, the Financial Accounting Standards Board (FASB) ratified Emerging Issues Task Force Issue 06-3, "How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement" (EITF 06-3). EITF 06-3 requires a company to disclose its accounting policy (i.e., gross or net presentation) regarding the presentation of taxes within the scope of EITF 06-3. If taxes are significant, a company should disclose the amount of such taxes for each period for which an income statement is presented. The provisions of EITF 06-3 are effective for the Company on February 1, 2007. The Company is currently evaluating the impact, if any, that EITF 06-3 will have on its financial statements.

*Uncertainty in Income Taxes*

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), to clarify the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards (SFAS) 109, "Accounting for Income Taxes." Effective January 1, 2007, FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the impact, if any, that FIN 48 will have on its financial statements. The potential impact of adoption could be the increase or reduction of certain tax contingency reserves.

*Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157), which clarifies the definition of fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 will be effective for the Company on February 1, 2008. The Company is currently evaluating the impact, if any, that SFAS 157 will have on its financial statements.

*Effects of Prior Year Misstatements*

In September 2006, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 provides interpretive guidance regarding the SEC's views on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The provisions of SAB 108 will be effective for the Company for the fiscal year ended January 31, 2007. The Company is currently evaluating the impact, if any, of applying SAB 108 on its financial statements.

**QAD INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

## 3. COMPUTATION OF NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share:

| | Three Months Ended October 31, | | Nine Months Ended October 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | (in thousands, except per share data) | | | |
| Net income | $ 947 | $ 2,688 | $ 3,476 | $ 9,038 |
| Weighted average shares of common stock outstanding — *basic* | 32,238 | 32,236 | 32,465 | 32,798 |
| Weighted average shares of common stock equivalents issued using the treasury stock method | 673 | 842 | 727 | 882 |
| Weighted average shares of common stock and common stock equivalents outstanding — *diluted* | 32,911 | 33,078 | 33,192 | 33,680 |
| Basic net income per share | $ 0.03 | $ 0.08 | $ 0.11 | $ 0.28 |
| Diluted net income per share | $ 0.03 | $ 0.08 | $ 0.10 | $ 0.27 |

Common stock equivalent shares consist of the shares issuable upon the exercise of stock options using the treasury stock method. For the three and nine months ended October 31, 2006, shares of common stock equivalents of approximately 4.4 million and 3.8 million, respectively, were not included in the diluted calculation because they were anti-dilutive. For the three and nine months ended October 31, 2005, shares of common stock equivalents of approximately 1.8 million and 1.9 million, respectively, were not included in the diluted calculation because they were anti-dilutive.

## 4. COMPREHENSIVE INCOME

Comprehensive income includes changes in the balances of items that are reported directly as a separate component of stockholders' equity in the Company's Condensed Consolidated Balance Sheets. The components of comprehensive income are as follows:

| | Three Months Ended October 31, | | Nine Months Ended October 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | (in thousands) | | | |
| Net income | $ 947 | $ 2,688 | $ 3,476 | $ 9,038 |
| Foreign currency translation adjustments | 337 | 22 | (1,184) | (1,586) |
| Comprehensive income | $ 1,284 | $ 2,710 | $ 2,292 | $ 7,452 |

## 5. BUSINESS COMBINATIONS

The results of operations of the following acquired businesses are included in the Condensed Consolidated Financial Statements from the respective dates of acquisition.

*Precision Software Limited*

On September 20, 2006, QAD acquired Dublin, Ireland-based Precision Software Limited (Precision), a provider of transportation management software solutions to more than 900 customer sites in 55 countries. Precision has main offices in Ireland and the United States with approximately 100 employees, and will operate as a division of QAD.

**QAD INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

The Company acquired all of the stock of Precision. The Precision business includes certain tangible assets and all intangible assets, including a trade name, customer relationships and all intellectual property rights to Precision's software solutions. At closing, QAD paid $8.1 million in cash, of which $2.6 million is held in escrow, contingent upon the completion of an audit of the acquired opening balance sheet. Future contingent payments of $7.2 million may be made over the next two years bringing the total maximum consideration to $15.3 million.

The purchase price was allocated to net assets acquired including intellectual property, trade name and customer relationships. The current purchase price allocation is preliminary and subject to adjustment based on future contingent payments and the final valuation of tax reserves and contingencies.

*Bisgen Ltd.*

On June 30, 2006, the Company acquired UK-based Bisgen Ltd. (Bisgen). Bisgen develops and sells Customer Relationship Management (CRM) software, marketed under the eBisgen name. The Company acquired the entire capital of Bisgen including all intellectual property rights to Bisgen's CRM software for approximately $0.9 million. Included in the purchase is contingent consideration whereby the Company will pay a minimum $0.2 million earn-out to Bisgen based on future license sales related to CRM.

The purchase price was allocated to goodwill, intellectual property, a restrictive covenant, customer relationships and assumed net liabilities. The current purchase price allocation is preliminary and subject to adjustment based on the final valuation of tax reserves and contingencies.

*Soft Cell N.V.*

In March 2006, QAD acquired the rights to certain assets of Soft Cell N.V. (Soft Cell), a company headquartered in Belgium, including sole ownership of all intellectual property rights owned by Soft Cell that were subject to co-ownership by QAD, as well as ownership of intellectual property rights to certain other related technology for total consideration of $1.4 million. Specifically, the acquired assets included the purchase of certain tangible assets and all intangible assets, including all intellectual property rights to all former and current software versions and technology belonging to Soft Cell, the trade name "Soft Cell", and customer relationships. The transaction excluded all debt, outstanding customer claims and other liabilities.

Prior to the acquisition, in fiscal 2006, the Company had purchased co-ownership rights from Soft Cell to certain technology. This purchased technology was technologically feasible at the original purchase date and there were no significant issues related to integration with QAD software. The total purchase price for all modules was approximately $3.9 million and payment was due in phases from February 2005 through May 2006. As of March 2006, QAD owed Soft Cell $0.5 million related to the purchased technology. As part of the acquisition, this amount was no longer owed and, as such, QAD lowered the amount previously recorded in capitalized software from $3.9 million to $3.4 million.

The acquired intellectual property is primarily comprised of two versions of Soft Cell financial software, version 3 and version 5, of which version 5 is complementary to MFG/PRO. Version 5 has been capitalized as intellectual property and will be amortized over three years, beginning in the period the product is sold to customers.

Because some of the acquired assets were not compatible with the Company's core business, subsequent to March 2006, QAD sold certain assets acquired to third-parties, including a license to version 3 of the software, customer contracts, the "Soft Cell" trade name and certain fixed assets, for total consideration of $1.1 million.

**QAD INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

## 6. CAPITALIZED SOFTWARE COSTS

Capitalized software costs and accumulated amortization at October 31, 2006 and January 31, 2006 were as follows:

| | October 31, 2006 | January 31, 2006 |
|---|---|---|
| | (in thousands) | |
| Capitalized software costs: | | |
| Acquired software technology | $ 8,120 | $ 6,197 |
| Capitalized software development costs | 2,203 | 1,520 |
| | 10,323 | 7,717 |
| Accumulated amortization | (2,380) | (2,466) |
| Capitalized software costs, net | $ 7,943 | $ 5,251 |

Included in capitalized software costs as of October 31, 2006 and January 31, 2006 is $3.5 million and $3.9 million, respectively, of purchased software related to the Soft Cell transactions. Additionally, during the nine months ended October 31, 2006, the Company capitalized $1.0 million in internally incurred development costs related to this product. The capitalized acquired software and development costs related to the Soft Cell technology will be amortized over three years beginning when the product is sold to customers, which is expected to occur in fiscal 2008. For further explanation of the various transactions with Soft Cell N.V., see note 5 “Business Combinations” within these Notes to Condensed Consolidated Financial Statements.

In addition, the increase in capitalized software costs from January 31, 2006 to October 31, 2006 is partially due to $0.6 million software technology acquired from Bisgen Ltd. in the second quarter of fiscal 2007, and $2.4 million software technology acquired from Precision Software Limited in the third quarter of fiscal 2007.

The change in capitalized software development costs from January 31, 2006 to October 31, 2006 includes $1.1 million of “Capitalized software development costs” being removed from the balance sheet. It is the Company’s policy to write-off capitalized software development costs once fully amortized. Accordingly, the corresponding $1.1 million of “Accumulated amortization” was also removed from the balance sheet. These write-offs do not impact “Capitalized software costs, net.”

Amortization of capitalized software costs was $1.0 million and $1.2 million for the nine months ended October 31, 2006 and October 31, 2005, respectively, and is included in “Cost of license fees” in the accompanying Condensed Consolidated Statements of Operations.

## 7. GOODWILL AND INTANGIBLE ASSETS

*Goodwill*

The changes in the carrying amounts of goodwill for the nine months ended October 31, 2006, by reporting unit, were as follows (reporting unit regions are defined in note 11 “Business Segment Information” within these Notes to Condensed Consolidated Financial Statements):

| | North America | EMEA | Asia Pacific | Latin America | Total |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Balances, January 31, 2006 | $ — | $ 9,511 | $ 282 | $ 847 | $ 10,640 |
| Additions | 260 | 260 | — | — | 520 |
| Impact of foreign currency translation | — | 751 | 17 | (25) | 743 |
| Balances, October 31, 2006 | $ 260 | $ 10,522 | $ 299 | $ 822 | $ 11,903 |

**QAD INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

The increase in goodwill from January 31, 2006 to October 31, 2006 is partially due to $0.5 million in goodwill recorded in connection with the Soft Cell N.V. and Bisgen Ltd. acquisitions due to the excess of purchase price over estimated fair value of acquired net assets. For further explanation of acquisition related transactions, see note 5 "Business Combinations" within these Notes to Condensed Consolidated Financial Statements.

The Company is required to analyze goodwill for impairment on at least an annual basis. The Company has chosen the fourth quarter of its fiscal year as its annual test period.

*Intangible Assets*

| | October 31, 2006 | January 31, 2006 |
|---|---|---|
| | (in thousands) | |
| Amortizable intangible assets | $ 1,584 | $ 152 |
| Less: accumulated amortization | (260) | (105) |
| Net amortizable intangible assets | $ 1,324 | $ 47 |

Intangible assets are included in "Other assets, net" in the Company's Condensed Consolidated Balance Sheets. The increase in amortizable intangible assets from January 31, 2006 to October 31, 2006 is due to intangible assets related to the Bisgen and Precision acquisitions. For further discussion of these acquisitions, see note 5 "Business Combinations" within these Notes to Condensed Consolidated Financial Statements.

As of October 31, 2006 and January 31, 2006, excluding goodwill, all of the Company's intangible assets were determined to have definite useful lives, and therefore were subject to amortization.

Intangible assets are principally comprised of customer relationships, trade name and a covenant not to compete. The aggregate amortization expense related to amortizable intangible assets was $0.1 million and $0.2 million for each of the three and nine months ended October 31, 2006 and 2005, respectively.

The estimated remaining amortization expense related to amortizable intangible assets for the years ended January 31, 2007, 2008, 2009 and 2010 is $0.2 million, $0.5 million, $0.4 million and $0.2 million, respectively. No additional amortization of these assets is estimated in fiscal 2011 and thereafter.

**8. LONG-TERM DEBT**

| | October 31, 2006 | January 31, 2006 |
|---|---|---|
| | (in thousands) | |
| Total debt | | |
| Notes payable | $ 17,533 | $ 17,715 |
| Capital lease obligations | 72 | 74 |
| | 17,605 | 17,789 |
| Less current maturities | 271 | 243 |
| Long-term debt | $ 17,334 | $ 17,546 |

*Notes Payable*

In July 2004, QAD Ortega Hill, LLC, a wholly owned subsidiary of the Company, entered into a loan agreement with Mid-State Bank & Trust. The loan had an original principal balance of $18.0 million and bears interest at a fixed rate of 6.5%. This is a non-recourse loan, which is secured by real property located in Summerland, California. The loan matures in July 2014. Over the term of the loan, the Company shall make 119 monthly payments of $115,000 and one final payment of $15.4 million. As of October 31, 2006 and January 31, 2006, the principal balance of the loan was $17.5 million and $17.7 million, respectively.

**QAD INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

*Credit Facility*

Effective April 7, 2005, the Company entered into an unsecured loan agreement with Comerica Bank. The agreement provides a three-year commitment for a $20 million line of credit (CB Facility). The maximum amount that can be borrowed under the CB Facility is subject to a borrowing base calculation of 1.5 times the four-quarter trailing earnings before interest, taxes, depreciation and amortization (EBITDA), less the total amount of letters of credit and other similar obligations. At October 31, 2006, the maximum that could have been borrowed under the facility was $19.6 million. The agreement includes an annual commitment fee of between 0.25% and 0.50% multiplied by the average unused portion of the $20 million CB Facility. The rate is determined by the ratio of funded debt to the Company's 12-month trailing EBITDA.

The CB Facility provides that the Company will maintain certain financial and operating covenants which include, among other provisions, maintaining a minimum liquidity ratio of 1.3 to 1.0, a minimum 12-month trailing EBITDA of $10 million and minimum cash balance in the United States of $10 million. Borrowings under the CB Facility bear interest at a floating rate based on LIBOR or prime plus the corresponding applicable margins, ranging from 0.75% to 1.75% for the LIBOR option or -0.25% to 0.25% for the prime option, depending on QAD's funded debt to 12-month trailing EBITDA ratio. At October 31, 2006, a prime rate borrowing would have had an effective rate of 8.00% and a 30 day LIBOR borrowing would have had an effective rate of approximately 6.07%.

As of October 31, 2006, there were no borrowings under the CB Facility and the Company was in compliance with the financial covenants.

## 9. STOCKHOLDERS' EQUITY

*Stock Based Compensation*

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (SFAS 123R) that addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for equity instruments of the company or liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method under Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees", and generally requires instead that such transactions be accounted for using a fair-value-based method. Under the intrinsic value method, the recorded stock-based compensation expense was related to the amortization of the intrinsic value of stock options issued by the Company. Options granted with exercise prices equal to the grant date fair value of the Company's stock have no intrinsic value and therefore no expense was recorded for these options under APB 25. Other equity-based awards for which stock-based compensation expense was recorded were generally grants of restricted stock awards related to acquisition activity which were measured at fair value on the date of grant based on the number of shares granted and the quoted price of the Company's common stock. Such value has been recognized as an expense over the corresponding service period.

The Company adopted SFAS 123R beginning February 1, 2006. The Company has elected the modified prospective transition method as permitted by SFAS 123R and accordingly prior periods' results have not been restated to reflect the impact of SFAS 123R. Under this method, the Company is required to recognize stock-based compensation for all new awards that are granted on or subsequent to February 1, 2006 and all previously granted awards that vest on or subsequent to February 1, 2006. Stock-based compensation is measured based on the fair values of all stock-based awards on the dates of grant. Under SFAS 123R, stock-based awards granted prior to its adoption will be expensed over the remaining portion of their vesting period. These awards will be expensed under a straight-line method using the same fair value measurements which were used in calculating pro forma stock-based compensation expense under SFAS 123.

**QAD INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

SFAS 123R requires the use of a valuation model to calculate the fair value of stock-based awards. The Company has elected to use the Black-Scholes option-pricing model to determine the fair value of stock-based awards on the date of grant. For stock-based awards granted on or after February 1, 2006, the Company will amortize stock-based compensation expense on a straight-line basis over the requisite service period, with 25% vesting each year of the four year vesting period.

In accordance with SFAS 123R, beginning in the first quarter of fiscal 2007, the Company presents any benefits of realized tax deductions in excess of recognized compensation expense as a cash flow from financing activities in the accompanying Condensed Consolidated Statement of Cash Flows, rather than as a cash flow from operating activities, as was prescribed under accounting rules applicable prior to adoption of SFAS 123R. This requirement reduces the amounts the Company records as net cash provided by operating activities and increases net cash provided by financing activities. Total cash flow remains unchanged from what would have been reported under prior accounting rules. There were no excess tax benefits recorded for options exercised in the nine months ended October 31, 2006 as those tax benefits were not realized as a reduction to income taxes payable.

SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Stock-based compensation expense was recorded net of estimated forfeitures for the three and nine months ended October 31, 2006, such that the amount of expense recorded represents expense related to only those stock-based awards that are expected to ultimately vest.

In the three months ended October 31, 2006, the Company recognized stock-based compensation expense of $1.3 million which reduced gross profit by $0.2 million, increased operating expenses by $1.1 million and reduced net income by $0.8 million, or $0.03 per diluted share net of tax.

For the nine months ended October 31, 2006, the Company recognized stock-based compensation expense of $3.9 million which reduced gross profit by $0.7 million, increased operating expenses by $3.2 million and reduced net income by $2.5 million, or $0.07 per diluted share net of tax.

Prior to the adoption of SFAS 123R, the Company accounted for employee stock-based compensation using the intrinsic value method prescribed by APB 25. As presented below, the Company applied the disclosure provisions of SFAS 123, as amended by SFAS 148, “Accounting for Stock-Based Compensation – Transition and Disclosure” as if the fair value method had been applied. If this method had been used, the Company’s net income and earnings per share for the three and nine months ended October 31, 2005 would have been adjusted to the pro forma amounts below (in thousands except per share data):

| | Three Months Ended October 31, 2005 | Nine Months Ended October 31, 2005 |
|---|---|---|
| | (unaudited) | |
| Net income, as reported | $ 2,688 | $ 9,038 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 17 | 52 |
| Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | 923 | 2,376 |
| Pro forma net income | $ 1,782 | $ 6,714 |
| Basic and diluted earnings per share: | | |
| As reported | | |
| Basic | $ 0.08 | $ 0.28 |
| Diluted | $ 0.08 | $ 0.27 |
| Pro forma | | |
| Basic | $ 0.06 | $ 0.20 |
| Diluted | $ 0.05 | $ 0.20 |

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**(unaudited)**

The weighted average assumptions used to value the option grants, stock appreciation rights (SARs) and the employee stock purchase plan (ESPP) are shown in the following table. As the ESPP was terminated effective January 1, 2006, no data is provided for the nine month period ended October 31, 2006.

| | Nine Months Ended October 31, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Stock Options/ SARs | ESPP | Stock Options | ESPP |
| Expected life in years (1) | 3.14 | — | 5.0 | 0.25 |
| Risk free interest rate (2) | 4.83% | — | 4.15% | 3.44% |
| Volatility (3) | 49% | — | 84% | 34% |
| Dividend rate (4) | 1.29% | — | 1.29% | 1.29% |

(1) The expected life of stock options granted under the stock plans is based on historical exercise patterns, which the Company believes are representative of future behavior.

(2) The risk-free interest rate is based on the U.S. Treasury yield for a term consistent with the expected life of the awards in effect at the time of grant.

(3) The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of the Company's common stock, which it believes is representative of the expected volatility over the expected life of the option.

(4) The Company expects to continue paying quarterly dividends at the same rate it has over the last year.

*Stock Plans*

On June 7, 2006, the shareholders approved the QAD Inc. 2006 Stock Incentive Program (the 2006 Program). This program replaces the QAD 1997 Stock Incentive Program (the 1997 Program). Concurrently, the shareholders authorized a maximum of 5.3 million shares to be issued under the 2006 Program – 4 million newly authorized shares and 1.3 million shares previously authorized for use in the 1997 Program. The 2006 Program allows for incentive stock options, non-statutory stock options, restricted shares, rights to purchase stock, SARs, and other stock rights. As of October 31, 2006, 3.8 million shares were available for issuance.

At October 31, 2006, there were 4.3 million non-statutory stock options outstanding under the 1997 Program. Effective with the adoption of the 2006 Program, no further awards were granted using the 1997 Program. The 1997 Program replaced the QAD Inc. 1994 Stock Incentive Program (the 1994 Program). At October 31, 2006, there were 80,000 non-statutory stock options outstanding under the 1994 Program. If no action is taken, these non-statutory stock options will expire on February 1, 2007.

Under the 1997 Program and the 2006 Program, non-statutory stock options and SARs (equity awards) have generally been granted for a term of eight years. Under the 1994 Program, non-statutory stock options were generally granted for a term of ten years. Under all three programs, non-statutory stock options and SARs generally vest 25% after each year of service for four years and are contingent upon employment with the Company on the vesting date. Under the 2006 Program and 1997 Program, awards of non-statutory stock options and SARs to non-employee directors, generally vest over three years and are contingent upon providing services to the Company.

Under all three programs, officers, directors, employees, consultants and other independent contractors or agents of QAD or subsidiaries of QAD who are responsible for or contribute to the management, growth or profitability of its business are eligible for selection by the program administrators to participate. However, incentive stock options granted under the 2006 Program or the 1997 Program may only be granted to a person who is an employee of QAD or one of its subsidiaries.

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After the 2006 Program was adopted in June 2006, the Company began issuing all equity awards in the form of stock-settled SARs. SFAS 123R, which was adopted effective February 1, 2006, treats stock settled SARs similarly to non-statutory stock options. Granting SARs permits the Company to provide an equivalent value to non-statutory stock options to its employees with a less dilutive effect on the outstanding stock.

The following table summarizes the activity for outstanding equity awards for the nine months ended October 31, 2006:

| | Equity Awards (in thousands) | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at January 31, 2006 | 5,141 | $ 7.17 | | |
| Granted | 1,575 | 7.16 | | |
| Exercised | (514) | 3.39 | | |
| Cancelled/forfeited/expired | (375) | 9.43 | | |
| Outstanding at October 31, 2006 | 5,827 | $ 7.36 | 5.69 | $ 8,724 |
| Vested and expected to vest as of October 31, 2006 (1) | 5,179 | $ 7.32 | 5.51 | $ 8,213 |
| Exercisable at October 31, 2006 | 2,334 | $ 6.71 | 4.02 | $ 5,747 |

(1) The expected to vest equity awards are the result of applying the pre-vesting forfeiture rate assumptions to total outstanding equity awards.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the aggregate difference between the closing stock price of the Company's common stock on October 31, 2006 and the exercise price for in-the-money options) that would have been received by the option holders if all options had been exercised on October 31, 2006. The total intrinsic value of options exercised in the three and nine months ended October 31, 2006 was $0.6 million and $2.2 million, respectively. The weighted average grant date fair value of options granted in the three and nine months ended October 31, 2006 was $2.64 per share and $2.46 per share, respectively.

At October 31, 2006, there was approximately $9.4 million and $0.2 million of total unrecognized compensation cost related to unvested stock options and restricted stock, respectively. This cost is expected to be recognized over a weighted-average period of approximately 2.8 years.

Net cash received from option exercises under the 1997 Program and 1994 Program for the nine months ended October 31, 2006 was $1.4 million.

*Stock Repurchase*

In May 2006, the Company's Board of Directors approved an open market stock repurchase program authorized for one year to buy up to one million shares of the Company's common stock. For the nine months ended October 31, 2006 the Company repurchased 739,000 shares of its common stock at an average repurchase price of $7.53 per share, including fees. As a result, stockholders' equity was reduced for the nine months ended October 31, 2006 by $5.6 million.

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## 10. COMMITMENTS AND CONTINGENCIES

*Indemnifications*

The Company sells software licenses and services to its customers under written agreements. Each agreement contains the relevant terms of the contractual arrangement with the customer, and generally includes certain provisions for indemnifying the customer against losses, expenses and liabilities from damages that may be awarded against the customer in the event the Company's software is found to infringe upon certain intellectual property rights of a third party. Each agreement generally limits the scope of and remedies for such indemnification obligations in a variety of industry-standard respects, including but not limited to certain time-based scope limitations and a right to replace an infringing product.

The Company believes its internal development processes and other policies and practices limit its exposure related to the indemnification provisions of the agreements. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under the agreements, the Company cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions.

*Legal Actions*

The Company is subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these claims cannot be predicted with certainty, management does not believe that the outcome of any of these legal matters will have a material adverse effect on the Company's consolidated results of operations, financial position or liquidity.

## 11. BUSINESS SEGMENT INFORMATION

The Company operates in geographic business segments. The North America region includes the United States and Canada. The EMEA region includes Europe, the Middle East and Africa. The Asia Pacific region includes Asia and Australia. The Latin America region includes South America, Central America and Mexico.

The geographic business segments derive revenue from the sale of licenses, maintenance and services to third-party customers. License revenue is assigned to the regions based on the proportion of commissions earned by each region. Maintenance revenue is allocated to the region where the end user customer is located. Services revenue is assigned based on the region where the services are performed.

Operating income (loss) attributable to each business segment is based upon management's assignment of revenue and costs. Regional cost of revenue includes the cost of goods produced by the Company's production operations at the price charged to the distribution operation. Income from production operations and research and development costs are included in the corporate operating segment. Identifiable assets are assigned by geographic region based upon the location of each legal entity.

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**(unaudited)**

| | Three Months Ended October 31, | | Nine Months Ended October 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | (in thousands) | | | |
| Revenue: | | | | |
| North America | $ 24,514 | $ 21,606 | $ 72,508 | $ 68,003 |
| EMEA | 19,660 | 16,351 | 56,792 | 55,567 |
| Asia Pacific | 9,116 | 9,304 | 28,235 | 30,748 |
| Latin America | 4,034 | 4,151 | 11,563 | 11,120 |
| | $ 57,324 | $ 51,412 | $169,098 | $165,438 |
| Operating income (loss): | | | | |
| North America | $ 4,932 | $ 3,373 | $ 13,503 | $ 11,549 |
| EMEA | 526 | (277) | 856 | 288 |
| Asia Pacific | 639 | 404 | 1,706 | 2,727 |
| Latin America | (75) | 201 | (545) | (189) |
| Corporate | (4,758) | (804) | (12,627) | (3,972) |
| | $ 1,264 | $ 2,897 | $ 2,893 | $ 10,403 |

| | October 31, 2006 | January 31, 2006 |
|---|---|---|
| Identifiable assets: | | |
| North America | $ 106,539 | $ 125,187 |
| EMEA | 56,007 | 51,851 |
| Asia Pacific | 18,357 | 21,955 |
| Latin America | 7,784 | 8,065 |
| | $ 188,687 | $ 207,058 |

## 12. EXIT COSTS

In March 2005, the Company moved its data center from Carpinteria, California to its new headquarters in Summerland, California, which resulted in an initial charge of $0.9 million in exit costs. Later in fiscal 2006 and in the first nine months of 2007, adjustments of $0.2 million and $0.3 million, respectively, were required due to a previously unanticipated delay in subleasing the space. Although the Company has not secured a sublease agreement with a tenant, it expects to do so by February 2007.

## 13. SUBSEQUENT EVENT

On November 3, 2006, QAD acquired Duluth, Georgia-based FBO Systems, Inc., a provider of Enterprise Asset Management products and professional services. Approximately 70% of the all-cash purchase price consideration will be paid within 90 days of the November 3, 2006 close date, with the remaining 30%, subject to certain performance criteria, expected to be paid over a three-year period. The total net purchase price is expected to be approximately $4 million.

## ITEM 2 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements. These statements typically are preceded or accompanied by words like "believe," "anticipate," "expect" and words of similar meaning. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in these forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in Part I, Item 1A entitled "Risk Factors" within our Annual Report on Form 10-K for the year ended January 31, 2006. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date hereof. We undertake no obligation to revise or update or publicly release the results of any revision or update to these forward-looking statements. Readers should carefully review the risk factors and other information described in other documents we file from time to time with the Securities and Exchange Commission.

### INTRODUCTION

The following discussion should be read in conjunction with the information included within our Annual Report on Form 10-K for the year ended January 31, 2006, and the Condensed Consolidated Financial Statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q.

### BUSINESS OVERVIEW

QAD Inc., a Delaware Corporation (QAD), was founded in 1979 and is a leading provider of enterprise applications for global manufacturing and distribution companies. QAD applications provide critical functionality for managing manufacturing resources and operations within and beyond the enterprise, enabling global manufacturers to collaborate with their customers, suppliers and partners to make and deliver the right product, at the right cost and at the right time. We market, distribute, implement and support our products worldwide. Manufacturers of automotive, consumer products, electronics, food and beverages, industrial and life science products use QAD applications at approximately 5,500 licensed sites in more than 90 countries and in as many as 27 languages.

### CRITICAL ACCOUNTING POLICIES

We consider certain accounting policies related to revenue recognition, accounts receivable allowances, impairment of goodwill and intangible assets, capitalized software costs, valuation of deferred tax assets and tax contingency reserves and accounting for stock-based compensation to be critical policies due to the significance of these items to our operating results as well as the estimation processes and management judgment involved in each.

- *Revenue Recognition.* We generally license our software under non-cancelable license agreements including third-party software sold in conjunction with customer support and services. The types of services we sell typically consist of implementation, training or technical services. Revenue is recognized in accordance with the American Institute of Certified Public Accountant's Statement of Position (SOP) No. 97-2, "Software Revenue Recognition," as modified by SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition with Respect to Certain Transactions" and Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition." Our revenue recognition policy is as follows:

  *License Revenue.* We recognize revenue from license contracts when a non-cancelable, non-contingent license agreement has been signed, the software product has been delivered, no uncertainties exist surrounding product acceptance, fees from the agreement are fixed or determinable and collection is probable. Our typical payment terms vary by region. While most of our arrangements are within our normal payment terms, we have provided extended terms on occasion. Terms granted are typically less than one year and we have established a positive history of collection without concessions on those receivables. Provided all other revenue recognition criteria have been met, we recognize license revenue for these arrangements on delivery.

For license arrangements with multiple elements to be delivered, we use the residual method to recognize revenue. When a license agreement includes one or more elements to be delivered at a future date, and vendor-specific, objective evidence of the fair value of all undelivered elements exists, then the revenue for the undelivered elements are deferred. The fair value of the undelivered elements is determined based on the historical evidence of stand-alone sales of these elements to customers and the remaining portion of the arrangement fee is recognized as revenue. If evidence of the fair value of the undelivered elements does not exist, revenue is deferred and recognized when we have vendor-specific, objective evidence for undelivered elements or when delivery of all elements occurs. Subscription license revenue from our hosted product offerings is recognized ratably over the contract period.

Our standard products do not require significant production, modification or customization of software or services that are essential to the functionality of the software. Certain judgments affect the application of our license revenue recognition policy, such as the assessment of collectibility which is based on our review of a customer's credit worthiness and our historical experience with that customer, if applicable.

*Maintenance Revenue.* Revenue from ongoing customer support and product updates is recognized ratably over the term of the maintenance period, which in most instances is one year.

*Services Revenue.* Revenue from technical and implementation services is recognized as services are performed for time-and-materials contracts. Although infrequent, we do at times enter into fixed-price services contracts for which we recognize the services revenue on the percentage-of-completion method as prescribed by Accounting Research Bulletin No. 45, "Long-term Construction-Type Contracts", and in SOP No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." Revenue from training services is recognized as the services are performed.

We believe that we are currently in compliance with the applicable accounting standards governing revenue recognition. However, the accounting standard setting bodies continue to discuss various provisions of these guidelines with the objective of providing additional guidance on their future application. These discussions and the issuance of new interpretations, once finalized, could lead to unanticipated changes in recognized revenue. They could also drive significant adjustments to our business practices that could result in increased administrative costs, lengthened sales cycles and other changes that could affect our results of operations.

- *Accounts Receivable Allowances.* We review the collectibility of our accounts receivable each period by analyzing balances based on age and record specific allowances for any balances that we determine may not be fully collectible. We also provide an additional reserve based on historical data including analysis of credit memo data and other known factors. These determinations require management judgment. Actual collection of these balances may differ due to global or regional economic factors, challenges faced by customers within our targeted vertical markets or specific financial difficulties of individual customers.

- *Impairment of Goodwill and Intangible Assets.* Goodwill and other intangible assets at October 31, 2006, were $11.9 million and $1.3 million, respectively, accounting for 7% of our total assets. In assessing the recoverability of our intangibles, excluding goodwill, we must make assumptions regarding estimated future cash flows to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment losses for these assets. Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (SFAS 142) requires us to analyze goodwill for impairment on at least an annual basis. These periodic analyses are performed by an independent valuation consulting firm. In estimating the fair value of our individual reporting units, the enterprise fair value was considered based upon the income approach, which utilizes a discounted cash flow method to determine the fair value of the business based on the present value of future benefits the business is expected to generate. If the assumptions underlying these estimated future benefits change, we may be required to record impairment losses for these assets. For a further discussion of goodwill, see note 7 "Goodwill" within the Notes to Condensed Consolidated Financial Statements.

- *Capitalized Software Costs.* We capitalize software development costs incurred in connection with the localization and translation of our products once technological feasibility has been achieved based on a working model. We also capitalize software purchased from third parties or through business combinations

as acquired software technology if such software has reached technological feasibility. A working model is defined as an operative version of the computer software product that is completed in the same software language as the product to be ultimately marketed, performs all the major functions planned for the product and is ready for initial customer testing. Capitalized software costs are amortized on a straight-line basis over three years and charged to "Cost of license fees". We periodically compare the unamortized capitalized software development costs to the estimated net realizable value of the associated product. The amount by which the unamortized capitalized software costs of a particular software product exceeds the estimated net realizable value of that asset is reported as a charge to the statement of operations. This review requires management judgment regarding future cash flows. If these estimates or their related assumptions require updating in the future, we may be required to recognize losses for these assets.

- Valuation of Deferred Tax Assets and Tax Contingency Reserves. Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS 109), requires that the carrying value of our deferred tax assets reflects an amount that is more likely than not to be realized. In assessing the likelihood of realizing tax benefits associated with deferred tax assets and the need for a valuation allowance, we consider the weight of all available evidence, both positive and negative, including expected future taxable income and tax planning strategies that are both prudent and feasible. As part of our assessment of the recoverability of our net deferred tax assets, we determined that certain tax benefits associated with previously reserved net deferred tax assets were more likely than not realizable through future taxable income and future reversals of existing taxable temporary differences. As a result, we recorded a tax benefit of $0.4 million at April 30, 2005, resulting from the reduction of previously recorded valuation allowances. There was no reduction of valuation allowances recorded in the first nine months of fiscal 2007. Should we determine that we would not be able to realize all or part of the net deferred tax asset in the future, an adjustment to deferred tax assets would increase tax expense in the period such determination was made.

  We record tax contingency reserves based on the probable tax treatment of tax positions. Management uses judgment in determining the probability of an outcome related to a tax exposure area or controversy (e.g., audit by tax authorities), considering all available information. Should we in the future determine that additional reserves are required or that some portion of our existing reserves are no longer required, the adjustment to tax contingency reserves would impact tax expense in the period such determination was made.

- Stock-based Compensation Expense. Effective February 1, 2006, we adopted SFAS 123R using the modified prospective method and therefore have not restated prior periods' results. Under the fair value recognition provisions of SFAS 123R, we recognize stock-based compensation net of an estimated forfeiture rate and therefore only recognize compensation cost for those awards expected to vest over the service period of the award. Prior to SFAS 123R adoption, we accounted for share-based payments under APB 25 and accordingly, generally recognized compensation expense related to restricted stock awards that were granted in connection with acquisitions and stock options with intrinsic value. Forfeitures were accounted for as they occurred.

  Calculating stock-based compensation expense requires the use of highly subjective assumptions, including the expected term of the stock-based awards, stock price volatility, and pre-vesting option forfeitures. We estimate the expected life of options granted based on historical exercise patterns, which we believe are representative of future behavior. We estimate the volatility of our common stock at the date of grant based on the historical volatility of our common stock, which we believe is representative of future behavior. The assumptions used in calculating the fair value of stock-based awards represent our best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on the historical experience of our stock-based awards that are granted, exercised and cancelled. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. See note 9 "Stockholders' Equity" within Notes to Condensed Consolidated Financial Statements for additional information.

Historically, estimates described in our critical accounting policies that have required significant judgment and estimation on the part of management have been reasonably accurate.

**RESULTS OF OPERATIONS**

The following table sets forth, for the periods indicated, the percentage of total revenue represented by certain items reflected in our statements of operations:

| | Three Months Ended October 31, | | Nine Months Ended October 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Revenue: | | | | |
| License fees | 19% | 20% | 21% | 24% |
| Maintenance and other | 54 | 57 | 54 | 53 |
| Services | 27 | 23 | 25 | 23 |
| Total revenue | 100 | 100 | 100 | 100 |
| Costs and expenses: | | | | |
| Cost of license fees | 3 | 3 | 3 | 4 |
| Cost of maintenance, service and other revenue | 37 | 38 | 37 | 36 |
| Sales and marketing | 27 | 27 | 28 | 28 |
| Research and development | 17 | 14 | 18 | 14 |
| General and administrative | 13 | 12 | 12 | 12 |
| Amortization of intangibles from acquisitions | 1 | — | — | — |
| Total costs and expenses | 98 | 94 | 98 | 94 |
| Operating income | 2 | 6 | 2 | 6 |
| Other (income) expense | (1) | — | (1) | (1) |
| Income before income taxes | 3 | 6 | 3 | 7 |
| Income tax expense | 1 | 1 | 1 | 2 |
| Net income | 2% | 5% | 2% | 5% |

*Total Revenue*. Total revenue for the third quarter of fiscal 2007 was $57.3 million, an increase of $5.9 million, or 11%, from $51.4 million in the third quarter of fiscal 2006. Holding foreign currency exchange rates constant to those applicable in the third quarter of fiscal 2006, total revenue for the current quarter would have been approximately $56.8 million, representing a $5.4 million increase when compared to the same period last year. When comparing categories within total revenue at constant rates, our current quarter results included higher licenses, services and maintenance and other revenue. International revenue as a percentage of total revenue was 57% in the third quarter of fiscal 2007, as compared to 58% in the same period of the prior fiscal year. The North America and Europe, Middle East and Africa (EMEA) regions experienced increases in total revenue while the Latin America and Asia Pacific regions declined slightly quarter over quarter. Contributing to the increase in total revenue in the third quarter of fiscal 2007 was revenue generated from the September 20, 2006 acquisition of Precision Software, a company which sells transportation software. Revenue recognized from the Precision products totaled $0.8 million in the quarter, of which $0.7 million was services revenue.

Total revenue for the first nine months of fiscal 2007 was $169.1 million, an increase of $3.7 million, or 2%, from $165.4 million in the first nine months of fiscal 2006. Holding foreign currency exchange rates constant to those applicable in the first nine months of fiscal 2006, total revenue for the current year would have been approximately $168.8 million, representing a $3.4 million increase when compared to the same period last year. When comparing categories within total revenue at constant rates, the first nine months of fiscal 2007 included lower license revenue offset by higher services, maintenance and other revenue. International revenue as a percentage of total revenue was 57% in the first nine months of fiscal 2007, as compared to 59% in the same period of the prior year. The shift was primarily attributed to an increase in revenue in our North America region. Our EMEA and Latin America regions also increased while our Asia Pacific region declined.

*License Revenue*. License revenue was $11.0 million for the third quarter of fiscal 2007, up $0.9 million, or 9%, from $10.1 million for the third quarter of fiscal 2006. Holding foreign currency exchange rates constant to fiscal 2006, license revenue for the current quarter would have been approximately $10.9 million, representing a $0.8 million, or 8%, increase from the same period last year. License revenue increased in our North America and

EMEA regions when comparing quarter over quarter results while our Latin America and Asia Pacific regions declined quarter over quarter. When comparing the current quarter to the same quarter in the previous year, discounts granted to customers for software licenses have remained relatively consistent. One of the metrics that management uses to measure license revenue performance is the number of customers that have placed sizable license orders in the period. During the third quarter of fiscal 2007, six customers placed license orders totaling more than $300,000, of which none exceeded $1 million. This compared to the fiscal 2006 third quarter in which three customers placed license orders totaling more than $300,000, of which none exceeded $1 million.

License revenue was $34.7 million for the first nine months of fiscal 2007, down $5.5 million, or 14%, from $40.2 million for the first nine months of fiscal 2006. Holding foreign currency exchange rates constant to fiscal 2006, license revenue for the current year would have been unchanged at $34.7 million. All regions experienced decreases period over period with the exception of our EMEA region. During the nine months ended October 31, 2006, when compared to the same period in the prior year, discounts granted to customers for software licenses remained consistent. During the first nine months of fiscal 2007, 20 customers placed license orders totaling more than $300,000, of which none exceeded $1 million. This compared to 17 customers who placed license orders in the first nine months of fiscal 2006 totaling more than $300,000, of which two exceeded $2 million and one exceeded $4 million.

*Maintenance and Other Revenue*. Maintenance and other revenue was $30.9 million for the third quarter of fiscal 2007, representing an increase of $1.6 million, or 6%, from $29.3 million for the third quarter of fiscal 2006. When we hold exchange rates constant to those prevailing in the third quarter of fiscal 2006, fiscal 2007 maintenance and other revenue would have been approximately $30.8 million. Maintenance and other revenue was $91.8 million for the first nine months of fiscal 2007, up $4.4 million, or 5%, from the same period last year at $87.4 million. Holding exchange rates constant to those prevailing in the first nine months of fiscal 2006, the current year's maintenance and other revenue would have been $91.7 million.

Maintenance and other revenue increased across all regions during the third quarter of fiscal 2007 when compared to the same quarter in the previous year except for the Asia Pacific region, which was flat. When comparing maintenance and other revenue in the nine months ended October 31, 2006 to the same periods ended October 31, 2005, all regions increased. Factors impacting the comparison of the third quarter and first nine months of the current year to the same periods last year include favorability due to additional maintenance on new license sales, offset by cancellations within our existing customer base and the timing of customer commitments to contract renewals. We measure our rate of contract renewals routinely by determining the number of customer sites with active contracts as of the end of the previous reporting period and comparing this to the number of those same customers that have renewed or are in the process of renewing as of the current period end. Our maintenance contract renewal rate for the third quarters and first nine months of both fiscal 2007 and 2006 was in excess of 90%.

*Services Revenue.* Services revenue was $15.4 million for the third quarter of fiscal 2007, representing an increase of $3.4 million, or 28%, when compared to the same period last year at $12.0 million. Holding exchange rates constant to those prevailing during the third quarter of fiscal 2006, services revenue for the third quarter of fiscal 2007 would have been approximately $15.1 million, reflecting a $3.1 million, or 26%, increase from the same period last year. Services revenue recognized in the current quarter related to the Precision business was $0.7 million. When comparing the current quarter to the same quarter of the prior year, services revenue increased across all regions, with the most notable increase in our North America region.

For the first nine months of fiscal 2007 services revenue was $42.5 million, representing an increase of $4.7 million, or 12%, when compared to the same period last year at $37.8 million. Holding exchange rates constant to those prevailing during the first nine months of fiscal 2006, services revenue for fiscal 2007 would have been approximately $42.4 million, reflecting a $4.6 million increase when compared to last year. Services revenues for the first nine months of fiscal 2007 increased in all regions when compared to the same period in the previous year.

The following table sets forth, for the periods indicated, reported stock compensation expense for the three and nine month periods ended October 31, 2006 and 2005.

*(in thousands, unaudited)*

| | Three Months Ended October 31, | | Nine Months Ended October 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Stock-based compensation expense by function: | | | | |
| Cost of maintenance, service and other revenue | $ 240 | $ 28 | $ 701 | $ 83 |
| Sales and marketing | 315 | — | 940 | — |
| Research and development | 214 | — | 639 | — |
| General and administrative | 522 | — | 1,607 | — |
| Total stock-based compensation expense | 1,291 | 28 | 3,887 | 83 |
| Income tax benefit | (447) | (11) | (1,420) | (31) |
| Stock-based compensation, net of tax | $ 844 | $ 17 | $ 2,467 | $ 52 |

*Total Cost of Revenue.* Total cost of revenue (combined cost of license fees and cost of maintenance, service and other revenue) was $23.2 million and $21.0 million and as a percentage of total revenue was 40% and 41% for the third quarter of fiscal 2007 and 2006, respectively. Holding exchange rates constant to those prevailing during the third quarter last year, total cost of revenue for the third quarter of fiscal 2007 would have been approximately $0.3 million lower at $22.9 million and the cost of revenue percentage would have been unchanged at 40%.

For the first nine months of fiscal 2007 and 2006, total cost of revenue was $67.7 million and $65.9 million and as a percentage of total revenue was 40% in each of the comparative periods. Holding exchange rates constant to those prevailing during the first nine months of fiscal 2006, total cost of revenue for the fiscal 2007 period would have been approximately $0.1 million lower at $67.6 million and would have been unchanged when expressed as a percentage of total revenue at 40%.

On a quarter-over-quarter and year-over-year basis, our margins were favorably impacted by improvements in our maintenance, services and other margin, partially offset by the change in revenue mix from licenses to services, which carries lower margins.

*Sales and Marketing.* Sales and marketing expense increased $1.7 million, or 13%, to $15.6 million for the third quarter of fiscal 2007 from $13.8 million in the comparable prior year period. Holding exchange rates constant to last year, current quarter expense would have been approximately $0.2 million lower at $15.4 million. Personnel expenses, which were primarily related to commissions and bonuses, increased $0.7 million. In addition, marketing expenses were $0.4 million higher in the third quarter of fiscal 2007 when compared to the same quarter in the previous year. Marketing expenses primarily related to various sales related and telemarketing programs in the EMEA and Asia Pacific regions. Stock compensation expense accounted for $0.3 million of the fiscal 2007 increase.

Sales and marketing expense increased $1.5 million, or 3%, to $47.1 million for the first nine months of fiscal 2007 from $45.6 million in the comparable prior year period. Holding exchange rates constant to last year, current year to date expense would have been $0.1 million lower, or $47.0 million. The primary reasons for the increase in sales and marketing expense year-over-year were increases in travel of $0.5 million, bonuses and commissions of $1.4 million, marketing of $0.5 million and stock compensation expense of $0.9 million. The increase in expenses in those categories during the first nine months of fiscal 2007 was partially offset by decreases in partner fees of $0.5 million primarily related to a large Asia Pacific sales transaction last year, a decrease in severance expense of $0.7 million primarily related to EMEA, a reduction in recruiting expense of $0.6 million and a decrease of $0.3 million in the cost of our annual user conference.

*Research and Development.* Research and development expense, which is managed on a global basis, increased $2.5 million, or 35%, to $9.8 million for the third quarter of fiscal 2007 when compared to the same quarter last year

at $7.3 million. Holding exchange rates constant to last year, current quarter expense would have remained unchanged at $9.8 million. Personnel and related costs increased $2.0 million due to hiring, primarily in our development centers in India and China. Research and development employees were also acquired through acquisitions in the current year. In addition to the increase in personnel expenses, travel and stock compensation each increased $0.2 million.

On a year-to-date basis, research and development expense increased $6.5 million, or 28%, to $30.1 million for fiscal 2007 when compared to the same period last year at $23.6 million. Holding exchange rates constant to last year, current year to date expense would have remained unchanged at $30.1 million. The year over year increase was mainly related to higher personnel and related costs of $5.1 million, reflecting the impact of establishing development centers in India and China, our focus on product development through acquisitions and added personnel expense in the United States. In addition, travel and professional fees were $0.7 million and $0.5 million higher, respectively, while stock compensation expense was $0.6 million. The increase in those expense categories was partially offset by an increase of $0.9 million of capitalized development costs compared to the same period last year.

*General and Administrative.* General and administrative expense increased $1.1 million, or 17%, to $7.4 million for the third quarter of fiscal 2007 from the same quarter last year at $6.3 million. Holding exchange rates constant to last year, current quarter expense would have been $7.3 million. Stock compensation expense in the current quarter represented an increase of $0.5 million. In addition, professional fees were higher by $0.5 million primarily related to human resources and other strategic initiatives.

On a year-to-date basis, general and administrative expense was $21.1 million, representing a $1.5 million, or 8%, increase from $19.6 million in the same period last year. Holding exchange rates constant to last year, current year expense would have remained unchanged at $21.1 million. Stock compensation expense in the first nine months of fiscal 2007 was $1.6 million. In addition, personnel expenses were higher by $0.5 million. These increases were partially offset by higher capitalized costs of $0.3 million.

*Other (Income) Expense*. Other income, net was $0.2 million and $0.3 million for the third quarter of fiscal 2007 and 2006, respectively. The $0.1 million decrease in other income, net primarily related to a $0.5 million insurance payment from a lawsuit received in the third quarter of fiscal 2006, partly offset by $0.3 million of higher interest income.

Other income, net was $2.7 million and $1.1 million for the first nine months of fiscal 2007 and 2006, respectively. The $1.6 million change primarily related to $1.0 million higher interest income earned in the current year when compared to the same prior year period, partially due to higher interest rates. In addition, exchange gains were $0.7 million higher in the current year when compared to last year, mainly related to the Euro.

*Income Tax Expense.* We recorded income tax expense of $0.5 million for the current quarter and $0.6 million for the same quarter last year. These amounts include taxes in jurisdictions that were forecasted to be profitable during these periods. The third quarter fiscal 2006 tax provision includes a one-time tax benefit of $0.4 million related to a reversal of a tax exposure reserve resulting from the closure of a statute of limitations.

We recorded income tax expense of $2.1 million and $2.5 million for the first nine months of fiscal 2007 and 2006, respectively. These amounts include taxes in jurisdictions that were forecasted to be profitable during these periods. Year-to-date tax expense in fiscal 2006 includes benefits related to the reversal of deferred tax asset valuation allowances of $0.4 million, attributable to the realization of certain deferred tax assets in foreign jurisdictions, as it was determined that it was more likely than not that these benefits would be realized. The deferred tax asset valuation allowances which were reversed related to foreign subsidiaries with net operating loss carryforwards that have become profitable and are forecasting continued profitability. Fiscal 2006 also includes a one-time tax benefit of $0.4 million related to a reversal of a tax exposure reserve resulting from the closure of a statute of limitations.

We have not recognized a benefit for deferred tax assets that management has determined are not more likely than not to be realized.

## LIQUIDITY AND CAPITAL RESOURCES

We have historically financed our operations and met our capital expenditure requirements through cash flows from operations, sale of equity securities and borrowings.

### Working Capital

Our working capital was $12.8 million and $20.7 million as of October 31, 2006 and January 31, 2006, respectively. The $7.9 million decrease in working capital was primarily due to a $26.3 million decrease in current assets, partially offset by an $18.4 million decrease in current liabilities. The $26.3 million decrease in current assets related primarily to a $19.4 million decrease in accounts receivable due to seasonal declines following high year-end renewal billings. Cash and equivalents decreased $9.6 million to $50.4 million as of October 31, 2006 from $60.0 million as of January 31, 2006. Cash decreased primarily due to cash paid for the acquisition of Precision Software of $8.1 million, of which $2.6 million was held in escrow and classified as restricted cash as of October 31, 2006. In addition, during fiscal 2007, we repurchased $5.6 million of our own common stock and made $2.4 million in dividend payments. Decreases in cash related to those activities were partially offset by cash from operations. For additional explanation of cash changes, please see the “Cash Flows” section below.

Current liabilities declined $18.4 million related to a decrease in deferred revenue due to seasonal declines following high year-end maintenance renewal billings.

We have historically calculated accounts receivable days’ sales outstanding (DSO) using the countback, or last-in first-out, method. This method calculates the number of days of *billed* revenue in the accounts receivable balance as of the period end. When reviewing the performance of our business units, DSO under the countback method is used by management. It is management’s belief that the countback method best reflects the relative health of our accounts receivable as of a given quarter-end or year-end because of the cyclical nature of our billings. Our billing cycle includes high maintenance renewal billings at year-end that will not be recognized as earned revenue until future periods.

DSO under the countback method was 66 days at October 31, 2006, compared to 55 days at January 31, 2006 and 61 days at October 31, 2005. DSO using the average method, which utilizes the accounts receivable balance and *earned* revenue in the calculation, was 67 days at October 31, 2006, compared to 93 days at January 31, 2006 and 67 days at October 31, 2005.

### Cash Flows

Following is a summary of cash flows for the first nine months of fiscal 2007 and 2006:

*Operating Activities*

Net cash provided by operating activities was $10.9 million and $19.1 million in the first nine months of fiscal 2007 and 2006, respectively. The $8.2 million decrease in fiscal 2007 from fiscal 2006 related primarily to a decline in net income of $5.6 million as well as a larger decline in deferred revenue of $5.1 million, which has a negative effect on cash flow. Other changes in net cash provided by operating activities consist of a smaller decline in other assets of $1.5 million and a smaller decline in accounts receivable of $1.5 million, primarily related to lower collections. Stock compensation expense during the first nine months of fiscal 2007 was $3.8 million which is a non-cash expense and therefore has a positive effect on operating cash flow. Changes in accounts payable resulted in a $1.9 million positive effect on cash flow due to higher accounts payable balance in fiscal 2007 compared to fiscal 2006.

During the first nine months of fiscal 2007 we incurred an additional $0.3 million of exit costs related to our data center move from leased facilities to our corporate headquarters and $0.2 million of exit costs related to a reduction of office space in the Netherlands.

*Investing Activities*

Net cash (used in) provided by investing activities for the first nine months of fiscal 2007 and 2006 was $(13.3) million and $4.3 million, respectively. The first nine months of fiscal 2007 and 2006 included $3.7 million and $5.9 million, respectively, of property and equipment purchases. The prior year purchases

primarily related to the build-out of the data center at our new company headquarters. The current year purchases primarily related to computer equipment. In the first nine months of fiscal 2007, we completed three acquisitions and have paid to date $9.6 million associated with those transactions, including $2.6 million of restricted cash held in escrow until certain contingencies are removed. Deferred payments related to the acquisitions of $7.9 million are expected to be paid through fiscal year 2009. In addition, we subsequently sold certain acquired tangible and intangible assets for $1.1 million. For further discussion of business combinations, see note 5 “Business Combinations” within Notes to Condensed Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

In fiscal 2006, we sold $13.0 million in marketable securities and deposited the proceeds into our cash account.

*Financing Activities*

Net cash used in financing activities was $6.3 million and $23.9 million for the first nine months of fiscal 2007 and 2006, respectively.

During the second quarter of fiscal 2007, the Board of Directors authorized the repurchase of up to one million shares of QAD common stock over a one year period. The first nine months of fiscal 2007 includes $5.6 million related to the repurchase of 739,000 shares at an average price of approximately $7.53 per share.

During fiscal 2006, we purchased 2 million shares of QAD common stock from Recovery Equity Investors II, L.P. for $7.40 per share for total cash consideration of $14.8 million. In addition, we repaid the outstanding balance of $7.6 million on the Comerica Bank Credit Facility.

The first nine months of the current and prior year also include $1.4 million and $2.2 million, respectively, in proceeds from the issuance of common stock, primarily related to the exercise of stock options. During the first nine months of fiscal 2007 and 2006, $2.4 million and $2.5 million, respectively, in dividends were paid to stockholders.

We believe that the cash on hand, net cash provided by operating activities and the available borrowings under our existing credit facility will provide us with sufficient resources to meet our current and long-term working capital requirements, debt service and other cash needs.

**CONTRACTUAL OBLIGATIONS**

*Notes Payable*

In July 2004, QAD Ortega Hill, LLC, a wholly owned subsidiary of QAD Inc., entered into a loan agreement with Mid-State Bank & Trust. The loan has a principal amount of $18.0 million and bears interest at a fixed rate of 6.5%. This is a non-recourse loan, which is secured by real property located in Summerland, California. The loan matures in July 2014. Over the term of the loan, we shall make 119 monthly payments of $115,000 and one final payment of $15.4 million.

*Credit Facility*

Effective April 7, 2005, we entered into an unsecured loan agreement with Comerica Bank. The agreement provides a three-year commitment for a $20 million line of credit (CB Facility).

The maximum amount that can be borrowed under the CB Facility is subject to a borrowing base calculation of 1.5 times the four-quarter trailing earnings before interest, taxes, depreciation and amortization (EBITDA) less the total amount of letters of credit and other similar obligations. At October 31, 2006, the maximum that could have been borrowed under the facility was $19.6 million. The agreement includes an annual commitment fee of between 0.25% and 0.50% multiplied by the average unused portion of the $20 million CB Facility. The rate is determined by the ratio of funded debt to our 12-month trailing EBITDA. Effective May 9, 2005, the CB Facility was amended.

The amendment increased the amount of QAD common stock that we may repurchase in any trailing four-quarter period from $20 million to $30 million.

The CB Facility provides that we will maintain certain financial and operating covenants which include, among other provisions, maintaining a minimum liquidity ratio of 1.3 to 1.0, a minimum 12-month trailing EBITDA of $10 million and a minimum cash balance in the United States of $10 million. Borrowings under the CB Facility bear interest at a floating rate based on LIBOR or prime plus the corresponding applicable margins, ranging from 0.75% to 1.75% for the LIBOR option or -0.25% to 0.25% for the prime option, depending on QAD's funded debt to 12-month trailing EBITDA ratio. At October 31, 2006, a prime rate borrowing would have had an effective rate of 8.00% and a 30 day LIBOR borrowing would have had an effective rate of approximately 6.07%.

As of October 31, 2006, there were no borrowings under the CB Facility and we were in compliance with the debt covenants.

## ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

*Foreign Exchange*. For the nine months ended October 31, 2006 and 2005, approximately 35% of our revenue was denominated in foreign currencies. Approximately 45% of our expenses were denominated in currencies other than the U.S. dollar for the nine months ended October 31, 2006 and 2005. As a result, fluctuations in the values of the respective currencies relative to the currencies in which we generate revenue and incur expenses could adversely impact our results.

Fluctuations in currencies relative to the U.S. dollar have affected and will continue to affect period-to-period comparisons of our reported results of operations. Foreign currency transaction gains totaled $1.5 million and $0.9 million for the nine months ended October 31, 2006 and 2005, respectively. Due to constantly changing currency exposures and the volatility of currency exchange rates, we may experience currency losses in the future, and we cannot predict the effect of exchange rate fluctuations upon future operating results. Although we do not currently undertake hedging transactions, we may choose to hedge a portion of our currency exposure in the future, as we deem appropriate.

*Interest Rates.* We invest our surplus cash in a variety of financial instruments, consisting principally of bank time deposits and short-term marketable securities with maturities of less than one year. Our investment securities are held for purposes other than trading. Cash balances held by subsidiaries are generally invested in short-term time deposits with local operating banks. Additionally, our short-term and long-term debt bears interest at variable rates.

We prepared sensitivity analyses of our interest rate exposure and our exposure from anticipated investment and borrowing levels for fiscal 2007 to assess the impact of hypothetical changes in interest rates. Based upon the results of these analyses, a 10% adverse change in interest rates from the 2006 fiscal year-end rates would not have a material adverse effect on the fair value of investments and would not materially impact our results of operations or financial condition for fiscal 2007.

## ITEM 4 – CONTROLS AND PROCEDURES

*Evaluation of disclosure controls and procedures.* Under the supervision and with the participation of QAD management, including the Chief Executive Officer and Chief Financial Officer, as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

*Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

The Company is not party to any material legal proceedings. QAD is from time to time party, either as plaintiff or defendant, to various legal proceedings and claims which arise in the ordinary course of business. While the outcome of these claims cannot be predicted with certainty, management does not believe that the outcome of any of these legal matters will have a material adverse effect on the Company's consolidated financial position or results of operations.

### ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors reported in Item 1A within the Company's Annual Report on Form 10-K for the year ended January 31, 2006.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Stock repurchase activity during the three months ended October 31, 2006 was as follows:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---|---|---|---|---|
| 8/1/06 – 8/31/06 | 36,400 | $ 7.56 | 36,400 | 420,700 |
| 9/1/06 – 9/30/06 | 139,600 | $ 7.56 | 139,600 | 281,100 |
| 10/1/06 – 10/31/06 | 20,100 | $ 7.96 | 20,100 | 261,000 |

(1) In May 2006, the Board of Directors authorized an open market repurchase program for one year to buy up to one million shares of QAD common stock. As of October 31, 2006, 739,000 shares had been repurchased under the program.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS

Exhibits

31.1 Certification by the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification by the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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.

QAD Inc.
(Registrant)

Date: December 8, 2006

By: /s/ DANIEL LENDER
Daniel Lender
Executive Vice President, Chief Financial Officer
(on behalf of the Registrant)

By: /s/ VALERIE J. MILLER
Valerie J. Miller
Vice President, Corporate Controller
(Chief Accounting Officer)

**Exhibit 31.1**

**CERTIFICATIONS UNDER**
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Karl F. Lopker, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of QAD Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13(a)-15(e) and 15(d)-15(e) ) and internal control over financial reporting (as defined in Exchange Act Rules 13(a)-15(f) and 15(d)-15(f)) for the Registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: Decmber 8, 2006

/s/ KARL F. LOPKER

Karl F. Lopker
Chief Executive Officer
QAD Inc.

**Exhibit 31.2**

**CERTIFICATIONS UNDER**
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Daniel Lender, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of QAD Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13(a)-15(e) and 15(d)-15(e) ) and internal control over financial reporting (as defined in Exchange Act Rules 13(a)-15(f) and 15(d)-15(f)) for the Registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

   c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: December 8, 2006

/s/ DANIEL LENDER

Daniel Lender
Chief Financial Officer
QAD Inc.

**Exhibit 32.1**

**CERTIFICATION FURNISHED PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of QAD Inc. (the "Company") on Form 10-Q for the period ending July 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Karl F. Lopker, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: December 8, 2006

/s/ KARL F. LOPKER

Karl F. Lopker
Chief Executive Officer
QAD Inc.

**Exhibit 32.2**

**CERTIFICATION FURNISHED PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of QAD Inc. (the "Company") on Form 10-Q for the period ending July 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Daniel Lender, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: December 8, 2006

/s/ DANIEL LENDER

Daniel Lender
Chief Financial Officer
QAD Inc.